

Business & Society



Ethics and Stakeholder Management

7e

ARCHIE B. CARROLL

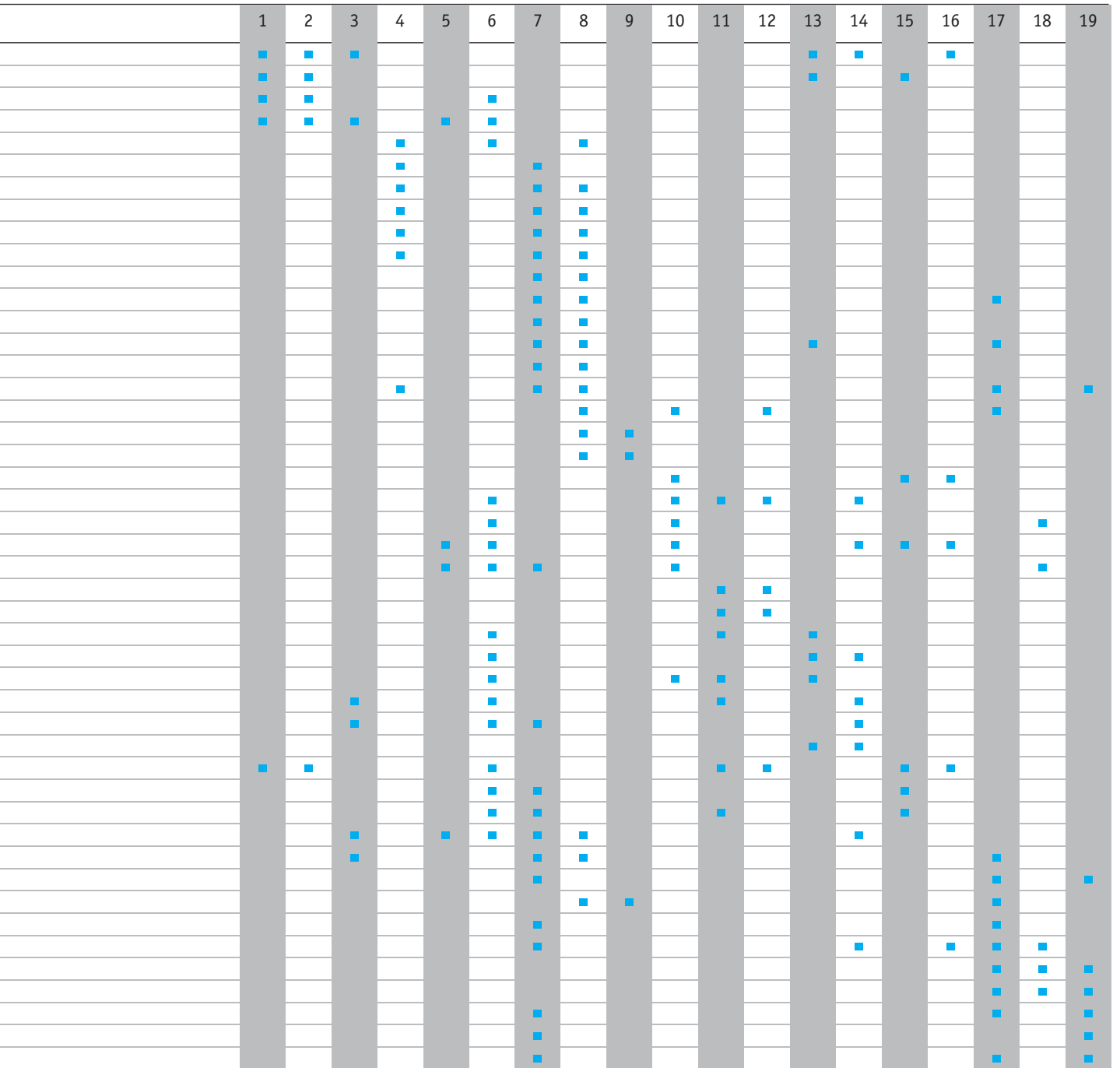
ANN K. BUCHHOLTZ

Case Matrix

This case matrix provides a listing of the cases in the back of the book and shows how they can accompany the text chapters. A given case may be appropriate for multiple chapters.

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797	Case 4 The Body Shop International PLC (1998–2007)
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923	Case 39 Dead Peasant Life Insurance
926	Case 40 The Case of the Fired Waitress
929	Case 41 Pizza Redlining: Employee Safety or Discrimination?
933	Case 42 After-Effects of After-Hours Activities: The Case of Peter Oiler
935	Case 43 Tattoos and Body Jewelry: Employer and Employee Rights
937	Case 44 Is Hiring on the Basis of "Looks" Unfair or Discriminatory?
941	Case 45 When Management Crosses the Line
942	Case 46 The Case of Judy

Chapter Number



BUSINESS & SOCIETY

Ethics and Stakeholder Management

Seventh Edition

Archie B. Carroll
University of Georgia

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University of Georgia



**Business & Society: Ethics and
Stakeholder Management, 7th Edition**

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Preface

B*usiness & Society: Ethics and Stakeholder Management*, Seventh Edition, employs a stakeholder management framework that emphasizes business's social and ethical responsibilities to external and internal stakeholder groups. A managerial perspective is embedded within the book's dual themes of business ethics and stakeholder management. The ethics dimension is central because it has become increasingly clear that ethical or moral considerations are woven into the fabric of the public issues that organizations face. Economic and legal issues are inevitably present, too. However, these aspects are treated more directly in other business administration courses.

The stakeholder management perspective is essential because it requires managers to (1) identify the various groups or individuals who have stakes in the firm or its actions, decisions, and practices, and (2) incorporate those stakeholders' concerns into the firm's strategic plans and daily operations. Stakeholder management is an approach that increases the likelihood that decision makers will integrate ethical wisdom with management wisdom in all that they do.

As this edition goes to press, we are beginning to reach some closure on the fraud and ethics scandals that have dominated the business news since the early 2000s. The Enron scandal and subsequent scandals involving such firms as WorldCom, Tyco, Arthur Andersen, Adelphia, Global Crossing, and HealthSouth constituted an ethical tsunami. Most of the trials of the CEOs and top executives of these firms have concluded, and a number of them are currently serving time behind bars. The horrific attacks on the World Trade Center and the Pentagon on September 11, 2001, are still in our memories—especially for their relevance to such topics as crisis management, global ethics, the business–government relationship, and impacts on both internal and external stakeholders. These major events will be with us forever, and we urge readers to keep in mind the extent to which our world is now changed as they read through the book and consider its content.

Applicable Courses for Text

This text is appropriate for college and university courses that carry such titles as Business and Society; Business and Its Environment; Business Ethics; Business and Public Policy; Social Issues in Management; Business, Government, and Society; and Stakeholder Management. This book is appropriate for either a required or elective course seeking to meet the standards (revised January 31, 2007) of the Association to Advance Collegiate Schools of Business (AACSB International). The book has been used successfully in both undergraduate and graduate courses.

Though the AACSB does not require any specific courses, its standards indicate that the school's curriculum should result in undergraduate and master's degree programs that contain topics covered in this textbook. For an undergraduate degree program, learning experiences should be provided in such general knowledge and skill areas as: *ethical understanding and reasoning abilities* and *multicultural and diversity understanding*. For both undergraduate and master's degree programs, learning experiences should be provided in such general knowledge and skill areas as *ethical and legal responsibilities in organizations and society* and *domestic and global environments of business*.

Stated another way, the book is ideal for coverage of perspectives that form the context for business: ethical and global issues; the influence of political, social, legal and regulatory, environmental, and technological issues; and the impact of diversity on organizations. The book provides perspectives on business, society, and ethics in the United States as well as in Europe and other parts of the world: versions of the previous edition were published in Canada and in China. A special effort has been made to include some examples from different parts of the world to illustrate major points.

Objectives in Relevant Courses

Depending on the placement of a course in the curriculum or the individual instructor's philosophy or strategy, this book could be used for a variety of objectives. The courses for which it is intended include several essential goals.

1. Students should be made aware of the expectations and demands that emanate from stakeholders and are placed on business firms.
2. As prospective managers, students need to understand appropriate business responses and management approaches for dealing with social, political, environmental, technological, and global issues and stakeholders.
3. An appreciation of ethical issues and the influence these issues have on society, management decision making, behavior, policies, and practices is important.
4. The broad question of business's legitimacy as an institution in a global society is at stake and must be addressed from both a business and societal perspective. These topics are vital for business to build trust with society and all stakeholders.
5. The increasing extent to which social, ethical, public, and global issues must be considered from a strategic perspective is critical in such courses.

New to the Seventh Edition

This Seventh Edition has been updated and revised to reflect the most recent research, laws, cases, and examples appropriate for courses in which it is used. Material in this new edition includes:

- New research, surveys, and examples throughout all the chapters
- Coverage throughout the text on the most recent ethics scandals and their influence on business, society, organizations, and people
- Chapter on “Corporate Governance: Foundational Issues” moved to Part 2 of the book to emphasize its escalating importance in recent years
- Discussion of recent developments with the Sarbanes-Oxley Act and the Alien Tort Claims Act, two laws with significant importance to managers today
- New “Ethics in Practice Cases” and “Search the Web” features in each chapter
- Forty-six end-of-text cases:
 - Twelve new cases, including those on Hewlett-Packard (HP), Say-on-Pay, Should Business Hire Illegal Aliens?, Chiquita Bananas, Coke & Pepsi in India, the Credit Card Industry, and Tattoo/Body Art as Employee Rights?
 - Twenty two revised and updated cases
 - Twelve cases carried over from the previous edition
- A Case Matrix inside the front cover that suggests appropriate chapter uses for end-of-text cases
- An Ethics in Practice Case Matrix inside the back cover that recommends chapter uses for “Ethics in Practice Cases” that appear in the various chapters
- Favorite cases from past editions are included in the *Instructor’s Manual with Test Bank* so that they may be duplicated and used in class
- A revised *Instructor’s Manual*

“Ethics in Practice” Cases

Continuing in this Seventh Edition are in-chapter features titled “Ethics in Practice” Cases. Interspersed throughout the chapters, these short features present either (1) actual ethical situations faced by companies or managers or (2) dilemmas faced personally in the work experiences of our former students. These latter types of cases are real-life situations actually confronted by our students in their full-time and part-time work experiences. The students contributed these cases on a voluntary basis, and we are pleased they gave us permission to use them. We would like to acknowledge them for their contributions to the book. Instructors may wish to use these as mini-cases for class discussion on a daily basis when a lengthier case is not assigned.

“Search the Web” Features

The “Search the Web” inserts in each chapter highlight an important and relevant webpage or pages that augment each chapter’s text material. The “Search the Web” feature may highlight a pertinent organization and its activities or special topics covered in the chapter. These features permit students to explore topics in more detail. Most of the websites have links to other related sites. The use of search engines to find other relevant materials is encouraged because the Web now catalogs a wealth of relevant information to the text topics and cases.

Structure of the Book

PART 1. BUSINESS, SOCIETY, AND STAKEHOLDERS

Part 1 of the book provides an introductory coverage of pertinent business, society, and stakeholder topics and issues. Because most courses for which this book is intended evolved from the issue of corporate social responsibility, this concept is treated early on. Part 1 documents and discusses how corporate social responsiveness evolved from social responsibility and how these two matured into a concern for corporate social performance and corporate citizenship. The stakeholder management concept is also given early coverage because it provides a way of thinking about all topics in the book.

PART 2. CORPORATE GOVERNANCE AND STRATEGIC MANAGEMENT ISSUES

The second part of the text addresses corporate governance and strategic management for stakeholder responsiveness. The purpose of this part is to discuss management considerations for dealing with the issues discussed throughout the text. Corporate governance is covered early because in the past decade this topic has been identified to be vital for effective strategic management. The strategic management perspective is useful because these issues have impacts on the total organization and are a serious concern for many upper-level managers. Special treatment is given to corporate public policy, issues and crisis management, and public affairs management.

Some instructors may elect to cover Part 2 later in their courses. Part 2 could easily be covered after Part 4 or 5. This option would be most appropriate for those using the book for a business ethics course or for those who desire to spend less time on the governance, strategy, and management perspectives.

PART 3. BUSINESS ETHICS AND MANAGEMENT

Four chapters dedicated to business ethics topics are presented in Part 3. In real life, business ethics cannot be separated from the full range of external and

internal stakeholder concerns. Part 3 focuses on business ethics fundamentals, personal and organizational ethics, business ethics and technology, and ethical issues in the global arena.

PART 4. EXTERNAL STAKEHOLDER ISSUES

Vital topics here include business relations with government, consumers, the environment, and the community. In each of these topic areas we see social and ethical issues that dominate business today. The business–government relationship is divided into a chapter on regulatory initiatives for monitoring business practices and another chapter addressing business attempts to influence government—primarily through lobbying. Consumers, the environment, and community stakeholders are then treated in separate chapters.

PART 5. INTERNAL STAKEHOLDER ISSUES

The primary stakeholders covered in this part are employees. Here we consider workplace issues and the key themes of employee rights, employment discrimination, and affirmative action. Two chapters address the changing social contract between business and employees and the urgent topic of employee rights. A final chapter treats the important topic of employment discrimination and affirmative action. Owner stakeholders could be seen as internal stakeholders, but we have decided to cover them in Part 2 alongside the subject of corporate governance.

CASE STUDIES AT END OF TEXT

The forty-six cases placed at the end of the book address a wide range of topics and decision situations. The cases are of varying length. Twelve of the cases are new to the Seventh Edition; among these are some longer cases. Twenty-two other cases have been updated. All the cases are intended to provide instructors and students with real-life situations within which to further analyze course issues and topics covered throughout the book. The cases have intentionally been placed at the end of the text material so that instructors will feel freer to use them with any text material they desire. The Case Matrix that appears inside the front cover provides suggested chapter usage for each of the cases.

Many of the cases in this book have ramifications that spill over into several areas, and almost all of them may be used for different chapters. Preceding the cases is a set of guidelines for case analysis that the instructor may wish to use in place of (or in addition to) the questions that appear at the end of each case.

Some cases from previous editions have been moved to the *Instructor's Manual with Test Bank*. If instructors wish to use some of their favorite previous cases, you may copy and distribute them in class or contact your local representative to have a custom edition created to include the cases you have selected.

Support for the Instructor

INSTRUCTOR'S MANUAL WITH TEST BANK

Prepared by Leigh Johnson of Murray State University, M. Suzanne Clinton of the University of Central Oklahoma, and B. J. Parker, the *Instructor's Manual with Test Bank* includes learning objectives, teaching suggestions, complete chapter outlines, highlighted key terms, answers to discussion questions, suggestions for using the management and organization video, case notes, supplemental cases, and NEW group exercises. The test bank for each chapter includes true/false, multiple-choice, short-answer, and essay questions. This edition's strengthened test bank now offers questions correlated to AACSB guidelines and learning standards and identified by level of difficulty.

A computerized version of the test bank is also available electronically. ExamView[®], an easy-to-use test-generating program, enables instructors to create printed tests, Internet tests, and online (LAN-based) tests quickly. Instructors can use the software provided to enter their own questions and customize the appearance of the tests they create. The QuickTest wizard permits test generators to use an existing bank of questions, creating a test in minutes using a step-by-step selection process.

The *Instructor's Manual with Test Bank* is available only on the website and on the Instructor's Resource CD-ROM. ExamView is available only on the Instructor's Resource CD-ROM.

POWERPOINT SLIDES

Prepared by Deborah J. Baker of Texas Christian University, the PowerPoint presentation is colorful and varied; it is designed to hold students' interest and reinforce each chapter's main points. The PowerPoint presentation is available only on the website and on the Instructor's Resource CD-ROM.

ABC VIDEO (DVD ISBN 0-324-58063-0)

Bring the programming power of ABC into your classroom with this DVD of high-interest clips. Short segments—perfect for introducing key concepts—cover a range of issues found within the text. Suggestions for video usage are provided in the *Instructor's Manual with Test Bank*, making it easy to gain the most from this exceptional resource.

INSTRUCTOR'S RESOURCE CD-ROM (0-324-58068-1)

Included are the *Instructor's Manual with Test Bank* and PowerPoint slides.

BUSINESS AND COMPANY RESOURCE CENTER

Instructors may elect to bundle within the student text an access card to the Business and Company Resource Center (BCRC). Infomark bookmarks related to chapter material will be included online to aid instructors in assignment creation using BCRC.

WEBSITE

This website (<http://academic.cengage.com/management/carroll>) features interactive quizzes, flashcards, and BCRC resources. Instructors can download resources, including the *Instructor's Manual with Test Bank* and PowerPoint presentation slides.

Acknowledgments

First, we would like to express gratitude to our professional colleagues in the Social Issues in Management (SIM) Division of the Academy of Management, the International Association for Business and Society (IABS), and the Society for Business Ethics (SBE). Over the years these individuals have meant a lot to us and have helped to provide a stimulating intellectual environment for pursuing these topics in which we have a common interest. Many of these individuals are cited in this book quite liberally, and their work is appreciated.

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Professor Carroll has served on the editorial review boards of *Business and Society*, *Business Ethics Quarterly*, *Academy of Management Review*, *Journal of Management*, and the *Journal of Public Affairs*. He is former division chair of the Social Issues in Management (SIM) Division of the Academy of Management, a founding board member of the International Association for Business and Society (IABS), and former president of the Society for Business Ethics. He was elected a Fellow of the Academy of Management and the Southern Management Association.

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Part 1

Business, Society, and Stakeholders

- CHAPTER 1** | *The Business and Society Relationship*
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The Business and Society Relationship

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Characterize business and society and their interrelationships.
- 2 Describe pluralism and identify its attributes, strengths, and weaknesses.
- 3 Clarify how our pluralistic society has become a special-interest society.
- 4 Identify, discuss, and illustrate the factors leading up to business criticism.
- 5 Single out the major criticisms of business and characterize business's general response.
- 6 Categorize the major themes of the book: managerial approach, ethics, and stakeholder management.

For decades now, news stories have brought to the attention of the public countless social and ethical issues that have framed the business and society relationship. Much of this has been reported as some form of business criticism.

The recent period of criticism began with the rash of scandals first brought to light in late 2001 and continues today. Initially, the Enron scandal was exposed when the firm filed for bankruptcy. Eventually, the degree of fraud impacting investors, employees, and others became known to the general public. The Enron scandal did not occur in isolation. Senior officers, banks, accountants, credit agencies, lawyers, stock analysts, and others were implicated. By 2007, thirty states had sided with Enron shareholders in their quest for damages from investment banks implicated due to their role in the accounting fraud. The argument has been that the investment banks should be held liable as participants in the fraud.¹

A most damaging indictment fell upon the accounting firm of Arthur Andersen, which eventually went bankrupt due to fraud and complicity in the Enron debacle. Scandals involving WorldCom, Global Crossing, Tyco, and Adelphia all came to light throughout 2002; analysts to this day are still trying to figure out what went wrong and why. The Enron debacle was an ethical tsunami that has redefined business's relationships with the world. Since then, other corporate names have appeared in the news for allegedly committing violations of the public trust or for raising questions regarding corporate ethics: Martha Stewart, Rite Aid, ImClone, HealthSouth, and Boeing. As *BusinessWeek* observed, "Watching executives climb the courthouse steps became a spectator sport...."²

Serious questions have been raised about a host of other business issues: corporate governance, executive compensation, backdated stock options, the use of illegal immigrants as employees, high fuel prices, minimum wage, the safety of SUVs, the distraction of cell phones, the healthiness of fast food, and so on. The litany of such issues could go on and on, but these examples illustrate the continuing tensions between business and society, which can be traced to recent high-profile incidents, trends, or events.

Many other common issues carrying social or ethical implications have arisen within the relationship between business and society. Some of these general issues have included downsizing of pension programs, reduced health insurance benefits, sexual harassment in the workplace, abuses of corporate power, toxic waste disposal, insider trading, whistle-blowing, product liability, fetal protection issues, and use of political action committees by business to influence the outcome of legislation.

These examples of both specific corporate incidents and general issues are typical of the kinds of stories about business and society that one finds today in newspapers, magazines, television, and on the Internet. We offer these concerns as illustrations of the widespread interactions between business and society that capture the headlines almost daily.

Most of these events are situations in which the public or some segment of the public believes that a firm has done something wrong or treated some individual or group unfairly. In some cases, major laws have been broken. In virtually all of these incidents, questions of whether business firms have behaved properly have arisen—that is, whether they have been socially responsible or ethical. Ethical questions are typically present in these kinds of conflicts. In today's socially conscious environment, a business firm frequently finds itself on the defensive. It finds itself being criticized for some action it has taken or failed to take. Whether a business is right or wrong sometimes does not matter. Powerful groups, aided by a cooperative media looking for stories, can frequently exert enormous pressure on businesses and wield significant influence on public opinion, causing firms to take or not take particular courses of action.

In other instances, such as the general issues mentioned earlier, businesses are attempting to deal with broad societal concerns (such as the "rights" movement,

discrimination in the workplace, loss of jobs to foreign countries, or violence in the workplace). Businesses must weigh the pros and cons of these issues and adopt the best postures, given the many, and often conflicting, points of view that are held and expressed. Although the best responses are not always easy to identify, businesses must respond and be prepared to live with the consequences.

At the broadest level, we are discussing the role of business in society. In this book, we will address many of these concerns—the role of business relative to the role of government in our socioeconomic system; what a firm must do to be considered socially responsible; what managers must do to be considered ethical; and what responsibilities companies have in an age of globalization. These issues require immediate attention and thoughtful courses of action, which quite often become the next subject of debate on the roles and responsibilities of business in society.

We have nearly completed the first decade of the new millennium, and many economic, legal, ethical, and technological issues about business and society continue to be debated. This period is turbulent. It has been characterized by significant changes in the world, in the economy, in society, in technology, and in global relationships. Against this backdrop of ongoing turbulence in the business and society relationship, we want to discuss some concepts and ideas that are fundamental to an understanding of where we are and how we got here.

Business and Society

This chapter will contend with some basic concepts that are important in the continuing business and society discussion. Among these concepts are pluralism, our special-interest society, business criticism, corporate power, and corporate social response to stakeholders. First, let us briefly define and explain two key terms: *business* and *society*.

BUSINESS: DEFINED

Business may be defined as the collection of private, commercially oriented (profit-oriented) organizations, ranging in size from one-person proprietorships (such as Sons of Italy Pizzeria, Gibson's Men's Wear, and Zim's Bagels) to corporate giants (such as Johnson & Johnson, GE, Coca-Cola, Dell Inc., and UPS). Between these extremes, of course, are many medium-sized proprietorships, partnerships, and corporations.

When we discuss business in this collective sense, we include businesses of all sizes and in all types of industries. But as we embark on our discussion of business and society, we will doubtless find ourselves speaking more of big business in selected industries. Big business is highly visible. Its products and advertising are more widely known. Consequently, big business is more frequently in the critical public eye. In addition, people in our society often associate size with power, and the powerful are given closer scrutiny. Although it is well known that small

businesses in our society far outnumber large ones, the pervasiveness, power, visibility, and impact of large firms keep them on the front page much more of the time.

With respect to different industries, some are simply more conducive to the creation of visible social problems than are others. For example, many manufacturing firms by their nature cause air and water pollution. They contribute to climate changes. Such firms, therefore, are more likely to be subject to criticism than a life insurance company, which emits no obvious pollution. The auto industry, most recently in relation to SUVs, is a particular case in point. Much of the criticism against General Motors (GM) and the other automakers is raised because of their high visibility as manufacturers, the products they make (which are the largest single source of air pollution), and the popularity of their products (many families own one or more cars).

Some industries are highly visible because of the advertising-intensive nature of their products (for example, Procter & Gamble, Delta Airlines, Anheuser-Busch, and Home Depot). Other industries (for example, the cigarette, toy, and food products industries) are scrutinized because of the possible effects of their products on health or because of their roles in providing health-related products (such as pharmaceutical firms).

When we refer to business in its relationship with society, therefore, we focus our attention on large businesses in particular industries. But we should not lose sight of the fact that small- and medium-sized companies also are important. In fact, over the past decade, problems have arisen for small businesses because they have been subjected to many of the same regulations and demands as those imposed by government on large organizations. In many instances, however, smaller businesses do not have the resources to meet the requirements for increased accountability on many of the social fronts that we will discuss.

SOCIETY: DEFINED

Society may be defined as a community, a nation, or a broad grouping of people having common traditions, values, institutions, and collective activities and interests. As such, when we speak of business and society relationships, we may in fact be referring to business and the local community (business and Atlanta), business and the country as a whole, business and the global community, or business and a specific group of people (consumers, investors, minorities).

When we discuss business and the entire society, we think of society as being composed of numerous interest groups, more or less formalized organizations, and a variety of institutions. Each of these groups, organizations, and institutions is a purposeful aggregation of people who have united because they represent a common cause or share a set of common beliefs about a particular issue. Examples of interest groups or purposeful organizations are numerous: Friends of the Earth, Common Cause, chambers of commerce, National Association of Manufacturers, People for the Ethical Treatment of Animals (PETA), and Rainforest Action Network.

Society as the Macroenvironment

The environment of society is a key concept in analyzing business and society relationships. At its broadest level, the societal environment might be thought of as a **macroenvironment**, which includes the total environment outside the firm. The macroenvironment is the complete societal context in which the organization resides. The idea of the macroenvironment is just another way of thinking about society. In fact, early courses on business and society in business schools were sometimes (and some still are) titled “Business and Its Environment.” The concept of the macroenvironment, however, evokes different images or ways of thinking about business and society relationships and is therefore useful in terms of framing or understanding the total business context.

A convenient conceptualization of the macroenvironment is to think of it as being composed of four segments: social, economic, political, and technological.³

The **social environment** focuses on demographics, lifestyles, and social values of the society. Of particular interest here is the manner in which shifts in these factors affect the organization and its functioning. The influx of illegal immigrants over the past few years has brought noticeable changes to the social environment. The **economic environment** focuses on the nature and direction of the economy in which business operates. Variables of interest might include such indices as gross national product, inflation, interest rates, unemployment rates, foreign-exchange fluctuations, global trade, balance of payments, and various other indicators of economic activity. In the past decade, hyper-competition and the global economy have dominated the economic segment of the environment. Businesses moving jobs offshore has been a controversial trend.

The **political environment** focuses on the processes by which laws get passed and officials get elected and all other aspects of the interaction between the firm, political processes, and government. Of particular interest to business in this segment are the regulatory process and the changes that occur over time in business regulation of various industries and various issues. The passage of the Sarbanes-Oxley Act in 2002 continues to be a contentious issue. Lobbying and political contributions are ongoing controversies. Finally, the **technological environment** represents the total set of technology-based advancements taking place in society. This segment includes new products, processes, and materials, as well as the states of knowledge and scientific advancement. The process of technological change is of special importance here.⁴ In recent years, computer-based technologies and biotechnology have been driving this segment of environmental turbulence.

Thinking of business and society relationships embedded in a macroenvironment provides us with a useful way of understanding the kinds of issues that constitute the broad milieu in which business functions. Throughout this book, we will see evidence of these turbulent environmental segments and will come to appreciate what challenges managers face as they strive to develop effective organizations. Each of the many specific groups and organizations that make up our pluralistic society can typically be traced to one of these four environmental segments.

A Pluralistic Society

A society's pluralistic nature makes for business and society relationships that are more dynamic and novel than those in some other societies. **Pluralism** refers to a diffusion of power among society's many groups and organizations. The following definition of a pluralistic society is helpful: "A pluralistic society is one in which there is wide decentralization and diversity of power concentration."⁵

The key descriptive terms in this definition are *decentralization* and *diversity*. In other words, power is dispersed among many groups and people. Power is not in the hands of any single institution (such as business, government, labor, or the military) or a small number of groups. Many years ago, in *The Federalist Papers*, James Madison speculated that pluralism was a virtuous scheme. He correctly anticipated the rise of numerous organizations in society as a consequence of it. Some of the virtues of a pluralistic society are summarized in Figure 1-1.

PLURALISM HAS STRENGTHS AND WEAKNESSES

All social systems have strengths and weaknesses. A pluralistic society prevents power from being concentrated in the hands of a few. It also maximizes freedom of expression and action. Pluralism provides for a built-in set of checks and balances so that no single group dominates. By contrast, a weakness in a pluralistic system is that it creates an environment in which diverse institutions pursue their own self-interests, with the result that there is no unified direction to bring together individual pursuits. Another weakness is that groups and institutions proliferate to the extent that their goals tend to overlap, thus causing confusion as to which organizations best serve which functions. Pluralism forces

Figure 1-1 *The Virtues of a Pluralistic Society*

A Pluralistic Society ...

- Prevents power from being concentrated in the hands of a few
- Maximizes freedom of expression and action and strikes a balance between monism (social organization into one institution) on the one hand and anarchy (social organization into an infinite number of persons) on the other^a
- Is one in which the allegiance of individuals to groups is dispersed
- Creates a widely diversified set of loyalties to many organizations and minimizes the danger that a leader of any one organization will be left uncontrolled^b
- Provides a built-in set of checks and balances, in that groups can exert power over one another with no single organization (business, government) dominating and becoming overly influential

Sources: ^aKeith Davis and Robert L. Blomstrom, *Business and Society: Environment and Responsibility*, 3d ed. (New York: McGraw-Hill, 1975), 63.

^bJoseph W. McGuire, *Business and Society* (New York: McGraw-Hill, 1963), 132.

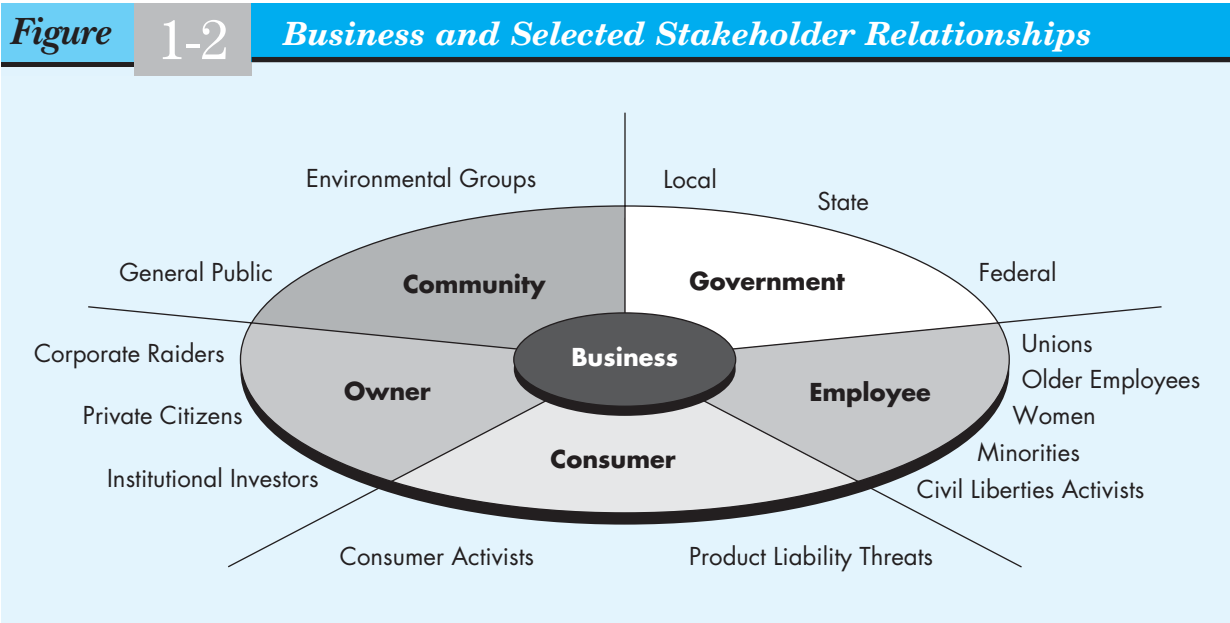
conflict onto center stage because of its emphasis on autonomous groups, each pursuing its own objectives. In light of these concerns, a pluralistic system does not appear to be very efficient.

History and experience have demonstrated, however, that the merits of pluralism are considerable and that most people in society prefer the situation that has resulted from it. Indeed, pluralism has worked to achieve some equilibrium in the balance of power of the dominant institutions that constitute our society.

MULTIPLE PUBLICS, SYSTEMS, AND STAKEHOLDERS

Knowing that society is composed of so many different semiautonomous and autonomous groups might cause one to question whether we can realistically speak of society in a definitive sense that has any generally agreed-upon meaning. Nevertheless, we do speak in such terms, knowing that, unless we specify a particular societal subgroup or subsystem, we are referring to *all* those persons, groups, and institutions that constitute our society. Thus, when we speak of business/society relationships, we usually refer either to particular segments or subgroups of society (consumers, women, minorities, environmentalists, youth) or to business and some system in our society (politics, law, custom, religion, economics). These groups of people or systems may also be referred to in an institutional form (business and the courts, business and Common Cause, business and the church, business and the AFL-CIO, business and the Federal Trade Commission).

Figure 1-2 depicts in graphical form the points of interface between business and some of these multiple publics, systems, or stakeholders with which business



interacts. Stakeholders are those groups or individuals with whom an organization interacts or has interdependencies. We will develop the stakeholder concept further in Chapter 3. It should be noted that each of the stakeholder groups can be further subdivided into more specific subgroups.

If sheer numbers of relationships are an indicator of complexity, we could easily argue that business's current relationships with different segments of society constitute a truly complex social environment. If we had the capacity to draw a diagram similar to Figure 1-2 that displayed all the detail composing each of those points of interface, it would be too complex to comprehend. Today, managers cannot sidestep this problem, because management must live with these interfaces on a daily basis.

A Special-Interest Society

A pluralistic society often becomes a **special-interest society**. That is, as the idea of pluralism is pursued to an extreme, a society is created that is characterized by tens of thousands of special-interest groups, each pursuing its own focused agenda. General-purpose interest organizations, such as Common Cause and the U.S. Chamber of Commerce, still exist. However, the past two decades have been characterized by increasing specialization on the part of interest groups representing all sectors of society—consumers, employees, investors, communities, the natural environment, government, and business itself. One newspaper headline noted that “there is a group for every cause.” Special-interest groups have not only grown in number at an accelerated pace but have also become increasingly activist, intense, diverse, and focused on single issues. Such groups are increasingly committed to their causes.

An example of the proliferation of special-interest groups was described by the owner of a service station in Washington, DC, who watched as a debate over free markets, capitalism, and the environment brought different groups to his pumps. There were activists from the American Land Rights Association, Americans for Tax Reform, American Conservative Union, and FreeRepublic, all arriving in American-made, gas-guzzling, U.S.-flag-draped SUVs to fuel up on high octane. Counter-protestors arrived representing the U.S. Public Interest Research Group; and two Greenpeace activists arrived, costumed as the Exxon Tiger and Saddam Hussein.⁶

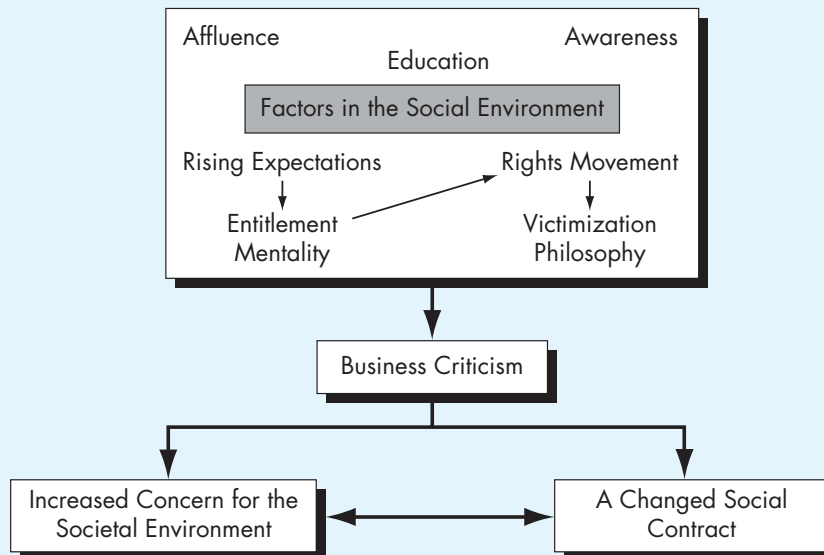
The consequence of such specialization is that each of these groups has been able to attract a significant following that is dedicated to the group's goals. Increased memberships have meant increased revenues and a sharper focus as each of these groups has aggressively sought its limited purposes. The likelihood of these groups working at cross-purposes and with no unified set of goals has made life immensely more complex for the major institutions, such as business and government, that have to deal with them.

Business Criticism and Corporate Response

It is inevitable in a pluralistic, special-interest society that the major institutions that make up that society, such as business and government, will become the subjects of considerable scrutiny and criticism. Our purpose here is not so much to focus on the negative as to illustrate how the process of business criticism has shaped the evolution of the business/society relationship today. Were it not for the fact that individuals and groups have been critical of business, we would not be dealing with this subject in a book or a course, and few changes would occur in the business/society relationship over time. But such changes have taken place, and it is helpful to see the role that business criticism has assumed in leading and bringing about change. The concept of business response to criticism will be developed more completely in Chapter 2, where we present the complete business criticism/response cycle.

Figure 1-3 illustrates how certain factors that have arisen in the social environment have created an atmosphere in which business criticism has taken place and flourished. In this chapter, we describe the response on the part of business as an increased concern for the social environment and a changed social contract (relationship) between business and society. Each of these factors merits special consideration.

Figure 1-3 *Social Environment Factors, Business Criticism, and Corporate Response*



FACTORS IN THE SOCIAL ENVIRONMENT

Many factors in the social environment have created a climate in which criticism of business has taken place and flourished. Some of these factors occur relatively independently, but some are interrelated with others. In other words, they occur and grow hand in hand.

Affluence and Education

Two factors that have developed side by side are affluence and education. As a society becomes more prosperous and better educated, higher expectations of its major institutions, such as business, naturally follow.

Affluence refers to the level of wealth, disposable income, and standard of living of the society. Measures of the U.S. standard of living indicate that it has been rising for decades but leveling off during the past five years or so. A recent study has found that the rate at which an entire generation's lot in life improves relative to previous generations has slightly declined.⁷ In spite of these effects, overall affluence remains high. Per capita personal income continues to rise, though at a slower rate, and this has created a high standard of living for the U.S.

http://SEARCH THE WEB WEB

SPECIAL-INTEREST GROUPS

One of the most interesting and demanding pressures on the business/society relationship is that exerted by special-interest groups. Many of these groups focus on specific topics and then direct their concerns or demands to companies they wish to influence. Special-interest groups have become more numerous and increasingly activist, diverse, and focused on single issues. Unique companies, such as Good Money, Inc., that specialize in socially responsible and ethical investing, consuming, and business practices, have reason to catalog and monitor these interest groups.

One of Good Money's webpages, "Social Investing and Consuming Activist Groups and Organizations," found at http://www.goodmoney.com/directry_active2.htm, lists and briefly describes a few of the special-interest groups with which business must contend. Good Money's webpages contain more information about the following special-interest groups, but it catalogs many more.

- Environmental Defense Fund—A group that reports and acts on a broad range of regional, national, and international environmental issues.
- Social Accountability International—A human rights organization dedicated to the ethical treatment of workers around the world.
- Public Interest Research Groups (The PIRGs)—Groups that promote social action to safeguard the public interest.
- Rainforest Action Network—An organization whose mission is to save the world's rainforests from destruction.
- Sweatshop Watch—Coalition of labor, community, civil rights, immigrants' rights, women's and religious organizations and individuals committed to eliminating sweatshop conditions in the garment industry.

citizenry. This movement toward affluence is found in many of the world's developed countries and is also occurring in developing countries as global capitalism spreads.

Alongside an increased standard of living has been a growth in the average formal **education** of the populace. The U.S. Census Bureau reported that between 1970 and 2000, when the last census was taken, the number of American adults who were high school graduates grew from 55 percent to 83 percent, and the number who were college graduates increased from 11 percent to 24 percent. As citizens continue to become more highly educated, their expectations of life generally rise. The combination of affluence and education has formed the underpinning for a society in which criticism of major institutions, such as business, naturally arises.

Awareness Through Television and the Internet

Closely related to formal education is the high and growing level of public awareness in our society. Although newspapers and magazines are still read by only a fraction of our population, a more powerful medium—television—is accessed by virtually our entire society. Through television, the citizenry gets a variety of information that contributes to a climate of business criticism. In addition, the Internet and mobile phone explosion has brought elevated levels of awareness in our country and around the world. Through e-mails and blogs, the average citizen is incredibly aware of what is going on in the world.

The prevalence and power of TV touches all socioeconomic classes. Several statistics document the extent to which our society is dependent on TV for information. According to data compiled by the A. C. Nielsen Company, the average daily time spent viewing television per household in 1950 was four and one-half hours. By 2007, Nielsen reports this figure had grown to more than eight hours. A typical day for an American household now divides into three nearly equal parts: eight hours of sleep, eight hours of TV, and eight hours of work or school. Though the household average is now eight hours and fourteen minutes, the average person watches four and one-half hours per day. These figures are the highest they have ever been in more than fifty years.⁸ In the United States today, over 98 percent of homes have color TVs, and a great majority of Americans have two or more televisions. These statistics suggest that television is indeed a pervasive and powerful medium in our society.

24/7 News and Investigative News Programs. There are at least three ways in which information that leads to criticism of business appears on television. First, there are straight news shows, such as the ubiquitous 24-hour cable news channels, the evening news on the major networks, and investigative news programs. It is debatable whether or not the major news programs are treating business fairly, but in one major study conducted by Corporate Reputation Watch, senior executives identified media criticism, along with unethical behavior, as the biggest threats to a company's reputation. Reflecting on the lessons learned from Enron, WorldCom, Tyco, and other high-profile cases

of corporate wrongdoing, half the executives surveyed thought unethical behavior and media criticism were the biggest threats to their corporate reputations.⁹

The downbeat slant in reporting both business news and political news led James Fallows to write a book titled *Breaking the News: How the Media Undermine American Democracy*. Fallows skewers what media writer Howard Kurtz calls “drive-by journalism,” which tends to take down all institutions in its sights.¹⁰ Fallows goes on to argue that the media favor sizzle over substance and that they have a mindless fixation on conflict rather than truth. In this environment, business is an easy target because of its high visibility and power.

Although many business leaders believe that the news media are biased against them by exaggerating the facts and overplaying the issues, journalists see it differently. They counter that business executives try to avoid them, are evasive when questioned about major issues, and try to downplay problems that might reflect negatively on their companies. The consequence is an adversarial relationship that helps to explain some of the unfavorable coverage.

Business has to deal not only with the problems of 24/7 news coverage but also with a continuing proliferation of investigative news programs, such as *60 Minutes*, *20/20*, *Dateline NBC*, and PBS’s *FRONTLINE*, which seem to delight in exposés of corporate wrongdoings or questionable practices. Whereas the straight news programs make some effort to be objective, the investigative shows are tougher on business, tending to favor stories that expose the dark side of the enterprises or their executives. These shows are enormously popular and influential, and many companies squirm when their reporters show up on their premises complete with camera crews.

Prime-Time Television Programs. The second way in which criticisms of business appear on TV is through prime-time television programs. Television’s depiction of businesspeople brings to mind the scheming oilman J. R. Ewing of *Dallas*, whose backstabbing shenanigans dominated prime-time TV for years (1978–1991) before it went off the air. More recently, the popular TV show *The Apprentice*, featuring billionaire businessman Donald Trump, has depicted aspiring business executives in often-questionable roles. More often than not, the businessperson has been portrayed across the nation’s television screens as a smirking, scheming, cheating, and conniving “bad guy.” Research suggests that Hollywood seems to be hostile toward the corporate world. A recent report released by the Business & Media Institute reported a study of the top twelve prime-time dramas, in which 77 percent of the plots involving business were negative toward businesspeople. In this study, business characters committed almost as many serious felonies as drug dealers, child molesters, and serial killers combined. On one show, *Law & Order*, half of the felons were businesspeople.¹¹

Some recent TV shows where this negative portrayal of business has been evident include *CSI*, *Law & Order*, *Shark*, *Las Vegas*, and *Criminal Minds*. In business’s defense, a vice president of the U.S. Chamber of Commerce put it this way: “There is a tendency in entertainment television to depict many businesspeople as wealthy, unscrupulous, and succeeding through less-than-honorable dealings. This is totally incorrect.”¹²

Any redeeming social values that business and businesspeople may have rarely show up on television. Rather, businesspeople are often cast as evil and greedy social parasites whose efforts to get more for themselves are justly condemned and usually thwarted.¹³ There are many views as to why this portrayal has occurred. Some would argue that business is being characterized accurately. Others say that the television writers are dissatisfied with the direction our nation has taken and believe they have an important role in reforming American society.¹⁴ When Hollywood is not depicting business in a bad light on TV, it may be doing it through the movies.

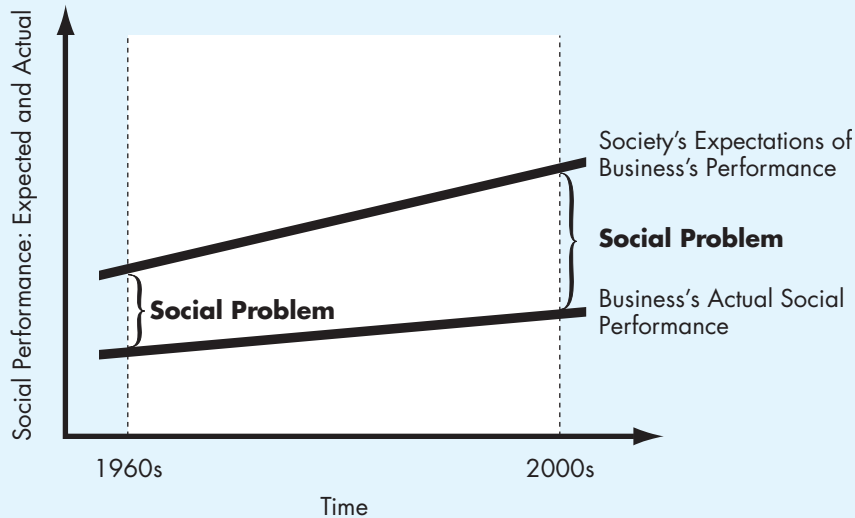
Commercials. A third way in which television contributes to business criticism is through commercials. This may be business's own fault. To the extent that business does not honestly and fairly portray its products and services on TV, it undermines its own credibility. Commercials are a two-edged sword. On the one hand, they may sell more products and services in the short run. On the other hand, they could damage business's long-term credibility if they promote products and services deceptively. According to RealVision, an initiative to raise awareness about television's impact on society, TV today promotes excessive commercialism as well as sedentary lifestyles.¹⁵

In three specific settings—news coverage, prime-time programming, and commercials—a strained environment is fostered by this “awareness” factor made available through the power and pervasiveness of television. We should make it clear that the media are not to blame for business's problems. If it were not for the fact that the behavior of some businesses is questionable, the media would not be able to create this kind of environment. The media, therefore, makes the public more aware of questionable practices and should be seen as only one major factor that contributes to the environment in which business now finds itself.

Revolution of Rising Expectations

In addition to affluence, formal education, and awareness through television and the Internet, other societal trends have fostered the climate in which business criticism has occurred. Growing out of these factors has been a **revolution of rising expectations** held by many. This is defined as a belief or an attitude that each succeeding generation ought to have a standard of living higher than that of its predecessor. A recent Pew Charitable Trusts study has revealed that, according to census data, today this is more of a dream than a reality. Median income for men has declined slightly over the past twenty years, but household incomes remain high due to the number of women now working full-time.¹⁶

In spite of this new reality, the rising expectations effect is still at work. A survey conducted in 2007 found that 45 percent of those surveyed expected to be more financially secure in their retirement years than their parents.¹⁷ It follows from this that people's expectations of major institutions, such as business, should be greater also. Building on this line of thinking, one could argue that business criticism is evident today because society's rising expectations of business's social performance have outpaced business's ability to meet these growing expectations.

Figure**1-4*****Society's Expectations versus Business's Actual Social Performance***

To the extent that this has occurred over the past twenty years, business finds itself with a larger social problem.¹⁸

A **social problem** has been described as a gap between society's expectations of social conditions and the current social realities.¹⁹ From the viewpoint of a business firm, the social problem is experienced as the gap grows between society's *expectations* of the firm's social performance and its *actual* social performance. Rising expectations typically outpace the responsiveness of institutions such as business, thus creating a constant predicament in that it is subject to criticism. Figure 1-4 illustrates the larger "social problem" that business faces today. It is depicted by the "gap" between society's expectations of business and business's actual social performance.

Although the general trend of rising expectations continues, the revolution moderates at times when the economy is not as robust. Job situations, health, family lives, and overall quality of life continue to rise. Persistent social problems, such as crime, poverty, homelessness, AIDS, environmental pollution, alcohol and drug abuse, and, now, terrorism and potential pandemics such as bird flu, are always there to moderate rising expectations.²⁰

Entitlement Mentality

One notable outgrowth of the revolution of rising expectations has been the development of an **entitlement mentality**. Years ago, the Public Relations Society of America conducted a study of public expectations, with particular focus on public attitudes toward the philosophy of entitlement. The entitlement mentality is

the general belief that someone is owed something (for example, a job, an education, a living wage, or health care) just because she or he is a member of society. The survey was conducted on a nationwide basis, and a significant gap was found between what people thought they were entitled to have and what they actually had—a steadily improving standard of living, a guaranteed job for all those willing and able to work, and products certified as safe and not hazardous to one's health.²¹

Near the end of the first decade of the 2000s, jobs, fair wages, insurance, retirement programs, and health care have become issues over which entitlement thinking has been discussed. Each of these has significant implications for business when “entitlements” are not received.

Rights Movement

The revolution of rising expectations, the entitlement mentality, and all of the factors discussed so far have contributed to what has been termed the **rights movement** that is evident in society today. The Bill of Rights was attached to the U.S. Constitution almost as an afterthought and was virtually unused for more than a century. But in the past several decades, and at an accelerating pace, the U.S. Supreme Court has heard large numbers of cases aimed at establishing for some groups various legal rights that perhaps never occurred to the founders of our nation.²²

Some of these rights, such as the right to privacy and the right to due process, have been perceived as generic for all citizens. However, in addition to these generalized rights, there has been activism for rights for particular groups in U.S. society. This modern movement began with the civil rights cases of the 1950s. Many groups have been inspired by the success of African Americans and have sought progress by similar means. Thus, we have seen the protected status of minorities grow to include Hispanic Americans, Asian Americans, Native Americans, women, the handicapped, the aged, and other groups. At various levels—federal, state, and local—we have seen claims for the rights of homosexuals, smokers, nonsmokers, obese persons, people living with HIV/AIDS, convicted felons, and illegal immigrants, just to mention a few.

There seems to be no limit to the numbers of groups and individuals seeking “rights” in our society. Business, as one of society's major institutions, has been hit with an ever-expanding array of expectations as to how people want to be treated, not only as employees but also as owners, consumers, and members of the community. The “rights” movement is interrelated with the special-interest society we discussed earlier and sometimes follows an “entitlement” mentality among some people and within some sectors of society.

John Leo, a columnist for *U.S. News & World Report*, has argued for a moratorium on new rights.²³ He has argued that “freshly minted” rights are so common these days that they even appear on cereal boxes. He cites as a classic example Post Alpha-Bits boxes, which a few years ago carried a seven-point “Kids’ Bill of Rights” that included one right concerning world citizenship (“you have the right to be seen, heard, and respected as a citizen of the world”) and one

right entitling each cereal buyer to world peace (“you have the right to a world that is peaceful and an environment that is not spoiled”). One cannot help but speculate what challenges business will face when every “goal, need, wish, or itch” is more and more framed as a right.²⁴

Victimization Philosophy

It has become apparent during the past twenty years that there are growing numbers of individuals and groups who see themselves as having been victimized by society. *New York* magazine featured a cover story on “The New Culture of Victimization,” with the title “Don’t Blame Me!”²⁵ *Esquire* probed what it called “A Confederacy of Complainers.”²⁶ Charles Sykes published *A Nation of Victims: The Decay of the American Character*.²⁷ Sykes’s thesis, with which these other observers would agree, is that the United States is fast becoming a “society of victims.”

What is particularly interesting about the novel **victimization philosophy** is the widespread extent to which it is dispersing in the population. According to these writers, the victim mentality is just as likely to be seen among all groups in society—regardless of race, gender, age, or any other classification. Sykes observed that previous movements may have been seen as a “revolution of rising expectations,” whereas the victimization movement might be called a “revolution of rising sensitivities” in which grievance begets grievance.

In such a society of victims, feelings rather than reason prevail, and people start perceiving that they are being unfairly “hurt” by society’s institutions—government, business, and education. One example is worthy of note. In Chicago, a man complained to the Minority Rights Division of the U.S. Attorney’s office that McDonald’s was violating equal-protection laws because its restaurants’ seats were not wide enough for his unusually large backside. As Sykes observes, “The new culture reflects a readiness not merely to feel sorry for oneself but to wield one’s resentments as weapons of social advantage and to regard deficiencies as entitlements to society’s deference.”²⁸

As the previous example illustrates, the philosophy of victimization is intimately related to and sometimes inseparable from the rights movement and the entitlement mentality. Taken together, these new ways of viewing one’s plight—as someone else’s unfairness—may pose special challenges for business managers in the future.

In summary, affluence and education, awareness through television, the revolution of rising expectations, an entitlement mentality, the rights movement, and the victimization philosophy have formed a backdrop against which criticism of business has grown and flourished. This helps to explain why we have an environment that is so conducive to criticism of business. In the next two subsections, we will see what some of the criticisms of business have been, and we will discuss some of the general results of such criticisms.

CRITICISMS OF BUSINESS: USE AND ABUSE OF POWER

Many criticisms have been pointed toward business over the years: Business is too big, it's too powerful, it pollutes the environment and exploits people for its own gain, it takes advantage of workers and consumers, it does not tell the truth, and so on. If one were to identify a common thread that seems to run through all the complaints, it seems to be business's use and perceived abuse of power. This is an issue that will not go away. In a cover story, *BusinessWeek* posed the question: "Too Much Corporate Power?" In this feature article, *BusinessWeek* presented its surveys of the public regarding business power. Most Americans are willing to acknowledge that Corporate America gets much credit for the good fortunes of the country. In spite of this, 72 percent of Americans said business has too much power over too many aspects of their lives.²⁹ In a later issue, *BusinessWeek* ran another cover story; this time it asked, "Is Wal-Mart Too Powerful?"³⁰ Whether at the general level or the level of the firm, questions about business's power continue to be raised.

Some of the points of friction between business and the public, in which corporate power is identified as partially the culprit, include such topics as corporate governance; CEO pay; investor losses; outsourcing jobs; mounting anger and frustration over health care, drug prices, and gas prices; poor airline service; HMOs that override doctors' decisions; in-your-face marketing; email spam; globalization; corporate bankrolling of politicians; sweatshops; urban sprawl; and low wages. Before discussing business power in more detail, we should note that in addition to the use or abuse of power, the major criticism seems to be that business often engages in questionable or unethical behavior with respect to its stakeholders.

What is **business power**? Business power refers to the ability or capacity to produce an effect or to bring influence to bear on a situation or people. Power, in and of itself, may be either positive or negative. In the context of business criticism, however, power often is perceived as being abused. Business certainly does have enormous power, but whether it abuses power is an issue that needs to be carefully examined. We will not settle this issue here, but the allegation that business abuses power remains the central theme behind the details.

Levels of Power

Business power exists at and may be manifested at several different levels. Four such levels include the macro level, the intermediate level, the micro level, and the individual level.³¹ The *macro level* refers to the corporate system—Corporate America—the totality of business organizations. Power here emanates from the sheer size, resources, and dominance of the corporate system. As the corporate system has become more global, its impact has become more far-reaching as well. The *intermediate level* refers to groups of corporations acting in concert in an effort to produce a desired effect—to raise prices, control markets, dominate purchasers, promote an issue, or pass or defeat legislation. Prime examples are

Ethics in Practice Case

DRINK SPECIALS?

While working as a waitress in a busy restaurant/bar, I observed a practice that was very common but appeared questionable. Often, in busy places of business, it is all too easy for employees to bend the rules and get away with it. Managers have so much on their hands that they have to trust their employees and, sadly, not everyone is trustworthy. In our restaurant, servers and bartenders were given a daily “spill sheet” on which they were supposed to record any alcoholic (and, especially, expensive) drinks that were accidentally spilled in the course of business that day.

When an employee is moving fast and dodging customers, spills are a natural occurrence, and the “spill sheet” was meant to take those accidents into account for the restaurant. When I began working there, I realized that at the end of the night not all of the spills on the list were genuine. Employees, typically bartenders because they had direct access, would serve free drinks to their friends all night and put the drinks on the spill sheet.

To accommodate large numbers of missing drinks, bartenders would serve their friends the same kind of beer all night and then claim a dropped case of that brand of beer. They could also claim a dropped liquor bottle and have enough to keep alcohol flowing for their friends. Other employees would also take

responsibility for some of the spills to make the bartenders appear credible.

I was asked on several occasions to take responsibility for a fake “spill.” In this way, employees used the spill sheet to their advantage instead of for its intended purpose. They would serve free drinks courtesy of “spilling” until the volume reached was just under the suspicious level. As long as a pattern was not formed, the managers never knew they were being deceived.

1. What type of ethical standards, if any, were the employees in the restaurant living by when they committed this common but questionable action? Is the “entitlement mentality” at work here?
2. If you were an employee and you saw this situation, would you think it should be reported or would you keep your mouth shut and let the practice continue? If you were asked to participate and take a “spill” for the team, what would you do? Why?
3. If your manager ever confronted you about some excessive spilling, would you personally think it was more ethical to protect the other employees or tell your manager the truth?

Contributed Anonymously

OPEC (gas prices), airlines, cable TV companies, banks, pharmaceutical companies, or defense contractors pursuing interests they have in common. The combined effect of companies acting in concert is considerable. The *micro level* of power is the level of the individual firm. This might refer to the exertion of power or influence by any major corporation—Google, Wal-Mart, Nike, ExxonMobil, or IBM, for example. The final level is the *individual level*. This refers to the individual corporate leader exerting power—Meg Whitman (eBay), Steve Jobs (Apple), Jeffrey Immelt (GE), Bill Gates (Microsoft), or Anne Mulcahy (Xerox).

The important point here is that as one analyzes corporate power, one should think in terms of the different levels at which that power is manifested. When this is done, it is not easy to conclude whether corporate power is excessive or has been abused. Specific levels of power need to be examined before conclusions can be reached.

Spheres of Power

In addition to levels of power, there are also many different spheres or arenas in which this power may be manifested. Figure 1-5 depicts one way of looking at the four levels identified and some of the spheres of power that also exist. *Economic power* and *political power* are two spheres that are referred to often, but business has other, more subtle forms of power as well. These other spheres include *social and cultural power*, *power over the individual*, *technological power*, and *environmental power*.³²

Is the power of business excessive? Does business abuse its power? Apparently, many people think so. To provide sensible and fair answers to these questions, however, one must carefully specify which level of power is being referred to and in which sphere the power is being employed. When this is done, it is not simple to arrive at generalizable answers.

Furthermore, the nature of power is such that it is sometimes wielded unintentionally. Sometimes it is consequential; that is, it is not wielded intentionally but nevertheless exerts its influence, even though no attempt is made to exercise it.³³

Figure 1-5 *Levels and Spheres of Corporate Power*

Levels Spheres	Macro Level (the business system)	Intermediate Level (several firms)	Micro Level (single firm)	Individual Level (single executive)
Economic				
Social/Cultural				
Individual				
Technological				
Environmental				
Political				

Balance of Power and Responsibility

Whether or not business abuses its power or allows its use of power to become excessive is a central issue that cuts through all the topics we will be discussing in this book. But power should not be viewed in isolation from responsibility, and this power/responsibility relationship is the foundation of calls for corporate social responsibility. The **iron law of responsibility** is a concept that addresses this: “In the long run, those who do not use power in a manner which society considers responsible will tend to lose it.”³⁴ Stated another way, whenever power and responsibility become substantially out of balance, forces will be generated to bring them into closer balance.

When power gets out of balance, a variety of forces come to bear on business to be more responsible and more responsive to the criticisms being made against it. Some of these more obvious forces include governmental actions, such as increased regulations and new laws. The investigative news media become interested in what is going on, and a whole host of special-interest groups bring pressure to bear. In the *BusinessWeek* cover story cited earlier, the point was made that “it’s this power imbalance that’s helping to breed the current resentment against corporations.”³⁵

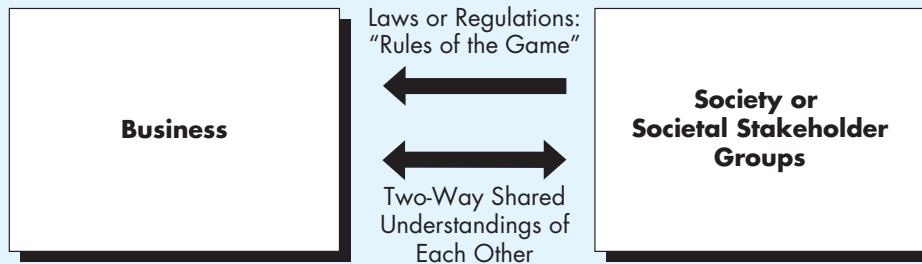
The tobacco industry is an excellent example of an industry that has felt the brunt of efforts to address allegations of abuse of power. Complaints that the industry produces a dangerous, addictive product and markets that product to young people have been made for years. The U.S. Food and Drug Administration (FDA) tried to assert jurisdiction over cigarettes and has been trying to rein in tobacco companies through aggressive regulation. One major outcome of this effort to bring the tobacco industry under control was a \$368 billion settlement, to be paid over 25 years, in which the tobacco firms settle lawsuits against them, submit to new regulations, and meet strict goals for reducing smoking in the United States. Although the industry continues to fight these measures, as it always has, it is expected that by the year 2022 tobacco’s role in American society will be forever reduced.³⁶

In 2002, the U.S. Congress quickly passed the Sarbanes-Oxley Act, which was designed to rein in the power and abuse that were manifested in such scandals as Enron, WorldCom, Arthur Andersen, and Tyco. Executives have been grumbling that the new law is costly, cumbersome, and redundant, but this illustrates what happens when power and responsibility get out of balance.³⁷ Today, companies continue to lobby Congress to amend Sarbanes-Oxley to make it less strict.

BUSINESS RESPONSE: CONCERN AND CHANGING SOCIAL CONTRACT

Growing out of criticisms of business and the idea of the power/responsibility equation has been an increased concern on the part of business for the stakeholder environment and a changed social contract. We previously indicated that the social environment was composed of such factors as demographics, lifestyles, and social values of the society. It may also be seen as a collection of conditions, events,

Figure 1-6 *Elements in the Social Contract*



and trends that reflect how people think and behave and what they value. As firms have sensed that the social environment and the expectations of business are changing, they have realized that they must change, too.

One way of monitoring the business/society relationship is through the **social contract**. This is a set of two-way understandings that characterize the relationship between major institutions—in our case, business and society. The social contract is changing, and this change is a direct outgrowth of the increased importance of the social environment. The social contract has been changing to reflect society's expectations of business, especially in the social and ethical realms.

The social contract between business and society, as illustrated in Figure 1-6, is partially articulated through:

1. *laws and regulations* that society has established as the framework within which business must operate; and
2. *shared understandings* that evolve as to each group's expectations of the other.

Laws and regulations spell out the "rules of the game" for business. Shared understandings, on the other hand, are more subtle and create room for misunderstandings. These shared understandings reflect mutual expectations regarding each other's roles, responsibilities, and ethics. These unspoken components of the social contract represent what might be called the normative perspective on the relationship (that is, what "ought" to be done by each party to the social contract).³⁸

A parallel example to the business/society social contract may be seen in the relationship between a professor and the students in his or her class. University regulations and the course syllabus spell out the formal "laws and regulations" aspect of the relationship. The shared understandings address those expectations that are generally understood but not necessarily spelled out formally. An example might be "fairness." The student expects the professor to be "fair" in making assignments, in the level of work expected, in grading, and so on. Likewise, the professor expects the student to be fair in evaluating him or her on

course evaluation forms, to be fair by not passing off someone else's work as his or her own, and so on.

An editorial from *BusinessWeek* on the subject of the social contract summarizes well the modern era of business and society relationships:

Today it is clear that the terms of the contract between society and business are, in fact, changing in substantial and important ways. Business is being asked to assume broader responsibilities to society than ever before, and to serve a wider range of human values. . . . Inasmuch as business exists to serve society, its future will depend on the quality of management's response to the changing expectations of the public.³⁹

Another *BusinessWeek* editorial commented on the new social contract by saying, "Listen up, Corporate America. The American people are having a most serious discussion about your role in their lives." The editorial was referring to the criticisms coming out in the early 2000s about abuse of corporate power.⁴⁰ Such a statement suggests that we will constantly witness changes in the social contract between business and society.

Focus of the Book

This book takes a *managerial approach* to the business and society relationship. The managerial approach emphasizes two main themes that are important to managers today: **business ethics** and **stakeholder management**. First, let us discuss the managerial approach.

MANAGERIAL APPROACH

Managers are practical, and they have begun to deal with social and ethical concerns in ways similar to those they have used to deal with traditional business functions—marketing, finance, operations, and so forth—in a rational, systematic, and administratively sound fashion. By viewing issues of social and ethical concern from a managerial frame of reference, managers have been able to reduce seemingly unmanageable concerns to ones that can be dealt with in a balanced and evenhanded fashion. Yet, at the same time, managers have had to integrate traditional economic and financial considerations with ethical and social considerations.

A managerial approach to the business/society relationship confronts the individual manager continuously with questions such as:

- What changes are occurring or will occur in society's expectations of business that mandate business's taking the initiative with respect to particular societal or ethical problems?
- Did business in general, or our firm in particular, have a role in creating these problems?

- What impact is social change having on the organization, and how should we best respond to it?
- Can we reduce broad social problems to a size that can be effectively addressed from a managerial point of view?
- What are the specific problems, alternatives for solving these problems, and implications for management's approach to dealing with social issues?
- How can we best plan and organize for responsiveness to socially related business problems?

Urgent vs. Enduring Issues

From the standpoint of urgency in managerial response, management is concerned with two broad types or classes of social issues. First, there are those issues or crises that arise on the spur of the moment and for which management must formulate relatively quick responses. A typical example might be a protest group that shows up on management's doorstep one day, arguing vehemently that the company should withdraw its sponsorship of a violent television show scheduled to air the next week.

Second, there are issues or problems that management has time to deal with on a more long-term basis. These issues include environmental pollution, employment discrimination, and occupational safety and health. In other words, these are enduring issues that will be of concern to society for a long time and for which management must develop a reasonably thoughtful organizational response. Management must thus be concerned with both short-term and long-term capabilities for dealing with social problems and the organization's social performance.

The test of success of the managerial approach will be the extent to which leaders can improve an organization's social performance by taking a managerial approach rather than dealing with issues and crises on an ad hoc basis. Such a managerial approach will require balancing the needs of urgency with the careful response to enduring issues.

BUSINESS ETHICS THEME

The managerial focus attempts to take a practical look at the social issues and expectations business faces, but ethical questions inevitably come into play. **Ethics** basically refers to issues of right, wrong, fairness, and justice, and business ethics focuses on ethical issues that arise in the commercial realm. Ethical factors run throughout our discussion because questions of right, wrong, fairness, and justice, no matter how slippery they are to deal with, permeate business's activities as it attempts to interact successfully with major stakeholder groups: employees, customers, owners, government, and the global and local communities. In light of the ethical scandals in recent years, the ethics theme resonates as one of the most critical dimensions of business and society relationships.

The principal task of management is not only to deal with the various stakeholder groups in an ethical fashion but also to reconcile the conflicts of

Ethics in Practice Case

DONATIONS FOR PROFIT

While working as the director of junior golf at a Nashville area golf course, I was put in charge of fund-raising. This task required me to spend numerous hours calling and visiting local businesses, seeking their donations for our end-of-the-summer golf tournament. After weeks of campaigning for money, I was pleased to have raised \$3,000 for the tournament. The money was intended to be used for prizes, food, and trophies for the two-day Tournament of Champions.

I notified the golf course manager of my intentions to spend the money at a local golf store to purchase prizes for the participants. Upon hearing of my decision to spend all of the contribution money on the tournament, my manager asked me to spend only \$1,500. I was confused by this request because I had encouraged various companies to contribute by telling them that their money would all be spent on the children registered in the tournament. My manager, however, told me that the golf course would pocket the other \$1,500 as pure profit. He said the economy had been struggling and that the course could use any extra money to boost profits.

I was deeply angered that I had given my word to these companies and now the golf course was going to pocket half the donations. Feeling that my manager was in the wrong, I went to him again, this time with an ultimatum. The money was either to be spent entirely on the tournament or I would return all of the checks personally, citing my manager's plan as the reason. In response, he said that I could spend the money any way I desired, but he would appreciate it if I were frugal with the money. I spent it all.

1. Was my manager wrong for seeking to pocket the donation money as profit? Does it make any difference that the golf course was experiencing perilous economic times? (After all, if the course goes out of business, tournaments cannot be held at all).
2. Was I right in challenging my manager? Should I have handled this differently?
3. Do you think the companies would have felt cheated if the golf course had pocketed their donations?

Contributed by Eric Knox

interest that occur between the organization and the stakeholder groups. Implicit in this challenge is the ethical dimension that is present in practically all business decision making where stakeholders are concerned. In addition to the challenge of treating fairly the groups with which business interacts, management faces the equally important task of creating an organizational climate in which all employees make decisions with the interests of the public, as well as those of the organization, in mind. At stake is not only the firm's reputation but also the reputation of the business community in general.

STAKEHOLDER MANAGEMENT THEME

As we have indicated throughout this chapter, **stakeholders** are individuals or groups with which business interacts who have a “stake,” or vested interest, in the firm. They could be called “publics,” but this term may imply that they are outside the business sphere and should be dealt with as external players rather than as integral constituents of the business and society relationship. As a matter of fact, stakeholders actually constitute the most important elements of that broad grouping known as *society*.

We consider two broad groups of stakeholders in this book. Owner stakeholders are considered first. Though all chapters touch on the stakeholder management theme, Chapter 4 specifically addresses the topic of corporate governance in which owner stakeholders are represented by boards of directors. Later, we consider *external stakeholders*, which include government, consumers, the natural environment, and community members. Domestic and global stakeholders are major concerns. We treat government first because it represents the public. It is helpful to understand the role and workings of government in order to best appreciate business’s relationships with other groups. Consumers may be business’s most important stakeholders. Members of the community are crucial, too, and they are concerned about a variety of issues. One of the most important is the natural environment. All these issues have direct effects on the public. Social activist groups representing external stakeholders also must be considered to be a part of this classification.

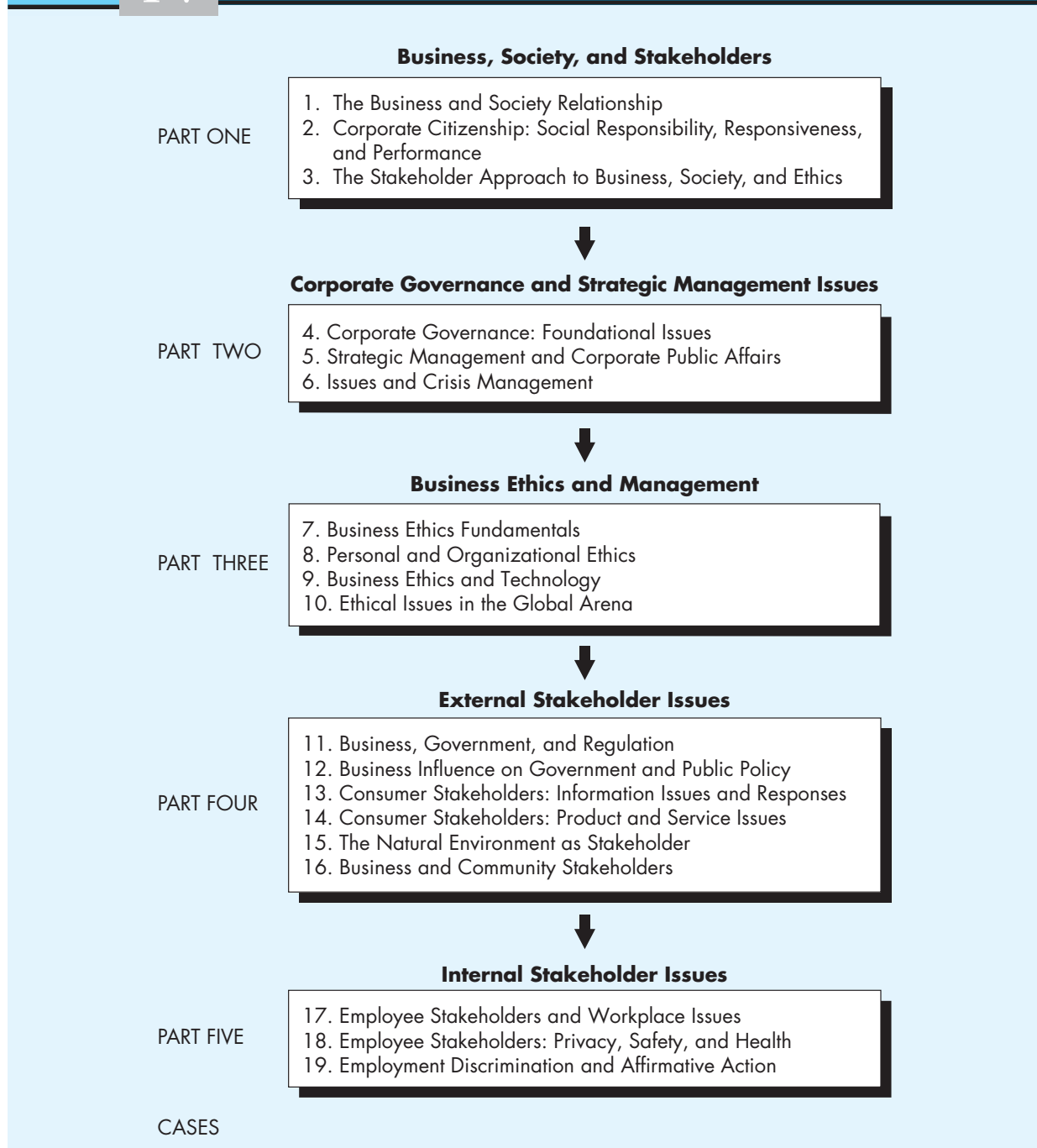
The second broad grouping of stakeholders are *internal stakeholders*. Business owners are treated in our discussion of corporate governance, but then later in the book, employees are the principal group of internal stakeholders addressed. We live in an organizational society, and many people think that their roles as employees are just as important as their roles as investors or owners. Both of these groups have legitimate legal and moral claims on the organization, and management’s task is to address their needs and balance these needs against those of the firm and of other stakeholder groups. We will develop the idea of stakeholder management more fully in Chapter 3.

Structure of the Book

The structure of this book is outlined in Figure 1-7.

In Part 1, titled “Business, Society, and Stakeholders,” there are three chapters. Chapter 1 provides an overview of the business and society relationship. Chapter 2 covers corporate citizenship: social responsibility, responsiveness, and performance. Chapter 3 addresses the stakeholder management concept. These chapters provide a crucial foundation for understanding all of the discussions that follow. They provide the context for the business and society relationship.

Figure 1-7 *Organization and Flow of the Book*



Part 2 is titled “Corporate Governance and Strategic Management Issues.” Chapter 4 covers the vital topic of corporate governance, which has become more prominent during the past five years. The next two chapters address management-related topics. Chapter 5 covers strategic management and corporate public affairs. Chapter 6 addresses issues management and crisis management.

Part 3, “Business Ethics and Management,” focuses exclusively on business ethics. Business ethics fundamentals are established in Chapter 7, and personal and organizational ethics are discussed in more detail in Chapter 8. Chapter 9 addresses business ethics and technology. Chapter 10 treats business ethics in the global or international sphere. Although ethical issues cut through and permeate virtually all discussions in the book, this dedicated treatment of business ethics is warranted by a need to explore in added detail the ethical dimension in management.

Part 4, “External Stakeholder Issues,” addresses the major external stakeholders of business. In Chapter 11, because government is such an active player in all the groups to follow, we consider business/government relationships and government regulations. In Chapter 12, we discuss how business endeavors to shape and influence government and public policy. Chapters 13 and 14 address consumer stakeholders. Chapter 15 addresses the natural environment as stakeholder. Chapter 16 addresses business and community stakeholder issues, including corporate philanthropy.

In Part 5, “Internal Stakeholder Issues,” employees are the sole stakeholders addressed because the treatment of owner stakeholders appeared in Part 2. Chapter 17 considers employees and major workplace issues, and Chapter 18 looks carefully at the issues of employee privacy, safety, and health. In Chapter 19, we focus on the special case of employment discrimination.

Depending on the emphasis desired in the course, Part 2 could be covered where it is currently located, or it could be postponed until after Part 5. Alternatively, it could be omitted if a strategic management orientation is not desired.

Taken as a whole, the book strives to take the reader through a building-block progression of basic concepts and ideas that are vital to the business and society relationship and to explore the nature of social and ethical issues and stakeholder groups with which management must interact. It considers the external and internal stakeholder groups in some depth.

Summary

The pluralistic business system in the United States has several advantages and some disadvantages. Within this context, business firms must deal with a multitude of stakeholders and an increasingly special-interest society. A major force that shapes the public’s view

of business is the criticism that business receives from a variety of sources. Factors in the social environment that have contributed to an atmosphere in which business criticism thrives include affluence, education, public awareness developed through the media (especially TV and

the Internet), the revolution of rising expectations, a growing entitlement mentality, the rights movement, and a philosophy of victimization. In addition, actual questionable practices on the part of business have made it a natural target. The ethics scandals, including Enron and post-Enron, have perpetuated criticisms of business. Not all firms are guilty, but the guilty bring negative attention to the entire business community. One result is that the trust and legitimacy of the entire business system is called into question.

A major criticism of business is that it abuses its power. To understand power, one needs to recognize that it may exist and operate at four different levels: the level of the entire business system, groups of companies acting in concert, the

level of the individual firm, and the level of the individual corporate executive. Moreover, business power may be manifested in several different spheres: economic, political, technological, environmental, social, and individual. It is difficult to assess whether business is actually abusing its power, but it is clear that business has enormous power and that it must exercise this power carefully. Power evokes responsibility, and this is the central reason that calls for corporate responsiveness have been prevalent in recent years. The iron law of responsibility calls for greater balance in business power and responsibility. These concerns have led to a changing social environment for business and a changed social contract.

Key Terms

affluence (page 12)

business (page 5)

business ethics (page 24)

business power (page 19)

economic environment (page 7)

education (page 13)

entitlement mentality (page 16)

ethics (page 25)

iron law of responsibility (page 22)

macroenvironment (page 7)

pluralism (page 8)

political environment (page 7)

revolution of rising expectations (page 15)

rights movement (page 17)

social contract (page 22)

social environment (page 7)

social problem (page 16)

society (page 6)

special-interest society (page 10)

stakeholder management (page 24)

stakeholders (page 27)

technological environment (page 7)

victimization philosophy (page 18)

Discussion Questions

1. In discussions of business and society, why is there a tendency to focus on large rather than small- or medium-sized firms? Have the corporate ethics scandals of the early 2000s affected small- and medium-sized firms? If so, in what ways have these firms been affected?
2. What is the one greatest strength of a pluralistic society? What is the one greatest weakness? Do these characteristics work for or against business?
3. Identify and explain the major factors in the social environment that create an atmosphere in which business criticism takes place and prospers. How are the factors related to one another?
4. Give an example of each of the four levels of power discussed in this chapter. Also, give an

example of each of the spheres of business power.

5. Explain in your own words the *iron law of responsibility* and the *social contract*. Give an example of a shared understanding between

you as a consumer or an employee and a firm with which you do business or for which you work. Was Congress justified in passing the Sarbanes-Oxley Act in 2002 due to the business scandals of the early 2000s?

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Corporate Citizenship: Social Responsibility, Responsiveness, and Performance

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Explain how corporate social responsibility (CSR) evolved and now encompasses economic, legal, ethical, and philanthropic components.
- 2 Provide business examples of CSR and corporate citizenship.
- 3 Differentiate between corporate citizenship, social responsibility, responsiveness, and performance.
- 4 Elaborate on the concept of corporate social performance (CSP).
- 5 Explain how corporate citizenship develops in stages in companies.
- 6 Describe the socially responsible investing movement.

For the past three decades, business has been undergoing the most intense scrutiny it has ever received from the public. As a result of the many allegations being leveled at it—charges that it has little concern for the consumer, cares nothing about the deteriorating social order, has no concept of acceptable ethical behavior, and is indifferent to the problems of minorities and the environment—concern is continuing to be expressed as to what responsibilities business has to society. These concerns have generated an unprecedented number of pleas for corporate social responsibility (CSR). More recently, CSR has been embraced in the broader term—*corporate citizenship*. Concepts that have evolved from CSR include corporate social *responsiveness* and corporate social *performance*. Today, many business executives prefer the term *corporate citizenship* as an inclusive reference to social responsibility issues.

CSR is a “front-burner” issue within the business community and continues to grow each year. An example of this growth was the formation in 1992 of an organization called **Business for Social Responsibility (BSR)**. According to BSR, it was formed to fill an urgent need for a national business alliance that fosters socially responsible corporate policies. In 2007, BSR reported among its membership such recognizable names as Levi Strauss & Co., Cisco Systems, GE, Wal-Mart, Mattel, Honeywell, Coca-Cola, UPS, Tom’s of Maine, and hundreds of others. The mission statement of BSR states that it “seeks to create a just and sustainable world by working with companies to promote more responsible business practices, innovation and collaboration.”¹

In this chapter, we intend to explore several different aspects of the CSR topic and to provide some insights into what CSR means and how businesses are carrying it out. We are dedicating an entire chapter to the CSR issue and concepts that have emerged from it because it is a core idea that underlies most of our discussions in this book.

The Corporate Social Responsibility Concept

In Chapter 1, we traced how criticisms of business have led to increased concern for the social environment and a changed social contract. Out of these ideas has grown the notion of corporate social responsibility, or CSR. Before providing some historical perspective, let us impart an initial view of what corporate social responsibility means.

<http://SEARCHTHEWEB.WEB>

BUSINESS FOR SOCIAL RESPONSIBILITY

Businesses in growing numbers are very interested in CSR. One leading organization that companies join to advocate CSR is Business for Social Responsibility (BSR). BSR is a national business association that helps companies seeking to implement policies and practices that contribute to the companies’ sustained and responsible success. BSR also operates the Business for Social Responsibility Education Fund, a nonprofit research, education, and advocacy organiza-

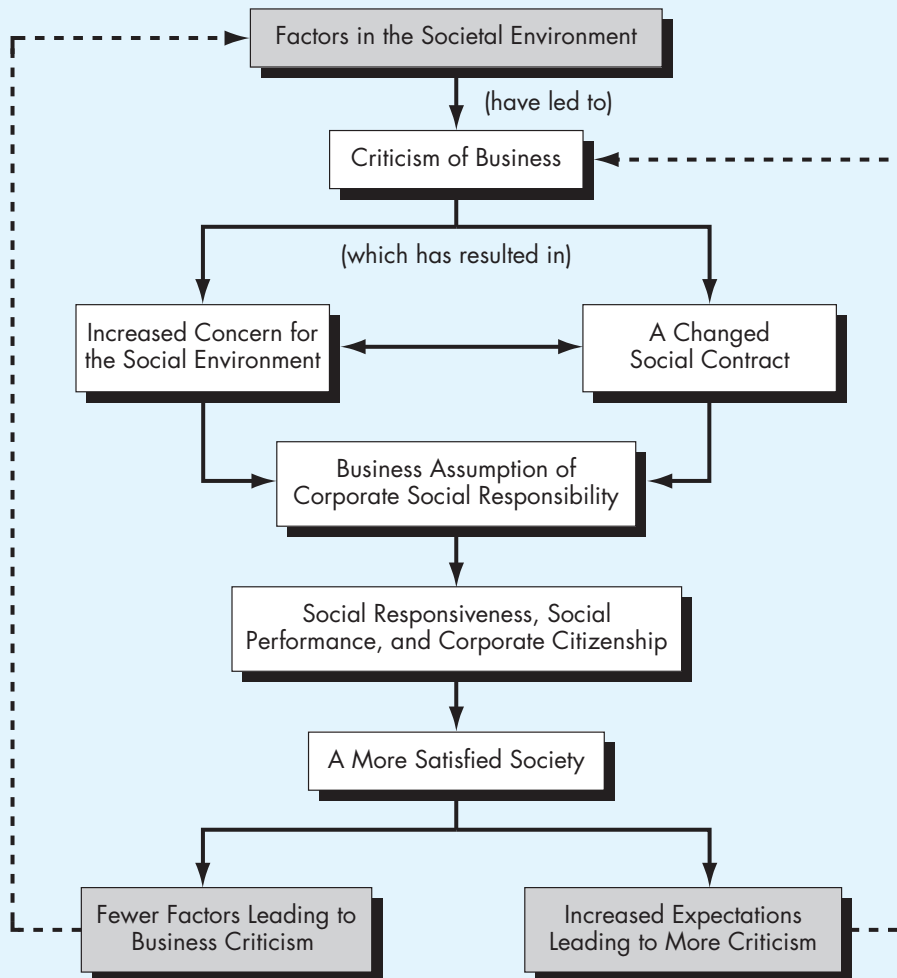
tion that promotes more responsible business practices in the broad business community and in society. BSR conducts programs on a range of social responsibility and stakeholder issues, including business ethics, the workplace, the marketplace, the community, the environment, and the global economy.

To learn more about what business is actually doing in the realm of corporate social responsibility, visit BSR’s website at <http://wwwbsr.org>.

An early view of CSR stated: “**Corporate social responsibility** is seriously considering the impact of the company’s actions on society.”² Another early definition was that “social responsibility . . . requires the individual to consider his [or her] acts in terms of a whole social system, and holds him [or her] responsible for the effects of his [or her] acts anywhere in that system.”³

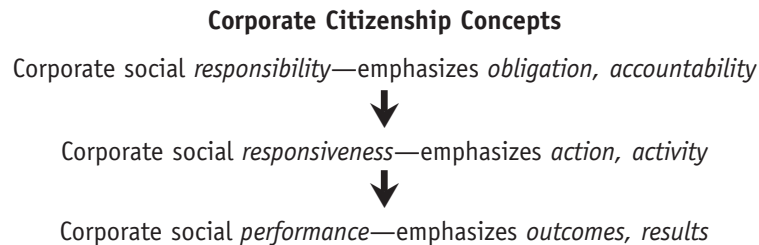
Both of these definitions provide useful insights into the concept of social responsibility that will help us appreciate some brief history. Figure 2-1 illustrates the business criticism/social response cycle, depicting how the concept of CSR

Figure 2-1 *Business Criticism/Social Response Cycle*



grew out of the ideas introduced in Chapter 1—business criticism and the increased concern for the social environment and the changed social contract. We see also in Figure 2-1 that the commitment to social responsibility by businesses has led to increased corporate *responsiveness* to stakeholders and improved social (stakeholder) *performance*—ideas that are developed more fully in this chapter.

As we will discuss later in more detail, some today prefer the term *corporate citizenship* to collectively embrace the host of concepts related to CSR. However, for now, a useful summary of the themes or emphases of each of the chapter title concepts helps us see the flow of ideas accentuated as these concepts have developed:



The growth of these ideas has brought about a society more satisfied with business. However, this satisfaction, although it has reduced the number of factors leading to business criticism, has at the same time led to increased expectations that have resulted in more criticism. This double effect is depicted in Figure 2-1. The net result is that the overall levels of business social performance and societal satisfaction should increase with time in spite of this interplay of positive and negative factors. Should business not be responsive to societal expectations, it could conceivably enter a downward spiral, resulting in significant deterioration in the business/society relationship. The tsunami of corporate fraud scandals beginning in 2001–2002 seriously called businesses’ concern for society into question, and this concern continues today.

HISTORICAL PERSPECTIVE ON CSR

The concept of business responsibility that prevailed in the United States during most of our history was fashioned after the traditional, or classical, *economic model*. Adam Smith’s concept of the “invisible hand” was its major starting point. The classical view held that a society could best determine its needs and wants through the marketplace. If business is rewarded on the basis of its ability to respond to the demands of the market, the self-interested pursuit of that reward will result in society getting what it wants. Thus, the “invisible hand” of the market transforms self-interest into societal interest. Unfortunately, although the marketplace has done a reasonably good job in deciding what goods and services should be produced, it has not fared as well in ensuring that business always acts fairly and ethically.

Years later, when laws constraining business behavior began to proliferate, it might be said that a *legal model* emerged. Society’s expectations of business

changed from being strictly economic in nature to encompassing issues that had been previously at business's discretion. Over time, a *social model* and then a *stakeholder model* have evolved.

In practice, although business subscribed to the economic emphasis and was willing to be subjected to an increasing number of laws imposed by society, the business community later did not fully live by the tenets of even these early conceptions of business responsibility. As McKie observed, "The business community never has adhered with perfect fidelity to an ideologically pure version of its responsibilities, drawn from the classical conception of the enterprise in economic society, though many businessmen [people] have firmly believed in the main tenets of the creed."⁴

MODIFICATION OF THE ECONOMIC MODEL

A modification of the classical economic model was seen in practice in at least three areas: philanthropy, community obligations, and paternalism.⁵ History shows that businesspeople did engage in **philanthropy**—contributions to charity and other worthy causes—even during periods characterized by the traditional economic view. Voluntary **community obligations** to improve, beautify, and uplift were evident. One early example of this was the cooperative effort between the railroads and the YMCA immediately after the Civil War to provide community services in areas served by the railroads. Although these services economically benefited the railroads, they were at the same time philanthropic in nature.⁶

During the latter part of the nineteenth century and even into the twentieth century, **paternalism** appeared in many forms. One of the most visible examples was the company town. Although business's motives for creating company towns (for example, the Pullman/Illinois experiment) were mixed, business had to do a considerable amount of the work in governing them. Thus, some companies took on a form of paternalistic social responsibility.⁷

The emergence of large corporations during the late 1800s played a major role in hastening movement away from the classical economic view. As society developed from the economic structure of small, powerless firms governed primarily by the marketplace to large corporations in which power was more concentrated, questions of the responsibility of business to society surfaced.⁸

Although the idea of corporate social responsibility had not yet fully developed in the 1920s, managers even then had a positive view of their role. Community service was in the forefront. The most visible example was the Community Chest movement, which received its impetus from business. Morrell Heald suggests that this was the first large-scale endeavor in which business leaders became involved with other nongovernmental community groups for a common, nonbusiness purpose that necessitated their contribution of time and money to community welfare projects.⁹ The social responsibility of business, then, had received a further broadening of its meaning.

The 1930s signaled a transition from a predominantly laissez-faire economy to a mixed economy, in which business found itself one of the constituencies monitored

by a more activist government. From this time well into the 1950s, business's social responsibilities grew to include employee welfare (pension and insurance plans), safety, medical care, retirement programs, and so on. McKie has suggested that these new developments were spurred both by governmental compulsion and by an enlarged concept of business responsibility.¹⁰

Neil J. Mitchell, in his book *The Generous Corporation*, presents an interesting thesis regarding how CSR evolved.¹¹ Mitchell's view is that the ideology of corporate social responsibility, particularly philanthropy, was developed by American business leaders as a strategic response to the antibusiness fervor that was beginning in the late 1800s and early 1900s. The antibusiness reaction was the result of specific questionable practices, such as railroad price gouging, and public resentment of the emerging gigantic fortunes being made by late nineteenth-century moguls, such as John D. Rockefeller and Andrew Carnegie.¹²

As business leaders came to realize that the government had the power to intervene in the economy and, in fact, was being encouraged to do so by public opinion, there was a need for a philosophy that promoted large corporations as a force for social good. Thus, Mitchell argued, business leaders attempted to persuade those affected by business power that such power was being used appropriately. An example of this early progressive business ideology was reflected in Carnegie's 1889 essay "The Gospel of Wealth," which asserted that business must pursue profits but that business wealth should be used for the benefit of the community. Philanthropy, therefore, became the most efficient means of using corporate wealth for public benefit. A prime example of this was Carnegie's funding and building of more than 2,500 libraries.¹³

In a discussion of little-known history, Mitchell documents by specific examples how business developed this idea of the generous corporation and how it had distinct advantages: It helped business gain support from national and local governments, and it helped to achieve in America a social stability that was unknown in Europe during that period. In Berenbeim's review of Mitchell's book, he argues that the main motive for corporate generosity in the early 1900s was essentially the same as it was in the 1990s—to keep government at arm's length.¹⁴

CSR's Acceptance and Broadening of Meaning

The period from the 1950s to the present may be considered the modern era, in which the concept of corporate social responsibility gained considerable acceptance and broadening of meaning. During this time, the emphasis has moved from little more than a general awareness of social and moral concerns to a period in which specific issues, such as corporate governance, product safety, honesty in advertising, employee rights, affirmative action, environmental sustainability, ethical behavior, and global CSR, have taken center stage. The *issue* orientation eventually gave way to the more recent focus on social performance and corporate citizenship. First, however, we can expand upon the modern view of CSR by examining a few definitions or understandings of this term that have developed in recent years.

EVOLVING MEANINGS OF CSR

Let's now return to the basic question: What does corporate social responsibility really mean? Up to this point, we have been operating with a rather simple definition of social responsibility:

Corporate social responsibility is seriously considering the impact of the company's actions on society.

Although this definition has inherent ambiguities, we will find that most of the definitions presented by others also have limitations. A second definition is worth considering:

*Social responsibility is the obligation of decision makers to take actions which protect and improve the welfare of society as a whole along with their own interests.*¹⁵

This definition suggests two active aspects of social responsibility—*protecting* and *improving*. To protect the welfare of society implies the avoidance of negative impacts on society. An example would be avoiding environmental pollution. To improve the welfare of society implies the creation of positive benefits for society. An example would be building a new community center. Like the first definition, this second characterization contains several words that are perhaps unavoidably vague.

A third definition that is useful is also quite general. But, unlike the previous two, it places social responsibilities in context vis-à-vis economic and legal objectives of business:

*The idea of social responsibility supposes that the corporation has not only economic and legal obligations, but also certain responsibilities to society which extend beyond these obligations.*¹⁶

<http://SEARCHTHEWEBWEB>

CRO: CORPORATE RESPONSIBILITY OFFICER MAGAZINE LAUNCHED

In Fall 2006, *CRO Magazine* took over the 20-year-old *Business Ethics* magazine. The new magazine is targeted toward those individuals who occupy the role of corporate responsibility officer in their companies. But it is also targeted readers in the ranks of CEOs, CFOs, directors of HR, and others interested in this vital topic. As the first issue of the magazine suggested, the question in business today has shifted from *whether* to be engaged in corporate social responsibility to *how* to be engaged.

To read about the magazine's new mission and format, go to <http://www.thecro.com> and see what topics are important to practitioners today. In a recent issue, some of the following corporate social responsibility topics were described and highlighted: Who is a CRO? Gap, Inc.'s take on corporate responsibility, International CSR, Ethics & Governance, and the Challenge of Marketing CSR.

This statement is attractive in that it acknowledges the importance of economic objectives (e.g., profits) side by side with legal obligations, while also encompassing a broader conception of the firm's responsibilities. It is limited, however, in that it does not clarify what the certain responsibilities that extend beyond these are.

A fourth definition relates CSR to management's growing concern with stakeholders and ethics:

Corporate social responsibility relates primarily to achieving outcomes from organizational decisions concerning specific issues or problems which (by some normative standard) have beneficial rather than adverse effects upon pertinent corporate stakeholders. The normative correctness of the products of corporate action have been the main focus of corporate social responsibility.¹⁷

This definition is helpful because it emphasizes the outcomes, products, or results of corporate actions for stakeholders, which are only implicit in the other definitions. Over the years, a number of different definitions or views on CSR have evolved.¹⁸

A FOUR-PART DEFINITION OF CSR

Each of the definitions of corporate social responsibility discussed previously is valuable. At this point, we would like to present Carroll's four-part definition of CSR, which focuses on the *types* of social responsibilities business has. Carroll's definition helps us to understand the components of CSR, and it is the definition that we will build upon in this book:

The social responsibility of business encompasses the economic, legal, ethical, and discretionary (philanthropic) expectations that society has of organizations at a given point in time.¹⁹

Carroll's four-part definition places economic and legal expectations of business in context by relating them to more socially oriented concerns. These social concerns include ethical responsibilities and philanthropic (voluntary/discretionary) responsibilities.

Economic Responsibilities

First, business has **economic responsibilities**. It may seem odd to call an economic responsibility a social responsibility, but, in effect, this is what it is. First and foremost, the American social system calls for business to be an economic institution. That is, it should be an institution whose objective is to produce goods and services that society wants and to sell them at fair prices—prices that society thinks represent the true value of the goods and services delivered and that provide business with profits adequate to ensure its survival and growth and to reward its investors. While thinking about its economic responsibilities, business employs many management concepts that are directed toward financial effectiveness—attention to revenues, costs, investments, strategic decision making,

and the host of business concepts focused on maximizing the long-term financial performance of the organization. Today, the global hyper-competition in business has highlighted the importance of business's economic responsibilities. But economic responsibilities are not enough.

Legal Responsibilities

Second, business has **legal responsibilities**. Just as society has sanctioned our economic system by permitting business to assume the productive role mentioned earlier, as a partial fulfillment of the social contract, it has also established the ground rules—the laws—under which business is expected to operate. Legal responsibilities reflect society's view of "codified ethics" in the sense that they embody basic notions of fair practices as established by our lawmakers. It is business's responsibility to society to comply with these laws. If business does not agree with laws that have been passed or are about to be passed, our society has provided a mechanism by which dissenters can be heard through the political process. In the past decades, our society has witnessed a proliferation of laws and regulations striving to control business behavior. A notable *Newsweek* cover story titled "Lawsuit Hell: How Fear of Litigation Is Paralyzing Our Professions" emphasizes the burgeoning role that the legal responsibility of organizations is assuming.²⁰ The legal aspect of the business and society relationship will be examined further in later chapters as pertinent issues arise.

As important as legal responsibilities are, they do not embrace the full range of behaviors expected of business by society. On its own, law is inadequate for at least three reasons. First, the law cannot possibly address all the topics or issues that business may face. New issues continuously emerge, such as Internet-based business (e-commerce), genetically modified foods, and dealing with illegal immigrants. Second, the law often lags behind more recent concepts of what is considered appropriate behavior. For example, as technology permits more exact measurements of environmental contamination, laws based on measures made by obsolete equipment become outdated but are not frequently changed. Third, laws are made by lawmakers and may reflect the personal interests and political motivations of legislators rather than appropriate ethical justifications. A sage once said: "Never go to see how sausages or laws are made." It may not be a pretty picture. Although we would like to believe that our lawmakers are focusing on "what is right," political maneuvering often suggests otherwise.

Ethical Responsibilities

Because laws are essential but not adequate, **ethical responsibilities** are needed to embrace those activities and practices that are expected or prohibited by society even though they are not codified into law. Ethical responsibilities embody the full scope of norms, standards, values, and expectations that reflect what consumers, employees, shareholders, and the community regard as fair, just, and consistent with the respect for or protection of stakeholders' moral rights.²¹

In one sense, changes in ethics or values precede the establishment of laws because they become the driving forces behind the initial creation of laws and

Ethics in Practice Case

FEELING “USED”

While attending college, I spent a few years working at a used-textbook store. The majority of the books we sold were purchased from students, individuals, and used-book wholesalers. Sometimes, when putting books out on the shelves, I would encounter books with phrases like “Instructor’s Copy” or “Sample Copy—Not for Resale” printed on the covers. When I asked my boss about these books, he told me that they were free copies given out to instructors, but it was perfectly legal for us to sell the books because we had purchased them from another person. This made sense to me and satisfied my curiosity.

Later in the day, my boss showed me a pile of these sample-copy books and said that we should take colored tape and cover up the areas that contained the phrases such as “Sample Copy.” When I asked why we did this, he told me that, although we were legally able to sell the books, the phrases sometimes discouraged customers from buying these copies even though the content was identical to the standard copies. I then asked how we got these books if they were instructor copies and were not supposed to be resold.

I was told that the publishing companies sent free copies of books to professors to let them read and evaluate them in the hope that they would order the book as material for their classes. We got some of

these books when professors sold their sample copies to us or a used-book wholesaler, but the majority came from individuals who went around college campuses (calling themselves *book-buyers*) buying these books from professors and then selling them to a used-book store or a used-book wholesaler.

My boss also stated that, because the content inside was the same, we really did not care if they were the standard copy or a sample copy and, therefore, we bought and sold these books for the same prices as the standard copies.

1. Is it a socially responsible (legal? ethical?) practice for a bookstore to purchase and then resell these books that were given out as free copies?
2. Is it an ethical practice for the bookstore to conceal the fact that these books are, indeed, instructor’s or sample copies?
3. Is it an ethical practice for book-buyers to roam the halls of college campuses and buy these free books from professors who no longer want them?
4. Is it an ethical practice for professors to sell books that were sent to them as free sample copies?

Contributed Anonymously

regulations. For example, the civil rights, environmental, and consumer movements reflected basic alterations in societal values and thus may be seen as ethical bellwethers, foreshadowing and leading to later legislation. In another sense, ethical responsibilities may be seen as embracing and reflecting newly emerging values and norms that society expects business to meet, even though they may reflect a higher standard of performance than that currently required by law. Ethical responsibilities in this sense are often ill defined or continually evolving. As a result, debate as to their legitimacy continues. Regardless, business is

expected to be responsive to newly emerging concepts of what constitutes ethical practices. In recent years, ethics in the global arena have complicated and extended the study of acceptable business norms and practices.

Superimposed on these ethical expectations originating from societal and stakeholder groups are the implied levels of ethical performance suggested by a consideration of the great ethical principles of moral philosophy, such as justice, rights, and utilitarianism.²²

Because ethical responsibilities are so important, we devote the four chapters in Part 3 to the subject. For the moment, let us think of ethical responsibilities as encompassing those decision, policy, and behavior areas in which society expects certain levels of moral or principled performance but which it has not yet articulated or codified into law.

Philanthropic Responsibilities

Fourth, there are business's voluntary, discretionary, or **philanthropic responsibilities**. Though not responsibilities in the literal sense of the word, these are viewed as responsibilities because they reflect current expectations of business by the public. The amount and nature of these activities are voluntary, guided only by business's desire to engage in social activities that are not mandated, not required by law, and not generally expected of business in an ethical sense. Nevertheless, the public has an expectation that business will "give back," and thus this category has become a part of the social contract between business and society. Such activities might include corporate giving, product and service donations, employee volunteerism, partnerships with local government and other organizations, and any other kind of voluntary involvement of the organization and its employees with the community or other stakeholders.

Examples of companies fulfilling their philanthropic responsibilities and "doing well by doing good" are many:

- Chick-fil-A, the fast-food restaurant, through the WinShape Centre Foundation, operates foster homes for more than 120 children, sponsors a summer camp that hosts more than 1,700 campers every year from 24 states, and has provided college scholarships for more than 16,500 students.²³
- Chiquita, the banana producer, now recycles 100 percent of the plastic bags and twine used on its farms, and it has improved working conditions by building housing and schools for its employees' families.²⁴
- Timberland underwrites skills training for women working for its suppliers in China. In Bangladesh, it helps provide micro-loans and health services for laborers.²⁵
- UPS has committed \$2 million to a two-year program, the Volunteer Impact Initiative, designed to help nonprofit organizations develop innovative ways to recruit, train, and manage volunteers.
- Whole Foods gives away 5 percent of its profits to various charities and sells only goods produced in ways it considers to be ethical. It also refuses to sell overfished marine life like Chilean sea bass.²⁶

- Thousands of companies give away money, services, and volunteer time to education, youth, health organizations, arts and culture, neighborhood improvement, minority affairs, and programs for the handicapped.

Though there is sometimes an ethical motivation for companies getting involved in philanthropy, more often it is viewed as a practical way by which the company can demonstrate that it is a good corporate citizen. In addition, some companies engage in philanthropy because they perceive an “institutional” expectation that they do so. That is, they see other major companies in their industry doing so and think they also need to participate to be accepted.

A major distinction between ethical responsibilities and philanthropic responsibilities is that the latter typically are not *expected* in a moral or an ethical sense. Communities desire and expect business to contribute its money, facilities, and employee time to humanitarian programs or purposes, but they do not regard firms as unethical if they do not provide these services at the desired levels. Therefore, these responsibilities are more discretionary, or voluntary, on business’s part, although the societal expectation that they be provided has been around for some time. This category of responsibilities is often referred to as good “corporate citizenship.”

In summary, our four-part CSR definition forms a conceptualization that includes the economic, legal, ethical, and philanthropic expectations placed on organizations by society at a given point in time. Figure 2-2 summarizes the four components, society’s expectation regarding each component, and explanations.

It is suggested that business has accountability for each of these areas of responsibility and performance. This four-part definition provides us with categories within which to place the various expectations that society has of business. With each

Figure 2-2 *Understanding the Four Components of Corporate Social Responsibility*

Type of Responsibility	Societal Expectation	Explanations
Economic	REQUIRED of business by society	Be profitable. Maximize sales, minimize costs. Make sound strategic decisions. Be attentive to dividend policy. Provide investors with adequate and attractive returns on their investments.
Legal	REQUIRED of business by society	Obey all laws, adhere to all regulations: environmental and consumer laws; laws protecting employees. Comply with Sarbanes-Oxley Act. Fulfill all contractual obligations. Honor warranties and guarantees.
Ethical	EXPECTED of business by society	Avoid questionable practices. Assume law is a floor on behavior, operate above minimum required. Respond to spirit as well as letter of law. Do what is right, fair, and just. Assert ethical leadership.
Philanthropic	DESIRED/EXPECTED of business by society	Be a good corporate citizen. Give back. Make corporate contributions. Provide programs supporting community—education, health/human services, culture and arts, civic. Provide for community betterment. Engage in volunteerism.

of these categories considered to be an indispensable facet of the total social responsibility of business, we have a conceptual model that more completely describes the kinds of expectations that society has of business. A major advantage of this model is that it can accommodate those who have argued against CSR by characterizing an economic emphasis as separate from a social emphasis. This model offers these two facets along with others that collectively make up corporate social responsibility.

The Pyramid of Corporate Social Responsibility

A helpful way of graphically depicting the four-part definition of CSR is envisioning a pyramid composed of four layers. This **Pyramid of Corporate Social Responsibility (CSR)** is shown in Figure 2-3.²⁷

Figure 2-3 *The Pyramid of Corporate Social Responsibility*



Source: Archie B. Carroll, "The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders," *Business Horizons* (July–August 1991), 42. Copyright © 1991 by the Foundation for the School of Business at Indiana University. Used with permission.

The pyramid portrays the four components of CSR, beginning with the basic building block of economic performance at the base. At the same time, business is expected to obey the law, because the law is society's codification of acceptable and unacceptable practices. In addition, there is business's responsibility to be ethical. At its most basic level, this is the obligation to do what is right, just, and fair and to avoid or minimize harm to stakeholders (employees, consumers, the environment, and others). Finally, business is expected to be a good corporate citizen—to fulfill its philanthropic responsibility to contribute financial and human resources to the community and to improve the quality of life.

No metaphor is perfect, and the Pyramid of CSR is no exception. It is intended to illustrate that the *total* social responsibility of business is composed of distinct components that, when taken together, make up the whole. Although the components have been treated as separate concepts for discussion purposes, they are not mutually exclusive and are not intended to juxtapose a firm's economic responsibilities with its other responsibilities. At the same time, a consideration of the separate components helps the manager to see that the different types or kinds of obligations are in constant and dynamic tension with one another. The most critical tensions, of course, are those between economic and legal, economic and ethical, and economic and philanthropic. The traditionalist might see this as a conflict between a firm's "concern for profits" and its "concern for society," but it is suggested here that this is an oversimplification.

Pyramid to Be Taken as a Unified Whole. A CSR or stakeholder perspective would focus on the total pyramid as a unified whole and on how the firm might engage in decisions, actions, policies, and practices that *simultaneously* fulfill all its component parts. This pyramid should not be interpreted to mean that business is expected to fulfill its social responsibilities in some sequential fashion, starting at the base. Rather, business is expected to fulfill all its responsibilities simultaneously.

In summary, the total social responsibility of business entails the concurrent fulfillment of the firm's economic, legal, ethical, and philanthropic responsibilities. In equation form, this might be expressed as follows:

$$\begin{aligned} & \textit{Economic Responsibilities} + \textit{Legal Responsibilities} + \textit{Ethical Responsibilities} \\ & + \textit{Philanthropic Responsibilities} \\ & = \textit{Total Corporate Social Responsibility} \end{aligned}$$

Stated in more practical and managerial terms, the socially responsible firm should strive to:

- Make a profit
- Obey the law
- Be ethical
- Be a good corporate citizen

CSR Definition and Pyramid Are Stakeholder Models. It is especially important to note that the four-part CSR definition and the Pyramid of CSR represent a stakeholder model. That is, each of the four components of responsibility

addresses different stakeholders in terms of the varying priorities in which the stakeholders are affected. Economic responsibilities most dramatically impact owners/shareholders and employees (because if the business is not financially successful, owners and employees will be directly affected). When Enron went bankrupt and then the Arthur Andersen accounting firm went out of business in 2002, employees were displaced and significantly affected. Legal responsibilities are certainly crucial with respect to owners, but in today's society, the threat of litigation against businesses frequently emanates from employees and consumer stakeholders. Ethical responsibilities affect all stakeholder groups, but an examination of the ethical issues business faces today suggests that they involve consumers and employees most frequently. Because of the fraud of the early 2000s, investor groups have also been greatly affected. Finally, philanthropic responsibilities most affect the community, but it could be reasoned that employees are next affected because some research has suggested that a company's philanthropic performance significantly affects its employees' morale and their perceived work/life balance.

The role of stakeholders in discussions of CSR is inseparable. In fact, there have been recent calls for CSR to be redefined as corporate "stakeholder" responsibility, rather than corporate social responsibility.²⁸ This would be entirely consistent with the view presented in this chapter.

Figure 2-4 presents this stakeholder view of CSR, along with a hypothetical priority scheme in which the stakeholder groups are addressed/affected by the companies' actions in that realm. The numbers in the columns are not based on empirical evidence but are only suggestive to illustrate how stakeholders are affected. Other priority schemes could easily be argued.

As we study business's major areas of social concern, as presented in various chapters in Parts 2 and 3 of the book, we will see how our model's four facets (economic, legal, ethical, and philanthropic) provide us with a useful framework for conceptualizing the issue of corporate social responsibility. The social contract

Figure 2-4 *A Stakeholder View of Corporate Social Responsibility*

CSR Component	Stakeholder Group Addressed and Primarily Affected				
	Owners	Consumers	Employees	Community	Others
Economic	1	4	2	3	5
Legal	3	2	1	4	5
Ethical	3	1	2	4	5
Philanthropic	3	4	2	1	5

Note: Numbers suggest one prioritization of stakeholders addressed and affected within each CSR component. Numbers are illustrative only. Do you agree with these priorities? Why? Why not? Discuss.

between business and society is to a large extent formulated from mutual understandings that exist in each area of our basic model. But it should be noted that the ethical and philanthropic categories, taken together, more nearly capture the essence of what people generally mean today when they speak of the social responsibility of business. Situating these two categories relative to the legal and economic obligations, however, keeps them in proper perspective and provides a more complete understanding of CSR.

CSR in Practice. What do companies have to do to be seen as socially responsible? One study done by Walker Information sought to discover what the general public perceived to be the activities or characteristics of socially responsible companies. Figure 2-5 summarizes what the sample said were the top 20 activities/characteristics of socially responsible companies.²⁹ The items in this listing are quite compatible with our discussion of CSR. It should be noted that most of these characteristics would be representative of the legal, ethical, and philanthropic/discretionary components of our four-part CSR definition.

Walker Information concluded that the public thinks CSR factors impact a company's reputation just as do traditional business factors, such as quality, service, and price. A related question on its survey pertained to the impact of social irresponsibility on firm reputation. The Walker Information study found that companies that are ethical and comply with the law can reap rewards from

Figure 2-5 *Top 20 Activities or Characteristics of Socially Responsible Companies*

- Makes products that are safe
- Does not pollute air or water
- Obeys the law in all aspects of business
- Promotes honest/ethical employee behavior
- Commits to safe workplace ethics
- Does not use misleading/deceptive advertising
- Upholds stated policy banning discrimination
- Utilizes "environmentally friendly" packaging
- Protects employees against sexual harassment
- Recycles within company
- Shows no past record of questionable activity
- Responds quickly to customer problems
- Maintains waste-reduction program
- Provides/pays portion of medical
- Promotes energy-conservation program
- Helps displaced workers with placement
- Gives money to charitable/educational causes
- Utilizes only biodegradable/recycling materials
- Employs friendly/courteous/responsive personnel
- Tries continually to improve quality

Source: Walker Information. Used with permission.

CSR activities and enjoy enhanced reputations. However, those that are perceived to be unethical or that do not comply with the law can do little in the way of CSR activities to correct their images. Thus, the penalties for disobeying the law are greater than the rewards for helping society.

Arguments Against and For Corporate Social Responsibility

In an effort to provide a balanced view of CSR, we will consider the arguments that traditionally have been raised against and for it. We should state clearly at the outset, however, that those who argue *against* corporate social responsibility are not using the comprehensive four-part CSR definition and model presented previously in their considerations. Rather, it appears that the critics are viewing CSR more narrowly—as only the efforts of the organization to pursue social goals (primarily our philanthropic category). Some critics equate CSR with only the philanthropic category.

Only a very few businesspeople and academics argue against the fundamental notion of CSR today. The debate among businesspeople more often centers on the kinds and degrees of CSR and on subtle ethical questions, rather than on the basic question of whether or not business should be socially responsible or a good corporate citizen. Among academics, economists and finance specialists are probably the easiest groups to identify as questioning corporate social goals. But even some of them no longer resist CSR on the grounds of economic theory.

ARGUMENTS AGAINST CSR

Classical Economics

Let us first look at some of the arguments that have surfaced over the years from the anti-CSR school of thought. Most notable has been the classical economic argument. This traditional view holds that management has one responsibility: to maximize the profits of its owners or shareholders. This classical economic school, led by the late Milton Friedman, argued that social issues are not the concern of businesspeople and that these problems should be resolved by the unfettered workings of the free-market system.³⁰ Further, this view holds that if the free market cannot solve the social problem, then it falls upon government and legislation to do the job.

Friedman softens his argument somewhat by his assertion that management is “to make as much money as possible while conforming to the basic rules of society, *both those embodied in the law and those embodied in ethical customs.*”³¹ When Friedman’s entire statement is considered, it appears that he accepts three of the four categories of the four-part model—economic, legal, and ethical. The only category not specifically embraced in his quote is the voluntary or philanthropic category. In any event, it is clear that the economic argument views CSR more narrowly than we have in our four-part model.

Business Not Equipped

A second objection to CSR has been that business is not equipped to handle social activities. This position holds that managers are oriented toward finance and operations and do not have the necessary expertise (social skills) to make social decisions.³² Although this may have been true at one point in time, it is less true today.

Dilutes Business Purpose

A third objection is closely related to the idea that business is not equipped for social activities: if managers were to pursue corporate social responsibility vigorously, it would tend to dilute the business's primary purpose.³³ The objection here is that CSR would put business into fields of endeavor not related to their "proper aim."³⁴ There is virtually no practical evidence, however, that this objection has been realized.

Too Much Power Already

A fourth argument against CSR is that business already has enough power—economic, environmental, and technological—and so why should we place in its hands the opportunity to wield additional power?³⁵ In reality, today, business has this social power, regardless of the argument. Further, this view tends to ignore the potential use of business's social power for the public good.

Global Competitiveness

One other argument that merits mention is that by encouraging business to assume social responsibilities, we might be placing it in a risky position in terms of global competition. One consequence of being socially responsible is that business must internalize costs that it formerly passed on to society in the form of dirty air, unsafe products, consequences of discrimination, and so on. The increase in the costs of products caused by including social considerations in the price structure might necessitate raising the prices of products, making them less competitive in international markets. The net effect might be to dissipate the country's advantages gained previously through technological advances. This argument weakens somewhat when we consider the reality that social responsibility is quickly becoming a global concern, not one restricted to U.S. firms and operations.

The arguments presented here constitute the principal claims made by those who oppose the CSR concept as it once was *narrowly* conceived. Many of the reasons given appear logical. Value choices as to the type of society the citizenry would like to have, at some point, become part of the total social responsibility decision. Whereas some of these objections might have had validity at one point in time, it is doubtful that they carry much weight today.

ARGUMENTS FOR CSR

Enlightened Self-Interest

For starters, there are two essential points worthy of consideration: "(1) Industrial society faces serious human and social problems brought on largely by the rise of

the large corporations, and (2) managers must conduct the affairs of the corporation in ways to solve or at least ameliorate these problems."³⁶ This generalized justification of corporate social responsibility is appealing. It actually comes close to what is a first argument for CSR—namely, that it is in business's long-range self-interest to be socially responsible. These two points provide an additional dimension by suggesting that it was partially business's fault that many of today's social problems arose in the first place and, consequently, that business should assume a role in remedying these problems. It may be inferred from this that deterioration of the social condition must be halted if business is to survive and prosper in the future.

The long-range self-interest view, sometimes referred to as "enlightened self-interest," holds that if business is to have a healthy climate in which to exist in the future, it must take actions now that will ensure its long-term viability. Perhaps the reasoning behind this view is that society's expectations are such that if business does not respond on its own, its role in society may be altered by the public—for example, through government regulation or, more dramatically, through alternative economic systems for the production and distribution of goods and services.

It is sometimes difficult for managers who frequently have a short-term orientation to appreciate that their rights and roles in the economic system are determined by society. Business must be responsive to society's expectations over the long term if it is to survive in its current form or in a less restrained form. This concern for the long-term viability of society is the primary driver in the current concern for *sustainability*, which is starting to become a synonym for CSR.

Warding Off Government

One of the most practical reasons for business to be socially responsible is to ward off future government intervention and regulation. Today, there are numerous areas in which government intrudes with an expensive, elaborate regulatory apparatus to fill a void left by business's inaction. To the extent that business polices itself with self-disciplined standards and guidelines, future government intervention can be somewhat forestalled. Later, we will discuss some areas in which business could have prevented intervention and simultaneously ensured greater freedom in decision making had it imposed higher standards of behavior on itself.

Resources Available

Two additional arguments supporting CSR deserve mention together: "Business has the resources" and "Let business try."³⁷ These two views maintain that because business has a reservoir of management talent, functional expertise, and capital, and because so many others have tried and failed to solve general social problems, business should be given a chance. These arguments have some merit, because there are some social problems that can be handled, in the final analysis, only by business. Examples include a fair workplace, producing safe products, and engaging in fair advertising. Admittedly, government can and does assume a role in these areas, but business must make the final decisions.

Proacting vs. Reacting

Another argument supporting CSR is that “proacting is better than reacting.” This position holds that proacting (anticipating and initiating) is more practical and less costly than simply reacting to problems once they have developed. Environmental pollution is a good example, particularly business’s experience with attempting to clean up rivers, lakes, and other waterways that were neglected for years. In the long run, it would have been wiser and less expensive to have prevented the environmental deterioration from occurring in the first place.

Public Support

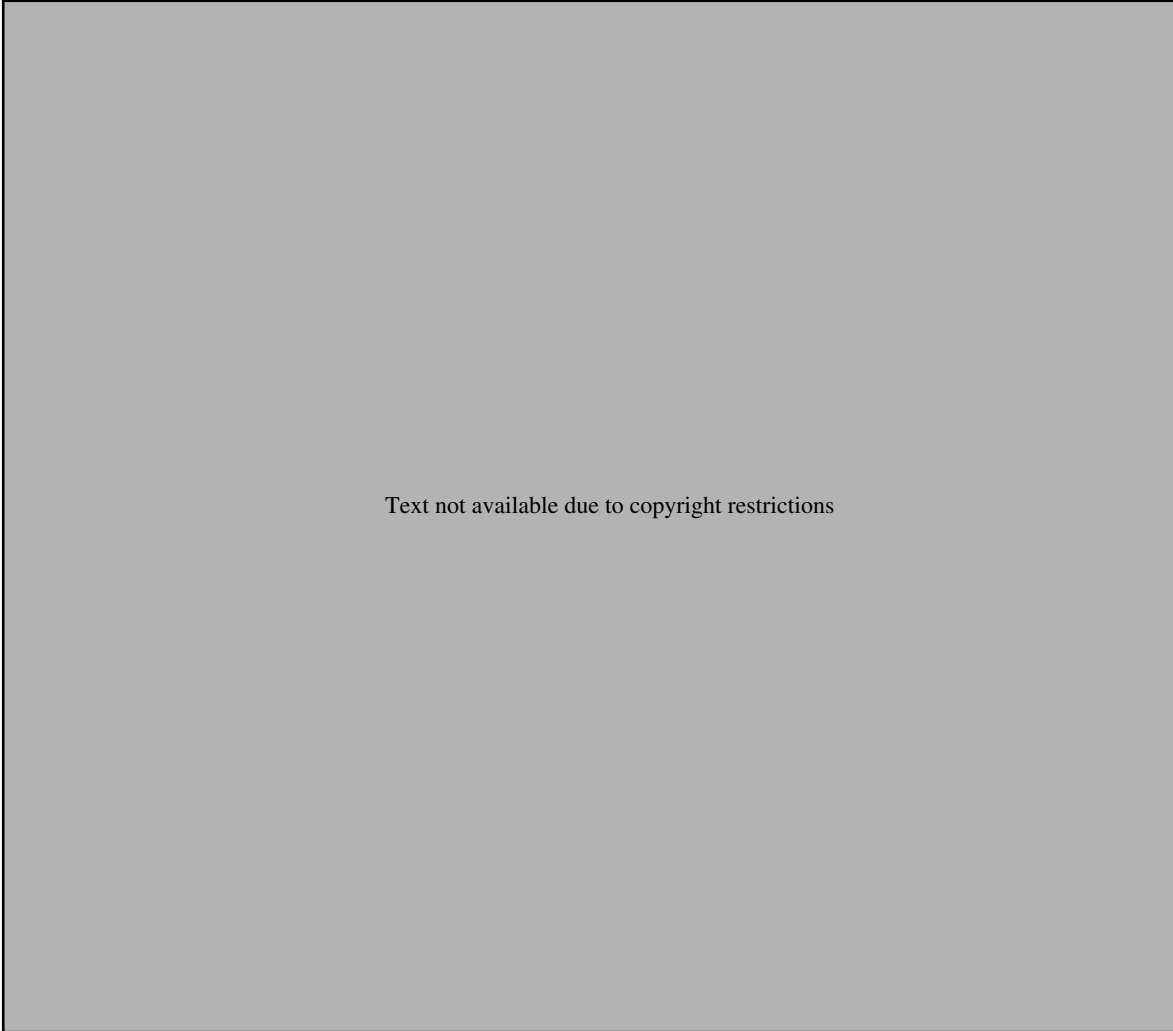
A final argument in favor of CSR is that the public strongly supports it.³⁸ Within the past decade, a *BusinessWeek*/Harris poll revealed that, with a stunning 95 percent majority, the public believes not only that companies should focus on profits for shareholders but also that companies should be responsible to their workers and communities, even if making things better for workers and communities requires companies to sacrifice some profits.³⁹

THE BUSINESS CASE FOR CSR

After considering both the pros and cons of CSR, most businesses and managers today embrace the idea. In recent years, the “business case” for corporate social responsibility has been unfolding. The business case reflects why businesspeople believe that CSR brings distinct benefits or advantages to business organizations and the business community. In this argument, CSR directly benefits the “bottom line.” Michael Porter, the astute business guru and perhaps the most listened to and respected consultant today in upper-level management circles and boardrooms, has pointed out how corporate and social initiatives are intertwined. According to Porter: “Today’s companies ought to invest in corporate social responsibility as part of their business strategy to become more competitive.” In a competitive context, “the company’s social initiatives—or its philanthropy—can have great impact. Not only for the company but also for the local society.”⁴⁰

In his book *The Civil Corporation*, Simon Zadek has identified four ways in which firms respond to CSR pressures, and he holds that these form a composite business case for CSR. His four approaches are as follows:⁴¹

- *Defensive approach.* This is an approach designed to alleviate pain. Companies will do what they have to do to avoid pressure that makes them incur costs.
- *Cost–benefit approach.* This traditional approach holds that firms will undertake those activities if they can identify direct benefits that exceeds costs.
- *Strategic approach.* In this approach, firms will recognize the changing environment and engage with CSR as part of a deliberate emergent strategy.
- *Innovation and learning approach.* In this approach, an active engagement with CSR provides new opportunities to understand the marketplace and enhances organizational learning, which leads to competitive advantage.



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Companies may vary as to why they pursue a CSR strategy, but these approaches, taken together as arguments, build a strong business case for the pursuit of socially responsible business. Figure 2-6 summarizes the business case for CSR taken from two different sources.

MILLENNIUM POLL ON CORPORATE SOCIAL RESPONSIBILITY

As we think about the first decade of the new millennium, it is useful to consider the results of the millennium poll on CSR. This representative survey of 1,000

Ethics in Practice Case

THE SOCIALLY RESPONSIBLE SHOE COMPANY

When Blake Mycoskie was visiting Argentina in 2006, a bright idea came to him. At the same time that he was wearing *alpargatas*, resilient, lightweight, canvas slip-ons, shoes typically worn by Argentinean farm workers, he was also visiting poor villages, where many of the residents had no shoes at all. His bright idea was that he was going to start a shoe company and give away a pair of shoes to some needy child or person for every pair of shoes he sold. Thus, the basic mission of his company was formulated.

Employing self-financing, especially at first, Blake decided to name his company *Toms: Shoes for Tomorrow*. Blake is from Texas, and he likes to read books about such business success stories as those of Ted Turner, Richard Branson, and Sam Walton. He appends the following message at the end of his emails: "Disclaimer: you will not win the rat race wearing Toms."

In the summer of 2006, he unveiled his first line of Toms shoes. Stores such as American Rag and Fred Segal in Los Angeles, and Scoop in New York, started carrying his shoes. By fall, he had sold 10,000 pairs of Toms and was off to the Argentina countryside, along with several volunteers, to give away 10,000 pairs of shoes. In a *Time* magazine article, Blake was quoted as saying, "I always thought I'd spend the first half of my life making money and the second

half giving it away. I never thought I could do both at the same time."

By February 2007, Blake's company had orders from 300 stores for 41,000 of his spring and summer collection of shoes, and he has big plans to go international by entering markets in Japan, Australia, Canada, France, and Spain in summer 2008. The company is also planning to introduce a line of children's shoes called *Tiny Toms*. Another shoe drop is planned for Argentina, with future trips targeting Asia and Africa.

Questions for Discussion

1. How would you assess Toms' CSR using the four-part CSR definition? Is the company based on the typical business case for CSR or more of an ethical/philanthropic model?
2. Do you believe Blake's twin goals of economics and social responsibility are compatible for the long term and at the current level? Review the company's website to see additional information: <http://www.tomshoes.com/>.
3. What challenges do you foresee for the company's future?

Sources: Nadia Mustafa, "A Shoe That Fits So Many Souls," *Time* (Feb. 5, 2007), C2; "Good Guy of the Month," *Oprah Magazine* (Feb. 1, 2007); *Elle* (Dec. 1, 2006); Toms Shoes website: retrieved May 19, 2007, <http://www.tomshoes.com/>.

people in 23 countries on six continents revealed how important citizens of the world felt corporate social responsibility really was. The survey revealed the following prospects that major companies would be expected to do in the twenty-first century.⁴²

CORPORATE RESPONSIBILITY IN THE TWENTY-FIRST CENTURY

In the twenty-first century, major companies will be expected to do all of the following:

- Demonstrate their commitment to society's values and their contribution to society's social, environmental, and economic goals through actions.
- Fully insulate society from the negative impacts of company operations and its products and services.
- Share the benefits of company activities with key stakeholders as well as with shareholders.
- Demonstrate that the company can make more money by doing the right thing, in some cases reinventing its business strategy. This "doing well by doing good" will reassure stakeholders that the new behavior will outlast good intentions.

The survey findings suggest that CSR is fast becoming a global expectation that requires a comprehensive strategic response. Ethics and CSR need to be made core business values integrated into all aspects of the firm.

Corporate Social Responsiveness

We have discussed the evolution of corporate social responsibility, a definitional model for understanding social responsibility, and the arguments for and against it. It is now worthwhile to consider a related idea that has arisen over the distinction between the terms *responsibility* and *responsiveness*. **Corporate social responsiveness** is depicted as an *action-oriented* variant of CSR.

A general argument that has generated much discussion holds that the term *responsibility* is too suggestive of efforts to pinpoint accountability or obligation. Therefore, it is not dynamic enough to fully describe business's willingness and activity—apart from obligation—to respond to social demands. For example, Ackerman and Bauer criticized the CSR term by stating, "The connotation of 'responsibility' is that of the process of assuming an obligation. It places an emphasis on motivation rather than on performance." They go on to say, "Responding to social demands is much more than deciding what to do. There remains the management task of doing what one has decided to do, and this task is far from trivial."⁴³ They argue that "social responsiveness" is a more appropriate description of what is essential in the social arena.

Their point was well made, especially when it was first set forth. *Responsibility*, taken quite literally, does imply more of a state or condition of having assumed an obligation, whereas *responsiveness* connotes a dynamic, action-oriented condition. We should not overlook, however, that much of what business has done and is doing has resulted from a particular motivation—an assumption of obligation—whether assigned by government, forced by special-interest groups, or voluntarily assumed. Perhaps business, in some instances, has failed to accept and internalize the obligation,

and thus it may seem odd to refer to it as a responsibility. Nevertheless, some motivation that led to social responsiveness had to be there, even though in some cases it was not articulated to be a responsibility or an obligation. Figure 2-7 summarizes other experts' views regarding corporate social *responsiveness*.

Thus, the corporate social responsiveness dimension that has been discussed by some as an alternative focus to that of social responsibility is, in actuality, an *action phase* of management's response in the social sphere. The responsiveness orientation enables organizations to justify and apply their social responsibilities without getting bogged down in the quagmire of accountability, which can so easily occur if organizations try to get an exact determination of what their true responsibilities are before they take any action.

In an interesting study of social responsiveness among Canadian and Finnish forestry firms, researchers concluded that the social responsiveness of a corporation will proceed through a predictable series of phases and that managers will tend to respond to the most powerful stakeholders.⁴⁴ This study demonstrates that social responsiveness is a *process* and that stakeholder *power*, in addition to a sense of responsibility, may sometimes drive the process.

Figure 2-7 Alternative Views of Corporate Social Responsiveness

Sethi's Three-Stage Schema

Sethi proposes a three-stage schema for classifying corporate behavior: social obligation, social responsibility, and social *responsiveness*. Social responsiveness suggests that what is important is that corporations be "anticipatory" and "preventive." This third stage is concerned with business's long-term role in a dynamic social system.

Frederick's CSR₁, CSR₂, and CSR₃

CSR₁ refers to the traditional accountability concept of CSR. CSR₂ is responsiveness-focused. It refers to the capacity of a corporation to *respond* to social pressures. It involves the literal act of responding or of achieving a responsive posture to society. It addresses the mechanisms, procedures, arrangements, and patterns by which business responds to social pressures. CSR₃ refers to corporate social rectitude, which is concerned with the moral correctness of the actions or policies taken.

Epstein's Process View

Responsiveness is a part of the corporate social policy *process*. The emphasis is on the process aspect of social responsiveness. It focuses on both individual and organizational processes "for determining, implementing, and evaluating the firm's capacity to anticipate, respond to, and manage the issues and problems arising from the diverse claims and expectations of internal and external stakeholders."

Sources: S. Prakash Sethi, "Dimensions of Corporate Social Performance: An Analytical Framework," *California Management Review* (Spring 1975), 58–64; William C. Frederick, "From CSR1 to CSR2: The Maturing of Business-and-Society Thought," Working Paper No. 279 (Graduate School of Business, University of Pittsburgh, 1978). See also William Frederick, *Business and Society*, (Vol. 33, No. 2, August 1994), 150–164; and Edwin M. Epstein, "The Corporate Social Policy Process: Beyond Business Ethics, Corporate Social Responsibility and Corporate Social Responsiveness," *California Management Review* (Vol. XXIX, No. 3, 1987), 104.

Corporate Social Performance

For the past few decades, there has been a trend toward making the concern for social and ethical issues increasingly pragmatic. The responsiveness thrust that we just discussed was a part of this trend. It is possible to integrate some of these concerns into a model of **corporate social performance (CSP)**. The performance focus is intended to suggest that what really matters is what companies are able to accomplish—the results or outcomes of their acceptance of social responsibility and adoption of a responsiveness philosophy. In developing a conceptual framework for CSP, we not only have to specify the nature (economic, legal, ethical, philanthropic) of the responsibility, but we also need to identify a particular philosophy, pattern, mode, or strategy of responsiveness. Finally, we need to identify the stakeholder issues or topical areas to which these responsibilities are manifested. The issues, and especially the degree of organizational interest in the issues, are always in a state of flux. As the times change, so does the emphasis on the range of social/stakeholder issues that business must address.

Also of interest is the fact that particular issues are of varying concern to businesses, depending on the industry in which they exist as well as other factors. A bank, for example, is not as pressed on environmental issues as a manufacturer. Likewise, a manufacturer is considerably more concerned with the issue of environmental protection than is an insurance company.

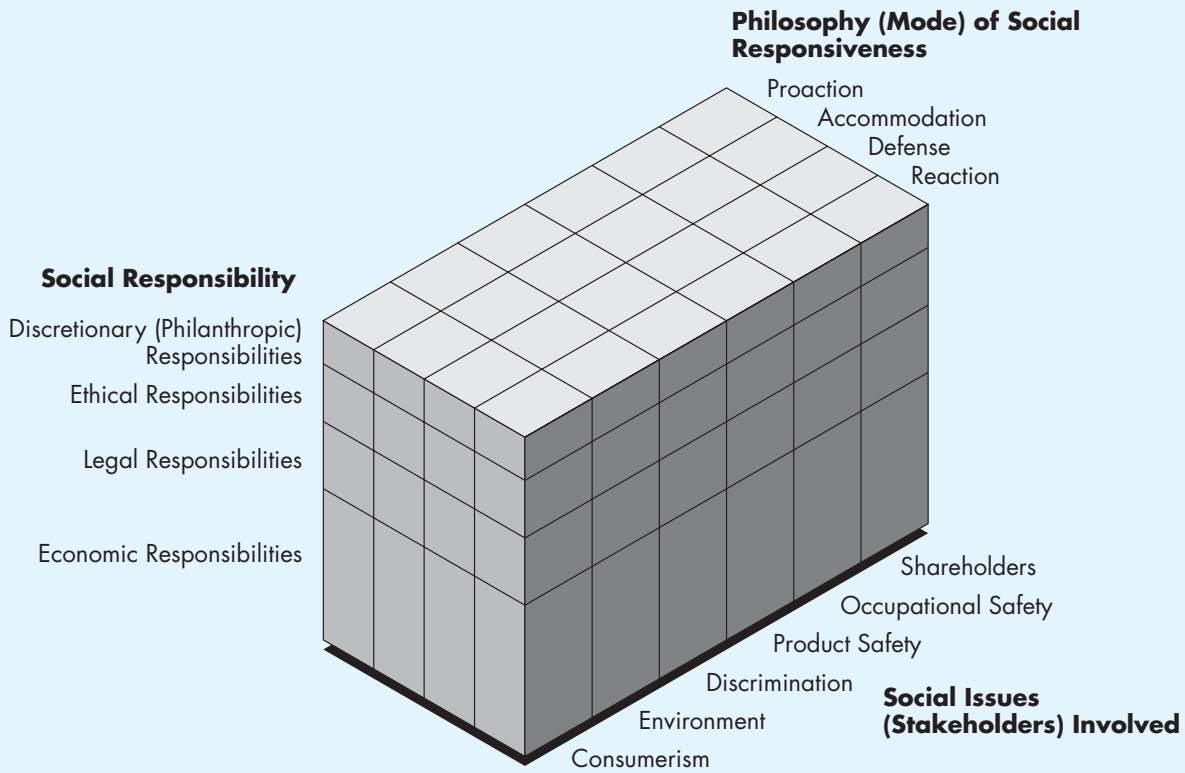
CARROLL'S CSP MODEL

Figure 2-8 illustrates Carroll's **corporate social performance model**, which brings together the three major dimensions we have discussed:

1. Social responsibility categories—economic, legal, ethical, and discretionary (philanthropic)
2. Philosophy (or mode) of social responsiveness—e.g., reaction, defense, accommodation, and proaction
3. Social (or stakeholder) issues involved—consumers, environment, employees, etc.)⁴⁵

One dimension of this model pertains to all that is included in our definition of social responsibility—the economic, legal, ethical, and discretionary (philanthropic) components. Second, there is a social responsiveness continuum. Although some writers have suggested that this is the preferable orientation when one considers social responsibility, the model in Figure 2-8 suggests that responsiveness is just one additional aspect to be addressed if CSP is to be achieved. Four positions on a responsiveness continuum have been suggested: reaction, defense, accommodation, and proaction. The third dimension of the model concerns the scope of social or stakeholder issues (for example, consumerism, environment, product safety, and discrimination) that management must address.

Figure 2-8 *Carroll's Corporate Social Performance Model*



Source: Archie B. Carroll, "A Three-Dimensional Conceptual Model of Corporate Social Performance," *Academy of Management Review* (Vol. 4, No. 4, 1979), 503. Reproduced with permission.

The corporate social performance model is intended to be useful to both academics and managers. For academics, the model is primarily a conceptual aid to understanding the distinctions among the concepts of corporate social responsibility that have appeared in the literature: responsibility, responsiveness, social issues/stakeholders. What previously have been addressed as separate definitions of CSR are treated here as three separate aspects of CSP. The model's major use to the academic, therefore, is in helping to systematize the important concepts that must be taught and understood in an effort to clarify the CSR concept. The model is a modest but necessary step toward understanding the major facets of CSP.

The conceptual model can assist managers in understanding that social responsibility is not separate and distinct from economic performance. The model

integrates economic concerns into a social performance framework. In addition, it places ethical and philanthropic expectations into a rational economic and legal framework. The model can help the manager systematically think through major stakeholder issues. Although it does not provide the answer to how far the organization should go, it does provide a framework that could lead to better-managed social performance. Moreover, the model could be used as a planning tool and as a diagnostic problem-solving tool. The model can assist the manager by identifying categories within which the organization can be situated.

There have been several extensions, reformulations, or reorientations of the CSP model. Figure 2-9 summarizes some of these. Figure 2-10 depicts Wartick and Cochran's CSP model extensions, which help to flesh out some important details.

Figure 2-9 Corporate Social Performance: Extensions, Reformulations, Reorientations

Wartick and Cochran's CSP Extensions

Wartick and Cochran proposed several changes/extensions to the CSP model. They proposed that the "social issues" dimension had matured into a new management field known as "social issues management." They extended the CSP model further by proposing that the three dimensions be viewed as depicting *principles* (corporate social responsibilities, reflecting a philosophical orientation), *processes* (corporate social responsiveness, reflecting an institutional orientation), and *policies* (social issues management, reflecting an organizational orientation).

Wood's Reformulated CSP Model

Wood elaborated and reformulated Carroll's model and Wartick and Cochran's extensions and set forth a reformulated model. Her new definition of corporate social performance was, "A business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and other observable outcomes as they relate to the firm's societal relationships." She took this definition further by proposing that each of the three components—principles, processes, and outcomes—is composed of specific elements.

Swanson's Reorientation of CSP

Swanson elaborated on the dynamic nature of the principles, processes, and outcomes reformulated by Wood. Relying on research from corporate culture, her reoriented model links CSP to the personally held values and ethics of executive managers and other employees. She proposed that the executive's sense of morality highly influences the policies and programs of environmental assessment, stakeholder management, and issues management carried out by employees. These internal processes are means by which organizations can impact society through *economizing* (efficiently converting inputs into outputs) and *ecologizing* (forging community-minded collaborations).

Sources: Steven L. Wartick and Philip L. Cochran, "The Evolution of the Corporate Social Performance Model," *Academy of Management Review* (Vol. 10, 1985), 765–766; Donna J. Wood, "Corporate Social Performance Revisited," *Academy of Management Review* (October 1991), 691–718; D. L. Swanson, "Addressing a Theoretical Problem by Reorienting the Corporate Social Performance Model," *Academy of Management Review* (Vol. 20, No. 1, 1995), 43–64. D. L. Swanson, "Toward an Integrative Theory of Business and Society: A Research Strategy for Corporate Social Performance," *Academy of Management Review* (Vol. 24, No. 3, 1999), 506–521.

Figure 2-10 Wartick and Cochran's Corporate Social Performance Model Extensions

Principles	Processes	Policies
Corporate Social Responsibilities	Corporate Social Responsiveness	Social Issues Management
(1) Economic (2) Legal (3) Ethical (4) Discretionary	(1) Reactive (2) Defensive (3) Accommodative (4) Proactive	(1) Issues Identification (2) Issues Analysis (3) Response Development
Directed at:	Directed at:	Directed at:
(1) The Social Contract of Business (2) Business as a Moral Agent	(1) The Capacity to Respond to Changing Societal Conditions (2) Managerial Approaches to Developing Responses	(1) Minimizing "Surprises" (2) Determining Effective Corporate Social Policies
Philosophical Orientation	Institutional Orientation	Organizational Orientation

Source: Steven L. Wartick and Philip L. Cochran, "The Evolution of the Corporate Social Performance Model," *Academy of Management Review* (Vol. 10, 1985), 767.

Corporate Citizenship

Business practitioners and academics alike have grown fond of the term *corporate citizenship* in reference to businesses' corporate social performance. Earlier in the chapter, we argued that corporate citizenship was a collective term embracing the *corporate social responsibility*, *responsiveness*, and *performance* concepts described above. But we can probe further and ask: Does corporate citizenship have a distinct meaning apart from the concepts discussed earlier? A careful look at the concept and its literature shows that, although it is a useful and attractive term, it is not distinct from the terminology we have described earlier, except in the eyes of some writers who have attempted to give it a specific, narrow meaning. Nevertheless, it is a popular term, and it is worth exploring further because it is often used as a synonym for CSR.

If one thinks about companies as "citizens" of the countries in which they reside, corporate citizenship just means that these companies have certain responsibilities that they must fulfill in order to be perceived as good corporate citizens. One view is that "corporate citizenship is not a new concept, but one whose time has come."⁴⁶ In today's global business environment, some would argue that multinational enterprises are citizens of the world.

Broad Views

Corporate citizenship has been described by some as a broad, encompassing term that basically embraces all that is implied in the concepts of social responsibility,

responsiveness, and performance. Corporate citizenship has been defined as “serving a variety of stakeholders well.”⁴⁷ Fombrun also proposes a broad conception. He holds that corporate citizenship is composed of a three-part view that encompasses (1) a reflection of shared moral and ethical principles, (2) a vehicle for integrating individuals into the communities in which they work, and (3) a form of enlightened self-interest that balances all stakeholders’ claims and enhances a company’s long-term value.⁴⁸

Davenport’s research also resulted in a broad definition of corporate citizenship that includes a commitment to ethical business behavior and balancing the needs of stakeholders, while working to protect the environment.⁴⁹ Carroll has recast his four categories of corporate social responsibility as embracing the “four faces of corporate citizenship”—economic, legal, ethical, and philanthropic. Each face, aspect, or responsibility reveals an important facet that contributes to the whole. He poses that “just as private citizens are expected to fulfill these responsibilities, companies are as well.”⁵⁰

Narrow Views

At the narrow end of the spectrum, Altman speaks of corporate citizenship in terms of corporate community relations. In this view, it embraces the functions through which business intentionally interacts with nonprofit organizations, citizen groups, and other stakeholders at the community level.⁵¹ Other definitions of corporate citizenship fall between these broad and narrow perspectives, and some refer to global corporate citizenship as well, as increasingly companies are expected to conduct themselves appropriately wherever they are doing business.

Drivers of Corporate Citizenship

A pertinent question is, “What drives companies to embrace corporate citizenship?” According to one major survey, there are both internal (to the companies) motivators and external pressures that drive companies toward corporate citizenship.⁵²

Internal motivators include:	External pressures include:
Traditions and values	Customers and consumers
Reputation and image	Expectations in the community
Business strategy	Laws and political pressures
Recruiting/retaining employees	

Benefits of Corporate Citizenship

The benefits of good corporate citizenship to stakeholders are fairly apparent. But what are the benefits of good corporate citizenship to business itself? The benefits to companies of corporate citizenship, defined broadly, appear to be the following.⁵³

- Improved employee relations (e.g., improves employee recruitment, retention, morale, loyalty, motivation, and productivity)

- Improved customer relationships (e.g., increases customer loyalty, acts as a tiebreaker for consumer purchasing, enhances brand image)
- Improved business performance (e.g., positively impacts bottom-line returns, increases competitive advantage, encourages cross-functional integration)
- Enhanced company's marketing efforts (e.g., helps create a positive company image, helps a company manage its reputation, supports higher prestige pricing, and enhances government affairs activities)

STAGES OF CORPORATE CITIZENSHIP

Like individual development, companies develop or grow in their maturity for dealing with corporate citizenship issues. A major contribution to how this growth occurs has been presented by Philip Mirvis and Bradley Googins at the Center for Corporate Citizenship at Boston College. The Center holds that the essence of corporate citizenship is how companies deliver on their core values in a way that minimizes harm, maximizes benefits, is accountable and responsive to key stakeholders, and supports strong financial results.⁵⁴ This definition is quite compatible with the four-part definition of CSR presented earlier.

The development of corporate citizenship, in the Center's model, reflects a stage-by-stage process in which seven dimensions (e.g., citizenship concept, strategic intent, leadership, structure, etc.) evolve as they move through five stages, and companies become more sophisticated in their approaches to corporate citizenship. This five-stage model begins with Stage 1, which is Elementary, and grows toward Stage 5, which is Transforming.


As seen in Figure 2-11, the citizenship concept starts with an emphasis on "jobs, profits & taxes" in Stage 1 and progresses through several emphases such as "philanthropy, environmental protection," "stakeholder management," "sustainability or triple bottom line," and finally, "change the game." Similarly, the other vital dimensions change orientations as they evolve through the five stages.

Another aspect of the five stages of corporate citizenship is that companies at each stage face different developmental challenges. Thus, in Stage 1 the challenge is to "gain credibility." As the companies grow toward Stage 5, the challenges are to build capacity, create coherence, deepen commitment. Figure 2-12 graphically depicts the developmental challenges that trigger the movement of corporate citizenship through the five stages of growth.

Mirvis and Googins provide company examples that illustrate the various stages. GE is pictured as a company coming to the realization in Stage 1 that it must extend its emphases beyond financial success. Chiquita, Nestlé, and Shell Oil are depicted as companies becoming engaged in Stage 2. In Stage 3, Baxter International and ABB are identified as innovative companies striving to create coherence. BP's commitment to sustainability is provided as an example of Stage 4, where the theme is integration. Finally, the experiences of Unilever, widely noted for its socio-economic investments in emerging markets, is presented as a company at Stage 5 with an emphasis on transformation in its corporate citizenship.

The stages of the corporate citizenship model effectively presents the challenges of credibility, capacity, coherence, and commitment that firms move through as

Figure 2-11 *Stages of Corporate Citizenship*

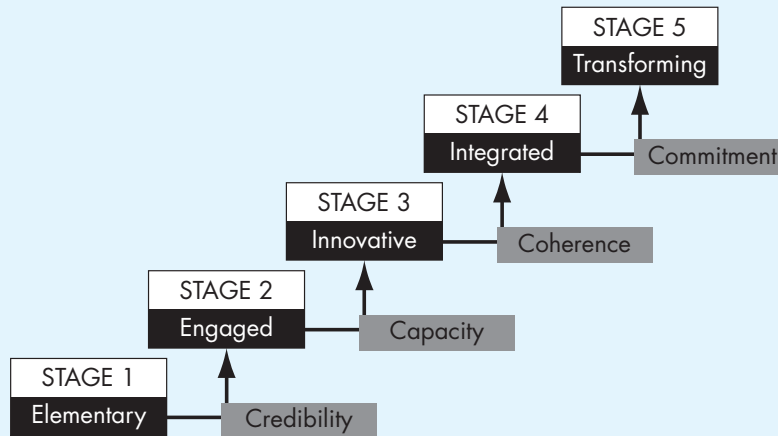
STAGES OF CORPORATE CITIZENSHIP		 THE CENTER FOR CORPORATE CITIZENSHIP AT BOSTON COLLEGE				
		STAGE 1: Elementary	STAGE 2: Engaged	STAGE 3: Innovative	STAGE 4: Integrated	STAGE 5: Transforming
Dimensions	Citizenship Concept	Jobs, Profits & Taxes	Philanthropy, Environmental Protection	Stakeholder Management	Sustainability or Triple Bottom Line	Change the Game
	Strategic Intent	Legal Compliance	License to Operate	Business Case	Value Proposition	Market Creation or Social Change
	Leadership	Lip Service, Out of Touch	Supporter, In the Loop	Steward, On Top of it	Champion, In Front of It	Visionary, Ahead of the Pack
	Structure	Marginal: Staff Driven	Functional Ownership	Cross-Functional Coordination	Organizational Alignment	Mainstream: Business Driven
	Issues Management	Defensive	Reactive, Policies	Responsive, Programs	Pro-Active, Systems	Defining
	Stakeholder Relationships	Unilateral	Interactive	Mutual Influence	Partnership Alliance	Multi-Organization
	Transparency	Flank Protection	Public Relations	Public Reporting	Assurance	Full Disclosure

Source: Philip Mirvis and Bradley K. Googins, *Stages of Corporate Citizenship: A Developmental Framework*, Boston: Center for Corporate Citizenship at Boston College Monograph, 2006, p. 3. Used with permission.

they come to grips with developing more comprehensive and integrated citizenship agendas. From their work, it is apparent that corporate citizenship is not a static concept but is one that progresses through different themes and challenges as firms get better and better over time.⁵⁵

The terminology and concepts of corporate citizenship are especially attractive because they resonate so well with the business community's attempts to describe their own socially responsive activities and practices. Therefore, we can expect that this concept will be around for some years to come. As we refer to CSR, social responsiveness, and social performance, we are also embracing activities that would typically fall under the purview of a firm's corporate citizenship.⁵⁶

Figure 2-12 *Developmental Challenges Triggering Movement of Corporate Citizenship*



Source: Philip Mirvis and Bradley K. Googins, *Stages of Corporate Citizenship: A Developmental Framework*, Boston: Center for Corporate Citizenship at Boston College Monograph, 2006, p. 5. Used with permission.

GLOBAL CORPORATE CITIZENSHIP

Global CSR and corporate citizenship are topics that are becoming more relevant with each passing year. As global capitalism increasingly becomes the marketplace stage for large- and medium-sized companies, the expectations that they address citizenship issues at a world-level also multiply. In Chapter 10, we will examine global business ethics in detail. Here, we just want to state briefly that there are also challenges for global CSR and citizenship. For the most part, these are international extensions of the concepts we will treat throughout this book, though companies obviously have to adapt when they find themselves in different cultures.

There are two aspects of the global emphasis worthy of mention. First, U.S.-based and other multinational enterprises from countries around the world are expected to be good corporate citizens in the countries in which they are doing business. Further, they are expected to tailor as carefully as possible their citizenship initiatives to conform to the cultural environment in which they find themselves. Second, it is important to note that academics and businesspeople around the world are now doing research on and advocating CSR and corporate citizenship concepts. In fact, there has been a virtual explosion of interest in these topics, especially in the United Kingdom, Europe, and Australia/New Zealand, but also in Asia and South America. Of course, these two points are related to one another because academic interest is sparked by business interest and helps to explain the growing appeal of the topic.

Two items illustrate the kind of thinking behind the idea of global corporate citizenship. The first is a definition of a global business citizen presented in a current book on the topic:

*A global business citizen is a business enterprise (including its managers) that responsibly exercises its rights and implements its duties to individuals, stakeholders, and societies within and across national and cultural borders.*⁵⁷

This view of a global business citizen is consistent with the discussions of this topic from a domestic perspective but points to its expanded application across national and cultural borders. With this working definition, we can see how the citizenship concepts presented in this chapter could be naturally expanded to embrace multinational enterprises.

A second illustration of the global reach is provided by a distinction between frameworks for understanding corporate social responsibility in America versus Europe, especially the United Kingdom. This distinction illustrates how CSR around the world has a lot in common but that we must consider the specific, national contexts to grasp the topic fully. Dirk Matten and Jeremy Moon maintain that CSR is more “explicit” in America, whereas it is more “implicit” in Europe. In their distinction, they hold that explicit CSR would normally consist of voluntary, self-interest-driven policies, programs, and strategies, as is typical in U.S.-based understandings of CSR. By contrast, implicit CSR would embrace the entirety of a country’s formal and informal institutions that assign corporations an agreed upon share of responsibility for society’s concerns. Implicit CSR, such as that seen in the United Kingdom and Europe, would embrace the values, norms, and rules evident in the local culture.⁵⁸ The authors seem to be saying that CSR is more implicit, or understood, in Europe because it is more a part of the culture than in the United States. In Europe, some aspects of CSR are more or less decreed or imposed by institutions, such as government, whereas in the United States, it is more voluntary and driven by companies’ specific, explicit actions.

In short, although CSR and corporate citizenship have much in common in terms of their applicability around the world and in diverse countries, differences may also be found, and these cultural differences might suggest divergent or dissimilar themes, depending on where business is being conducted. As the world economic stage increasingly becomes the common environment within which businesses function, convergence in CSR approaches would seem predictable.

Business’s Interest in Corporate Citizenship

Although there has been considerable academic research on the subjects of corporate social performance and citizenship over the past decade, we should stress that academics are not the only ones who are interested in this topic. Prominent business organizations and periodicals that report on corporate

citizenship and social performance include *Fortune* magazine, *CRO* magazine, and the Conference Board. We will briefly discuss several of these.

FORTUNE'S RANKINGS OF "MOST ADMIRABLE" AND "LEAST ADMIRABLE" COMPANIES

For many years now, *Fortune* magazine has conducted rankings of "America's Most Admired Companies" and has included among their "Eight Key Attributes of Reputation" the category of performance titled "Social Responsibility." The rankings are the result of a poll of more than 12,600 senior executives, outside directors, and financial analysts. In the social responsibility category, the most admired firms for 2006 were United Parcel Service (UPS), International Paper, Exelon, Publix Super Markets, and Chevron.⁵⁹ In a related vein, *Fortune* also publishes "The 100 Best Companies to Work For" on an annual basis. The top companies to work for in 2007 were Google, Genentech, Wegmans Food Markets, The Container Store, and Whole Foods Market.⁶⁰ It is not clear what specific impact the *Fortune* rankings have for these businesses, but surely they have some positive impact on the firms' general reputations. The important point to note here, however, is that the social responsibility category is one indicator of corporate citizenship and that it was included as a criterion for admired companies by one of our country's leading business magazines.

THE CONFERENCE BOARD'S RON BROWN AWARD FOR CORPORATE LEADERSHIP

The Conference Board gives the "Ron Brown Award for Corporate Leadership." The Conference Board claims this is the first presidential award to honor companies for outstanding achievements in employee and community relations.

It expects that this award will promote practices that improve business performance by supporting employees and communities. The Ron Brown Award for Corporate Leadership is presented annually at a White House ceremony, amid media coverage that ensures greater public awareness of the accomplishments being honored.

Core Principles of the Award

For a company to be eligible:

- Top management must demonstrate commitment to corporate citizenship.
- Corporate citizenship must be a shared value of the company, visible at all levels.
- Corporate citizenship must be integrated into a successful business strategy.

Key Criteria

For programs to be eligible, they must:

- Be at the "best practice" level—distinctive, innovative, and effective.
- Have a significant, measurable impact on the people they are designed to serve.

- Offer broad potential for social and economic benefits for U.S. society.
- Be sustainable and feasible within a business environment and mission.
- Be adaptable to other businesses and communities.

The most recent winners were Fannie Mae (for its Latino College Access Campaign and scholarship programs) and Weyerhaeuser Co. (for its disaster relief in the aftermath of Hurricanes Rita and Katrina).⁶¹

CRO MAGAZINE AWARDS

For several years, *Business Ethics* magazine, now called *CRO: Corporate Responsibility Officer*, has published its list of Annual Business Corporate Citizenship Awards. Its top five winners for 2007 were Green Mountain Coffee Roasters; Advanced Micro Devices, Inc.; Nike, Inc.; Motorola, Inc.; and Intel. Other top ten companies included IBM, Agilent Technologies, Timberland, Starbucks, and General Mills.⁶² The criteria used by the magazine to determine its winners include the following:⁶³

Award winners should meet many (though not necessarily all) of the following criteria:

- Be a leader in their field, out ahead of the pack, showing the way ethically.
- Have programs or initiatives in social responsibility that demonstrate sincerity and ongoing vibrancy, and that reach deep into the company.
- Have a significant presence on the national or world scene, so their ethical behavior sends a loud signal.
- Be a standout in at least one area of social responsibility, though recipients need not be exemplary in all areas.
- Have faced a recent challenge and overcome it with integrity, or taken other recent steps to show their ethical commitment is still very much alive.
- Be profitable in the most recent year, or show a strong history of healthy profitability.
- For the Living Economy Award, be a company that is locally based, human scale, stakeholder-owned, democratically accountable, and life-serving, seeking fair profits rather than maximum profits.

Companies that have been on the 100 Best Corporate Citizens list for all eight years since it has been published include the following: Intel, Timberland, Starbucks, Herman Miller, Cisco Systems, Pitney Bowes, Southwest Airlines, Cummins, Ecolab, Brady Corp., and St. Paul Travelers Co's.⁶⁴

Social Performance and Financial Performance Relationship

One issue that comes up frequently in considerations of corporate social responsibility/performance/citizenship is whether or not there is a demonstrable

Ethics in Practice Case

IS THERE A MARKET FOR A SUSTAINABLE HAMBURGER?

According to *Forbes* magazine, Burgerville does not just sell burgers; it sells good works. But, if you don't live in Oregon or Washington, you may have never heard about Burgerville, a company founded in 1961 in Vancouver, Washington. Today, there are 39 Burgerville restaurants spanning those two states.

In the 1990s, when Burgerville began losing sales to the national chains, Tom Mears, the chief executive, decided to differentiate his product, to sell "burgers with a soul." Mears, the son-in-law of the founder, decided to combine good food with good works. The company began to build its strategy around three key words: "Fresh, Local, and Sustainable." It pursued this strategy through partnerships with local businesses, farms, and producers. In 2003, *Gourmet* magazine recognized Burgerville as the home of the nation's freshest fast food.

According to the company website, "At Burgerville, doing business responsibly means doing business sustainably. One example of this is our commitment to purchasing 100% local wind power equal to the energy use of all our restaurants and corporate office." The company purchases its electricity from local windmills. Burgerville uses "sustainable agriculture," which means that their meat and produce are free from genetically modified seeds or livestock. In its cooking, the company avoids trans fats, and once the cooking oils are used up, they are converted into biodiesel. The company buys its antibiotic- and hormone-free beef locally.

In addition to burgers, Burgerville offers a wild coho salmon and Oregon hazelnut salad. Meals for children often come with seeds and gardening tools rather than the usual cheap toys offered at the national chains.

Burgerville extends its good works to its employees. The company pays 95 percent of the health insurance for its hundreds of workers. This adds \$1.5 million to its annual compensation expense. To get its affordable healthcare, employees have to work a minimum of twenty hours a week for at least six months, a more generous arrangement than most stores.

Being a good corporate citizen is expensive. Though the company won't reveal its financial bottom line, one industry consultant estimated that its margin is close to 10 percent; in comparison, McDonald's margin is 15 percent.

Questions for Discussion

1. Is the world ready for a socially responsible hamburger? How much would you be willing to pay, assuming the burgers really taste good?
2. What tensions among its economic, legal, ethical, and philanthropic responsibilities do you think are most pressing to Burgerville?
3. Does Burgerville sound like a business that might work in Oregon and Washington, but maybe not elsewhere? What is the future of Burgerville?

Source: "Fast Food: Want a Cause with That?" *Forbes* (Jan. 8, 2007), 83 Also see the company website: http://www.burgerville.com/html/about_us/index.html, accessed May 19, 2007.

relationship between a firm's social responsibility/performance and its financial performance. Unfortunately, attempts to measure this relationship have been typically hampered by measurement problems. The appropriate performance criteria for measuring financial performance and social responsibility are subject to debate. Furthermore, the measurement of social responsibility is difficult.

Over the years, studies on the social responsibility–financial performance relationship have produced varying results.⁶⁵ In a comprehensive meta-analysis reviewing thirty years of research on the relationship, Orlitzky, Schmidt, and Rynes support the conclusion that social performance and financial performance are positively related. The authors conclude their research by saying that “portraying managers’ choices with respect to CSP and CFP as an either/or trade-off is not justified in light of 30 years of empirical data.”⁶⁶

In understanding the research, it is important to note that there have been at least three different views, hypotheses, or perspectives that have dominated these discussions and research.

Perspective 1

Perhaps the most popular view is the belief that socially responsible firms are more financially profitable. To those who advocate the concept of social performance, it is apparent why they would like to think that social performance is a driver of financial performance and, ultimately, a corporation’s reputation. If it could be demonstrated that socially responsible firms, in general, are more financially successful and have better reputations, this would significantly bolster the CSP view, even in the eyes of its critics.

Perspective 1 has been studied extensively. The findings of many of the studies that have sought to demonstrate this relationship have been either flawed in their methodology or inconclusive. In spite of this, some studies have claimed to have successfully established this linkage. The most positive conclusion linking CSP with CFP was the Orlitzky, Schmidt, and Rynes meta-analysis reported previously.⁶⁷

Perspective 2

This view, which has not been studied as extensively, argues that a firm’s financial performance is a driver of its social performance. This perspective is built somewhat on the idea that social responsibility is a “fair weather” concept; that is, when times are good and companies are enjoying financial success, we witness higher levels of social performance. In their study, Preston and O’Bannon found the strongest evidence that financial performance either precedes, or is contemporaneous with, social performance. This evidence supports the view that social–financial performance correlations are best explained by positive synergies or by “available funding.”⁶⁸

Perspective 3

This position argues that there is an interactive relationship among social performance, financial performance, and corporate reputation. In this symbiotic view, the three major factors influence each other, and, because they are so interrelated, it is not easy to identify which factor is driving the process. Regardless of the perspective taken, each view advocates a significant role for CSP, and it is expected that researchers will continue to explore these perspectives for years to come. Figure 2-13 depicts the essentials of each of these views.

Finally, it should be mentioned that the “contingency” view of Husted suggests that CSP should be seen as a function of the “fit” between specific strategies and

Figure 2-13 *Relationships Among Corporate Social Performance (CSP), Corporate Financial Performance (CFP), and Corporate Reputation (CR)*

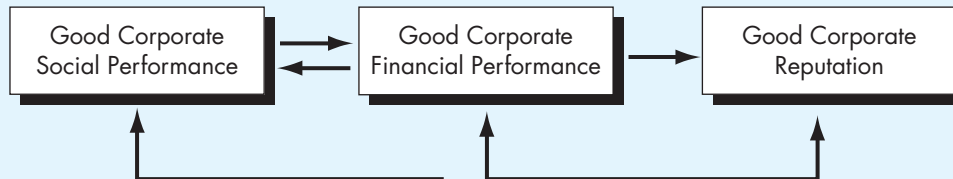
Perspective 1: CSP Drives the Relationship



Perspective 2: CFP Drives the Relationship



Perspective 3: Interactive Relationships Among CSP, CFP, and CR

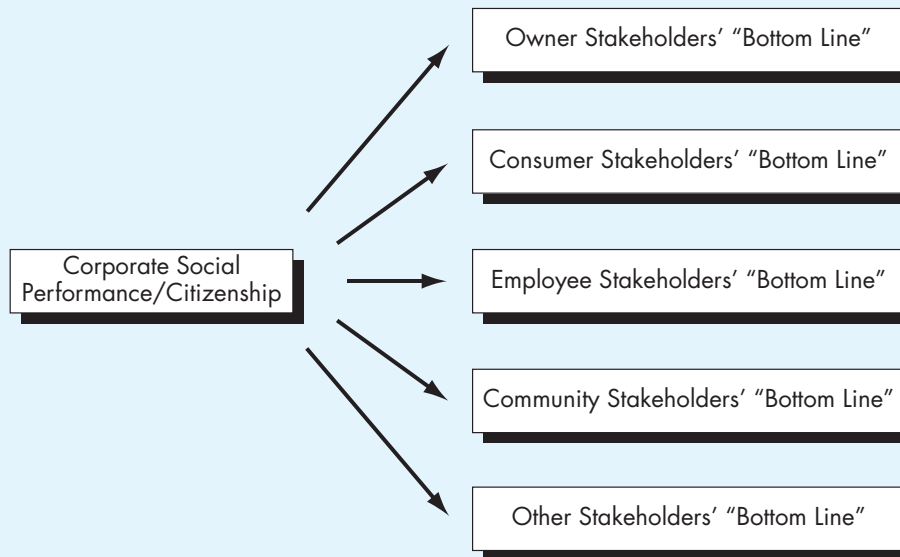


structures and the nature of the social issue. He argues that the social issue is determined by the expectational gaps of the firm and its stakeholders that occur within or between views of what is and/or what ought to be, and that high corporate social performance is achieved by closing these expectational gaps with the appropriate strategy and structure.⁶⁹

A STAKEHOLDER BOTTOM-LINE PERSPECTIVE

A basic premise of all these perspectives is that there is only one “bottom line”—a corporate financial bottom line that addresses primarily the stockholders’, or owners’, investments in the firm. An alternative view is that the firm has “multiple bottom lines” that benefit from corporate social performance. This stakeholder-bottom-line perspective argues that the impacts or benefits of CSP cannot be fully measured or appreciated by considering only the impact on the firm’s financial bottom line.

Figure 2-14 *Relationship Between Corporate Social Performance/Citizenship and Stakeholders' "Multiple Bottom Lines"*



To truly operate with a stakeholder perspective, companies need to embrace the multiple-bottom-line view. Thus, CSP cannot be fully comprehended unless we also consider that its impacts on stakeholders, such as consumers, employees, the community, and other stakeholder groups, are noted, measured, and considered. Research may never conclusively demonstrate a simple relationship between CSP and financial performance. If a stakeholder perspective is taken, however, it may be more straightforward to assess the impact of CSP on multiple stakeholders' bottom lines. This model of CSP/corporate citizenship and stakeholders' bottom lines might be depicted like Figure 2-14.

The Triple Bottom Line

A variant of the "multiple bottom line" perspective is popularly known as the "**triple bottom line**" concept. The phrase *triple bottom line* has been attributed to John Elkington. The concept seeks to encapsulate for business the three key spheres of **sustainability**—*economic, social, and environmental*. The "economic bottom line" refers to the firm's creation of material wealth, including financial income and assets. The "social" bottom line is about the quality of people's lives and about equity between people, communities, and nations. The "environmental" bottom line is about protection and conservation of the natural environment.⁷⁰ It may easily be seen that these three topics are embodied in the Pyramid of CSR and

represent a version of the stakeholder-bottom-line concept. At its narrowest, the term is used as a framework for measuring and reporting corporate performance in terms of economic, social, and environmental indicators. At its broadest, the concept is used to capture the whole set of values, issues, and processes that companies must address to minimize harm resulting from their activities and to create economic, social, and environmental value.⁷¹ As a popular concept, it is a more detailed spelling out of the idea of corporate social performance.

As mentioned earlier, **corporate sustainability** is the goal of the triple-bottom-line approach. The goal of sustainability is to create long-term shareholder value by taking advantage of opportunities and managing risks related to economic, environmental, and social developments. Leaders in this area try to take advantage of the market's demand for sustainable products and services while successfully reducing and avoiding sustainability costs and risks. To help achieve these goals, the Dow Jones Sustainability Indexes were created to monitor and assess the sustainability of corporations.⁷²

Socially Responsible or Ethical Investing

Special-interest groups, the media, and academics are not alone in their interest in business's social performance. Investors are also interested. The **socially responsible** or **ethical investing** movement arrived on the scene in the 1970s and has continued to grow and prosper. By the early 2000s, social investing had matured into a comprehensive investing approach, complete with social and environmental screens, shareholder activism, and community investment. By 2007, the industry accounted for more than \$2.3 trillion of investments in the United States, according to the Social Investment Forum.⁷³

Historically, social responsibility investing can be traced back to the early 1900s, when church endowments refused to buy "sin" stocks—then defined as shares in tobacco, alcohol, and gambling companies. During the Vietnam War era of the 1960s and early 1970s, antiwar investors refused to invest in defense contracting firms. In the early 1980s, universities, municipalities, and foundations sold off their shares of companies that had operations in South Africa to protest apartheid. By the 1990s, self-styled socially responsible investing came into its own.⁷⁴ In the 2000s, social investing began celebrating the fact that social or ethical investing is now part of the mainstream.

Socially conscious investments have continued to grow. However, managers of socially conscious funds do not use only ethical or social responsibility criteria to decide in which companies to invest. They consider a company's financial health before all else. Moreover, a growing corps of brokers, financial planners, and portfolio managers are available to help people evaluate investments for their social impacts.⁷⁵

The concept of *social screening* is the backbone of the socially conscious investing movement. Investors seeking to put their money into socially responsible firms want to *screen out* those firms they consider to be socially

irresponsible or actively to *screen in* those firms they think of as being socially responsible. Thus, there are negative social screens and positive social screens. Some of the *negative social screens* that have been used in recent years include the avoidance of investing in tobacco products manufacturers, gambling casino operators, defense or weapons contractors, and firms doing business in South Africa.⁷⁶ In 1994, however, with the elimination of the official system of apartheid in South Africa, many eliminated this as a negative screen.

It is more difficult, and thus more challenging, to implement *positive social screens* because they require the potential investor to make judgment calls as to what constitutes an acceptable or a strong level of social performance on social investment criteria. Criteria that may be used as either positive or negative screens, depending on the firm's performance, might include the firm's record on issues such as equal employment opportunity and affirmative action, environmental sustainability, treatment of employees, corporate citizenship (broadly defined), and treatment of animals.

The recent experience of Pax World Funds, a socially responsible investor, illustrates how tricky social screening can be. When Starbucks introduced a coffee liqueur with Jim Beam bourbon, Pax World Fund thought it had no choice but to sell its \$23 million stake in Starbucks, even though it had long believed Starbucks to have a strong record of social responsibility. Pax World did divest itself of its Starbucks stock. In 2006, however, Pax World shareholders concluded that the company needed to eliminate its zero-tolerance policy on alcohol and gambling, and they approved more flexible guidelines for the future. Under the new guidelines, the company will focus more on positive social screens, like a company's record on corporate governance, climate change, and other social issues.⁷⁷

The financial performance of socially conscious funds shows that investors do not have to sacrifice profitability for principles. Recent evidence suggests that investors expect and receive competitive returns from social investments.⁷⁸

It should be added, moreover, that there is no clear and consistent evidence that returns from socially conscious funds will equal or exceed the returns from funds that are not so carefully screened. Therefore, socially conscious funds are valued most highly by those investors who really care about the corporate citizenship of companies in their portfolios and are willing to put their money at some risk. One study concluded that there is no penalty for improved corporate social performance in terms of institutional ownership and that high CSP tends in fact to lead to an increase in the number of institutional investors holding a given stock.⁷⁹

The Council on Economic Priorities has suggested that there are at least three reasons why there has been an upsurge in social or ethical investing:⁸⁰

1. There is more reliable and sophisticated research on CSP than in the past.
2. Investment firms using social criteria have established a solid track record, and investors do not have to sacrifice gains for principles.
3. The socially conscious 1960s generation is now making investment decisions.

In recent years, as more and more employees are in charge of their own IRAs and 401(k)s, people have become much more sophisticated about making

investment decisions than in the past. Further, more people are seeing social investments as a way in which they can exert their priorities concerning the balance of financial and social concerns.

The most prominent index or standard for social investments is KLD's Domini 400 Social Index. Patterned after the S&P 500 Index, the Domini Index claims to be the first benchmark for equity portfolios subject to multiple social screens. It is a widely recognized benchmark for measuring the impact of social screening on financial returns and the performance of socially screened portfolios. One can monitor the returns of companies that socially screen their investments via the Domini Index.⁸¹

Whether it be called social investing, ethical investing, or socially responsible investing, it is clear that social investing has "arrived" on the scene and has become a part of the mainstream. Over the decade from 1995 to 2005, socially responsible investing grew from \$639 billion to \$2.3 trillion. Socially responsible investing is growing globally as well.⁸² Socially conscious funds will continue to be debated in the investment community. The fact that they exist, have grown, and have prospered, however, provides evidence that the practice is a serious one and that there truly are investors in the real world who take the social performance issue quite seriously.

Summary

Important and related concepts include those of corporate citizenship, corporate social responsibility, responsiveness, and performance. The corporate social responsibility concept has a rich history. It has grown out of many diverse views. A four-part conceptualization was presented that broadly conceives CSR as encompassing economic, legal, ethical, and philanthropic components. The four parts were presented as part of the Pyramid of CSR.

The concern for corporate social responsibility has been expanded to include a concern for social responsiveness. The responsiveness theme suggests more of an action-oriented focus by which firms not only must address their basic obligations but also must decide on basic modes of responding to these obligations. A CSP model was presented that brought the responsibility and responsiveness dimensions together into a framework that also identified realms of social or stakeholder issues that must be considered. The identification of social

issues has blossomed into a field now called "issues management" or "stakeholder management."

The term *corporate citizenship* has arrived on the scene to embrace a whole host of socially conscious activities and practices on the part of businesses. This term has become quite popular in the business community. It is not clear that the concept is distinctively different than the emphases on corporate social responsibility, responsiveness, and performance, but it is a terminology that is coming into more frequent use. A "stages of corporate citizenship" model was presented that depicted how companies progress and grow in their increasing sophistication and maturity in dealing with corporate citizenship issues.

The interest in corporate social responsibility extends beyond the academic community. *Fortune* magazine polls executives annually on various dimensions of corporate performance; one major dimension is "Social Responsibility." The Conference Board gives an Award for Corporate Leadership, and

CRO: *Corporate Responsibility Officer* magazine recognizes outstanding “corporate citizens.”

Finally, the socially responsible or ethical investing movement seems to be flourishing. This indicates that there is a growing body of investors who are sensitive to business’s social and ethical (as well as financial) performance. Studies of the relationship between social responsibility and economic performance have not yielded consistent

results, but most recent studies have shown a positive relationship between the two. In the final analysis, sound corporate social (stakeholder) performance is associated with a “multiple-bottom-line effect” in which a number of different stakeholder groups experience enhanced bottom lines. The most well-known of these effects is the popular “triple bottom line,” with emphases on economics, society, and environment.

Key Terms

Business for Social Responsibility (BSR)

(page 34)

community obligations (page 37)

corporate citizenship (page 60)

corporate social performance (CSP) (page 57)

corporate social performance model (page 57)

corporate social responsibility (page 35)

corporate social responsiveness (page 55)

corporate sustainability (page 71)

economic responsibilities (page 40)

ethical investing (page 72)

ethical responsibilities (page 41)

legal responsibilities (page 41)

paternalism (page 37)

philanthropic responsibilities (page 43)

philanthropy (page 37)

Pyramid of Corporate Social Responsibility

(CSR) (page 45)

socially responsible (page 72)

sustainability (page 71)

triple bottom line (page 71)

Discussion Questions

1. Identify and explain the Pyramid of Corporate Social Responsibility. Provide several examples of each “layer” of the pyramid. Identify and discuss some of the tensions among the layers or components. How is the pyramid to be interpreted?
2. In your view, what is the single strongest argument *against* the idea of corporate social responsibility? What is the single strongest argument *for* corporate social responsibility? Briefly explain.
3. Differentiate corporate social responsibility from corporate social responsiveness. Give an example of each. How does corporate social performance relate to these terms?
4. Analyze how the triple bottom line and the Pyramid of CSR are similar and different. Draw a schematic that shows how the two concepts relate to one another.
5. Do research on different companies and try to identify at which stage of corporate citizenship these companies reside. What are the best examples you can find of companies having achieved Stage 5 of corporate citizenship?
6. Does socially responsible or ethical investing seem to you to be a legitimate way in which the average citizen might demonstrate her or his concern for CSR? Discuss.

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The Stakeholder Approach to Business, Society, and Ethics

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Define *stake* and *stakeholder* and describe the origins of these concepts.
- 2 Differentiate among the production, managerial, and stakeholder views of the firm.
- 3 Differentiate among the three values of the stakeholder model.
- 4 Explain the concept of stakeholder management.
- 5 Identify and describe the five major questions that capture the essence of stakeholder management.
- 6 Identify the three levels of stakeholder management capability (SMC).
- 7 Describe the key principles of stakeholder management.

Life in business organizations was once simpler. First, there were the investors who put up the money to get the business started. This was in the precorporate period, so there was only one person, or a few at most, financing the business. Next, the owners needed employees to do the productive work of the firm. Because the owners themselves were frequently the managers, another group—the employees—was needed to get the business going. Then, the owners needed suppliers to make raw materials available for production and customers to purchase the products or services they were providing. All in all, it was a less complex period, with minimal and understood expectations among the various parties.

It would take many pages to describe how and why we got from that relatively simple period to the complex state of affairs we face in today's society. Many of the factors we discussed in the first two chapters were driving forces behind this societal transformation. The principal factor, however, has been the recognition by the

public, or society, that the business organization is no longer the sole property or interest of the founder, the founder's family, or even a group of owner-investors.

The business organization today, especially the modern corporation, is the institutional centerpiece of a complex society. Our society today consists of many people with a multitude of interests, expectations, and demands as to what major organizations ought to provide to accommodate people's lives and lifestyles. We have seen business respond to the many expectations placed on it. We have seen an ever-changing social contract. We have seen many assorted legal, ethical, and philanthropic expectations and demands being met by organizations willing to change as long as the economic incentive was still present and honored. What was once viewed as a specialized means of providing profit through the manufacture and distribution of goods and services has become a multipurpose social institution that many people and groups depend on for their livelihoods, prosperity, and fulfillment.

In a society conscious of an always-improving lifestyle, with more groups every day laying claims to their share of the good life, business organizations today need to be responsive to individuals and groups they once viewed as powerless and unable to make such claims on them. We call these individuals and groups *stakeholders*. The stakeholder approach to management is an accepted framework that is poised for continuing development, especially in the business-and-society arena. In the academic and business community, advances in stakeholder theory have illustrated the crucial development of the stakeholder concept.¹

The stakeholder view got an added boost in 1996 when Britain's then Labour Party Leader Tony Blair called for an economy characterized by stakeholder capitalism as opposed to traditional shareholder capitalism. All over the world, people began discussing again an age-old question: To whom do companies belong to and in whose interests should they be run? These discussions sharply contrasted the traditional American and British view, wherein a public company has the overriding goal of maximizing shareholder returns, with the view held by the Japanese and much of continental Europe, wherein firms accept broader obligations that seek to balance the interests of shareholders with those of other stakeholders, notably employees, suppliers, customers, and the wider "community."²

In terms of corporate application, a model for the "stakeholder corporation" has even been proposed. It has been argued that "stakeholder inclusion" is the key to company success in the twenty-first century.³ A book titled *Stakeholder Power* presents a "winning plan for building stakeholder commitment and driving corporate growth."⁴ In 2002, another book, *Redefining the Corporation: Stakeholder Management and Organizational Wealth*, argued that the corporate model needs redefinition because of business size and socioeconomic power and the inaccuracy of the "ownership" model and its implications.⁵ Finally, the book *Stakeholder Theory and Organizational Ethics* has linked the stakeholder approach with business ethics, a topic of crucial interest to us in this chapter.⁶

An outgrowth of these developments is that it has become apparent that business organizations must address the legitimate needs and expectations of stakeholders if they want to be successful in the long run.⁷ Business must also address stakeholders because it is the ethical course of action to take. Stakeholders have expectations, claims, and rights that ought to be honored, and the stakeholder approach facilitates that pursuit. It is for these reasons that the stakeholder concept and orientation have become a central part of the vocabulary and thinking in the study of business, society, and ethics.

Origins of the Stakeholder Concept

The stakeholder concept has become a key to understanding business and society relationships. The term *stakeholder* is a variant of the more familiar and traditional concept of *stockholders*—the investors in or owners of businesses. Just as a private individual might own his or her house, automobile, or iPod, a stockholder owns a portion or a share of one or more businesses. Thus, a stockholder is also a stakeholder. However, stockholders are just one group of many legitimate stakeholders that business and organizations must address today to be effective.

WHAT IS THE STAKE IN STAKEHOLDER?

To appreciate the concept of stakeholders, it helps to understand the idea of a stake. A **stake** is an interest in or a share in an undertaking. If a group is planning to go out to dinner and a movie for the evening, each person in the group has a stake, or interest, in the group's decision. No money has yet been spent, but each member sees his or her interest (preference, taste, priority) in the decision. A stake may also be a claim. A claim is a demand for something due or believed to be due. We can see clearly that an owner or a stockholder has an interest in and an ownership of a share of a business.

The idea of a stake can range from simply an interest in an undertaking at one extreme to a legal claim of ownership at the other extreme. In between these two extremes might be a "right" to something. Such a right might be a legal right to certain treatment rather than a legal claim of ownership, such as that of a shareholder. Legal rights might include the right to fair treatment (e.g., not to be discriminated against) or the right to privacy (not to have one's privacy invaded or abridged). A right also might be thought of as a moral right, such as that expressed by an employee: "I've got a right not to be fired because I've worked here thirty years, and I've given this firm the best years of my life." Or a consumer might say, "I've got a right to a safe product after all I've paid for this."

As we have seen, there are several different types of stakes. Figure 3-1 summarizes various categories or types of stakes.

Figure 3-1 Types of Stakes

	An Interest	A Right	Ownership
Definitions	When a person or group will be affected by a decision, it has an interest in that decision.	(1) Legal Right: When a person or group has a legal claim to be treated in a certain way or to have a particular right protected.	When a person or group has a legal title to an asset or a property.
Examples	This plant closing will affect the community. This TV commercial demeans women, and I'm a woman. I'm concerned about the environment for future generations.	Employees expect due process, privacy; customers or creditors have certain legal rights.	"This company is mine. I founded it, and I own it," or "I own 1,000 shares of this corporation."
Definitions		(2) Moral Right: When a person or group thinks it has a moral or ethical right to be treated in a certain way or to have a particular right protected.	
Examples		Fairness, justice, equity.	

WHAT IS A STAKEHOLDER?

It follows, then, that a **stakeholder** is an individual or a group that has one or more of the various kinds of stakes in the organization. Just as stakeholders may be affected by the actions, decisions, policies, or practices of the business firm, these stakeholders also may affect the organization's actions, decisions, policies, or practices. With stakeholders, therefore, there is a potential two-way interaction or exchange of influence. In short, a stakeholder may be thought of as "any individual or group who can affect or is affected by the actions, decisions, policies, practices, or goals of the organization."⁸ This definition is quite broad, but in this broad concept, the organization or decision maker is more likely to explore its social and ethical responsibilities fully than when using a narrower definition.

Who Are Business's Stakeholders?

In today's competitive, global business environment, there are many individuals and groups who are business's stakeholders. From the business point of view, there are certain individuals and groups that have legitimacy in the eyes of management. That is, they have a legitimate, direct interest in, or claim on, the

operations of the firm. The most obvious of these groups are stockholders, employees, and customers. But, from the point of view of a highly pluralistic society, stakeholders include not only these groups, but other groups as well. These other groups include the community, competitors, suppliers, special-interest groups, the media, and society, or the public at large. Charles Holliday, Chairman and CEO of DuPont, recently stated: “We have traditionally defined four stakeholder groups important to DuPont—shareholders, customers, employees, and society.”⁹ It has also been strongly argued that the natural environment, nonhuman species, and future generations should be considered among business’s important stakeholders.¹⁰

THE PRODUCTION, MANAGERIAL, AND STAKEHOLDER VIEWS OF THE FIRM

The evolution and progress of the stakeholder concept parallels the growth and expansion of the business enterprise. In the traditional **production view of the firm**, owners thought of stakeholders as only those individuals or groups that supplied resources or bought products or services.¹¹ As time passed and we witnessed the growth of corporations and the resulting separation of ownership from control, business firms began to see their responsibilities toward other major constituent groups if they were to be managed successfully. Thus, we observed the development of the **managerial view of the firm**. Finally, as major internal and external changes occurred in business and its environment, managers were required to undergo a revolutionary conceptual shift in how they perceived the firm and its multilateral relationships with constituent or stakeholder groups. The result was the **stakeholder view of the firm**.¹² In actual practice, however, some managers have not yet come to appreciate the need for the stakeholder view, but this is changing rapidly. Figure 3-2 depicts the evolution from the production view to the managerial view of the firm, and Figure 3-3 illustrates the stakeholder view of the firm. The stakeholder view encompasses many different individuals and groups that are embedded in the firm’s internal and external environments.

In the stakeholder view of the firm, management must perceive its stakeholders as not only those groups that management thinks have some stake in the firm but also those groups that themselves think or perceive they have a stake in the firm. This is a necessary perspective that management must take at the outset, at least until it has had a chance to weigh carefully the legitimacy of the claims and the power of various stakeholders. We should note here that each stakeholder group is composed of subgroups. For example, the government stakeholder group includes federal, state, and local government stakeholders as subgroups.

PRIMARY AND SECONDARY STAKEHOLDERS

A useful way to categorize stakeholders is to think of them as primary and secondary and social and nonsocial; thus, stakeholders may be thought of as follows:¹³

Primary social stakeholders include:

- Shareholders and investors
- Employees and managers
- Customers
- Local communities
- Suppliers and other business partners

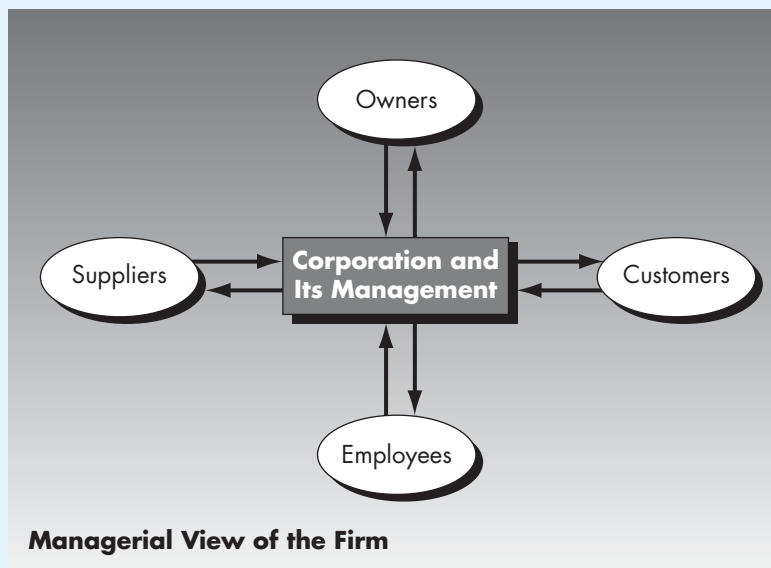
Secondary social stakeholders include:

- Government and regulators
- Civic institutions
- Social pressure groups
- Media and academic commentators
- Trade bodies
- Competitors

Figure 3-2 *The Production and Managerial Views of the Firm*



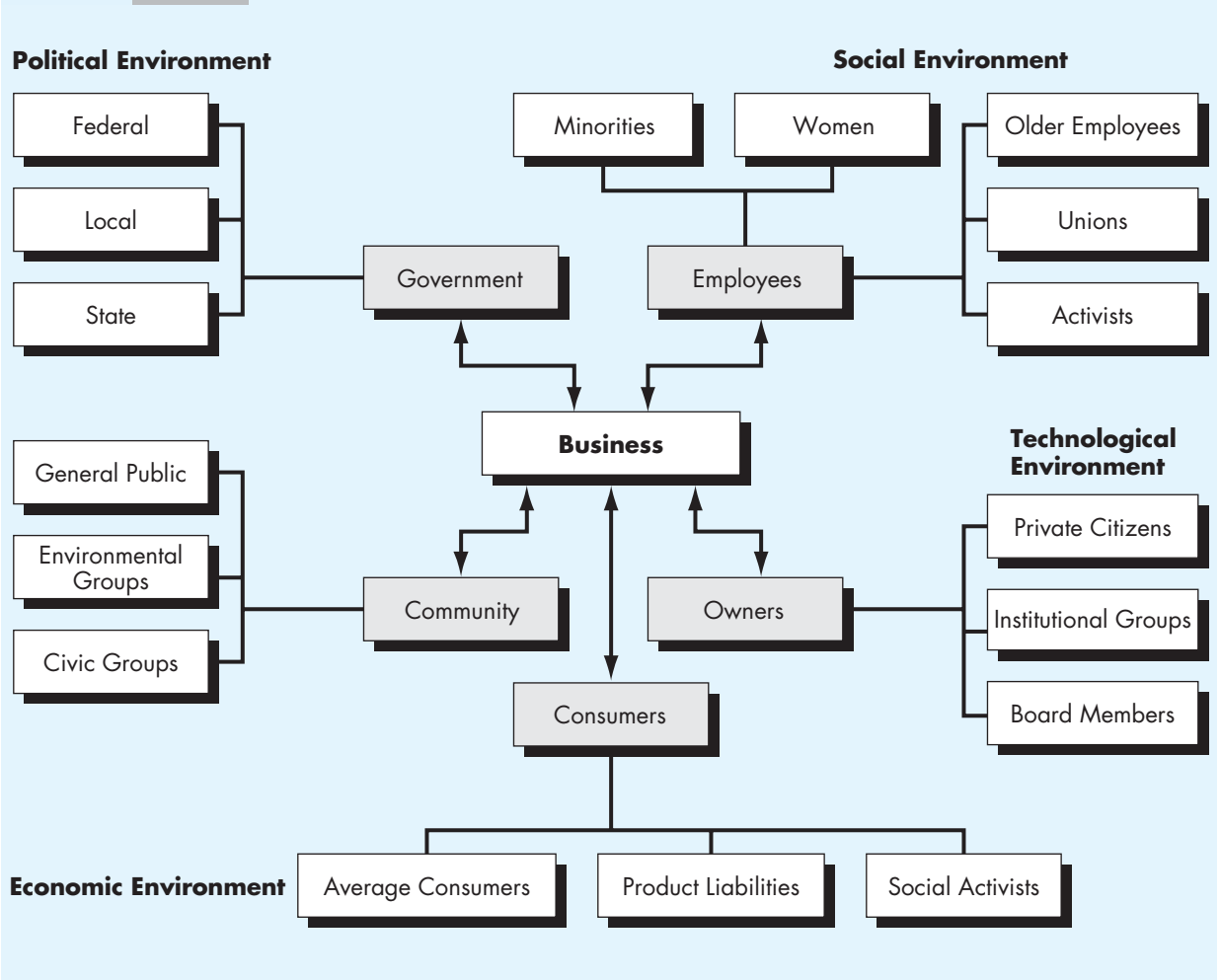
Production View of the Firm



Managerial View of the Firm

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Figure 3-3 *The Stakeholder View of the Firm*



Primary social stakeholders have a *direct* stake in the organization and its success and, therefore, are most influential. **Secondary social stakeholders** may be extremely influential as well, especially in affecting reputation and public standing, but their stake in the organization is more indirect. Therefore, management’s level of accountability to a secondary stakeholder may be lower, but these groups may wield significant power and quite often represent legitimate public concerns, so they cannot be ignored.¹⁴

Primary nonsocial stakeholders include:

- Natural environment
- Future generations
- Nonhuman species

Secondary nonsocial stakeholders include:

- Environmental interest groups (e.g., Friends of the Earth, Greenpeace, Rainforest Alliance)
- Animal welfare organizations (e.g., Humane Society, People for the Ethical Treatment of Animals—PETA)

Secondary stakeholders can quickly become primary ones. This often occurs by way of media or special-interest groups when the urgency of a claim (as in a boycott or demonstration) takes precedence over the legitimacy of that claim. In today's business environment, the media, with their 24/7 coverage of the news, have the power to transform a stakeholder's status instantaneously. Thus, it may be useful to think of primary and secondary classes of stakeholders for discussion purposes, but we should understand how easily and quickly those categories can shift.

CORE, STRATEGIC, AND ENVIRONMENTAL STAKEHOLDERS

There are other ways to categorize stakeholders. In an alternative scheme, stakeholders are thought of as being core, strategic, or environmental. **Core stakeholders** are a specific subset of strategic stakeholders that are essential for the *survival* of the organization. **Strategic stakeholders** are those stakeholder groups that are vital to the organization's success and the particular set of threats and opportunities it faces at a particular point in time. **Environmental stakeholders** are all others in the organization's environment that are not core or strategic. One could think of the relationship among these three groups of stakeholders as a series of concentric circles with core stakeholders in the middle and with strategic and environmental stakeholders extending out from the middle.¹⁵

Whether stakeholders are core, strategic, or environmental would depend on their major characteristics or attributes, such as legitimacy, power, or urgency. Thus, stakeholders could move from category to category in a dynamic, flowing, and time-dependent fashion. This set of terms for describing stakeholders is useful because it captures, to some degree, the contingencies and dynamics that must be considered in an actual situation.

A TYPOLOGY OF STAKEHOLDER ATTRIBUTES: LEGITIMACY, POWER, URGENCY

Expanding on the idea that stakeholders have such attributes as legitimacy, power, and urgency, a typology of stakeholders based on these three attributes was developed.¹⁶ When these three attributes are superimposed, as depicted in Figure 3-4, seven stakeholder categories are the result.

The three attributes of legitimacy, power, and urgency help us to see how stakeholders may be thought of and analyzed in these key terms. **Legitimacy**




Image not available due to copyright restrictions

refers to the perceived validity or appropriateness of a stakeholder's claim to a stake. Therefore, owners, employees, and customers represent a high degree of legitimacy due to their explicit, formal, and direct relationships with a company. Stakeholders that are more distant from the firm, such as social activist groups, competitors, or the media, might be thought to have less legitimacy.

Power refers to the ability or capacity to produce an effect—to get something done that otherwise may not be done. Therefore, whether one has legitimacy or not, power means that the stakeholder could affect the business. For example, with the help of the media, a large, vocal, social activist group, such as People for the Ethical Treatment of Animals (PETA), could wield extraordinary power over a business firm. In recent years, PETA has been successful in influencing the practices and policies of virtually all the fast-food restaurants regarding the treatment of chickens and cattle.

Urgency refers to the degree to which the stakeholder claim on the business calls for the business's immediate attention or response. Urgency may imply that something is critical—it really needs to get done. Or, it may imply that something needs to be done immediately or on a timely basis. A management group may perceive a union strike, a consumer boycott, or a social activist group picketing outside headquarters as urgent.

It has been suggested that at least one other criterion should be considered in addition to legitimacy, power, and urgency. This criterion is **proximity**.¹⁷ The spatial distance between the organization and its stakeholders is a relevant consideration in evaluating stakeholders' importance and priority. Stakeholders that share the same physical space or are adjacent to the organization may affect and be affected by the organization. If an organization is located next to a lake, river, or stream, for example, this becomes an important consideration for natural environment as stakeholder. In a global example, nation-states may share borders, introducing spatially related stakeholders. It has been argued, therefore, that the greater the proximity, the greater is the likelihood of relevant and important stakeholder relationships.¹⁸

An appropriate example of a stakeholder action that illustrates both power and urgency occurred in several dozen Home Depot stores around the country. In each of the stores, strange announcements began blaring from the intercom systems: *"Attention shoppers, on aisle seven you'll find mahogany ripped from the heart of the Amazon."* Shocked store managers raced through the aisles trying to apprehend the environmental activists who were behind the stunt. The activists had apparently gotten the access codes to the intercoms. After months of similar antics, Home Depot bowed to the demands of the environmental group and

<http://SEARCHTHEWEBWEB>

AWARD FOR STAKEHOLDER ACCOUNTABILITY

Berrett-Koehler Publishers, a small but influential publisher, received the 2006 Business Ethics Award for Stakeholder Accountability. Berrett-Koehler stands out for its excellent treatment of its authors as well as its engagement of employees, business partners, readers, and the community. The founder and president, Steve Piersanti, owns 52 percent of the company, and 46 percent is owned by more than 150 other stakeholders, including authors, customers, suppliers, and employees.

The publisher's self-described ambitious goal is "Creating a World that Works for All." The company is

home for a number of authors on the topics of corporate social responsibility and sustainability. One of its stakeholder projects is a collaboration with the Social Venture Network, a nonprofit organization, to create a series of low-cost paperback guides for starting and developing socially responsible businesses.

For more information on Berrett-Koehler's business ethics award, go to the website of *CRO: Corporate Responsibility Officer* magazine: <http://www.thecro.com/?q=node/167>. For more information on the company, go to: <http://www.bkconnection.com/static/story.asp>.

announced that it would stop selling wood chopped from endangered forests and, instead, stock wood products certified by a new organization called the Forest Stewardship Council (FSC).¹⁹ This newly founded group wasn't even on Home Depot's radar screen, and then, all of a sudden, it had to capitulate to selling only wood certified by the FSC.

The typology of stakeholder attributes suggests that managers must attend to stakeholders based on their assessment of the extent to which competing stakeholder claims reflect legitimacy, power, and urgency. Using the categories in Figure 3-4, therefore, the stakeholder groups represented by overlapping circles (for example, those with two or three attributes, such as Categories 4, 5, 6, and 7) are highly "salient" to management and would likely receive priority attention.

Strategic, Multifiduciary, and Synthesis Approaches

One major challenge embedded in the stakeholder approach is to determine whether it should be seen primarily as a way to better manage those groups known as stakeholders or as a way to treat more ethically those groups known as stakeholders. This issue is addressed by distinguishing among the strategic approach, the multifiduciary approach, and the stakeholder synthesis approach.²⁰

Strategic Approach

The *strategic approach* views stakeholders primarily as factors to be taken into consideration and managed while the firm is pursuing profits for its shareholders. In this view, managers take stakeholders into account because offended stakeholders might resist or retaliate (for example, through political action, protest, or boycott). This approach sees stakeholders as instruments that may facilitate or impede the firm's pursuit of its strategic business objectives. Thus, it is an instrumental view.

Multifiduciary Approach

The *multifiduciary approach* views stakeholders as more than just individuals or groups who can wield economic or legal power. This view holds that management has a fiduciary responsibility to stakeholders just as it has this same responsibility to shareholders. In this approach, management's traditional fiduciary, or trust, duty is expanded to embrace stakeholders on roughly equal footing with shareholders. Thus, shareholders are no longer of exclusive importance as they were under the strategic approach.²¹ This view broadens the idea of a fiduciary responsibility to include stockholders and other important stakeholders.

Stakeholder Synthesis Approach

A new, *stakeholder synthesis approach* is preferred because it holds that business does have moral responsibilities to stakeholders but that they should not be seen

as part of a fiduciary obligation. As a consequence, management's basic fiduciary responsibility to shareholders is kept intact, but it is also expected to be implemented within a context of ethical responsibility to other stakeholders. This ethical responsibility is business's duty not to harm, coerce, lie, cheat, steal, and so on.²² Thus, the result is the same in the multifiduciary and stakeholder synthesis views. However, the reasoning or rationale is different.

As we continue our discussion of stakeholder management, it should become clear that we are pursuing it from a balanced perspective. This balanced perspective suggests that we are integrating the strategic approach with the stakeholder synthesis approach. We should be managing strategically and morally at the same time. The stakeholder approach should not be just a better way to manage. It also should be a more ethical way to manage.

Three Values of the Stakeholder Model

In addition to the strategic, multifiduciary, and stakeholder synthesis approaches, there are three aspects or *values* of the stakeholder model of the firm that should be appreciated. These three values, although interrelated, include the descriptive, instrumental, and normative values or aspects of the stakeholder approach.²³

Descriptive Value

First, the stakeholder model has value because it is *descriptive*. That is, it provides language and concepts to effectively describe the corporation or organization. The corporation is a constellation of cooperative and competitive interests possessing both instrumental and intrinsic value. Understanding organizations in this way allows us to have a fuller description or explanation of how they function. The language and terms used in stakeholder theory are useful in helping us to understand organizations. As a result, we have seen stakeholder language and concepts used more and more in many fields of endeavor—business, government, politics, education, and so on.

Instrumental Value

Second, the stakeholder model has value because it is *instrumental*. It is useful in characterizing the relationship between the practice of stakeholder management and the resulting achievement of corporate performance goals. The fundamental premise here is that practicing effective stakeholder management should lead to the achievement of traditional business goals, such as profitability, stability, and growth.²⁴ Business school courses in strategic management often employ the instrumental model.

Normative Value

Third, the stakeholder model has value because it is *normative*. In the normative perspective, stakeholders are seen as possessing value irrespective of their

instrumental use to management. The normative view is often thought of as the moral or ethical view because it emphasizes how stakeholders *should* be treated. The “principle of stakeholder fairness” is the moral underpinning, or normative justification, for the stakeholder model.²⁵ Thus, the normative value of stakeholder thinking is of central importance in business ethics and business and society.

To summarize, stakeholder theory is *managerial* in the broad sense of the term in that it does not simply describe or predict but also recommends attitudes, structures, and practices that constitute stakeholder management. Management necessitates the simultaneous attention to the legitimate interests of all appropriate stakeholders in the creation of organizational structures and policies.²⁶

Key Questions in Stakeholder Management

The managers of a business firm have the responsibility of establishing the firm’s overall direction (its mission, strategies, goals, and policies) and seeing to it that these plans are carried out. As a consequence, managers have some long-term responsibilities and many that are of more immediate concern. Before the stakeholder environment became as turbulent and rapidly changing as it now is, the managerial task was relatively straightforward because the external environment was stable. As we have evolved to the stakeholder view of the firm, however, we see the managerial task as an inevitable consequence of the dynamic trends and developments we described in our first two chapters.

Stakeholder management has become important as managers have discovered the many groups that have to be addressed and relatively satisfied for the firm to meet its objectives. Without question, we still recognize the significance and necessity of profits as a return on the stockholders’ investments, but now we also perceive and understand the growing claims of other stakeholder groups and the success they have had in getting what they want.

The challenge of stakeholder management, therefore, is to see to it that the firm’s primary stakeholders achieve their objectives and that other stakeholders are dealt with ethically and are also relatively satisfied. At the same time, the firm is expected to be profitable. This is the classic “win-win” situation. It does not always occur, but it is the appropriate goal for management to pursue to protect its long-term best interests. Management’s second-best alternative is to meet the goals of its primary stakeholders, keeping in mind the important role of its owner-investors. Without economic viability, all other stakeholders’ interests become unresolved.

With these perspectives in mind, let us approach stakeholder management with the idea that managers can become successful stewards of their stakeholders’ resources by gaining knowledge about stakeholders and using this knowledge to predict and take care of their behaviors and actions. Ultimately, we should manage in such a way that we achieve our objectives ethically and effectively. Thus, the important functions of stakeholder management are to describe, to

analyze, to understand, and, finally, to manage. The quest for stakeholder management embraces social, ethical, and economic considerations. Normative as well as instrumental objectives and perspectives are essential.

Five key questions should be asked if we are to capture the essential information needed for stakeholder management:

1. *Who* are our stakeholders?
2. What are our stakeholders' *stakes*?
3. What *opportunities and challenges* do our stakeholders present to the firm?
4. What *responsibilities* (economic, legal, ethical, and philanthropic) does the firm have to its stakeholders?
5. What *strategies or actions* should the firm take to best address stakeholder challenges and opportunities?²⁷

Figure 3-5 presents a schematic of the decision process, outlining the five questions and key issues with respect to each.

WHO ARE OUR STAKEHOLDERS?

To this point, we have described the likely primary and secondary stakeholder groups of a business organization. To manage them effectively, each firm and its management group must ask and answer this question for itself: *Who are our stakeholders?* This stage is often called "stakeholder identification." To answer this question fully, management must identify not only generic stakeholder groups but also specific subgroups. A generic stakeholder group is a general or broad grouping, such as employees, shareholders, environmental groups, or consumers. Within each of these generic categories, there may be a few or many specific subgroups. Figure 3-6 illustrates some of the generic and specific stakeholder subgroups of a very large organization.

McDonald's Experience

To illustrate the process of stakeholder identification, it is helpful to consider some events in the life of McDonald's Corporation that resulted in their broadening significantly who were considered their stakeholders. The case study started in the late 1990s when the social activist group PETA (People for the Ethical Treatment of Animals), which claims 700,000 members, decided it was dissatisfied with some of McDonald's practices and decided it would launch a billboard and bumper-sticker campaign against the hamburger giant.²⁸ PETA felt McDonald's was dragging its feet on animal welfare issues, and so PETA went on the attack. PETA announced it would put up billboards saying, "The animals deserve a break today" and "McDonald's: Cruelty to Go" in Norfolk, Virginia, PETA's hometown. The ad campaign was announced when talks broke down between PETA and McDonald's on the subject of ways the company might foster animal-rights issues within the fast-food industry. Using concepts introduced earlier, PETA was a secondary social or nonsocial stakeholder and, therefore, had low legitimacy. However, its power and urgency were very high, as it was threatening the company with a highly visible, potentially destructive campaign that was being sympathetically reported by a cooperative media.

Figure 3-5 Stakeholder Management: Five Key Questions

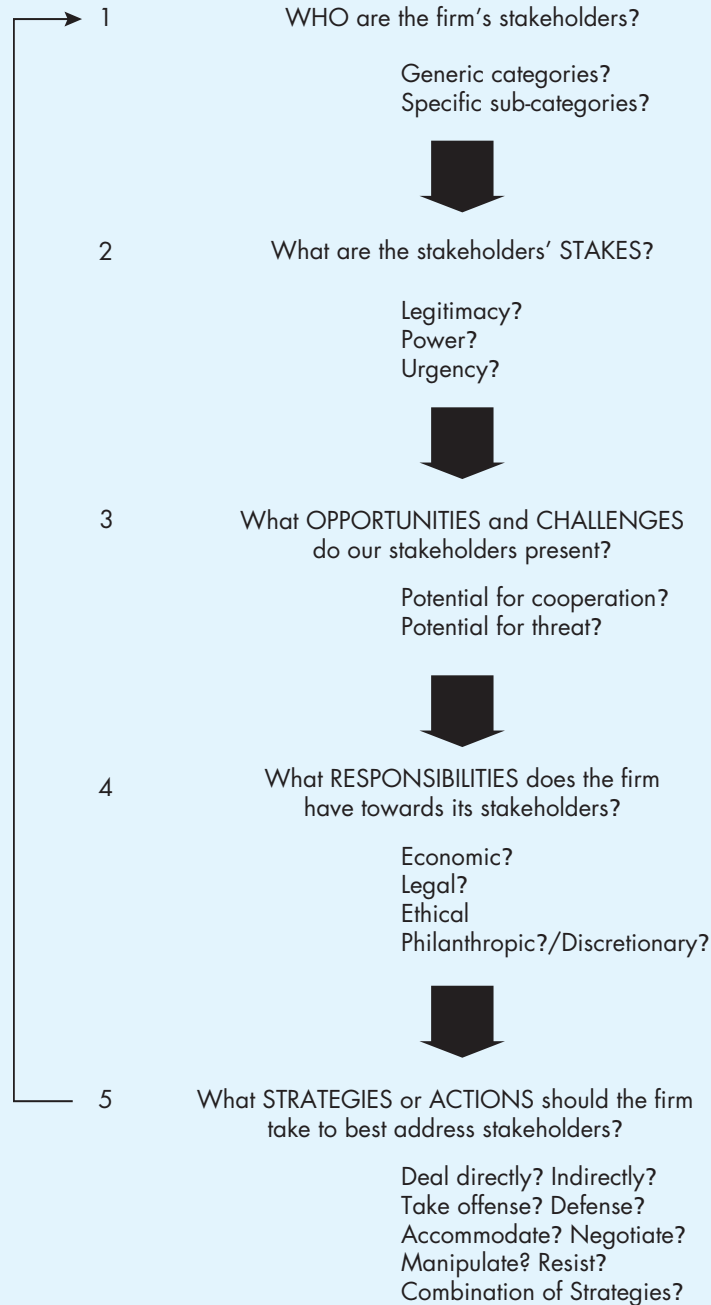


Figure 3-6 *Some Generic and Specific Stakeholders of a Large Firm*

Owners	Employees	Governments	Customers
Trusts	Young employees	Federal	Business purchasers
Foundations	Middle-aged employees	• EPA	Government purchasers
Mutual funds	Older employees	• FTC	Educational institutions
Universities	Women	• OSHA	Global markets
Board members	Minority groups	• CPSC	Special-interest groups
Management owners	Disabled	State	Internet purchasers
Employee pension funds	Special-interest groups	Local	
Individual owners	Unions		
Community	Competitors	Social Activist Groups	
General fund-raising	Firm A	People United to Save Humanity (PUSH)	
United Way	Firm B	Rainforest Action Network	
YMCA/YWCA	Firm C	Mothers Against Drunk Driving (MADD)	
Middle schools	Indirect competition	American Civil Liberties Union	
Elementary schools	Global competition	Consumers Union	
Residents who live close by		People for the Ethical Treatment of Animals (PETA)	
All other residents		National Rifle Association	
Neighborhood associations		National Resources Defense Council	
Local media		Citizens for Health	
Chamber of Commerce			
Environments			

It's not clear what all took place over the ensuing year, but it is evident that PETA's pressure tactics continued and escalated. In the early 2000s, McDonald's announced significant changes in the requirements it was placing on its chicken and egg suppliers. McDonald's announced that its egg suppliers must now improve the "living conditions" of its chickens. Specifically, McDonald's now insisted that its suppliers no longer cage its chickens wingtip to wingtip. Suppliers must now increase the space allotted to each hen from 48 square inches to 72 square inches. Suppliers would also be required to stop "forced molting," a process that increases egg production by denying hens food and water for up to two weeks.²⁹

It came out that during the ensuing year, PETA escalated its pressure tactics against the firm. PETA began distributing "unhappy meals" at restaurant playgrounds and outside the company's shareholder meeting. The kits, which

came in boxes similar to the Happy Meals that McDonald's sells to children, were covered with pictures of slaughtered animals. It also depicted a bloody, knife-wielding "Son of Ron" doll that resembled the Ronald McDonald clown, as well as toy farm animals with slashed throats. One image featured a bloody cow's head and the familiar fast-food phrase "Do you want fries with that?"³⁰ By the mid-2000s, PETA was still aggressively pursuing McDonald's and other firms, such as KFC, for the methods it used in the slaughter of chickens. PETA, in other words, has become the stakeholder that won't go away.

As a result of this actual example, we can see how the set of stakeholders that McDonald's had to deal with grew significantly from its traditional stakeholders to include powerful special-interest groups such as PETA. With the cooperation of the media, especially major newspapers and magazines and TV, PETA moved from being a secondary stakeholder to a primary stakeholder in McDonald's life.

Burger King Example

In the early 2000s, members of PETA and the Animal Rights Foundation of Florida (ARFF) began an attack on Burger King, similar to the attack on McDonald's. They greeted Burger King's new CEO with signs and banners reading, "Burger King: King of Cruelty," while showing a video documenting the abuses that PETA insisted that Burger King must stop. The organizations also ran a full-page ad in the *Miami Herald*, asking the new CEO to take action to reduce the suffering of chickens, pigs, and other animals on farms that supply the company's meats and eggs. This was the latest volley in PETA's "Murder King" campaign, in which hundreds of demonstrations against Burger King took place in more than a dozen countries and in every U.S. state.³¹

PETA has moved on to new issues and made itself an important stakeholder in many other firms. In 2007, PETA presented its State of the Union address in a TV ad in which a young woman took her clothes off in front of an American flag and Congress while emphasizing PETA's continued attacks on the meat, clothing, experimentation, and entertainment industries.

These actual experiences of companies illustrate the evolving nature of the question, "Who are our stakeholders?" In actuality, stakeholder identification is an unfolding process. However, by recognizing early the potential of failure if one does not think in stakeholder terms, the value and usefulness of stakeholder thinking can be readily seen. Had McDonald's, Burger King, KFC, and other firms perceived PETA as a stakeholder with power earlier on, perhaps it could have dealt with these challenges more effectively. These firms should have been aware of one of the basic principles of stakeholder responsibility: "Recognize that stakeholders are real and complex people with names, faces, and values."³²

Many businesses do not carefully identify their generic stakeholder groups, much less their specific stakeholder groups. This must be done, however, if management is to be in a position to answer the second major question, "What are our stakeholders' stakes?"

WHAT ARE OUR STAKEHOLDERS' STAKES?

Once stakeholders have been identified, the next step is to address the question: *What are our stakeholders' stakes?* Even groups in the same generic category frequently have different specific interests, concerns, perceptions of rights, and expectations. Management's challenge here is to identify the nature and legitimacy of a group's stake(s) and the group's power to affect the organization. As we discussed earlier, urgency is another critical factor.

Identifying Nature/Legitimacy of a Group's Stakes

Let's consider an example of stakeholders who possess varying stakes. Assume that we are considering corporate owners as a generic group of stakeholders and that the corporation is large, with several hundred million shares of stock outstanding. Among the ownership population are these more specific subgroups:

1. Institutional owners (trusts, foundations, churches, universities)
2. Large mutual fund organizations
3. Board of directors members who own shares
4. Members of management who own shares
5. Millions of small, individual shareholders

For all these subgroups, the nature of stakeholder claims on this corporation is ownership. All these groups have legitimate claims—they are all owners. Because of other factors, such as power or urgency, these stakeholders may have to be dealt with differently.

Identifying the Power of a Group's Stakes

When we examine power, we see significant differences. Which of the groups in the previous list are the most powerful? Certainly not the small, individual investors, unless they have found a way to organize and thus wield power. The powerful stakeholders in this case are (1) the institutional owners and mutual fund organizations, because of the sheer magnitude of their investments, and (2) the board and management shareholders, because of their dual roles of ownership and management (control).

However, if the individual shareholders could somehow form a coalition based on some interest they have in common, they could exert significant influence on management decisions. This is the day and age of dissident shareholder groups filing stockholder suits and proposing shareholder resolutions. These shareholder resolutions address issues ranging from complaints of excessive executive compensation to demands that firms improve their environmental protection policies or cease making illegal campaign contributions.

Identifying Specific Groups Within a Generic Group

Let us now look at a manufacturing firm in an industry in Ohio that is faced with a generic group of environmental stakeholders. Within the generic group of

environmental stakeholders might be the following specific groups:

1. Residents who live within a 25-mile radius of the plant
2. Other residents in the city
3. Residents who live in the path of the jet stream hundreds of miles away (some in Canada) who are being impacted by acid rain
4. Environmental Protection Agency (federal government)
5. Ohio's Environmental Protection Division (state government)
6. Friends of the Earth (environmental activist group)
7. The Wilderness Society (environmental activist group)
8. Ohioans Against Smokestack Emissions (social activist group)

It would require some degree of time and care to identify the nature, legitimacy, power, and urgency of each of these specific groups. However, it could and should be done if the firm wants to get a handle on its environmental stakeholders. Furthermore, we should stress that companies have an ethical responsibility to be sensitive to legitimate stakeholder claims even if the stakeholders have no power or leverage with management.

If we return for a moment to the McDonald's, Burger King, and KFC examples, we would have to conclude that PETA, as a special-interest, animal welfare group, did not have a great deal of legitimacy vis-à-vis these companies. PETA did claim animals' rights and treatment as a moral issue, however, and thus had some general legitimacy through the concerns it represented. Unfortunately for PETA, not all of the public shares its concerns or degree of concern with these issues. However, PETA had tremendous power and urgency. It was this power, wielded in the form of adverse publicity and media attention, that doubtless played a significant role in bringing about changes in these companies' policies.

WHAT OPPORTUNITIES AND CHALLENGES DO OUR STAKEHOLDERS PRESENT?

Opportunities and challenges represent opposite sides of the coin when it comes to stakeholders. The opportunities are to build harmonious, productive working relationships with the stakeholders. Challenges, on the other hand, usually present themselves in such a way that the firm must handle the stakeholders acceptably or be hurt in some way—financially (short term or long term) or in terms of its public image or reputation in the community. Therefore, it is understandable why our emphasis is on challenges rather than on opportunities posed by stakeholders.

These challenges typically take the form of varying degrees of expectations, demands, or threats. In most instances, they arise because stakeholders think or believe that their needs are not being met adequately. The examples of PETA presented earlier illustrate this point. The challenges also arise when stakeholder groups think that any crisis that occurs is the responsibility of the firm or that the

firm caused the crisis in some way. Examples of some stakeholder crises that illustrate this point include:³³

- *Pepsi and Coke.* It was reported in 2003–2004 that an Indian NGO (nongovernmental organization), the Centre for Science and Environment (CSE), was making life hard for these two soft drink distributors in Delhi, India. CSE tested bottles of their product and claimed they contained many times the amount of pesticides permitted by norms set by the European Union. It was even announced that the drinks would no longer be served in Indian's parliament. Both companies have continued to rebut the charges, but crises like these don't go away immediately.
- *Home Depot.* Under pressure from social activist groups such as Rainforest Action Network and staged "Days of Action" by protestors, the Atlanta-based chain agreed to stop selling products made from old-growth wood. The environmentalists threatened to follow up with newspaper ads, frequent pickets, and civil disobedience if the company did not agree. These groups have pressured Home Depot for over ten years now.
- *Boise* (an international distributor of office supplies and paper and an integrated manufacturer and distributor of paper, packaging, and building materials). In 2000, Rainforest Action Network (RAN) launched a campaign to transform the entire logging industry, starting with Boise. At that time, Boise was one of the top loggers and distributors of old-growth forest products in the United States and a top distributor of wood products from the world's most endangered forests, including the tropical rainforests of the Amazon and the boreal forests of Canada. Boise was also the largest logger of U.S. public lands and the sole logging company to oppose the U.S. Forest Service Roadless Area Conservation Policy in court.

In 2002, as a result of RAN's campaigning, Boise implemented a domestic old-growth policy, committing to "no longer harvesting timber from old-growth forests in the United States" by 2004. In 2003, to catch up with public values and meet the new marketplace standards, Boise dropped its opposition to the Roadless Policy and became the first U.S. logging and distribution company to commit to "eliminat[ing] the purchase of wood products from endangered areas."³⁴

If one looks at the business experiences of the recent past, including the crises mentioned here, it is evident that there is a need to think in stakeholder terms to fully understand the potential threats that businesses of all kinds face on a daily basis.

Opportunities and challenges might also be viewed in terms of *potential for cooperation* and *potential for threat*. It has been argued that such assessments of cooperation and threat are necessary so that managers might identify strategies for dealing with stakeholders.³⁵ In terms of potential for threat, managers need to consider the stakeholder's relative power and its relevance to a particular issue confronting the organization. In terms of potential for cooperation, the firm needs to be sensitive to the possibility of joining forces with other stakeholders for the advantage of all parties involved. Several examples of how cooperative alliances were formed include the following.

Figure 3-7 *Factors Affecting Potential for Stakeholder Threat and Cooperation*

	Increases or Decreases Stakeholder's Potential for Threat?	Increases or Decreases Stakeholder's Potential for Cooperation?
Stakeholder controls key resources (needed by organization)	Increases	Increases
Stakeholder does not control key resources	Decreases	Either
Stakeholder more powerful than organization	Increases	Either
Stakeholder as powerful as organization	Either	Either
Stakeholder less powerful than organization	Decreases	Increases
Stakeholder likely to take action (supportive of the organization)	Decreases	Increases
Stakeholder likely to take nonsupportive action	Increases	Decreases
Stakeholder unlikely to take any action	Decreases	Decreases
Stakeholder likely to form coalition with stakeholders	Increases	Either
Stakeholder likely to form coalition with organization	Decreases	Increases
Stakeholder unlikely to form any coalition	Decreases	Decreases

Source: Grant T. Savage, Timothy W. Nix, Carlton J. Whitehead, and John D. Blair, "Strategies for Assessing and Managing Organizational Stakeholders," *Academy of Management Executive* (Vol. V, No. 2, May 1991), 64. Reprinted with permission.

Ross Laboratories, a division of Abbott Laboratories, was able to develop a cooperative relationship with some critics of its sales of infant formula in third world countries. Ross and Abbott convinced these stakeholder groups (UNICEF and the World Health Organization) to join them in a program to promote infant health. Other firms, such as Nestlé, did not develop the potential to cooperate and suffered from consumer boycotts.³⁶ In 2007, Wal-Mart joined with one of its harshest critics, Service Employees International Union, in announcing they would join forces to press Congress to develop a system to provide low-cost health benefits for all Americans. In another example, ten major corporations banded together with environmental groups calling for a nationwide limit on carbon dioxide emissions and the creation of a market for trading allowances to emit the greenhouse gas.³⁷

Figure 3-7 presents a list of the factors that may increase or decrease a stakeholder's potential for threat or cooperation. By carefully analyzing these factors, managers should be able to better assess such potentials.

WHAT RESPONSIBILITIES DOES THE FIRM HAVE TO ITS STAKEHOLDERS?

Once threats and opportunities of stakeholders have been identified and understood, the next logical question is, "What responsibilities does the firm have in its relationships with all stakeholders?" Responsibilities here may be thought of in terms of the corporate social responsibility discussion presented in Chapter 2. What

Figure 3-8 Stakeholder/Responsibility Matrix

Stakeholders	Types of Responsibilities			
	Economic	Legal	Ethical	Philanthropic
Owners				
Customers				
Employees				
Community				
Public at Large				
Social Activist Groups				
Others				

economic, legal, ethical, and philanthropic responsibilities does management have to each stakeholder? Because most of the firm's economic responsibilities are principally to itself and its shareholders, the analysis eventually turns to legal, ethical, and philanthropic questions. The most pressing threats are typically presented as legal and ethical questions. Opportunities often are reflected in areas of philanthropy or "giving back" to the community.

We should stress, however, that the firm itself has an economic stake in the legal and ethical issues it faces. For example, when Johnson & Johnson (J&J) was faced with the Tylenol poisoning incident, it had to decide what legal and ethical actions to take and what actions were in the firm's best economic interests. In this classic case, J&J apparently judged that recalling the tainted Tylenol products was not only the ethical action to take but also would ensure its reputation for being concerned about consumers' health and well-being. Figure 3-8 illustrates the stakeholder/responsibility matrix that management faces when assessing the firm's responsibilities to stakeholders. The matrix may be seen as a template that managers might use to systematically think through its various responsibilities.

WHAT STRATEGIES OR ACTIONS SHOULD MANAGEMENT TAKE?

Once responsibilities have been assessed, a business must contemplate strategies and actions for addressing its stakeholders. In every decision situation, a multitude of alternative courses of action are available, and management must

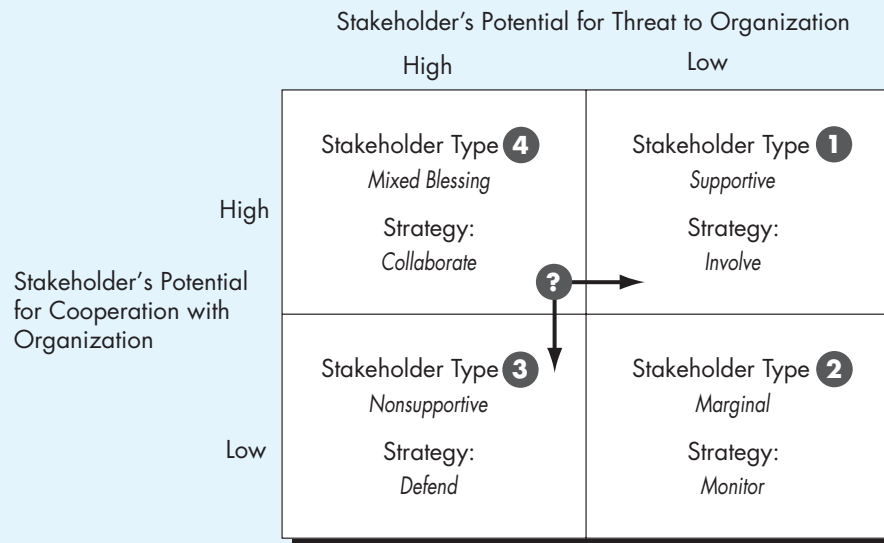
choose one or several that seem best. Important questions or decision choices that management has before it in dealing with stakeholders include:

- Do we deal *directly* or *indirectly* with stakeholders?
- Do we take the *offense* or the *defense* in dealing with stakeholders?
- Do we *accommodate*, *negotiate*, *manipulate*, or *resist* stakeholder overtures?
- Do we employ a *combination of the above* strategies or pursue a *singular course of action*?³⁸

In actual practice, managers will need to prioritize stakeholder demands before deciding what is the appropriate strategy to employ.³⁹ In addition, strategic thinking in terms of forms of communication, degree of collaboration, development of policies or programs, and allocation of resources, will need to be thought through carefully.⁴⁰

It has been argued that the development of specific strategies may be based on a classification of stakeholders' potentials for cooperation and threat. If we use these two dimensions, four stakeholder types and resultant generic strategies emerge.⁴¹ These stakeholder types and corresponding strategies are shown in Figure 3-9.

Figure 3-9 Diagnostic Typology of Organizational Stakeholders



Source: Grant T. Savage, Timothy W. Nix, Carlton J. Whitehead, and John D. Blair, "Strategies for Assessing and Managing Organizational Stakeholders," *Academy of Management Executive* (Vol. V, No. 2, May 1991), 64. Reprinted with permission.

Type 1—The Supportive Stakeholder

The supportive stakeholder is high on potential for cooperation and low on potential for threat. This is the ideal stakeholder. To a well-managed organization, supportive stakeholders might include its board of directors, managers, employees, and loyal customers. Others might be suppliers and service providers. The strategy here is one of involvement. An example of this might be the strategy of involving employee stakeholders through participative management or decentralization of authority. For decades, mutual funds were the smart, safe choice for small investors. The industry had a group of supportive stakeholders. The mutual fund scandal exposed in 2003–2004, however, demonstrated that many companies in the industry were more concerned with profits, thus allowing the small investors to take a beating. The industry damaged its supportive relationship with the small investor.

Type 2—The Marginal Stakeholder

The marginal stakeholder is low on both potential for threat and potential for cooperation. For large organizations, these stakeholders might include professional associations of employees, consumer interest groups, or stockholders—especially those that are not organized. The strategy here is for the organization to monitor the marginal stakeholder. Monitoring is especially called for to make sure circumstances do not change. Careful monitoring could avert later problems.

Type 3—The Nonsupportive Stakeholder

The nonsupportive stakeholder is high on potential for threat but low on potential for cooperation. Examples of this group could include competing organizations, unions, federal or other levels of government, and the media. Special-interest groups often fall in this category. The recommended strategy here is to defend against the nonsupportive stakeholder. An example of a special-interest group that many would regard as nonsupportive is the Earth Liberation Front (ELF), a movement that originated in the Pacific Northwest. In the early to mid-2000s, it claimed responsibility for a string of arsons in the suburbs of Los Angeles, Detroit, and Philadelphia. ELF's attacks targeted luxury homes and SUVs, the suburban status symbols that some environmentalists regard as despoilers of the Earth. Many such radical environmental groups have been called "ecoterrorists."⁴² Such organizations do not seem interested in establishing positive or supportive relationships with companies and industries. In the examples discussed earlier, PETA typically comes across as a nonsupportive stakeholder because of its high potential for threat.

Type 4—The Mixed-Blessing Stakeholder

The mixed-blessing stakeholder is high on both potential for threat and potential for cooperation. Examples of this group, in a well-managed organization, might include employees who are in short supply, clients, or customers. A mixed-blessing stakeholder could become a supportive or a nonsupportive stakeholder.

The recommended strategy here is to collaborate with the mixed blessing stakeholder. By maximizing collaboration, the likelihood is enhanced that this stakeholder will remain supportive. Today, many companies are regarding environmental groups as mixed blessings rather than nonsupportive. These firms are turning environmentalists into allies by building alliances with them for mutual gain. These businesses are learning that by listening to the environmentalists, they can lower their energy use and save money.⁴³

A summary statement regarding these four stakeholder types might be stated in the following way:⁴⁴

managers should attempt to satisfy minimally the needs of marginal stakeholders and to satisfy maximally the needs of supportive and mixed blessing stakeholders, enhancing the latter's support for the organization.

The four stakeholder types and recommended strategies illustrate what was referred to earlier in this chapter as the “strategic” or instrumental view of stakeholders. But, it could be argued that by taking stakeholders’ needs and concerns into consideration, we are improving businesses’ ethical treatment of them. We must go beyond just considering them, however. Management still has an ethical responsibility to stakeholders that extends beyond the strategic view. We will develop a fuller appreciation of what this ethical responsibility is in Chapters 7 through 10.

Tapping Expertise of Stakeholders

Especially with “supportive” stakeholders, but potentially with the other categories as well, it has been proposed that managers can turn “gadflies into allies.” It has been reasoned that nonprofit special-interest groups, especially nongovernmental activist organizations (NGOs), hold great promise for cooperation if managements would quit seeing them as “pests” and try to get them to join in the company endeavors.⁴⁵ Such NGOs have resources such as legitimacy, awareness of social forces, distinct networks, and specialized technical expertise that can be tapped by companies to gain competitive advantage. Each of these can provide benefits for companies. Some of the resulting benefits are heading off trouble, helping to set industry standards, shaping legislation, foreseeing shifts in demands, and accelerating innovation. Such partnering with stakeholders requires a change in perspective and mentality. If it is done, however, the companies will be better prepared to deal with stakeholders in the future.

An excellent example of a company tapping the expertise of its stakeholders and building on cooperative stakeholder relationships is Wal-Mart’s new “Sustainability 360” initiative announced in 2007. Wal-Mart has not only pushed its suppliers to be concerned about the environment, but it has also engaged its employees, communities, and customers in its sustainability efforts. Wal-Mart has challenged its associates and suppliers to come up with new ways to remove nonrenewable energy from products that Wal-Mart sells. Major suppliers such as Unilever, PepsiCo, and Universal Music have provided strong support.

Ethics in Practice Case

“TAXING” QUESTIONS FOR THIS PREPARER

While in college, I worked part-time for a prominent tax preparation service. I prepared customers’ taxes along with about twenty other employees at different offices. Bill had been working with the service for about three seasons, but this was my first tax season. Bill was very good at tax preparation and had a pretty good reputation. He was respected by management and seemed to do what he was asked to do.

On a few occasions, I had customers come in and want to see Bill. When I explained that Bill was not at the office that day and asked if I could assist them with any questions, they would want to wait for Bill before continuing any further. This struck me as odd because all of the files are located in the office as well as on the hard drives of the firm’s computers. Any employee can assist any customer, no matter who did the actual return.

When I later asked Bill about these customers, he told me that he did a few on his own time for people

Who couldn’t afford the company’s fees. This was bothersome to me because there was no telling how many times Bill had done this and how many customers he took away from the business.

1. Who are the stakeholders in this case and what are their stakes?
2. Was it unethical for Bill to be doing these taxes on his own time and meeting his customers at our office?
3. Was Bill actually doing the taxes on his own time or on company time when he wasn’t otherwise busy?
4. Should I have told the manager the little bit of information I knew about this situation? If so, what should I have told him?

Contributed Anonymously

The sustainability initiative has created new allies with groups such as Environmental Defense, which plans to work closely with Wal-Mart, along with several other environmental groups.⁴⁶

Effective Stakeholder Management

Effective stakeholder management requires the careful assessment of the five key questions posed here. To deal successfully with those who assert claims on the organization, managers must understand these core questions. It is tempting to wish that none of this were necessary. However, such wishing would require management to accept the production or managerial view of the firm, and these views are no longer tenable. Business today cannot turn back the clock to a simpler period. Business has been and will continue to be subjected to careful scrutiny of its actions, practices, policies, and ethics by current and future stakeholder groups.

This is the real world in which management lives, and management must accept it and deal with it. Criticisms of business and calls for better corporate citizenship have been the consequences of the changes in the business and society relationship, and the stakeholder approach to viewing the organization has become one needed response. To do less is to deny the realities of business's plight in the modern world, which is increasingly global in scope, and to fail to see the kinds of adaptations that are essential if businesses are to prosper in the present and in the future.

Stakeholder Thinking

In fairness, we should also note that there are criticisms and limitations of the stakeholder management approach. One major criticism relates to the complexity and time-consuming nature of identifying, assessing, and responding to stakeholder claims, which constitute an extremely demanding process. Also, the ranking of stakeholder claims is no easy task. Some managers continue to think in stockholder terms because this is easier. To think in stakeholder terms increases the complexity of decision making, and it is quite taxing for some managers to determine which stakeholders' claims take priority in a given situation. Despite its complexity, however, the stakeholder management view is most consistent with the environment that business faces today, and "stakeholder thinking" has become a necessary part of the successful manager's job. **Stakeholder thinking** is the process of always reasoning in stakeholder terms throughout the management process, and especially when an organization's decisions and actions have important implications for others.

Effective stakeholder management is facilitated by a number of other useful concepts. The following concepts—stakeholder culture, stakeholder management capability, the stakeholder corporation model, and principles of stakeholder management—round out a useful approach to stakeholder management effectiveness. Each of these will now be considered.

http://SEARCH THE WEB WEB

LEVELS OF STAKEHOLDER COMMITMENT

According to a recent article, there are four levels of stakeholder commitment. Each level is supported by key questions managers should ask to help apply stakeholder management.

Level 1. Basic Value Proposition. Key questions include: How do we make our stakeholders better off? What do we stand for? **Level 2. Sustained Stakeholder Cooperation.** Key question: What are the principles or values on which we base our everyday engagement with stakeholders? **Level 3. Understand-**

ing Broader Societal Issues. Key question: Do we understand how our basic value proposition and principles fit or contradict key trends and opinions in society? **Level 4. Ethical Leadership.** Key questions: What are the values and principles that inform my leadership? What is my sense of purpose? What do I stand for as a leader?⁴⁷

To read the complete article, go to the Business Roundtable Institute for Corporate Ethics website: <http://www.corporate-ethics.org/>.

Developing a Stakeholder Culture

In recent years, the importance of developing a strong, values-based corporate culture has been identified as a key to successful enterprises. Corporate culture refers to the taken-for-granted beliefs, functional guidelines, ways of doing things, priorities, and values important to managers.⁴⁸ It has recently been proposed that developing a strong **stakeholder culture** is a major idea behind successful stakeholder management. Stakeholder culture embraces the beliefs, values, and practices that organizations have developed for addressing stakeholder issues and relationships. There are at least five categories of stakeholder cultures that reside on a continuum from little concern to great concern for stakeholders.⁴⁹

The first is *agency* culture, which basically is not concerned with others. The next are two cultures characterized by limited morality—*corporate egoist* and *instrumentalist*—which focus mostly on the firm's shareholders as the important stakeholders. These cultures focus on short-term profit maximization. The final two cultures are broadly moral—*moralist* and *altruist*. Both of these cultures are morally based and provide the broadest concern for stakeholders.⁵⁰ Effective stakeholder management requires the development of a corporate culture that most broadly conceives of responsibilities to others. In the above scheme, the moralist and altruist cultures would be most compatible with stakeholder management and a stakeholder corporation.

Stakeholder Management Capability

Another way of thinking about effective stakeholder management is in terms of the extent to which the organization has developed its **stakeholder management capability (SMC)**.⁵¹ Stakeholder management capability may reside at one of three levels of increasing sophistication.

Level 1—The Rational Level

This first level simply entails the company identifying who their stakeholders are and what their stakes happen to be. This is the level that would enable management to create a stakeholder map, such as that depicted in Figure 3-3. The **rational level** is descriptive and somewhat analytical, because the legitimacy of stakes, the stakeholders' power, and urgency are identified. This actually represents a beginning or early level of SMC. Most organizations have at least identified who their stakeholders are, but not all have analyzed the nature of the stakes or the stakeholders' power. This first level has also been identified as the component of *familiarization* and *comprehensiveness*, because management operating at Level 1 is seeking to become familiar with their stakeholders and to develop a comprehensive assessment as to their identification and stakes.⁵²

Level 2—The Process Level

At the **process level**, organizations go a step further than Level 1 and actually develop and implement approaches, procedures, policies, and practices by which the firm may scan the environment and receive relevant information about stakeholders, which is then used for decision-making purposes. An applicable stakeholder principle here is “constantly monitoring and redesigning processes to better serve stakeholders.”⁵³ Typical approaches at the process level include portfolio analysis processes, strategic review processes, and environmental scanning processes, which are used to assist managers in their strategic management.⁵⁴ Other approaches, such as issues management or crisis management (Chapter 6), might also be considered examples of Level 2 SMC. This second level has been described as *planning integrativeness*, because management does focus on planning processes for stakeholders and integrating a consideration for stakeholders into organizational decision making.⁵⁵

Level 3—The Transactional Level

The **transactional level** is the highest and most developed of the three levels. This is the highest goal for stakeholder management—the extent to which managers actually engage in transactions (relationships) with stakeholders.⁵⁶ At this highest level of SMC, management must take the initiative in meeting stakeholders face-to-face and attempting to be responsive to their needs. The transactional level may require actual negotiations with stakeholders.⁵⁷ This also is the *communication level*, which is characterized by *communication proactiveness, interactiveness, genuineness, frequency, satisfaction, and resource adequacy*. Resource adequacy refers to management actually spending resources on stakeholder transactions.⁵⁸ Regarding stakeholder communications, a relevant principle is that business must “engage in intensive communication and dialogue with (all) stakeholders, not just those who are friendly.”⁵⁹

Steven Walker and Jeff Marr, in their important book *Stakeholder Power: A Winning Plan for Building Stakeholder Commitment and Driving Corporate Growth*, argue that companies should compete on the basis of intangible assets—a company’s priceless relationships with customers, employees, suppliers, and shareholders. Based on their own firm’s 60-year history as a pioneer in corporate reputation and market research and from case studies of organizations as diverse as LensCrafters, DHL, and Edison International, the authors offer a practical model for hardwiring stakeholder management into company strategy and reaping the rewards through continuous innovation, learning, and profitable growth.⁶⁰ These ideas capture the essential nature of Level 3—the transactional level—of stakeholder management capability.

An example of Level 3 SMC is provided in the agreement reached between the Mitsubishi Group and an environmentalist organization, the Rainforest Action Network (RAN), based in San Francisco. Mitsubishi agreed to curb its pollution and protect the rain forest in an agreement that was the result of five years of negotiations and meetings with RAN. The agreement would never have been

possible if the two groups had not been willing to establish a relationship in which each side made certain concessions.⁶¹

Another example of Level 3 has been the relationship established between General Motors Corp. (GMC) and the Coalition for Environmentally Responsible Economies (Ceres). More than a decade ago, these two organizations actually began to talk with one another, and the result was a mutually beneficial collaboration. The arrangement became a high-profile example of a growing trend within the environmental movement—that of using quiet discussions and negotiations rather than noisy protests to change corporate behavior. Though many positive outcomes have come from this improved stakeholder relationship, issues continue to arise that pose the potential for the two to be at odds with one another. Beginning in 2002, for example, Ceres and other environmental groups have been demanding tougher governmental fuel-economy standards, while automakers such as GM have intensified their lobbying to keep existing rules in place, probably because of the popularity of high-fuel-consumption SUVs.⁶²

Stakeholder Engagement

Recently, there has been growing interest in the topic of stakeholder engagement. **Stakeholder engagement** may be seen as one approach by which companies implement the transactional level of strategic management capability. Companies may employ different strategies in terms of the degree of engagement with their stakeholders. A ladder of stakeholder engagement that depicts a number of steps from low engagement to high engagement has been set forth as a continuum of engagement postures that companies might follow.⁶³ Lower levels of stakeholder engagement might be used for informing and explaining. Middle levels might involve token gestures of participation such as placation, consultation, and negotiation. Higher levels of stakeholder engagement might be active or responsive attempts to involve stakeholders in company decision making. At the highest level, terms such as *involvement*, *collaboration*, or *partnership* might be appropriate descriptions of the relationship established. An example of this highest level might be when a firm enters into a strategic alliance with a stakeholder group to seek the group's opinion in a product design that would be sensitive to the group's concerns, such as environmental impact or product safety. This was illustrated when McDonald's entered into an alliance with the Environmental Defense Fund to eliminate polystyrene packaging that was not biodegradable.⁶⁴

This idea of stakeholder engagement is relevant to developing what Tapscott and Ticoll refer to as *The Naked Corporation*. In their recent book, they argue that there are ten characteristics of the open enterprise and that "environmental engagement" and "stakeholder engagement" are two critical factors. Environmental engagement calls for an open operating environment: sustainable ecosystems, peace, order, and good public governance. Stakeholder engagement calls for these open enterprises to put resources and effort into reviewing, managing, recasting, and strengthening relationships with stakeholders, old and new.⁶⁵ The "open

enterprise” with an emphasis on “transparency” has become crucial because of the corporate scandals of the early 2000s.

Companies do not have the time or the resources to enter into high levels of stakeholder engagement with all stakeholder groups. Therefore, managers need to selectively evaluate the stakeholder’s attributes such as legitimacy, power, and urgency or potential for threat or cooperation before deciding upon the ideal degree of engagement.

The Stakeholder Corporation

Perhaps the ultimate form of the stakeholder approach or stakeholder management is the “**stakeholder corporation.**” The primary element of this concept is **stakeholder inclusiveness.**⁶⁶

In the future, development of loyal relationships with customers, employees, shareholders, and other stakeholders will become one of the most important determinants of commercial viability and business success. Increasing shareholder value will be best served if your company cultivates the support of all who may influence its importance.

Advocates of the stakeholder corporation would embrace the idea of “**stakeholder symbiosis.**” Stakeholder symbiosis is an idea that recognizes that all stakeholders depend on each other for their success and financial well-being.⁶⁷ Executives who have a problem with this concept would probably also have trouble becoming a part of stakeholder corporations.

Principles of Stakeholder Management

Based upon years of observation and research, a set of “**principles of stakeholder management**” has been developed for use by managers and organizations. These principles, known as “the Clarkson principles,” were named after the late Max Clarkson, a dedicated researcher on the topic of stakeholder management. The principles are intended to provide managers with guiding precepts regarding how stakeholders should be treated. Managers interested in effective stakeholder management, the transactional level of stakeholder management capability, and the stakeholder corporation, would quickly seek to use these guidelines. Figure 3-10 summarizes these principles. The key words in the principles suggest action words that should reflect the kind of cooperative spirit that should be used in building stakeholder relationships: *acknowledge, monitor, listen, communicate, adopt, recognize, work, avoid, acknowledge conflicts.*

Figure**3-10*****Principles of Stakeholder Management—
“The Clarkson Principles”***

- Principle 1** Managers should **acknowledge** and actively **monitor** the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision making and operations.
- Principle 2** Managers should **listen** to and openly **communicate** with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.
- Principle 3** Managers should **adopt** processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.
- Principle 4** Managers should **recognize the interdependence** of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.
- Principle 5** Managers should **work cooperatively** with other entities, both public and private, to ensure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.
- Principle 6** Managers should **avoid altogether** activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks that, if clearly understood, would be patently unacceptable to relevant stakeholders.
- Principle 7** Managers should **acknowledge the potential conflicts** between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of stakeholders, and should address such conflicts through open communication, appropriate reporting, incentive systems and, where necessary, third-party review.

Source: *Principles of Stakeholder Management* (Toronto: The Clarkson Centre for Business Ethics, Joseph L. Rotman School of Management, University of Toronto, 1999), 4.

Strategic Steps Toward Successful Stakeholder Management

The global competition that characterizes business firms in the twenty-first century necessitates a stakeholder approach, both for managing effectively and managing ethically. The stakeholder approach requires that stakeholders be moved to the center of management’s vision. Three strategic steps may be taken that can lead today’s global competitors toward a more balanced view, which is needed in today’s changing business environment.⁶⁸

1. **Governing Philosophy.** *Integrating stakeholder management into the firm’s governing philosophy.* Boards of directors and top management groups should

move the organization from the idea of “shareholder agent” to “stakeholder trustee.” Long-term shareholder value will be the objective of this transition in corporate governance. For stakeholder management to be successful, it must be seen as the overall, governing principle of the enterprise.

2. **Values Statement.** *Create a stakeholder-inclusive “values statement.”* Various firms have done this. Johnson & Johnson’s was called a “credo.” Microsoft calls its a “values statement.” Microsoft emphasizes integrity and honesty, and accountability to customers, shareholders, partners, and employees. Regardless of what such a values statement is called, such a pledge reinforces the organization’s commitment to stakeholders by way of a public statement.

3. **Measurement System.** *Implement a stakeholder performance measurement system.* Such a system should be auditable, integrated, and monitored as stakeholder relations are improved. Measurement is evidence of serious intent to achieve results, and such a system will motivate a sustainable commitment to the stakeholder view.

The key to effective stakeholder management is in its *implementation*. Corporate social responsibility is made operable when companies translate their stakeholder dialogue into practice.⁶⁹ After studying three companies in detail—Cummins Engine Company, Motorola, and the Royal Dutch/Shell Group—researchers concluded that the key to effective implementation is in recognizing and using stakeholder management as a *core competence*. When this is done, at least four indicators or manifestations of successful stakeholder management will be apparent. First, stakeholder management results in *survival*. Second, there are *avoided costs*. Third, there was *continued acceptance and use* in the companies studied. This implies success. Fourth, there was evidence of *expanded recognition and adoption* of stakeholder-oriented policies by other companies and consultants.⁷⁰ These indicators suggest the value and practical benefits that may be derived from the stakeholder approach. Finally, it should be mentioned that organizations develop learning processes over time in implementing their changing or evolving stakeholder orientations.⁷¹

Summary

A stakeholder is an individual or a group that claims to have one or more stakes in an organization. Stakeholders may affect the organization and, in turn, be affected by the organization’s actions, policies, practices, and decisions. The stakeholder approach extends beyond the traditional production and managerial views of the firm and warrants a much broader conception of the parties involved in the organization’s functioning and success. Both primary and

secondary social and nonsocial stakeholders assume important roles in the eyes of management. A typology of stakeholders suggests that three attributes are especially important: legitimacy, power, and urgency.

Strategic, multifiduciary, and stakeholder synthesis approaches help us appreciate the perspectives that may be adopted with regard to stakeholders. The stakeholder synthesis approach is recommended because it highlights the ethical

responsibility business has to its stakeholders. The stakeholder view of the firm has three values: descriptive, instrumental, and normative. In a balanced perspective, managers are concerned with both goal achievement and ethical treatment of stakeholders.

Five key questions aid managers in stakeholder management: (1) Who are our stakeholders? (2) What are our stakeholders' stakes? (3) What challenges or opportunities are presented to our firm by our stakeholders? (4) What responsibilities does our firm have to its stakeholders? (5) What strategies or actions should our firm take with respect to our stakeholders? Effective stakeholder management requires the assessment and appropriate response to these five questions. In addition, the use of other relevant stakeholder thinking concepts is helpful. The concept of stakeholder

management capability (SMC) illustrates how firms can grow and mature in their approach to stakeholder management. The stakeholder corporation is a model that represents stakeholder thinking in its most advanced form. Other key ideas include stakeholder culture and stakeholder engagement.

Seven principles of stakeholder management are helpful in guiding managers toward more effective stakeholder thinking. Although the stakeholder management approach is quite complex and time-consuming, it is a way of managing that is in tune with the complex environment that business organizations face today. Successful steps in stakeholder management include making stakeholders a part of the guiding philosophy, creating value statements, and developing measurement systems that monitor results.

Key Terms

core stakeholders (page 88)

environmental stakeholders (page 88)

legitimacy (page 88)

managerial view of the firm (page 85)

power (page 89)

primary social stakeholders (page 87)

principles of stakeholder management (page 111)

process level (page 109)

production view of the firm (page 85)

proximity (page 90)

rational level (page 108)

secondary social stakeholders (page 87)

stake (page 83)

stakeholder (page 84)

stakeholder corporation (page 111)

stakeholder culture (page 108)

stakeholder engagement (page 110)

stakeholder inclusiveness (page 111)

stakeholder management capability (SMC)
(page 108)

stakeholder symbiosis (page 111)

stakeholder thinking (page 107)

stakeholder view of the firm (page 85)

strategic stakeholders (page 88)

transactional level (page 109)

urgency (page 90)

Discussion Questions

1. Explain the concepts of stake and stakeholder from your perspective as an individual. What kinds of stakes and stakeholders do you have? Discuss.
2. Explain in your own words the differences among the production, managerial, and stakeholder views of the firm.

3. Differentiate between primary and secondary social and nonsocial stakeholders in a business situation. Give examples of each.
4. Define the terms *core stakeholders*, *strategic stakeholders*, and *environmental stakeholders*. What factors affect into which of these groups stakeholders are categorized?
5. Choose any group of stakeholders listed in the stakeholder/responsibility matrix in Figure 3-7 and identify the four types of responsibilities the firm has to that stakeholder group.
6. How can a firm transition from Level 1 to Level 3 of stakeholder management capability (SMC)?
7. Is the stakeholder corporation a realistic model for business firms? Will stakeholder corporations become more prevalent in the twenty-first century? Why or why not?

Endnotes

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Part 2

Corporate Governance and Strategic Management Issues

- CHAPTER 4** | *Corporate Governance:
Foundational Issues*
- CHAPTER 5** | *Strategic Management and
Corporate Public Affairs*
- CHAPTER 6** | *Issues and Crisis Management*



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Corporate Governance: Foundational Issues

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Link the issue of legitimacy to corporate governance.
- 2 Identify the best practices that boards of directors can follow.
- 3 Discuss the problems that have led to the recent spate of corporate scandals and the efforts that are currently under way to keep them from happening again.
- 4 Discuss the principal ways in which shareholder activism exerted pressure on corporate management groups to improve governance.
- 5 Discuss the ways in which managers relate to shareholders and the issues arising from that relationship.
- 6 Discuss the issue of shareholder democracy, its current state, and the trend for the future.

In this second part of the book, we more closely examine how management has responded and should respond to the social, ethical, and stakeholder issues developed in this book. We begin in this chapter by exploring the ways in which the board and top managers govern the corporation. We then expand our view to look at how these social ethical and stakeholder issues fit not only into the strategic management and corporate public affairs functions of the firm, but also into the management of issues and crises.

In this chapter, we will explore corporate governance and the ways in which it has evolved. First, we will examine the concept of legitimacy and the part that corporate governance plays in establishing the legitimacy of business. We will explore how good corporate governance can mitigate the problems created by the

separation of ownership and control and examine some of the specific challenges facing those involved in corporate governance today.

Legitimacy and Corporate Governance

The twenty-first century began with the issue of corporate governance taking center stage. The bankruptcy of Enron, once the seventh-largest company in the United States, sent shock waves through the corporate world. When the bankruptcies of corporate giants WorldCom, Global Crossing, and Parmalat followed, investors throughout the world were left wondering where they could place their trust. These scandals threatened more than one country and more than the individual companies involved—the legitimacy of business as a whole had been called into question. Thus, to understand corporate governance, it is important to understand the idea of **legitimacy**. Legitimacy is a somewhat abstract concept, but it is vital in that it helps explain the importance of the relative roles of a corporation's charter, shareholders, board of directors, management, and employees—all of which are components of the modern corporate governance system.

Let us start with a slightly modified version of Talcott Parsons's definition of legitimacy. He argued that "organizations are legitimate to the extent that their activities are congruent with the goals and values of the social system within which they function."¹ From this definition, we may see legitimacy as a condition that prevails when there is congruence between the organization's activities and society's expectations. Thus, whereas legitimacy is a condition, **legitimation** is a dynamic process by which business seeks to perpetuate its acceptance. The dynamic process aspect should be emphasized, because society's norms and values change, and business must change if its legitimacy is to continue. It is also useful to consider legitimacy at both the micro, or company, level and the macro, or business institution, level.

At the *micro level of legitimacy*, we refer to individual business firms achieving and maintaining legitimacy by conforming to societal expectations. Companies seek legitimacy in several ways. First, a company may adapt its methods of operating to conform to what it perceives to be the prevailing standard. For example, a company may discontinue door-to-door selling if that marketing approach comes to be viewed in the public mind as a shoddy sales technique,² or a pharmaceutical company may discontinue offering free drug samples to medical students if this practice begins to take on the aura of a bribe. Second, a company may try to change the public's values and norms to conform to its own practices by advertising and other techniques.³ Amazon.com was successful at this when it began marketing through the Internet.

Finally, an organization may seek to enhance its legitimacy by identifying itself with other organizations, people, values, or symbols that have a powerful legitimate base in society.⁴ This occurs at several levels. At the national level,

companies proudly announce appointments of celebrities, former politicians, or other famous people to managerial positions or board directorships. At the community level, the winning local football coach may be asked to endorse a company by sitting on its board or promoting its products.⁵

The *macro level of legitimacy* is the level with which we are most concerned in this chapter. The macro level refers to the corporate system—the totality of business enterprises. It is difficult to talk about the legitimacy of business in pragmatic terms at this level. American business is such a potpourri of institutions of different shapes, sizes, and industries that saying anything conclusive about it is difficult. Yet this is an important level at which business needs to be concerned about its legitimacy. What is at stake is the acceptance of the form of business as an institution in our society. William Dill has suggested that business's social (or societal) legitimacy is a fragile thing:

*Business has evolved by initiative and experiment. It never had an overwhelmingly clear endorsement as a social institution. The idea of allowing individuals to joust with one another in pursuit of personal profit was an exciting and romantic one when it was first proposed as a way of correcting other problems in society; but over time, its ugly side and potential for abuse became apparent.*⁶

Business must now accept that it has a fragile mandate. It must realize that its legitimacy is constantly subject to ratification, and it must realize that it has no inherent right to exist. Business exists solely because society has given it that right.⁷

In comparing the micro view of legitimacy with the macro view, it is clear that, although specific business organizations try to perpetuate their own legitimacy, the corporate or business system as a whole rarely addresses the issue at all. This is unfortunate because the spectrum of powerful issues regarding business conduct clearly indicates that such institutional introspection is necessary if business is to survive and prosper. If business is to continue to justify its right to exist, we must remember the question of legitimacy and its operational ramifications.

THE PURPOSE OF CORPORATE GOVERNANCE

The purpose of corporate governance is a direct outgrowth of the question of legitimacy. The word *governance* comes from the Greek word for steering.⁸ The way in which a corporation is governed determines the direction in which it is steered. Owners of small private firms can steer the firm on their own; however, the shareholders of public firms must count on boards of directors to make certain that their companies are steered properly in their absence. For business to be legitimate and to maintain its legitimacy in the eyes of the public, it must be steered in a way that corresponds to the will of the people.

Corporate governance refers to the method by which a firm is being governed, directed, administered, or controlled and to the goals for which it is being governed. Corporate governance is concerned with the relative roles, rights, and accountability of such stakeholder groups as owners, boards of directors, managers, employees, and others who assert they are stakeholders.

COMPONENTS OF CORPORATE GOVERNANCE

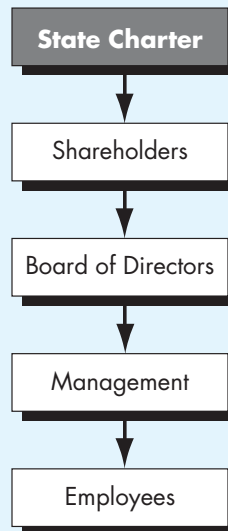
To appreciate fully the legitimacy and corporate governance issues, it is important that we understand the major groups that make up the corporate form of business organization, because it is only by so doing that we can appreciate how the system has failed to work according to its intended design. In this chapter, we will focus on the Anglo-American model toward which much of the world is converging.⁹ This convergence is driven largely by institutional investors who, as they invest more globally, are seeking governance mechanisms with which they are familiar and comfortable.¹⁰

Roles of Four Major Groups

The four major groups we need to mention in setting the stage are the shareholders (owner-stakeholders), the board of directors, the managers, and the employees. Overarching these groups is the **charter** issued by the state, giving the corporation the right to exist and stipulating the basic terms of its existence. Figure 4-1 presents these four groups, along with the state charter, in a hierarchy of corporate governance authority.

Under American corporate law, **shareholders** are the owners of a corporation. As owners, they should have ultimate control over the corporation. This control is manifested primarily in the right to select the board of directors of the company. Generally, the degree of each shareholder's right is determined by the number of shares of stock owned. The individual who owns 100 shares of Apple Computer,

Figure 4-1 *The Corporation's Hierarchy of Authority*



for example, has 100 “votes” when electing the board of directors. By contrast, the large public pension fund that owns 10 million shares has 10 million “votes.”

Because large organizations may have hundreds of thousands of shareholders, they elect a smaller group, known as the **board of directors**, to govern and oversee the management of the business. The board is responsible for ascertaining that the manager puts the interests of the owners (i.e., shareholders) first. The third major group in the authority hierarchy is **management**—the group of individuals hired by the board to run the company and manage it on a daily basis. Along with the board, top management establishes overall policy. Middle- and lower-level managers carry out this policy and conduct the daily supervision of the operative employees. **Employees** are those hired by the company to perform the actual operational work. Managers are employees, too, but in this discussion we use the term *employees* to refer to nonmanagerial employees.

Separation of Ownership from Control

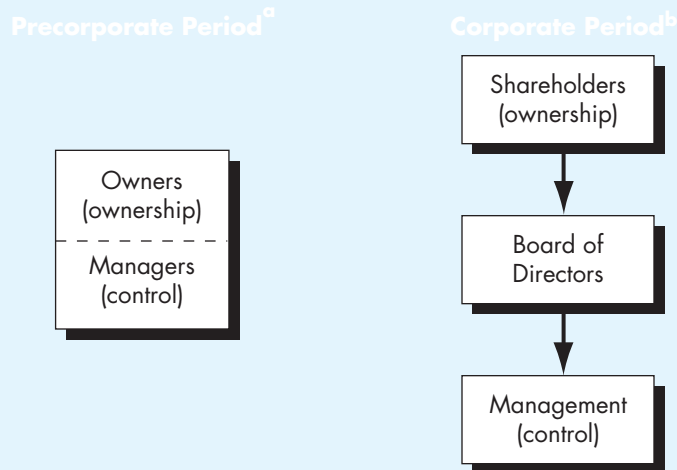
The social and ethical issues that have evolved in recent years focus on the *intended* versus *actual* roles, rights, responsibilities, and accountability of these four major groups. The major condition embedded in the structure of modern corporations that has contributed to the corporate governance problem has been the **separation of ownership from control**. In the precorporate period, owners were typically the managers themselves. Thus, the system worked the way it was intended; the owners also controlled the business. Even when firms grew larger and managers were hired, the owners often were on the scene to hold the management group accountable. For example, if a company got in trouble, the Carnegies or Mellons or Morgans were always there to fire the president.¹¹

As the public corporation grew and stock ownership became widely dispersed, a separation of ownership from control became the prevalent condition. Figure 4-2 illustrates the precorporate and corporate periods. The dispersion of ownership into hundreds of thousands or millions of shares meant that essentially no one person or group owned enough shares to exercise control. This being the case, the most effective control that owners could exercise was the election of the board of directors to serve as their representative and watch over management.

The problem with this evolution was that authority, power, and control rested with the group that had the most concentrated interest at stake—management. The corporation did not function according to its designed plan with effective authority, power, and control flowing downward from the owners. The shareholders were owners in a technical sense, but most of them perceived themselves as investors rather than owners. If you owned 100 shares of Walt Disney Co. and there were 10 million shares outstanding, you likely would see yourself as an investor rather than an owner. With just a telephone call issuing a sell order to your stockbroker, your “ownership” stake could be gone. Furthermore, with stock ownership so dispersed, no conscious, intended supervision of corporate boards was possible.

The other factors that added to management’s power were the corporate laws and traditions that gave the management group control over the **proxy process**—the method by which the shareholders elected boards of directors. Over time, it

Figure 4-2 Precorporate versus Corporate Ownership and Control



Sources: ^aIn the precorporate period, the owners were also the managers, and therefore ownership and control were combined. Later, large companies hired managers, but the owners were always there to exercise control. ^bIn the corporate period, ownership was separated from control by the intervention of a board of directors. Theoretically, the board should have kept control on behalf of owners, but it did not always turn out that way.

was not difficult for management groups to create boards of directors of like-minded executives who would simply collect their fees and defer to management on whatever it wanted. The result of this process was the opposite of what was originally intended: power, authority, and control began to flow upward from management rather than downward from the shareholders (owners). **Agency problems** developed when the interests of the shareholders were not aligned with the interests of the manager, and the manager (who is simply a hired *agent* with the responsibility of representing the owners' best interest) began to pursue self-interest instead of the owners' best interests.

Problems in Corporate Governance

It is clear from the preceding discussion that a potential governance problem is built into the corporate system because of the separation of ownership from control. It is equally clear that the board of directors is intended to oversee management on behalf

of the shareholders. However, this is where the system can break down. For corporate governance to function as it was originally intended, the board of directors must be an effective, potent body carrying out its roles and responsibilities in ascertaining that management pursue the shareholders' best interests.

With mechanisms for corporate governance in place, how could debacles like Enron and WorldCom still occur? Some of the blame must be placed on the auditors: Arthur Andersen was the auditor for Enron, WorldCom, and Global Crossing. Andersen had a built-in conflict of interest as a result of doing both consulting and auditing for the same company. For example, in 2000, Andersen earned \$25 million from auditing Enron and \$27 million from providing Enron with consulting services.¹² Lavish CEO paychecks and the boards who approved them also drew the ire of investors. Enron's Ken Lay made about \$220 million, and Global Crossing's Gary Winnick made more than \$500 million prior to the bankruptcies, which left many investors with nothing.¹³ Surprisingly, most of the behavior that led to these bankruptcies fell within the letter of the law. And so the response to them was geared toward changing the law, making it more difficult for firms to mislead investors. The Sarbanes-Oxley Act, designed to tighten up the auditing process, is discussed later in this chapter.

Are boards now doing what they are supposed to be doing? In fairness, boards have improved in many ways. Many positive changes resulted from the pressures institutional investors imposed in the past ten years: more directors are independent, more directors own stock in the company, and boards are more likely to demand change.¹⁴ The Enron debacle and subsequent legislation have increased expectations. In a post-Enron survey of corporate directors, 75 percent of respondents said they were spending more time on board matters each month, and 67 percent said that meetings of the full board were lasting longer.¹⁵ These improvements in boards show every indication of continuing. In an end-of-year survey for 2006, 86 percent of the responding boards indicated that they evaluate board performance regularly, and 59 percent of them instituted actions based on those evaluations.¹⁶

The Need for Board Independence

Board independence from management is a crucial aspect of good governance. It is here that the difference between **inside directors** and **outside directors** becomes most pronounced. Outside directors are independent from the firm and its top managers. They can come from a variety of backgrounds (e.g., top managers of other firms, academics, former government officials), but the one thing they have in common is that they have no other substantive relationship to the firm or its CEO. In contrast, inside directors have ties of some sort to the firm. Sometimes they are top managers in the firm; other times, insiders are family members or others with a professional or personal relationship to the firm or the CEO. To varying degrees, each of these parties is " beholden " to the CEO and, therefore, might be hesitant to speak out when necessary. Courtney Brown, an experienced director who served on many boards, said that he never saw a subordinate officer serving on a board dissent from the position taken by the CEO.¹⁷ Insiders might

also be professionals such as lawyers under contract to the firm or bankers whose bank does business with the firm: This can create conflict-of-interest situations.¹⁸ For example, a commercial banker/director may expect the company on whose board she or he is serving to restrict itself to using the services of her or his own firm and be willing to support the CEO in return for the business provided.

Another problem is managerial control of the board processes. CEOs often can control board perks such as director compensation and committee assignments. Board members who rock the boat might find they are left out in the cold. As one corporate board member told *Fortune*, shortly before the Enron debacle, "This stuff is wrong.... What people understand they have to do is go along with management, because if they don't they won't be part of the club.... What it comes down to is that directors aren't really independent. CEOs don't want independent directors."¹⁹ Since Enron imploded, changes in public policy and public opinion have led to an increase in the percentage of independent directors. However, the problem of board independence is one that will always merit attention.

ISSUES SURROUNDING COMPENSATION

The issue of executive pay is a lightning rod for those who feel that CEOs are placing their own interests over those of their shareholders. For example, people become outraged when they hear that the CEOs of America's 500 largest companies received a collective 38 percent pay raise in 2006 (representing about to \$7.5 billion or an average \$15.2 million each).²⁰ The outrage only grows with the realization that not all of these firms performed well that year. Two issues are at the heart of the CEO pay controversy: (1) the extent to which CEO pay is tied to firm performance, and (2) the overall size of CEO pay.

The CEO Pay/Firm Performance Relationship

The move to tie CEO pay more closely to firm performance grew in momentum when shareholders observed CEO pay rising as firm performance fell. Many executives had received staggering salaries, even while profits were falling, workers were being laid off, and shareholder return was dropping. Shareholders were assisted in their effort to monitor CEO pay by stricter disclosure requirements from the Securities and Exchange Commission (SEC). The revised compensation disclosure rule, adopted by the SEC in 1992, was designed to provide shareholders with more information about the relationship between firm performance and CEO compensation.²¹ According to the results of one study, it seems to have worked. Since the rule's implementation, compensation committees have met more frequently, lessened the number of insiders as members, and become more moderate in size. More importantly, largely through the use of stock options, CEO pay became more closely aligned with accounting and market performance measures than it was before the rule's implementation.²² Although boards of directors were still approving excessive salaries, they were tying the ups and downs of those salaries more closely to firm performance.²³

Efforts to strengthen the CEO pay/firm performance relationship have centered on the use of **stock options**. While they have improved the pay/performance relationship, they have also created a host of new problems. Stock options are designed to motivate the recipient to improve the value of the firm's stock. Put simply, an option allows the recipient to purchase stock in the future at the price it is today, i.e., "at the money." If the stock value rises after the granting of the option, the recipient will make money. The logic behind giving CEOs stock options is that those CEOs will want to increase the value of the firm's stock so that they will be able to exercise their options, buying stock in the future at a price that is lower than its worth. Of course, this logic only works if the option is granted at the true "at the money" price. The possibility of quick gains through misrepresentation of the pricing has led to numerous abuses. The following are the ones most frequently in the news.

Stock option **backdating** occurs when the recipient is given the option of buying stock at yesterday's price, resulting in an immediate and guaranteed wealth increase. This puts the stock option "in the money" rather than "at the money," which is where an option should be granted. Of course, backdating results in an immediate gain and is not in keeping with the purpose of stock options. This is not the only stock option abuse that has been observed. Even stock options granted "at the money" can be problematic when coupled with inside knowledge that the stock price is soon going to change. **Spring-loading** is the granting of a stock option at today's price but with the inside knowledge that something good is about to happen that will improve the stock's value. **Bullet-dodging** is the delaying of a stock option grant until right after bad news. Backdating is not inherently illegal but can be deemed so if documents were falsified to conceal the backdating. Spring-loading and bullet-dodging have been subjects of intense debate: the role of insider information in these two practices is a cause for concern. Adam Lashinsky of *Fortune* questions whether the benefits of stock options are worth these problems they create. He says, "So here's a radical proposal: scrap the whole system. Pay employees a competitive and living wage. Pay them more when the company does well but only after shareholders have been rewarded. Do that in the form of transparent bonuses and profit-sharing plans. Outsized riches should be reserved for the company founders, not the hired help, which, let's face it, is what most executives are."²⁴

Excessive CEO Pay

In addition to the relationship of CEO pay to firm performance, the overall size of CEO paychecks has struck a nerve with the public. This issue has taken on increasing meaning as CEO salaries have skyrocketed while worker salaries have waned. Executive Excess 2006, the annual CEO compensation survey by the Institute for Policy Studies and United for a Fair Economy, reported that the ratio of CEO pay to the average worker was 411:1. That is nearly ten times as large as the 42:1 ratio found in 1982 (and does not even include the value of stock options awarded).²⁵ Admittedly, this represents a decline from 2000, when the gap between CEO pay and average worker pay had risen to a staggering 531:1. Had

the minimum wage risen at the same rate as CEO pay from 1990 to 2005, the federal minimum wage would have been \$22.61 in 2005 instead of \$5.15.²⁶

When the executive's high level of pay results from dubious practices, such as financial misconduct or the exercising of options in a questionable way, shareholders have a right to try to recover those funds, but in the past they have lacked a mechanism for doing so easily. This is changing due to the increasing adoption of **clawback provisions**, compensation recovery mechanisms that enable a company to recoup compensation funds, typically in the event of a financial restatement or executive's misbehavior.²⁷ The use of clawback provisions is growing. Equilar, an executive compensation research firm, examined clawback provisions for 91 of the Fortune 100 in 2006: 18 percent of the firms disclosed some provision for compensation recovery.²⁸ They then analyzed the first fifty firm proxies filed in 2007 and found that 44 percent held clawback provisions.²⁹

Executive Retirement Plans

Executive retirement packages have traditionally flown under the radar, escaping the notice of shareholders, employees, and the public. However, as details of some retirement packages have become public, those packages have come under increased scrutiny. Former General Electric chairman and CEO Jack Welch's retirement package was disclosed during his divorce proceedings. Country club memberships, wine and laundry services, luxurious housing, and access to corporate jets were but a few of the perks that Welch has enjoyed.³⁰ The disclosure that the New York Stock Exchange had awarded its former chairman and CEO Richard Grasso a \$139.5 million retirement package, amid slumping stocks and cost pressures, also raised the ire of shareholders and their advocates.³¹ Although technically not a retirement package, the \$210 million exit package Robert Nardelli received following his ouster from Home Depot inflamed shareholder activists and outraged the public.³²

http://SEARCH THE WEB WEB

CEO PAYWATCH

The AFL-CIO sponsors CEO PayWatch (<http://www.aflcio.org/paywatch>), a website that is an "online center for learning about the excessive salaries, bonuses, and perks of the CEOs of major corporations." Visitors to the website can enter their pay and a firm's name and find out how many years they would have to work to make what the CEO of that firm makes in one year (or how many workers at your salary that CEO's

pay could support): they can also play "Greed: The Executive PayWatch Board Game" or "Smash Corporate Greed," a Whack-a-Mole type of game wherein greedy CEOs are the ones getting whacked. On a more serious note, the website provides instructions for assessing the pay of CEOs at public corporations and beginning a campaign of shareholder activism in any company.

Part of the public's frustration is that these CEO retirement packages stand in stark contrast to the retirement packages that workers will receive. Less than half of today's workers have retirement packages, and those who do usually have the less lucrative defined contribution (that specify what will be put into the retirement fund) rather than the defined benefit plans (that specify the benefit the retiree will receive).³³ For example, many companies have special retirement programs for select groups of key executives called "Top Hat" plans.³⁴ The disparity between executive retirement packages and the retirement package for the average worker has been a cause for concern because fewer than half of workers receive benefits in any way comparable to those that executives enjoy. As an example, the Fortune 1000 offer supplemental executive retirement plans (which are typically defined benefit) to 69 percent of their executives, while private sector employers offer defined benefit plans to 21 percent of their employees.³⁵ For top executives, Fortune 1000 companies offer nonqualified deferred compensation plans to 91 percent of their executives. In contrast, private sector employers offer defined contribution plans to 42 percent of their workers.³⁶

Outside Director Compensation

It was suggested earlier that there may be some link between CEO and executive compensation and board members. Therefore, it should not be surprising that directors' pay is becoming an issue, too. Paying board members is a relatively recent idea. Ninety years ago, it was illegal to pay nonexecutive board members. The logic was that because board members represented the shareholders, paying them out of the company's (i.e., shareholders') funds would be self-dealing.³⁷ A 1992 Korn/Ferry survey showed that board members typically spent 95 hours a year on the board. By 2000, that figure had increased to 173 hours. The average director received a 23 percent increase in pay for the 82 percent increase in time spent on the job.³⁸ Not surprisingly, a 2003 survey by *Corporate Board Member* magazine found that 80 percent of board members felt directors should be paid more in light of the "added responsibility of recent board governance reforms."³⁹ The situation seemed to have improved by 2007 when the same survey found that 73 percent of board members believed their compensation for board service was adequate.⁴⁰ However, in a clear nod to the additional requirements imposed by Sarbanes-Oxley legislation, 66 percent of the respondents noted that the chair of the audit committee should receive additional compensation.⁴¹

Transparency

The 2007 SEC rules on disclosure of executive compensation are designed to address some of the more obvious problems by making the entire pay packages of top executives transparent—including those items that were hidden previously, such as deferred pay, severance, accumulated pension benefits, and perks greater than \$10,000.⁴² Shareholder advocates argue that amendments to the proposed rule water down the impact of the change.⁴³ Nevertheless, there is general agreement that the new SEC requirements should provide greater transparency and so corporate boards have not fought the change. In a 2006 survey of board

members, 88 percent of board members responded that they welcomed the new transparency requirements.⁴⁴ There is even evidence that the rules had an impact prior to implementation. Michael S. Melbinger, a compensation lawyer, tells the story of a CEO who had a contract provision that not only reimbursed all his medical expenses (including deductibles and co-pays) but also provided a **tax gross-up**, which reimbursed him for the taxes he would have to pay on his medical benefits. In contrast, employees in this company were required to cover their own medical expenses. So when the CEO realized how bad it would look that the company not only paid all his medical bills but also the taxes on that benefit, he quickly gave up that perk.⁴⁵ Tax gross-ups, such as the \$11 million that AT&T CEO David Dorman received to pay the taxes on his \$29 million severance, are creating shareholder resentment when brought to light.⁴⁶

At this writing, the transparency requirements have just taken hold. After seeing the early filings, some experts expressed concern that the push for transparency was actually resulting in greater opacity. There is so much information that disclosure forms can take dozens of pages. According to Brian Foley, an independent compensation consultant, “Most of us in the trade don’t know whether to laugh or cry, when plowing through disclosure forms that run dozens of pages, with tables, footnotes and the kind of language that makes your hair hurt. My own test is, can I read it through or do I lose focus? I’ve been doing this for 30 years—if I lose focus, or can’t figure something out, God help the average person.”⁴⁷

The issue of executive compensation is complex. For one thing, not everyone agrees that the current levels of pay are overly extravagant. Some observers argue that executives are not overpaid; they contend that CEO salaries are appropriate to their responsibilities and that the excessive granting of stock options is clouding the data.⁴⁸ Still others argue that the efforts to curb excessive compensation are having the opposite effect. Joanne Lublin and Scott Thurm of the *Wall Street Journal* suggest that the increase in transparency has made it easier for executives to compare their pay to that of their peers, and this has led these executives to compete for higher pay; they also argue that stock options, designed to tie pay more closely to performance, have led to further abuses such as backdating and spring-loading.⁴⁹ These views run counter to the popular perception that excessive executive compensation is a simple case of greed, and they illustrate the challenge of addressing this issue effectively.

THE IMPACT OF THE MARKET FOR CORPORATE CONTROL

Mergers and acquisitions are another form of corporate governance, one that comes from outside the corporation. The expectation is that the threat of a possible takeover will motivate top managers to pursue shareholder, rather than self, interest. The merger, acquisition, and hostile takeover craze of the 1980s brought out many new issues related to corporate governance. The economic prosperity of the 1980s, coupled with the rise of junk bonds and other creative methods of financing, made it possible for small firms and individuals to buy large

corporations. Many corporate CEOs and boards went to great lengths to protect themselves from these takeovers. A major criticism of CEOs and boards during this period was that they were overly obsessed with self-preservation rather than making optimal decisions on behalf of their owners/stakeholders. Two of the key top management practices to emerge from the hostile takeover wave were poison pills and golden parachutes. We will briefly consider each of these and see how they fit into the corporate governance problem we have been discussing. Then, we will examine the issue of insider trading.

Poison Pill

A **poison pill** is intended to discourage or prevent a hostile takeover. They work much like their name suggests—when an acquirer tries to swallow (i.e., acquire) a company, the poison pill makes the company very difficult to ingest. Poison pills can take a variety of forms, but typically, when a hostile suitor acquires more than a certain percentage of a company's stock, the poison pill provides that other shareholders be able to purchase shares, thus diluting the suitor's holdings and making the acquisition prohibitively expensive (i.e., difficult to swallow). Some poison pills adopted by companies have been ruled illegal by the courts.⁵⁰ However, efforts to adopt poison pills continue. For example, Yahoo!'s board of directors adopted a poison pill that would make a hostile takeover prohibitively expensive. The plan gave Yahoo! shareholders the right to buy one unit of a share of preferred stock for \$250 if a person or group acquired at least 15 percent of Yahoo!'s stock. According to the company, the poison pill was not instituted in response to any specific acquisition threat but instead to “deter coercive takeover tactics.”⁵¹ Since then, the pace of poison pill adoption has seemed to be slowing as the efforts by shareholders to dismantle them increased and corporate governance scorecards downgraded firms that had poison pills in place.⁵²

Golden Parachutes

A **golden parachute** is a contract in which a corporation agrees to make payments to key officers in the event of a change in the control of the corporation.⁵³ The original intent of golden parachutes was to provide top executives involved in takeover battles with an incentive for not putting themselves before their shareholders. Executives might be tempted to fight a takeover attempt to preserve their employment when the takeover would benefit the shareholders by giving them a shareholder premium. However, a study of more than 400 takeover attempts found that golden parachutes had no effect on takeover resistance. Neither the existence of the parachute, nor the magnitude of the potential parachute payout, influenced CEO reactions to takeover attempts.⁵⁴

Critics offer many arguments against golden parachutes. They argue that executives are already being paid well to represent their companies and that receiving additional rewards constitutes “double dipping.” They also argue that these executives are, in essence, being rewarded for failure. The logic here is that if the executives have managed their companies in such a way that the companies' stock prices are low enough to make the firms attractive to takeover specialists, the

executives are being rewarded for failure. Another argument is that executives, to the extent that they control their own boards, are giving themselves the golden parachutes. This represents a conflict of interest.⁵⁵ At the time of this writing, the SEC is proposing new disclosure requirements for golden parachutes that may address some of these issues.⁵⁶

INSIDER TRADING SCANDALS

Insider trading is the practice of obtaining critical information from inside a company and then using that information for one's own personal financial gain. A scandal began in 1986 when the Securities and Exchange Commission (SEC) filed a civil complaint against Dennis B. Levine, a former managing partner of the Drexel Burnham Lambert investment banking firm, and charged him with illegally trading in 54 stocks. Levine then pled guilty to four criminal charges and gave up \$10.6 million in illegal profits—the biggest insider trading penalty up to that point.⁵⁷ He also spent 17 months in prison.

Levine's downfall set off a chain reaction on Wall Street. His testimony led directly to the SEC's \$100 million judgment against Ivan Boesky, one of Wall Street's most frenetically active individual speculators. In a consent decree, Boesky agreed to pay \$100 million, which was then described as by far the largest settlement ever obtained by the SEC in an insider trading case. Boesky, it turns out, had made a career of the high-rolling financial game known as **risk arbitrage**—the opportunistic buying and selling of companies that appear on the verge of being taken over by other firms.⁵⁸ The Boesky settlement set off a flurry of litigation as dozens of private and corporate lawsuits were filed in response to these disclosures.⁵⁹ Ivan Boesky then fingered Martin Siegel, one of America's most respected investment bankers, at Kidder Peabody. Apparently, Siegel and Boesky had begun conspiring in 1982, and over the next two years Siegel leaked information about upcoming takeovers to Boesky in exchange for \$700,000 in cash. Siegel pled guilty and began cooperating with investigators, and then he himself proceeded to finger two former executives at Kidder Peabody and one at Goldman Sachs.⁶⁰

The insider trading scandals rocked Wall Street as accusations reached the upper levels of the financial industry's power and salary structure. New arrests seemed to occur weekly, and one of the most frequently asked questions was "Who's next?"⁶¹ In 1987, Ivan Boesky was sentenced to three years in prison. However, Boesky helped prosecutors reel in the biggest fish of all—junk bond king Michael Milken. The Securities and Exchange Commission accused Milken and his employer, Drexel Burnham, of insider trading, stock manipulation, and other violations of federal securities laws. Drexel Burnham agreed in 1988 to plead guilty to six felonies, settle SEC charges, and pay a record fine of \$650 million. A year later, the junk bond market crashed and Drexel Burnham filed for bankruptcy. In 1990, Milken agreed to plead guilty to six felony counts of securities fraud, market manipulation, and tax fraud. He agreed to pay a personal fine of \$600 million and later was sentenced to ten years in prison.⁶² He served only two years in prison before being released. Insider trading concerns continue

today. In 2003, Martha Stewart was found guilty on four counts of making false statements and obstruction of justice regarding a controversial sale of ImClone Systems stock. She spent five months in prison, after which she began rebuilding her various businesses.⁶³ This brought the topic of insider trading back into the daily news, and it hasn't left. In 2007, federal authorities arrested thirteen people in what they describe as an insider trading scheme involving four investment banks and a web of hedge funds. Linda Thomsen, chief of enforcement at the SEC, described the scheme as "one of the most pervasive Wall Street insider trading rings since the days of Ivan Boesky and Dennis Levine."⁶⁴

Insider trading allegations cause the general public to lose faith in the stability and security of the financial industry. If large investors can act on information that smaller investors do not have, the playing field is not level. In 2001, to prop up investor confidence, the SEC instituted new disclosure rules designed to aid the small investor who historically has not had access to the information large investors hold. Regulation FD (fair disclosure) set limits on the common company practice of selective disclosure. When companies disclose meaningful information to shareholders and securities professionals, they must now do so publicly so that small investors can enjoy a more level playing field.⁶⁵

Improving Corporate Governance

We first discuss a landmark legislative effort to improve corporate governance. The Sarbanes-Oxley Act of 2002 (SOX) was passed in response to the public outcry for greater protection following the financial scandals of 2001. We then proceed to other efforts to improve corporate governance, which may be classified into two major categories for discussion purposes. First, changes could be made in the composition, structure, and functioning of boards of directors. Second, shareholders—on their own initiative or on the initiative of management or the board—could assume a more active role in governance. Each of these possibilities deserves closer examination.

SARBANES-OXLEY

On July 30, 2002, the **Accounting Reform and Investor Protection Act of 2002** was signed into law. Also known as the **Sarbanes-Oxley Act (SOX)**, it amends the securities laws to provide better protection for investors in public companies by improving the financial reporting of companies. According to the Senate Committee report, "the issue of auditor independence is at the center of (the SOX)."⁶⁶ Some of the ways the act endeavors to ensure auditor independence are by limiting the nonauditing services an auditor can provide, requiring auditing firms to rotate the auditors who work with a specific company, and making it unlawful for accounting firms to provide auditing services where conflicts of interest (as defined by the act) exist. In addition, the act enhances financial disclosure with requirements such as the reporting of off-balance-sheet transactions, the prohibiting of personal loans to executives and directors, and the

requirement that auditors assess and report upon the internal controls employed by the company. Other key provisions include the requirement that audit committees have at least one financial expert, that CEOs and CFOs certify and be held responsible for financial representations of the company, and that whistle-blowers are afforded protection. Corporations must also disclose whether they have adopted a code of ethics for senior financial officers and, if they haven't, provide an explanation for why they haven't.⁶⁷ The penalties for noncompliance with SOX are severe: A CEO or CFO who misrepresents company finances may be fined up to \$1 million and imprisoned for up to 10 years. If that misrepresentation is willful, the fine may go up to \$5 million with up to 20 years imprisonment.⁶⁸

After the passage of SOX, critics pointed to significant successes, while expressing concern over work that had yet to be accomplished. Some saw evidence that executives and directors were being more diligent in their reporting to shareholders but expressed concern that executives were becoming too risk-averse.⁶⁹ There has been an increase in firms turning private to avoid the regulations: the cost of compliance can be as much as three times the cost prior to the act's implementation.⁷⁰ Another example of an unintended consequence is the impact SOX has had on the chief financial officer (CFO) position. The requirements of SOX made it far less attractive to sit in the CFO position. CFOs were once considered the prime stars of the executive suite, in training to be promoted to CEO. However, SOX has changed the position's focus to compliance: CFOs no longer have time to look at the big picture of corporate strategy and thus they are less attractive as candidates for promotion to CEO.⁷¹ Some observers have even expressed concern about the effectiveness of some of the act's requirements. For example, the requirement that boards install an anonymous reporting channel for reporting fraud may decrease the reports that are given to non-anonymous channels.⁷² Others argue that the whistle-blower protection offered is insufficient.⁷³ Most observers agree that more time must pass before the impact of SOX can be fully assessed.

CHANGES IN BOARDS OF DIRECTORS

Due to the growing belief that CEOs and executive teams need to be made more accountable to shareholders and other stakeholders, boards have been undergoing a variety of changes. Here we will focus on several of the key areas of change, as well as some other recommendations that have been set forth for improving board functioning. Figure 4-3 summarizes some of these recommendations.

BOARD DIVERSITY

Prior to the 1960s, boards were composed primarily of white, male inside directors. It was not until the 1960s that pressure from Washington, Wall Street, and various stakeholder groups began to emphasize the concept of board diversity. Fifty years later, there are improvements, but board diversity is still sorely lacking. The Spencer Stuart 2006 Board Diversity Report examined board composition for the top 200 firms in the S&P 500.⁷⁴ The study reported that women represented

Figure 4-3 Improving Boards and Board Members

Building a Better Board^a

- Define the role the board intends to undertake.
- Be explicit about their financial goals.
- Widen the talent pool for directors, and seek the skills and experience that fit the future needs of the firm.
- Encourage constructive dissent.
- Divide and delegate work to promote deeper analysis.

Being a Better Board Member^b

- Be willing to challenge management.
- Be willing to do lots of homework.
- Control the flow of information.
- Meet outside of the CEO's sphere—both with other board members and lower-level managers.
- Don't sacrifice performance for collegiality.

Sources: ^aColin B. Carter and Jay W. Lorsch, "Director, Heal Thyself," *Wall Street Journal* (January 6, 2004), B2. ^bCarol Hymowitz, "How to Be a Good Director," *Wall Street Journal* (October 27, 2003), R1, R4

16 percent of all directors, and there were no women directors in 3 percent of the firms. Minorities represented 15 percent of all directors, with 1 percent Asian, 4 percent Hispanic, and 10 percent African American. Ten percent of the companies had no minority directors.⁷⁵

The board diversity issue is not confined to the United States. According to the 2005 Female FTSE Index, only 10.5 percent of the largest companies in the United Kingdom have women on their boards.⁷⁶ Quotas are not allowed in the United States and the United Kingdom, but other countries have used them to address the board diversity issue. The 500 publicly traded firms in Norway face closure if they do not meet a January 2008 deadline for achieving 40 percent female representation on their boards.⁷⁷ While not specifying quotas, France and Spain are also considering sanctions on publicly traded firms that do not put more female directors on their corporate boards.⁷⁸

Do diverse boards make a difference? Given the diversity of stakeholders, a diverse board is better able to hear their concerns and respond to their needs.⁷⁹ Diverse boards are also less likely to fall prey to groupthink because they would have the range of perspectives necessary to question the assumptions that drive group decisions.⁸⁰ There is some evidence of board diversity being associated with better financial performance.⁸¹ However, a cause-effect relationship is very difficult to determine because so many factors influence the performance of a firm.

OUTSIDE DIRECTORS

Legislative, investor, and public pressure have led firms to seek a greater ratio of outside to inside board members. Outside directors are those board members who

have no other relationship with the firm and its top managers; in contrast, inside directors are connected to the firm in ways other than board membership. Insiders are often top managers in the firm. However, they may also be family members of the CEO or others with a close relationship to the firm or its decision makers. Insiders might also be professionals who contract with the firm, such as lawyers or bankers. To varying degrees, each of these parties has a relationship with the CEO and, therefore, might be hesitant to speak out when necessary.

Outside directors are considered to be more independent because they are less likely to find themselves in conflict-of-interest situations. Institutional investors value board independence so highly that they are willing to pay a premium for firms with outside directors. A study by McKinsey & Company found that the premium was as high as 28 percent in Venezuela. Although it varied, each country's premium was well above 15 percent.⁸² South Korea passed a law requiring that outside directors occupy at least one-fourth of the positions on large company boards.⁸³ This worldwide increase in demand for outside directors is part of the reason they are in increasingly short supply. Another factor limiting the supply of directors is the greater level of expectations placed on board members by SOX and investor expectations. Board committees and subcommittees are now given more to do than ever before. Furthermore, the globalization of business has placed new demands on board members for travel. Last, firms realize the time demands placed on outside directors, and so they limit the number of outside boards on which their own executives may sit. For example, former GE CEO Jack Welch would not allow his senior managers to sit on the boards of other companies.⁸⁴

Do outside board members make a difference for both shareholders and stakeholders? As with diversity, a relationship between proportion of outside directors and financial performance is difficult to find. For that reason, scholars have looked to more targeted measures. In a recent study, outside directors were found to be associated with fewer shareholder lawsuits.⁸⁵ Regarding stakeholders, researchers found that outside directors were correlated positively with dimensions of social responsibility associated with both people and product quality.⁸⁶ Outside directors are a heterogeneous group and so the impact of appointing more outside directors to boards can be expected to vary with the characteristics of the directors who are appointed, such as their expertise, their experience, and the time they have available to give to their post.

USE OF BOARD COMMITTEES

The **audit committee** is responsible for assessing the adequacy of internal control systems and the integrity of financial statements. Recent scandals, like Enron and WorldCom, and the many companies that have subsequently needed to restate earnings underscore the importance of a strong audit committee. In a recent survey, 81 percent of board members felt that audit committee chairs should be paid more than chairs of other committees because of the added responsibilities stemming from the SOX.⁸⁷ The SOX mandates that the audit committee be composed entirely of independent board members and that there be at least one

identified financial expert, as defined in the SOX.⁸⁸ The principal responsibilities of an audit committee are as follows⁸⁹:

1. To ensure that published financial statements are not misleading
2. To ensure that internal controls are adequate
3. To follow up on allegations of material, financial, ethical, and legal irregularities
4. To ratify the selection of the external auditor

While the audit committee has taken central stage in the current corporate governance environment, other committees still play key roles. The **nominating committee**, which should be composed of outside directors, has the responsibility of ensuring that competent, objective board members are selected. The function of the nominating committee is to nominate candidates for the board and for senior management positions. In spite of the suggested role and responsibility of this committee, in most companies, the CEO continues to exercise a powerful role in the selection of board members. The **compensation committee** has the responsibility of evaluating executive performance and recommending terms and conditions of employment. This committee should be composed of outside directors. Both the New York Stock Exchange (NYSE) and NASDAQ require that the compensation committee be composed of independent board members. One might ask, however, how objective these board members are when the CEO has played a significant role in their election to the board. Finally, each board has a **public issues committee**, or **public policy committee**. Although it is recognized that most management structures have some sort of formal mechanism for responding to public or social issues, this area is important enough to warrant a board committee that would become sensitive to these issues, provide policy leadership, and monitor management's performance on these issues. Most major companies today have public issues committees that typically deal with issues such as affirmative action, equal employment opportunity, environmental affairs, employee health and safety, consumer affairs, political action, and other areas in which public or ethical issues are present. Debate continues over the extent to which large firms really use such committees, but the fact that they have

<http://SEARCHTHEWEB.WEB>

U.S. SEC EDGAR DATABASE

The U.S. SEC has made it possible for shareholders and other interested parties to retrieve publicly available filings through its website (<http://www.sec.gov>). Most filings submitted to the SEC are available 24

hours after they are received. The website also offers news and other investor information to enable shareholders to be more active and informed participants in the corporate governance process.

institutionalized such concerns by way of formal corporate committees is encouraging.

THE BOARD'S RELATIONSHIP WITH THE CEO

Boards of directors have always been responsible for monitoring CEO performance and dismissing poorly performing CEOs. Historically, however, chief executives were protected from the axe that hit other employees when times got rough. This is no longer true as tough, competitive economic times, the rising vigilance of outside directors, and the increasing power of large institutional investors have had CEOs "dropping like flies."⁹⁰ As the *Christian Science Monitor* commented, "While the perks of sitting in a corner office are great, job security isn't one of them."⁹¹

"You have to perform or perish," according to John A. Challenger, CEO of outplacement firm Challenger, Gray & Christmas Inc. "If you don't produce immediate results, you just don't have much room to move."⁹² In 2006, there were 28,058 board member and top executive turnovers, an increase of 68 percent over 2005.⁹³ Most telling was the speed with which these firings took place. Many were dismissed before their first annual review: top managers no longer could count on a honeymoon period.⁹⁴

Some analysts see the increasing turnover in CEOs as a positive thing. "I take it as a good sign, because it says boards of directors are tougher on CEOs than they used to be," says Donald P. Jacobs, former dean of the Kellogg School of Business at Northwestern University.⁹⁵ Still others express their concern. Rakesh Khurana of Harvard Business School opines, "We've made this a superhero job. Boards look at the CEO as a panacea and get fixated on the idea that one single individual will solve all the company's problems."⁹⁶ One thing is clear: boards cannot now be accused of always giving CEOs a free ride.

BOARD MEMBER LIABILITY

Concerned about increasing legal hassles emanating from stockholder, customer, and employee lawsuits, directors have been quitting board positions or refusing to accept them in the first place. In the past, courts rarely held board members personally liable in the hundreds of shareholder suits filed every year: instead, the **business judgment rule** prevailed. The business judgment rule holds that courts should not challenge board members who act in good faith, making informed decisions that reflect the company's best interests instead of their own self-interest. The argument for the business judgment rule is that board members need to be free to take risks without fear of liability. The issue of good faith is key here because the rule was never intended to absolve board members completely from personal liability. In cases where the good faith standard was not upheld, board members have paid a hefty price.

The TransUnion Corporation case involved an agreement among the directors to sell the company for a price the owners later decided was too low. A suit was filed, and the court ordered that the board members be held personally responsible

Ethics in Practice Case

MONITORING THE MONITORS

Board members are typically disciplined by not being reelected through shareholder vote. While shareholder vote can sometimes address firm performance issues, it is unlikely to be effective in addressing less public issues in a timely fashion. The Hewlett-Packard (HP) board found itself dealing with this type of problem when the details of confidential board discussions were being leaked to the press. Details of the firm's strategies as well as its CEO hiring deliberations had been made public, but it was unclear who on the board was supplying the information.

After interviews with board members failed to elicit the source of the leaks, then board chairman Patricia Dunn engaged an outside licensed investigative firm to determine who had provided confidential information to the media. This firm used "pretexting" (conscious misrepresentation to obtain information) as one of their techniques for collecting the information. Investigators pretended to be the board members whose calls were being investigated. The source of the leaks was found; however, uproar ensued over the investigation.

1. Who should be responsible for taking action when a board member engages in problematic behavior? If the chairman is responsible, when

should he or she involve the whole board? What are the costs of early full board involvement? What are the costs of late full board involvement?

2. One complaint lodged was that HP provided board members' home phone numbers to investigators. Was this out of line? Do board members have a responsibility to provide certain basic information, or was their privacy breached when their home phone numbers were given? A board member whose phone records proved he was not involved in any leaks still resigned the board in protest that his privacy was invaded by the pretexting. Was he right?
3. The law regarding pretexting is unclear. While it is illegal when used to obtain financial records, the use of pretexting in other situations—such as the phone records in this example—was not necessarily against the law. Should it be?
4. How might things have evolved differently if the ethicality rather than the legality of the practice had been the issue? Are the two synonymous or is there a difference?

for the difference between the price the company was sold for and a later-determined "fair value" for the deal.⁹⁷ In addition to the TransUnion case, Cincinnati Gas and Electric reached a \$14 million settlement in a shareholder suit that charged directors and officers with improper disclosure concerning a nuclear power plant.⁹⁸

The Caremark case further heightened directors' concerns about **personal liability**. Caremark, a home health care company, paid substantial civil and criminal fines for submitting false claims and making illegal payments to doctors and other health care providers. The Caremark board of directors was then sued for breach of fiduciary duties because the board members had failed in their

responsibility to monitor effectively the Caremark employees who violated various state and federal laws. The Delaware Chancery Court ruled that it is the duty of the board of directors to ensure that a company has an effective reporting and monitoring system in place. If the board fails to do this, individual directors can be held personally liable for losses that are caused by their failure to meet appropriate standards.⁹⁹

The issue of personal liability came to the forefront following the Enron and WorldCom debacles. Twelve WorldCom directors were ordered to pay \$24.75 million out of their personal funds instead of drawing on their D&O insurance.¹⁰⁰ Ten former Enron directors agreed to pay \$13 million from their personal funds.¹⁰¹ In a November 2006 decision, the Delaware Supreme Court affirmed the “Caremark Standard,” which states that directors can only be held liable if: “1. The director utterly failed to implement any reporting or information system or controls, or 2. having implemented such a system or controls, consciously failed to monitor or oversee its operations, disabling their ability to be informed of risks or problems requiring their attention.”¹⁰²

The Role of Shareholders

Shareholders are a varied group with a range of interests and expectations. They have one aspect in common, however, and that is that they are the owners of the corporation. As such, they have a right to have their voices heard. Putting that right into practice, however, has presented an ongoing challenge for shareholders and managers.

Our discussion begins with an overview of the state of shareholder democracy, which relates to giving shareholders the voice that their owner status should provide. We will then discuss shareholder activism, which results when shareholders do not get their concerns heard. We will close with recommendations for improved shareholder relations.

SHAREHOLDER DEMOCRACY

Many countries that take pride in their strong democratic traditions do not necessarily provide the same privileges to shareholders in corporate matters. In the United States, votes against board members have generally not been counted, and corporations have been free to ignore shareholder resolutions.¹⁰³ Withholding a vote for a board member has no impact because only the votes that were actually cast are counted.¹⁰⁴ Similarly, many European firms do not have one vote for each share issued.¹⁰⁵ The ability of shareholders to elect board members is central to the process because the elected board members will be governing the corporation.¹⁰⁶ If shareholders aren’t able to select their own representatives, the board is likely to become a self-perpetuating oligarchy.¹⁰⁷ Shareholder democracy begins with board elections, so it is not surprising that shareholder rights advocates have begun there. Three key issues that have arisen are majority vote, classified boards, and shareholder ballot access.

Majority vote is the requirement that board members be elected by a majority of votes cast. This is in contrast to the prevailing norm in which a board member who receives a single “yes” vote can claim his or her seat on the board. Furthermore, a “no” vote is more likely to be counted in this system.¹⁰⁸ Resolutions to adopt the majority vote format have dominated recent proxy seasons, so the majority vote is likely to evolve into the standard.¹⁰⁹ While this is good news in general for providing shareholders with more voice, the issue is complex and will require each firm to assess its impact and consequences.¹¹⁰ Gavin Anderson, CEO of GovernanceMetrics International (GMI), has called the majority voting movement an “unstoppable train.” Only 150 out of 9,000 publicly traded companies had adopted it by early 2007; however, Anderson predicted that in three to four years a majority of firms will have majority vote provisions in place.¹¹¹

Classified boards are boards that elect their members in staggered terms. For example, in a board of twelve members, four members might be elected each year and each would serve a three-year term. It would then take three years for the entire board slate to be replaced. Many shareholder activists oppose classified boards because of the time required to replace the board. Proponents of classified boards argue that board members need a longer term to get to know the firm and to make longer-term-oriented strategic decisions. The push for board declassification has gathered a great deal of momentum. By 2007, 53 percent of publicly traded companies had declassified boards, with more proposals put forth each year.¹¹²

Shareholder ballot access provides shareholders with the opportunity to propose nominees for the board of directors. This has been an issue of contention for years. In the prevailing system, shareholders must file a separate ballot if they want to nominate their own candidates for director positions. This procedure is time-consuming and costly, so shareholder groups are asking for the ability to place their candidates directly on the proxy materials. At this writing, the SEC is reviewing the request and is expected to take action. Their announcement has been delayed, which leads observers to believe that they do not have a consensus.¹¹³

The **role of the SEC** in promoting shareholder democracy in the United States is clear; the commission is responsible for protecting investor interests. However, many critics argue that the SEC often appears more focused on the needs of business than the needs of investors. In 1997, the SEC proposed amendments to its rules on shareholder resolutions. Some of the proposed amendments would have made it more difficult for shareholders to resubmit resolutions after they had been voted down. A 340-group coalition, including the Episcopal Church, the Methodist Church Pension Fund, the National Association for the Advancement of Colored People (NAACP), the Sierra Club, and the AFL-CIO, converged on Washington to protest the proposal. A study by the Social Investment Forum showed that 80 percent of past resolutions would have been barred after their third year if the original proposals had been accepted. Bowing to “considerable public controversy,” the SEC took only one action—reversing the “Cracker Barrel” decision. In 1991, when Cracker Barrel Old Country Store decided to fire, and no longer hire, gay employees, shareholders sought to have that policy overturned.

The SEC ruled that hiring falls under the category of **ordinary business decisions** and thus was entirely the province of corporate directors and officers. In 1998, the SEC reversed that ruling and returned to its earlier policy of deciding on a case-by-case basis.¹¹⁴ In 2007, the SEC opted not to push for tightening of hedge fund regulation and urged the Supreme Court to adopt standards that would make investors lawsuits more difficult.¹¹⁵

SHAREHOLDER ACTIVISM

One major reason that relations between management groups and shareholders have heated up is that shareholders have discovered the benefits of organizing and wielding power. **Shareholder activism** is not a new phenomenon. It goes back more than sixty years to 1932, when Lewis Gilbert, then a young owner of ten shares, was appalled by the absence of communication between New York–based Consolidated Gas Company’s management and its owners. Supported by a family inheritance, Gilbert decided to quit his job as a newspaper reporter and “fight this silent dictatorship over other people’s money.” He resolved to devote himself “to the cause of the public shareholder.”¹¹⁶

THE HISTORY OF SHAREHOLDER ACTIVISM

The history of shareholder activism is too detailed to report fully here, but Gilbert’s efforts planted a seed that grew, albeit slowly. The major impetus for the movement came in the 1960s and early 1970s. The early shareholder activists were an unlikely conglomeration—corporate gadflies, political radicals, young lawyers, an assortment of church groups, and a group of physicians.¹¹⁷ The movement grew out of a period of political and social upheaval—civil rights, the Vietnam War, pollution, and consumerism.

The watershed event for shareholder activism was Campaign GM in the early 1970s, also known as the Campaign to Make General Motors Responsible. Among those involved with this effort was, not surprisingly, Ralph Nader, who is discussed in more detail in Chapter 13. The shareholder group did not achieve all its objectives, but it won enough to demonstrate that shareholder groups could wield power if they worked hard enough at it. Two of Campaign GM’s most notable early accomplishments were that (1) the company created a public policy committee of the board, composed of five outside directors, to monitor social performance, and (2) GM appointed the Reverend Leon Sullivan as its first black director.¹¹⁸

One direct consequence of the success of Campaign GM was the growth of church activism. Church groups were the early mainstay of the corporate social responsibility movement and were among the first shareholder groups to adopt Campaign GM’s strategy of raising social issues with corporations. Church groups began examining the relationship between their portfolios and corporate practices, such as minority hiring and companies’ presence in South Africa. Church groups remain among the largest groups of institutional stockholders willing to take on management and press for what they think is right. Many churches’ activist efforts

are coordinated by the InterfaithCenter on Corporate Responsibility (ICCR), which coordinates the shareholder advocacy of about 275 religious orders with about \$90 billion in investments. The ICCR was instrumental in convincing Kimberly-Clark to divest the cigarette paper business and pressuring PepsiCo to move out of then Burma (now Myanmar).¹¹⁹

Shareholder activists have historically been socially oriented—that is, they wanted to exert pressure to make the companies in which they own stock more socially responsive. While that remains true for many, the mid-1980s brought a new trend, a growth in activist shareholders who are driven by a concern for profit. In 2007, Home Depot CEO Robert Nardelli was ousted due to pressure from activist shareholders, most notably Ralph Whitworth, cofounder of Relational Investors.¹²⁰ The successful ouster was not Whitworth's only goal. He continues to pressure Home Depot to nominate candidates for the board election and to have input in the firm's strategic direction.¹²¹

The growth of shareholder activism shows no signs of abating. In their preview of the upcoming proxy season, *Directorship* magazine gave the following forecast: "Get Ready for a Red-Hot Season: Last year's annual meetings were just the warm-up in the battle for corporate control. You ain't seen nothin' yet."¹²² Activist shareholders, known also as **corporate gadflies**, are no longer dismissed as nuisances. Instead, they are viewed as credible, powerful, and a force with which to be reckoned.¹²³ In fact, money managers and hedge funds are now advertising their activist orientation in the belief that being seen as aggressive gives them an edge.¹²⁴

SHAREHOLDER RESOLUTIONS

One of the major vehicles by which shareholder activists communicate their concerns to management groups is through the filing of **shareholder resolutions**. An example of such a resolution is: "The company should name women and minorities to the board of directors." To file a resolution, a shareholder or a shareholder group must obtain a stated number of signatures to require management to place the resolution on the proxy statement so that it can be voted on by all the shareholders. Resolutions that are defeated (fail to get majority votes) may be resubmitted provided that they meet certain SEC requirements for such resubmission.

Although an individual could initiate a shareholder resolution, she or he probably would not have the resources or means to obtain the required signatures to have the resolution placed on the proxy. Thus, most resolutions are initiated by large institutional investors that own large blocks of stock or by other activist groups that own few shares of stock but have significant financial backing. Foundations, religious groups, universities, and other such large shareholders are in the best position to initiate resolutions. The issues on which shareholder resolutions are filed vary widely, but they typically concern some aspect of a firm's social performance. Some of the resolutions in 2006 presaged the upcoming presidential election by calling for transparency in political contributions.¹²⁵

Most shareholder resolutions never pass, and even those that pass are typically nonbinding. So one might ask why groups pursue them. Meredith Benton, research associate with Walden Asset Management, describes why she would come to the point of wanting to put forth a resolution: “The process begins when there’s an issue of concern for our clients. We look at what the issue is and how it may impact the companies in our portfolio. Once we’ve determined what that impact might be and believe there’s a long-term business case for why one of our companies should be concerned about the issue, we approach the company. They have a couple different ways they can respond to us. They can ignore us, which happens sometimes. They can constructively engage with us and sit down with us. If they’re ignoring us or strongly disagreeing with our viewpoint, we have one more option, which is the shareholder resolution.”¹²⁶ Benton notes that resolutions are the most public aspect of what they do but that they actually have constructive conversations far more often.¹²⁷

SHAREHOLDER LAWSUITS

We earlier made reference to the **shareholder lawsuit** in the TransUnion case. Shareholders sued the board of directors for approving a buyout offer that the shareholders argued should have had a higher price tag. Their suit charged that the directors had been negligent in failing to secure a third-party opinion from experienced investment bankers. The case went to trial and resulted in a \$23.5 million judgment against the directors.¹²⁸ The TransUnion case may have been one of the largest successful shareholder suits, but it was dwarfed by the Cendant suit, which resulted in a \$2.83 billion class action settlement.¹²⁹

A 2007 study by the Stanford Law School Securities Class Action Clearinghouse found that the number of securities class action suits filed in 2006 plunged by 38 percent to 110 total filings, as compared to a total of 178 filings in 2005. The decrease in filings is even more dramatic when compared to the average number of 193 filed from 1996 through 2005. In fact, this is the fewest number of lawsuits filed since the adoption of the **Public Securities Litigation Reform Act of 1995**, which was intended to rein in excessive levels of private securities litigation. The decrease is attributed to tougher enforcement due to Sarbanes-Oxley, a stronger stock market, and the fact that so many class action suits had gone before.¹³⁰

INVESTOR RELATIONS

Over the years, corporate managements have neglected their owners. As share ownership has dispersed, there are several legitimate reasons why this separation has taken place. But there is also evidence that management groups have been too preoccupied with their own self-interests. In either case, corporations are beginning to realize that they have a responsibility to their shareholders that cannot be further neglected. Owners are demanding accountability, and it appears that they will be tenacious until they get it.

Public corporations have obligations to their shareholders and to potential shareholders. **Full disclosure** (also known as **transparency**) is one of these

responsibilities. Disclosure should be made at regular and frequent intervals and should contain information that might affect the investment decisions of shareholders. This information might include the nature and activities of the business, financial and policy matters, tender offers, and special problems and opportunities in the near future and in the longer term.¹³¹ Of paramount importance are the interests of the investing public, not the interests of the incumbent management team. Board members should avoid conflicts between personal interests and the interests of shareholders. Company executives and directors have an obligation to avoid taking personal advantage of information that is not disclosed to the investing public and to avoid any personal use of corporation assets and influence.

Another responsibility of management is to communicate with shareholders. Successful shareholder programs do exist. Berkshire Hathaway Inc. is a company known for attending to its shareholders, and CEO Warren Buffett is praised by shareholders in return.¹³² One indication of Berkshire Hathaway's relationship with shareholders is the annual meeting. Buffett calls the annual shareholders' meeting "Woodstock weekend for capitalists." It's not unusual for shareholders to attend a minor league baseball game decked out in their forest green Berkshire Hathaway T-shirts and caps. Many wait in line to have their pictures taken with Buffett or get his autograph.¹³³ With good investor relations, many serious problems can be averted. If shareholders are able to make their concerns heard outside the annual meeting, they are less likely to confront managers with hostile questions when the meeting is in session. If their recommendations receive serious consideration, they are less likely to put them in the form of a formal resolution. Constructive engagement is easier for all involved.¹³⁴

Summary

Recent events in corporate America have served to underscore the importance of good corporate governance and the legitimacy it is supposed to provide for business. To remain legitimate, corporations must be governed according to the intended and legal pattern. Governance debacles such as Enron threaten not only the legitimacy of the company in question, but also of business as a whole.

The modern corporation involves a separation of ownership from control, which has resulted in problems with managers not always doing what the owners would rather they do. Boards of directors are responsible for ensuring that managers represent the best interests of owners, but

boards sometimes lack the independence needed to monitor management effectively. This has led to serious problems in the corporate governance arena, such as excessive levels of CEO pay and a weak relationship between CEO pay and firm performance. Of course, at times, an effort to solve one problem can create another. The use of stock options in CEO compensation has helped to tie CEO pay more closely to firm performance, but it has resulted in skyrocketing levels of pay, as well as manipulation of option timing and pricing. Other issues are lavish executive retirement plans and outside director compensation. New SEC rules for transparency may have an impact on the compensation issue in the future.

In theory, the market for corporate control should also rein in CEO excesses. The threat of a takeover should motivate a CEO to represent shareholders' best interests, but the existence of poison pills can blunt the takeover threat by making it prohibitively expensive for an acquirer. Golden parachutes were designed to keep CEOs from trying to block takeover attempts, but they have not had their intended effect and they, too, present a host of problems.

The Sarbanes-Oxley Act (SOX) was a landmark piece of legislation, drafted in response to the financial scandals of 2001. As with all efforts to improve corporate governance, it has held both costs and benefits. The demands of SOX have led many firms to go private to avoid the costs involved in compliance; however, evidence indicates that boards are becoming more independent, devoting more time to the governance of the firm and not hesitating to fire a CEO who is not making the grade. Board liability has increased and that, too, is a motivation behind the increased vigilance that has been observed.

Although they are the firm's owners, shareholders are too diffuse and removed from the corporation to monitor the activities of the corporation

and its managers effectively. To protect their interests, shareholders have grouped together to regain their ownership power. Institutional shareholders own sufficient blocks of stock to get the ear of the firm's board and executives. They have been using this access to effect change, and their efforts are beginning to pay off. Shareholder democracy, while still an unrealized goal, is growing as shareholders fight for a greater voice in the firm's decisions. In response, firms are beginning to pay more attention to investor relations.

In many ways, corporate governance has improved. CEOs no longer enjoy job security when firm performance suffers. Corporations can no longer release false or misleading reports without threat of consequences. The growth in CEO pay has tapered off, although it remains at extremely high levels. These improvements are worthy of note, but they are insufficient to protect the legitimacy of business. Steps have been taken to lessen the likelihood of another Enron occurring, but continual vigilance must be maintained if corporate governance is to realize its promise and its purpose, that of representing shareholder interests and being responsive to the needs of the many individuals and groups who have a stake in the firm.

Key Terms

Accounting Reform and Investor Protection Act of 2002 (page 135)
agency problems (page 126)
audit committee (page 138)
backdating (page 129)
board of directors (page 125)
bullet-dodging (page 129)
business judgment rule (page 140)
charter (page 124)
classified boards (page 143)
clawback provisions (page 130)
compensation committee (page 139)
corporate gadflies (page 145)
corporate governance (page 123)

employees (page 125)
full disclosure (page 146)
golden parachute (page 133)
inside directors (page 127)
insider trading (page 134)
legitimacy (page 122)
legitimation (page 122)
majority vote (page 143)
management (page 125)
nominating committee (page 139)
ordinary business decisions (page 144)
outside directors (page 127)
personal liability (page 141)
poison pill (page 133)

proxy process (page 125)
 public issues committee (page 139)
 public policy committee (page 139)
 Public Securities Litigation Reform
 Act of 1995 (page 146)
 risk arbitrage (page 134)
 role of the SEC (page 143)
 Sarbanes-Oxley Act (SOX) (page 135)
 separation of ownership from control (page 125)

shareholder activism (page 144)
 shareholder ballot access (page 143)
 shareholder lawsuit (page 146)
 shareholder resolutions (page 145)
 shareholders (page 124)
 spring-loading (page 129)
 stock options (page 129)
 tax gross-up (page 132)
 transparency (page 146)

Discussion Questions

1. Explain the evolution of corporate governance. What problems developed? What are the current trends?
2. What are the major criticisms of boards of directors? Which single criticism do you find to be the most important? Why?
3. Explain how governance failures such as Enron could happen. How might they be avoided?
4. Outline the major suggestions that have been set forth for improving corporate governance. In your opinion, which suggestions are most important? Why?
5. In what ways have companies taken the initiative in becoming more responsive to owners/stakeholders? Where would you like to see more improvement? Discuss.

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Strategic Management and Corporate Public Affairs

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Describe the concept of corporate public policy and relate it to strategic management.
- 2 Articulate the four major strategy levels and explain enterprise-level strategy.
- 3 Explain corporate social performance reporting.
- 4 Identify the major activities of public affairs departments.
- 5 Highlight key trends with respect to the public affairs function.
- 6 Link public affairs with the strategic management function.
- 7 Indicate how public affairs may be incorporated into every manager's job.

Following on the topic of corporate governance, in this chapter and the next, we more closely examine how management has responded and should respond, in a strategic sense, to the kinds of social, ethical, and stakeholder issues developed in this book. In this chapter, we provide a broad overview of how social, ethical, and public issues fit into the general **strategic management processes** of the organization. We introduce the term *corporate public policy* to describe that component of management decision making that embraces these issues. Then, we discuss corporate public affairs, or public affairs management, as the formal organizational approach companies use in implementing these initiatives. The overriding goal of this chapter is to focus on planning for the turbulent social/ethical stakeholder environment, and this encompasses the strategic management process, environmental analysis, and public affairs management.

The Concept of Corporate Public Policy

The impact of the social-ethical-public-global-stakeholder environment on business organizations is becoming more pronounced each year. It is an understatement to suggest that this multifaceted environment has become tumultuous, and brief reminders of a few actual cases point out the validity of this claim quite dramatically. Procter & Gamble and its Rely tampon recall, Firestone and its radial tire debacle, Ford Motor Company and its disastrous Pinto gas tank problem, and Johnson & Johnson and its tainted Tylenol capsules are *classic* reminders of how social issues can directly affect a firm's product offerings. In addition, there are many examples in which social issues have had major impacts on firms at the general management level. Exxon's catastrophic *Valdez* oil spill, Dow Corning's ill-fated silicone breast implants, and the tobacco industry's battles with the federal and state government over the dangers of its product are all examples of the impacts of top-level decisions that entail ethical ramifications.

More recently, Coca-Cola's disastrous and massive recall of soft drinks in Belgium and France, its continuing controversy in India over the product's purity, and Bridgestone-Firestone's tire tread separations in a number of countries of the world and the United States provide examples of ethical issues that have dramatic implications for top executive decision makers. We would be remiss if we did not mention the scandals at such firms as Enron, WorldCom, Tyco, Adelphia, and HealthSouth, along with once-revered accounting firm Arthur Andersen, which went out of business due to its ethical transgressions in connection with Enron. In each case, public policy issues were relevant to the company's problems.

What started as an awareness of social issues and social responsibility matured into a focus on the management of social responsiveness and performance. Today, the trend reflects a preoccupation with ethics, stakeholders, and corporate citizenship as we complete the first decade of the new millennium. Corporate social responsibility is now a strategic issue with far-reaching implications for organizational purpose, direction, and functioning.

The term *corporate public policy* is an outgrowth of an earlier term, *corporate social policy*, which had been in general usage for decades. The two concepts have essentially the same meaning, but we will use "corporate public policy" because it is more in keeping with terminology more recently used in business. Much of what takes place under the banner of corporate public policy is also referred to as *corporate public affairs* or *corporate citizenship* by businesses today.

CORPORATE PUBLIC POLICY DEFINED

What is meant by *corporate public policy*?

Corporate public policy is a firm's posture, stance, strategy, or position regarding the public, social, global, and ethical aspects of stakeholders and corporate functioning.

Later in the chapter, we will discuss how businesses formalize this concern under the rubric of **corporate public affairs**, or public affairs management. Businesses encounter many situations in their daily operations that involve highly visible public and ethical issues. Some of these issues are subject to intensive public debate for specific periods of time before they become institutionalized. Examples of such issues include sexual harassment, AIDS in the workplace, affirmative action, product safety, environmental sustainability, and employee privacy. Other issues are more basic, more enduring, and more philosophical. These issues might include the broad role of business in society, the corporate governance question, and the relative balance of business versus government direction that is best for our society. Today, the broad issue of moving manufacturing, operations, and administration offshore to other countries has taken center stage.

The idea behind corporate public policy is that a firm must give specific attention to issues in which basic questions of justice, fairness, ethics, or public policy reside. The dynamic stakeholder environment of the past forty years, especially the last ten years, has necessitated that management employ a policy perspective to these issues. At one time, the social environment was thought to be a relatively constant backdrop against which the real work of business took place. Today these issues are central, and managers at all levels must address them. Corporate public policy is the process by which management addresses these significant concerns.

CORPORATE PUBLIC POLICY AND STRATEGIC MANAGEMENT

Where does corporate public policy fit into strategic management? First, let us briefly discuss strategic management. **Strategic management** refers to the overall management process that strives to identify corporate purpose and to position a firm relative to its market environment. A basic way in which the firm relates to its market environment is through the products and services it produces and the markets in which it chooses to participate. Strategic management is also thought of as a kind of overall or comprehensive organizational governance and management by the firm's top-level executives. In this sense, it represents the overall executive leadership function in which the sense of direction of the organization is decided upon and implemented.

Top management teams must address many issues as a firm is positioning itself relative to its environment. The more traditional issues involve product/market decisions—the principal strategic decisions of most organizations. Other decisions relate to marketing, finance, accounting, information systems, human resources, operations, research and development, competition, and so on. Corporate public policy is that part of the overall strategic management of the organization that focuses specifically on the public, ethical, and stakeholder issues that are embedded in the decision processes of the firm. Therefore, just as a firm needs to develop policy on human resources, operations, marketing, or finance, it also must develop corporate *public* policy to proactively address the host of issues we have been discussing and will discuss throughout this book.

One company that concluded it needed a formal corporate public policy is Citizens Bank of Canada, a company that has been trying to build a strong reputation in the area of corporate social responsibility since it opened its doors a decade ago. The bank's management concluded it needed more than the establishment of a few enlightened policies. It needed something that would set a systematic course and foundation for "doing well by doing good." Citizens' first step was the establishment of a document of guiding principles, called an *ethical policy*, which would steer the firm's practices toward its social and environmental commitments. To implement its policy and follow up on implementation, the bank created an "ethical policy compliance" unit. The initiatives of Citizens Bank illustrate the realization that companies come to regarding the need for formalized corporate public/ethics policy.¹

A recent and continuing issue that carries with it significant strategic as well as public and ethical implications is the current trend on the part of many American firms to outsource jobs to less expensive parts of the world. Once, it was just manufacturing jobs that were moved to China and other developing countries. Now, high-paying professional jobs, such as programming and accounting, are being moved to countries such as India, China, and Indonesia. The result has been a major public policy debate regarding these corporate decisions.²

RELATIONSHIP OF ETHICS TO STRATEGIC MANAGEMENT

Although a consideration of ethics is implicit in corporate public policy discussions, it is useful to make this relationship more explicit. Over the years, a growing number of observers have stressed this point. Early on, the moral component of corporate strategy was emphasized. Relevant here was the leadership challenge of determining future strategy in the face of rising moral and ethical standards. Coming to terms with the morality of choice may be the most strenuous undertaking in strategic decision making. This is particularly stressful in the inherently amoral corporation.³

The challenge of linking ethics and strategy was moved to center stage in the book *Corporate Strategy and the Search for Ethics*. Here, it was argued that if business ethics was to have any meaning beyond pompous moralizing, it must be linked to business strategy. The theme was that we can revitalize the concept of corporate strategy by linking ethics to strategy. This linkage permits the most pressing management issues of the day to be addressed in ethical terms. In the book, the concept of *enterprise strategy* was introduced as the idea that best links these two vital notions, and we will examine this concept in more detail in the next section.⁴

The concept of corporate public policy and the linkage between ethics and strategy are better understood when we think about the

1. four key levels at which strategy decisions arise, and
2. steps in the strategic management process in which these decisions are embedded.

Four Key Strategy Levels

Because organizations are hierarchical, it is not surprising to find that strategic management also is hierarchical in nature. That is, there are several different levels in the firm at which strategic decisions are made or the strategy process occurs. These levels range from the broadest or highest levels (where missions, visions, goals, and decisions entail higher risks and are characterized by longer time horizons, more subjective values, and greater uncertainty) to the lowest levels (where planning is done for specific functional areas, where time horizons are shorter, where information needs are less complex, and where there is less uncertainty). Four key strategy levels are important: enterprise-level strategy, corporate-level strategy, business-level strategy, and functional-level strategy.

FOUR STRATEGY LEVELS DESCRIBED

Enterprise-Level Strategy

The broadest level of strategic management is known as *societal-level strategy* or *enterprise-level strategy*, as it has come to be known. **Enterprise-level strategy** is the overarching strategy level that poses such basic questions as “What is the role of the organization in society?” and “What do we stand for?” Enterprise-level strategy, as we will discuss in more detail later, encompasses the development and articulation of corporate public policy. It may be considered the first and most important level at which ethics and strategy are linked. Today, corporate governance is one of the most important topics at this level because ultimately it falls upon boards of directors to provide leadership for the firm’s enterprise-level strategy.

Corporate-Level Strategy

Until fairly recently, corporate-level strategy was thought to be the broadest strategy level. In a limited, traditional sense, this is true, because **corporate-level strategy** addresses what are often posed as the most defining business questions for a firm: “What business(es) are we in or should we be in?” A relevant part of corporate strategy today is the decision whether to participate in global markets.

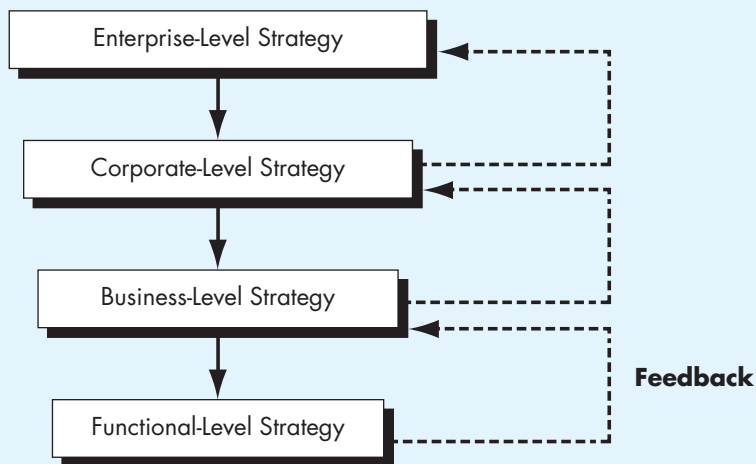
Business-Level Strategy

It is easy to see how **business-level strategy** is a natural follow-on because this strategy level is concerned with the question “How should we compete in a given business or industry?” Thus, a company whose products or services take it into many different businesses, industries, or markets might need a business-level strategy to define its competitive posture in each of them. A competitive strategy might be based on low cost or a differentiated product, or broad vs. narrow markets.

Functional-Level Strategy

This addresses the question “How should a firm integrate its various sub-functional activities, and how should these activities be related to changes taking place in the diverse functional areas (finance, marketing, human resources,

Figure 5-1 *The Hierarchy of Strategy Levels*



operations)?”⁵ Companies today try to avoid functional silos and operate in a more integrated way.

The purpose of identifying the four strategy levels is to clarify that corporate public policy is primarily a part of enterprise-level strategy, which, in turn, is but one level of strategic decision making that occurs in organizations. In terms of its implementation, however, the other strategy levels inevitably come into play. Figure 5-1 illustrates that enterprise-level strategy is the broadest level and that the other levels are narrower concepts that cascade from it.

EMPHASIS ON ENTERPRISE-LEVEL STRATEGY

The terms *enterprise-level strategy* and *societal-level strategy* may be used interchangeably. Neither of these terms is frequently used in the business community, but they are helpful here. Although many firms address the issues that enterprise-level strategy is concerned with, use of this terminology is concentrated primarily in the academic community. This terminology is used to describe the level of strategic thinking that is necessary if firms are to be fully responsive to today’s complex and dynamic stakeholder environment. Most organizations today convey their enterprise or societal strategy in their vision, missions, or values statements. Others embed their enterprise strategies in codes of conduct. Increasingly, these strategies are reflecting a global level of application.

Enterprise-level strategy needs to be thought of as a concept that more closely aligns “social and ethical concerns” with traditional “business concerns.”⁶ In setting the direction for a firm, a manager needs to understand the impact of changes in business strategy on the underlying values of the firm and the new stakeholder

relations that will emerge and take shape as a result. Enterprise-level strategy often addresses the overriding question of “What do we stand for?”⁷

Thus, at the enterprise level, the task of setting strategic direction involves understanding the role in society of a particular firm as a whole and its relationships to other social institutions. Important questions then become:

- What is the role of our organization in society?
- How is our organization perceived by our stakeholders?
- What principles or values does our organization represent?
- What obligations do we have to society at large, including the world?
- What are the broad implications for our current mix of businesses and allocation of resources?

Many firms have addressed some of these questions—perhaps only in part or in an ad hoc way. The point of enterprise-level strategy, however, is that the firm needs to address these questions intentionally, specifically, and cohesively in such a way that a corporate public policy is articulated.

How have business firms addressed these questions? What are the manifestations of enterprise-level thinking and corporate public policy? The manifestations show up in a variety of ways in different companies—for example, how a firm responds when faced with public crises. Does it respond to its stakeholders in a positive, constructive, and sensitive way or in a negative, defensive, and insensitive way? Corporate decisions and actions reveal the presence or absence of soundly developed enterprise-level strategy. Companies also demonstrate the degree of thinking that has gone into public issues by the presence or absence and use or nonuse of codes of ethics, codes of conduct, mission statements, values

http://SEARCH THE WEB WEB

ENTERPRISE-LEVEL STRATEGY IN ACTION

One of the best ways to appreciate a company's corporate public policy or enterprise-level strategy is to examine its posture on corporate citizenship. A company that was recognized recently for its corporate citizenship is Microsoft. Microsoft has been highly ranked for years as a good corporate citizen. In 2007, Microsoft was recognized again as one of the “100 Best Corporate Citizens” by *CRO: Corporate Responsibility Officer* magazine.

According to Microsoft, an important measure of a company's commitment to corporate citizenship is the way it conducts business and works productively with all

its stakeholders. Microsoft asserts that everything it does is guided by corporate values, codes of conduct, and company policies that ensure diversity and fair business practices among vendors and suppliers, provide for good stewardship of the environment in the way it creates and packages its products, and support collaboration with governments and industry on important technology issues such as interoperability and security.

To learn more about Microsoft's commitment to global citizenship, check out its website: <http://www.microsoft.com/about/corporatecitizenship/citizenship/default.aspx>.

statements, corporate creeds, vision statements, or other such policy-oriented codes and statements.

One company that has addressed these concerns is BorgWarner Corporation. In a document titled “Believe It: Managing by Shared Values at BorgWarner,” former Chairman James F. Bere posed and then answered these questions:

- What kind of company are we anyway?
- What does BorgWarner stand for?
- What do we believe?

Figure 5-2 presents the Vision and Beliefs of BorgWarner, a leader in advanced products and technologies such as power train components and systems solutions.

Figure 5-2 Vision and Beliefs of BorgWarner

Our Vision:

BorgWarner is the recognized leader in advanced products and technologies that satisfy customer needs in powertrain components and systems solutions.

Our Beliefs:

Respect for each other

BorgWarner must operate in a climate of openness, trust, and cooperation, in which each of us freely grants others the same respect and decency we seek for ourselves. We expect open, honest, and timely communication. As a global company, we invite and embrace the diversity of all our people.

Power of collaboration

BorgWarner is both a community of entrepreneurial businesses and a single enterprise. Our goal is to preserve the freedom each of us needs to find personal satisfaction while building a strong business that comes from unity of purpose. True unity is more than a melding of self-interests; it results when goals and values are shared.

Passion for excellence

BorgWarner chooses to be a leader—in serving our customers, advancing our technologies, and rewarding all who invest in us. To sustain our leadership, we relentlessly seek to improve our performance. We bring urgency to every business challenge and opportunity. We anticipate change and shape it to our purpose. We encourage new ideas that challenge the status quo, and we seek to involve every mind in the growth of our business.

Personal integrity

We at BorgWarner demand uncompromising ethical standards in all we do and say. We are committed to doing what is right—in good times and in bad. We are accountable for the commitments we make. We are, above all, an honorable company of honorable people.

Responsibility to our communities

BorgWarner is committed to good corporate citizenship. We strive to supply goods and services of superior value to our customers; to create jobs that provide meaning for those who do them; and to contribute generously of our talents and our wealth in the communities in which we do business.

Source: Company document, BorgWarner Corporation. © 1998–2006 BorgWarner Inc. All rights reserved. Reprinted with permission. For more information, check out the company website: <http://www.bwauto.com/about/vision/>.

This document clearly manifests enterprise-level strategy and corporate public policy.

Another good example of enterprise-level strategy is the corporate credo of Johnson & Johnson, shown in Figure 5-3. Note that the Johnson & Johnson credo focuses on statements of responsibility by enumerating its stakeholder groups in the following sequence:

- Doctors, nurses, patients, mothers and fathers (consumers)
- Employees
- Communities
- Stockholders

According to Johnson & Johnson, the company has drawn deeply on the strength of the Credo for guidance through the years. At no time was this more evident than

Figure 5-3 Johnson & Johnson Credo

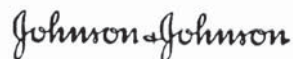
Our Credo

We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products 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.

We are responsible to the communities in which we live and 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: Reprinted with permission from Johnson & Johnson. For more information, see http://www.jnj.com/our_company/our_credo/index.htm?sessionId=RQUXI1QGKCKQCQPCCGSUOA. Retrieved June 5, 2007.

during the Tylenol crises of 1982 and 1986, when the McNeil Consumer & Specialty Pharmaceuticals (now McNeil Consumer Healthcare) product was adulterated with cyanide and used as a weapon. With Johnson & Johnson's good name and reputation at stake, company managers and employees made many decisions that were inspired by the philosophy embodied in the Credo. The company's reputation was preserved, and the Tylenol acetaminophen business was regained.

Today the Credo lives on in Johnson & Johnson as strongly as in the past. Company employees now participate in a periodic survey and evaluation of just how well the company performs its Credo responsibilities. These evaluations are then communicated back to senior management, and where there are deficiencies, corrective action is taken.⁸

Importance of Core Values

It is crucial that firms not only have values statements that provide guidance but that these values also "mean something." Ever since Jim Collins and Jerry Porras published *Built to Last: Successful Habits of Visionary Companies*, companies have felt they needed such statements. The authors made the case that many of the best companies adhere to a set of principles called *core values*. Core values are the deeply ingrained principles that guide all of a company's actions and decisions, and they serve as cultural cornerstones.⁹ Though 80 percent of today's *Fortune* 100 companies claim they have values statements that are publicly proclaimed, many of them have been debased because they are not followed. Companies need to make their values "mean something."¹⁰ To be effective, companies need to weave core values into everything that they do. If a company's core values are not used, they are hollow or empty, such as those found at Enron, and such values statements may be doing more harm than good.

The "**core values**" program that was implemented at the Aluminum Company of America (Alcoa) by one of its chairmen, Paul H. O'Neill, is illustrative. O'Neill had been chairman of Alcoa for less than three months when he began making decisions that seemed to reflect a new way of thinking at Alcoa. Four years later, it became apparent that Alcoa's six "core values" would provide the guiding direction for a new corporate conscience at the firm.¹¹

The six "core values" at Alcoa were identified and articulated by O'Neill and ten senior executives during 100 hours of discussions and reflections. The core values program, known as "Visions, Values, and Milestones," set forth a new ethics agenda built around the following six core values:

1. Integrity
2. Safety and health
3. Quality of work
4. Treatment of people
5. Accountability
6. Profitability

In terms of implementation, Alcoa first began disseminating the core values to its employees. Follow-up was done with films, training seminars, and

departmental meetings. Later, the company began evaluating employees to see how well they had been applying the core values in their work. Although Alcoa, like all large metal makers, has faced some tough economic times, O'Neill argued that whether business was good or bad, the firm was committed to its ethics program. O'Neill argued, "I don't think it's necessary to compromise your values to succeed economically."¹²

Herman Miller, maker of office furniture, reflects its core values and enterprise strategy in its statement of what it believes in:

What we believe in:

Inclusiveness & Diversity

Supplier Diversity

Design

Innovation

The Environment

Operational Excellence

Technology¹³

Over the years, Herman Miller has been judged to be *Fortune's* "most admired" major corporation in the category of social responsibility on several occasions.¹⁴

What do companies that emphasize core values or values-based management believe in? It has been argued that there are three basic organizational values that undergird all others: transparency, sustainability, and responsibility.¹⁵ Transparency emphasizes the company being open and honest, especially with employees. Sustainability is all about pacing the company's growth, and responsibility invokes the idea of commitment to social responsibility. A good example of a values-based business is Stonyfield Farms, a small New Hampshire yogurt company. In addition to making a profit, Stonyfield has a mission to help local dairy farmers get more money for their milk, as many were being paid less than it cost them to produce the milk. Their mission also led them to produce more organic foods for worldwide consumption.¹⁶

Other Manifestations of Enterprise-Level Strategic Thinking

Enterprise-level strategic thinking is manifested in other ways. It may include the extent to which firms have established board or senior management committees. Such committees might include the following: public policy/issues committees, ethics committees, governance committees, social audit committees, corporate philanthropy committees, corporate citizenship committees, and ad hoc committees to address specific public issues. The firm's public affairs function can also reflect enterprise-level thinking. Does the firm have an established public affairs office? To whom does the director of corporate public affairs report? What role does public affairs play in corporate-level decision making? Do public affairs managers play a formal role in the firm's strategic planning?

Another major indicator of enterprise-level strategic thinking is the extent to which the firm attempts to identify social or public issues, analyze them, and

integrate them into its strategic management processes. We will now discuss how corporate public policy is integrated into the strategic management process.

In the final analysis, a firm will need to undergo a “value shift” if it is interested in integrating ethical and social considerations into its financially driven strategic plans. Such a value shift, according to Lynn Sharp Paine, would require the firm to get back to basics and adopt a different kind of management than that typically practiced by companies. She argues that superior performers of the future will be those companies that can meet both the social and financial expectations of their stakeholders.¹⁷ This is a theme we are seeking to develop in this chapter and in this book.

The Strategic Management Process

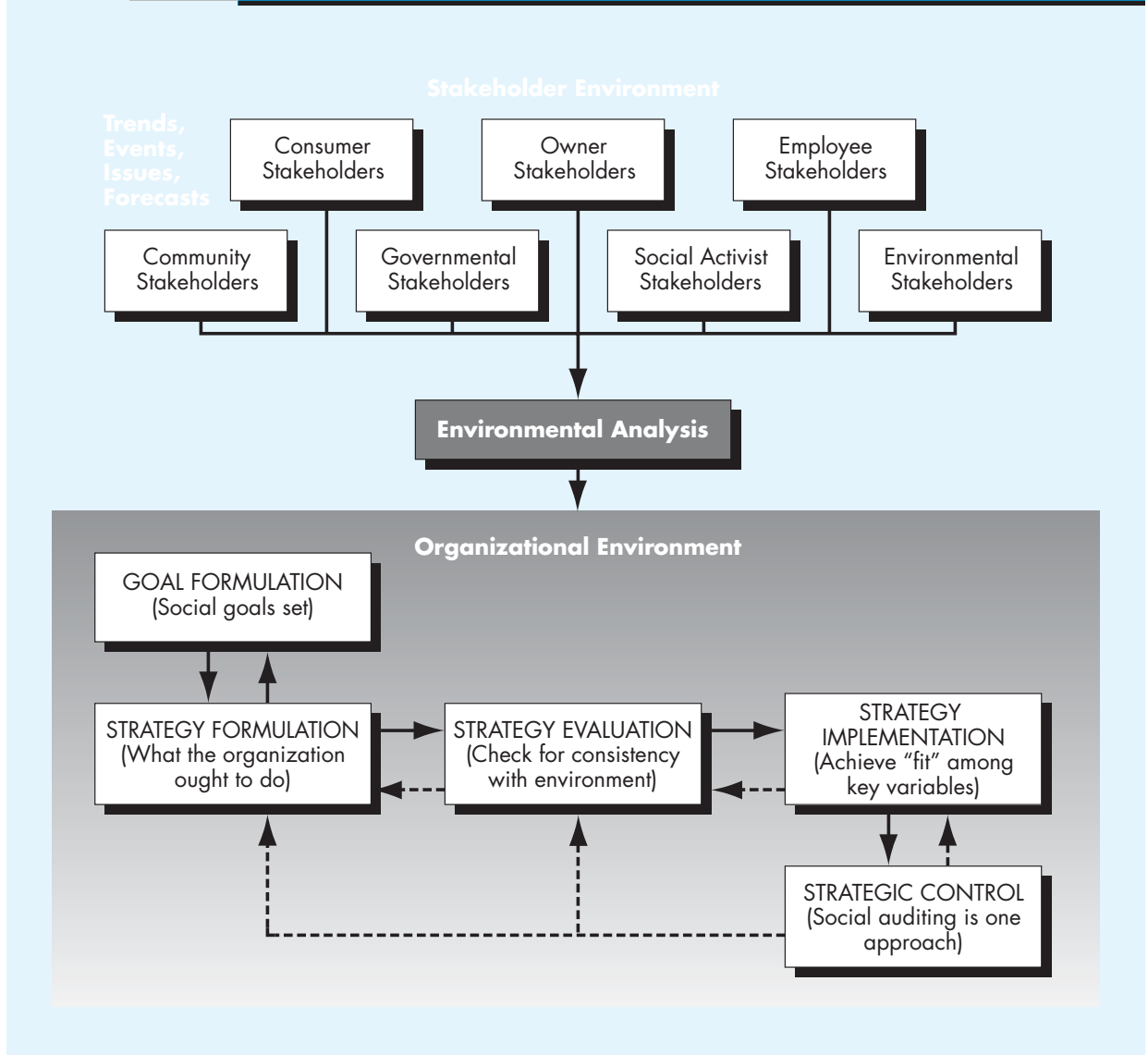
To understand how corporate public policy is just one part of the larger system of management decision making, it is useful to identify the major steps that make up the strategic management process. Boards and top management teams are responsible for activating the process. One conceptualization of the strategic management process includes six steps: (1) goal formulation, (2) strategy formulation, (3) strategy evaluation, (4) strategy implementation, (5) strategic control, and (6) environmental analysis.¹⁸ Figure 5-4 graphically portrays an expanded view of this process.

The environmental analysis component requires collection of information on trends, events, and issues that are occurring in the stakeholder environment, and this information is then fed into the other steps of the process. Although the tasks or steps often are discussed sequentially, they are in fact interactive and do not always occur in a neatly ordered pattern or sequence. Figure 5-4 also captures the relationship between the strategic management process and corporate public policy. Figure 5-5 illustrates Kenneth Andrews’s four major components of strategy formulation and how “acknowledged obligations to society” fit into the step of strategy formulation.¹⁹

STRATEGIC CORPORATE SOCIAL RESPONSIBILITY

In recent years, the term *strategic corporate social responsibility* has captured the idea of integrating a concern for society into the strategic management processes of the firm.²⁰ Such a perspective ensures that CSR is fully integrated into the firm’s strategy, mission, and vision. Strategic management also may be focused on a particular CSR topic or core value to the business firm. An example of this would be the concept of “sustainable strategic management.”²¹ In this concept, sustainability is focused on the “triple bottom line” as discussed earlier. In addition, this concept goes beyond the concern of the firm and argues that the survival and renewal of the greater economic system, social system, and ecosystem are important as well.

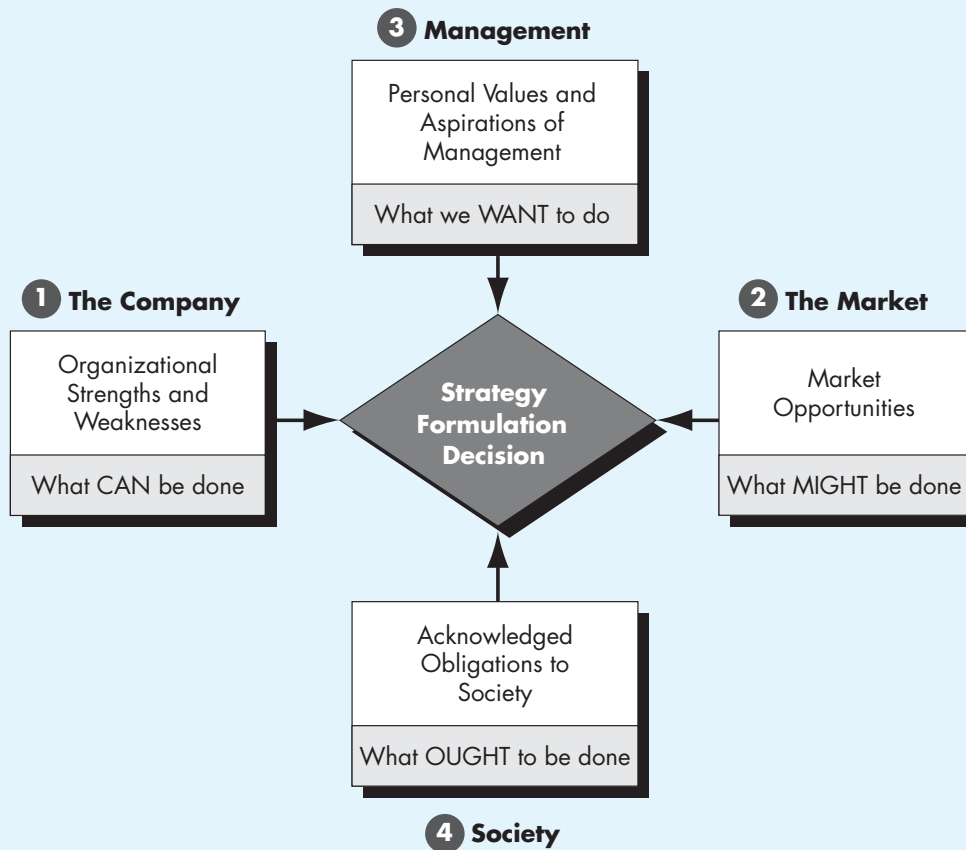
Figure 5-4 *The Strategic Management Process and Corporate Public Policy*



Strategic CSR and sustainable strategic management reflect a firm's enterprise-level strategy discussed earlier.

The notion of strategic CSR got a huge boost when strategy expert Michael Porter began advocating the importance of the linkage between competitive advantage, a crucial strategy concept, and CSR.²² Though Porter had been

Figure 5-5 *Four Components of Strategy Formulation*



preceded by others in advocating this linkage, the strength of his reputation has furthered the cause. He and coauthor Mark Kramer argued that the interdependence between business and society takes two forms: “inside-out linkages,” wherein company operations impact society, and “outside-in linkages,” wherein external societal forces impact companies.²³ In order to prioritize social issues, they proceed to categorize three broad ways corporations intersect with society. First, there are “generic social issues,” wherein a company’s operations do not significantly impact society and the issue isn’t material to the firm’s long-term competitiveness. Second, there are “value chain social impacts,” where a company’s normal operations significantly impact society. Finally, there are “social dimensions of competitive context,” wherein social issues affect the underlying drivers of a company’s competitiveness.²⁴

Porter and Kramer next divide up these three categories into two primary modes of corporate involvement. *Responsive CSR* addresses “generic social impacts” through good corporate citizenship and “value chain social impacts” by mitigating harm from negative corporate impacts on society. Then, *Strategic CSR* transforms “value chain social impacts” into activities that benefit society while simultaneously reinforcing corporate strategy and also advances strategic philanthropy that leverages relevant areas of competitiveness.²⁵

The above ideas are integrated into a series of steps that are intended to integrate business and society strategically. These steps include:

1. Identifying the points of intersection (inside-out and outside-in)
2. Choosing which social issues to address (generic, value chain social impacts, social dimensions of competitiveness)
3. Creating a corporate social agenda (Responsive vs. Strategic)
4. Integrating inside-out and outside-in practices (getting practices to work together)
5. Creating a social dimension to the value proposition (the company adds a social dimension to its value proposition, thus making social impact integral to the overall strategy).²⁶

An example presented of this final point is that of Whole Foods Market (WFM). The value proposition of WFM is to sell natural, organic, healthy food products to customers who passionately care about the environment. Social issues are central to WFM’s mission and are implemented through sourcing approaches, commitment to the environment, and use of environmentally friendly policies and practices.²⁷

The Porter–Kramer framework is useful because it applies strategic thinking to both leverage positive social and environmental benefits and mitigate negative social and environmental impacts in ways that enhance competitive advantage.²⁸ The challenge for companies, therefore, is to find the ways in which the social dimension can be added to the basic business endeavor.

SOCIAL AUDITING AND SOCIAL PERFORMANCE REPORTING

As a management function, strategic control, the fifth step in the strategic management process, seeks to ensure that the organization stays on track and achieves its goals, missions, and strategies. Planning is not complete without control because the control function strives to keep management activities in conformance with plans.

Management control encompasses three essential steps: (1) *setting standards* against which performance may be compared, (2) *comparing* actual performance with what was planned (the standard), and (3) *taking corrective action* to bring the two into alignment, if needed.²⁹ A planning system will not achieve its full potential unless at the same time it monitors and assesses the firm’s progress along key strategic dimensions. Furthermore, there is a need to monitor and control the

“strategic momentum” by focusing on a particular strategic direction while at the same time coping with environmental turbulence and change.³⁰ The social audit is a planning and control approach that is worthy of discussion within the context of strategic management. Some companies actually report their social performance relative to their standards. Others just report their social or values activities and achievements.

Development of the Social Audit

In the context of corporate social performance or corporate public policy, the idea of a **social audit**, or **social performance report**, as a technique for providing planning and control has been experimented with for a number of years. Although the term *social audit* has been used to describe a wide variety of activities embracing various forms of social performance reporting, in this discussion it is defined as follows:

The social audit is a systematic attempt to identify, measure, monitor, and evaluate an organization's performance with respect to its social efforts, goals, and programs.

Implicit here is the idea that some social performance planning has already taken place. And although we refer to the social audit here as a control process, it could just as easily be thought of as a planning and control system.³¹

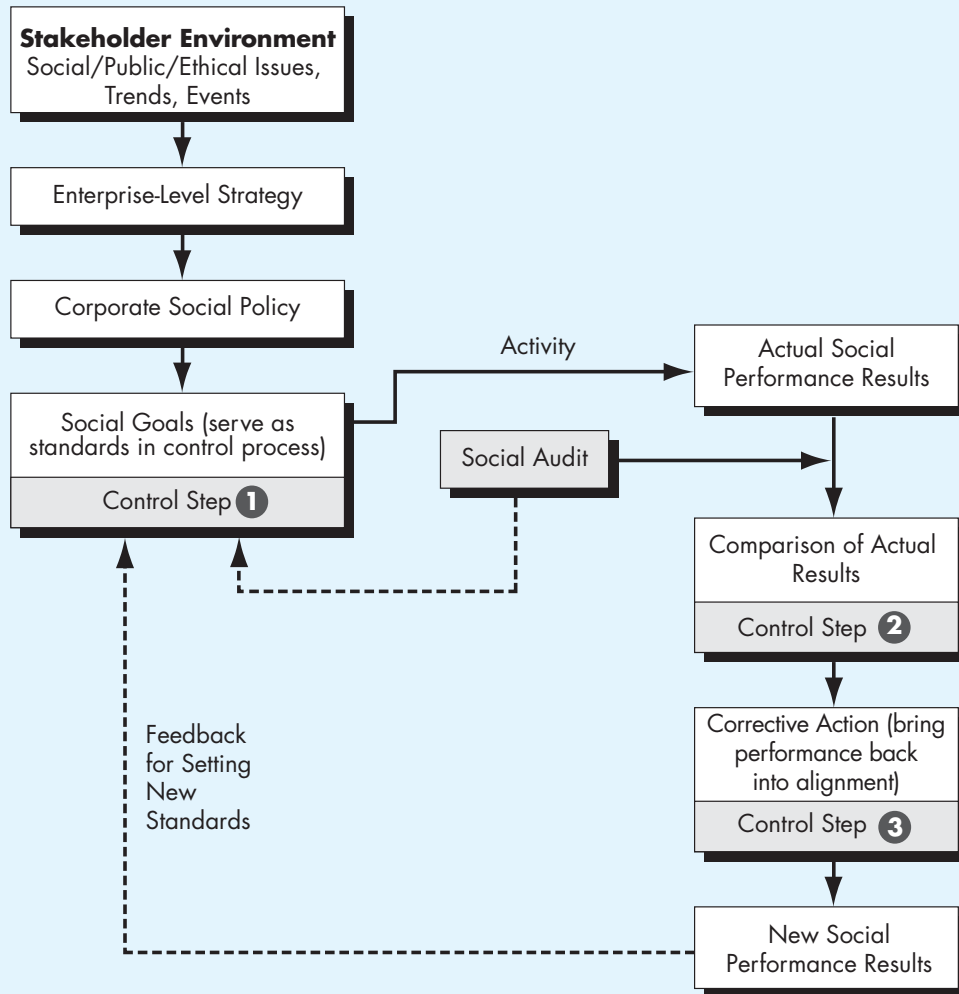
In the context of strategic control, the social audit could assume a role much like that portrayed in Figure 5-6. This figure is similar to the diagram of the strategic management process and corporate public policy shown in Figure 5-4, but it is modified somewhat to highlight social goals, corporate social performance, the social audit, and the first three steps in the strategic control process.

Although the corporate social audit is not in widespread use in industry today, it continues to be advocated as an approach by which companies can integrate social concerns into strategic management. More and more today, various special-interest groups want companies to reveal their social performance results in such areas as environmental sustainability, commitments to workplace conditions, fairness and honesty in dealings with suppliers, customer service standards, community and charitable involvement, and business practices in developing countries. The groups expecting this information range from social activist groups to investor groups such as mutual funds and institutional investors. The Body Shop is a company that has made widespread use of the social audit. In recent years, they have been referring to it as *values reporting*. See the Search the Web feature for more information on the Body Shop's initiatives.

CORPORATE SOCIAL PERFORMANCE REPORTING

Today, all of the following terms are used to describe social performance reports issued on an annual or periodic basis by companies interested in getting their message out: CSR Reports, Social Performance Reports, Corporate Citizenship

Figure 5-6 *The Social Audit in the Context of Strategic Control*



Reports, Sustainability Reports, Values Reports, and so on. Most of these reports use methodologies that are less rigorous than the original idea of social audits. What these reporting processes have in common is that they make the public and stakeholders aware of their social and ethical programs, activities, and achievements. Some of the more advanced reports actually report company achievements relative to previous goals set by management. Others just report what the company has done during the previous reporting period.

The impetus for social performance reports in recent years has come from societal and public interest groups' expectations that firms report their achievements in the social responsibility and sustainability arenas. Such reports typically require monitoring and measuring progress, and this is valuable to management groups wanting to track their own progress as well as be able to report it to other interested parties. Some companies create and issue such reports because it helps their competitive positions. For example, BP's sustainability reports provide the company with important "proof points" for their advertising campaigns.

Globalization is another driver for social performance reports. As more and more companies do business globally, they need to document their achievements when critics raise questions about their contributions, especially in developing countries. Companies such as Nike and Wal-Mart have been criticized for their use of sweatshops abroad, so they have an added incentive to keep track of their social performance and issue such reports. In a recent report, GE presented data documenting its performance with respect to its supplier network as the company strives to cope with globalization by raising and meeting standards abroad.³²

The nonprofit organization Ceres (pronounced "series") gets a lot of credit for the interest in social performance reports during the past ten years. Begun almost twenty years ago, Ceres is a national network of investors, environmental organizations, and other public interest groups working with companies and investors to address sustainability challenges. Global climate change has been a recent interest. The mission of Ceres is to integrate sustainability "into capital markets for the health of the planet and its people."³³ Because of its interests, it is little surprise that many companies today are using the terminology of Sustainability Reports.

A specific initiative of Ceres has been its annual award for Sustainability Reporting, begun less than ten years ago. These awards have doubtless increased attention to the idea of social performance reporting. The awards are now called the Ceres-ACCA Awards for Sustainability Reporting, recognizing the joint initiative

<http://SEARCHTHEWEBWEB>

THE BODY SHOP AND VALUES REPORTING

The Body Shop has played a significant role in spearheading the move for companies to report on their social and environmental performance. When they published their first Values Report in 1995, their "sustainability reporting" was described by the United Nations Environment Programme as "trailblazing." The Body Shop received a similar accolade from them following the 1997 Values Report, which was ranked highest of all social and environmental reports

globally. Later, their Values Reports got even more specialized, and a separate report was issued for various stakeholder groups: customers, employees, suppliers, environment, franchisees, and investors. To see the most recent Body Shop values reports and to learn more about values reporting at the Body Shop, go to: <http://www.thebodyshopinternational.com/Values+and+Campaigns/Our+Principles+and+Policies/>.

with the Association of Chartered Certified Accountants (ACCA). During the 2006 Awards competition, Ceres-ACCA proudly announced that it had received a record-breaking 102 entries. In 2006, the award winners were Vancity Group (Canada's largest credit union) for Best Sustainability Report, and Bristol-Myers Squibb Co. was the runner-up. Winners of Best First-Time Sustainability Reports were Green Mountain Coffee Roasters and Mountain Equipment Co-op.³⁴

The organization that keeps the most comprehensive data on social performance reports is CorporateRegister.com. CorporateRegister.com is a free directory of company-issued CSR, Sustainability, and Environment reports from around the world, and the site is continually updated with new reports and companies.³⁵ The tremendous growth in CSR Reports can be seen by data collected by CorporateRegister.com. In the year 2000, 823 reports were issued. In 2006, 2,235 reports were issued. This shows the number almost tripling in just six years. Companies from the following countries represented the top number of reports issued: the United Kingdom, the United States, Japan, Germany, Australia, and Canada. Up until 2003, most such reports were categorized as Environmental, but since that time, the two growing categories have been Corporate Responsibility and Sustainability.³⁶

Ceres launched the Global Reporting Initiative (GRI) to help create standardization in social performance reporting. GRI is now considered the de facto international standard (used by more than 850 companies) for corporate reporting on environmental, social, and economic performance.³⁷

Global Reporting Initiative

One of the major impediments to the advancement of effective social performance reporting has been the absence of standardized measures for social reporting. Standardization is a challenge that has been undertaken by a consortium of more than 300 global organizations called the **Global Reporting Initiative (GRI)**. The Global Reporting Initiative was established in 1997 with the mission of developing globally applicable guidelines for reporting on the economic, environmental, and social performance of corporations, governments, and nongovernmental organizations (NGOs). It was spearheaded by Ceres in conjunction with the U.N. Environment Programme (UNEP). GRI includes the participation of corporations, NGOs, accountancy organizations, business associations, and other worldwide stakeholders.³⁸

The GRI's Sustainability Reporting Guidelines were first released in draft form in 1999. They represented the first global framework for comprehensive sustainability reporting, encompassing the "triple bottom line" of economic, environmental, and social issues. In 2002, the GRI was established as a permanent, independent, international body with a multi-stakeholder governance structure. Now based in Amsterdam, its core mission is maintenance, enhancement, and dissemination of the guidelines through a process of ongoing consultation and stakeholder engagement. In 2004, in part due to the efforts of Ceres, its Coalition, and the Ceres companies, there are more than 600 organizations who report using the GRI. Through what is known as the G3 process, new GRI guidelines were

released in 2006.³⁹ The new GRI guidelines provide principles and guidance for firms to follow in developing their sustainability reports. The purpose of the principles is to help companies stay focused and to maximize value for internal and external stakeholders. U.S. companies participating have included Agilent, Baxter International, Coca-Cola Enterprises, Ford, Nike, GM, and Texaco.

As firms develop enterprise-level strategies and corporate public policies, the potential for social responsibility and sustainability reporting remains high. Social reporting is best appreciated not as an isolated, periodic attempt to assess social performance but rather as an *integral part* of the overall strategic management process as it has been described here. Because the need to improve planning and control will remain as long as management desires to evaluate its corporate social performance, the need for approaches such as the social audit and social

Ethics in Practice Case

NOT MUCH RANGE FOR THIS MANAGER

I used to work for a golf course at the driving range. My basic responsibilities and those of my fellow employees were quite simple. We took money from customers, gave them a basket of golf balls to hit, made sure there was an adequate supply of golf balls, and moved the tees on the driving range so there would be decent grass for the players to hit off. It was well known that everyone, including our manager, gave away free baskets of balls to family members and, occasionally, good friends. When the golf course acquired a new golf professional, giving away free baskets of balls was supposed to stop.

After the new golf pro had been working for a couple of months, he realized that all, or some, of the range personnel were still giving away free baskets of balls. Our manager at the time was still giving away free balls, along with all the employees, but the golf pro was not aware of this fact. The golf pro proceeded to talk to our manager and tell him that he needed to fire the employee who was continuing to give away free baskets of balls.

Because the job at the range did not require much work, everyone was laid back about the job and came in a little late almost every day. Our manager, who

was regularly at least 15 to 30 minutes late, set this trend. Within a week after the golf pro told our manager to fire the employee who was giving away the free baskets, I noticed that the employee who had been working there for the longest time had been fired. Once this employee was gone, our manager wrote up a new set of rules and posted them in the office. The first rule was NO FREE BASKETS OF BALLS. NO EXCEPTIONS! When I read this new rule, I assumed the fired employee had been caught by the golf pro giving away free baskets of balls. After I spoke with the fired employee, he told me that our manager fired him due to excessive tardiness.

1. Who, if anyone, in this case acted in an unethical manner? If they did, how?
2. Should I have told the golf pro the whole story? If I did, how would it affect the other employees and me?
3. Does the employee who was fired have a legal recourse to pursue further action?

Contributed Anonymously

responsibility reporting will likely be with us for some time, too. The net result of continued use and refinement should be improved corporate social performance and enhanced credibility of business in the eyes of its stakeholders and the public. In terms of practice, it must be said that social performance reporting has become more popular than the more complex task of social auditing. Regardless, both approaches serve much the same purpose and help to keep the organization on track with its social performance goals.

Public Affairs

Public affairs (PA) and **public affairs management** are umbrella terms used by companies to describe the management processes that focus on the formalization and institutionalization of corporate public policy. The public affairs function is a logical and increasingly prevalent component of the overall strategic management process. Public affairs experts argue that it has grown significantly into one of the most important parts of strategic management over the past decade and today may be seen as the strategic core business function for companies wanting to compete successfully internationally.⁴⁰

As an overall concept, public affairs management embraces corporate public policy, discussed earlier, along with **issues and crisis management**, which will be considered in more detail in Chapter 6. Indeed, many issues management and crisis management programs are housed in **public affairs departments** or intimately involve public affairs professionals. Corporate public affairs also embraces the broad areas of governmental relations and corporate communications.

It should be emphasized that different names are used to describe management's efforts to address the stakeholder environment. Many companies use different titles for the same functions. According to the most recent report of the Foundation for

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PUBLIC AFFAIRS COUNCIL

The Public Affairs Council is the leading association for public affairs professionals. It provides information, training, and other resources to its members to support their effective participation in government, community, and public relations activities at all levels. More than 600 member corporations, associations, and consulting firms work together to enhance the value and professionalism of the public affairs practice and to provide thoughtful leadership as corporate citizens.

One of the PAC's publications, *Integrating Corporate Social Responsibility Into Your Corporate Strategic Architecture*, provides a useful study on how CSR can and does play an integral role in achieving a firm's overall corporate strategy.

For more information on the Public Affairs Council, visit its webpage at <http://www.pac.org/index.shtml>.

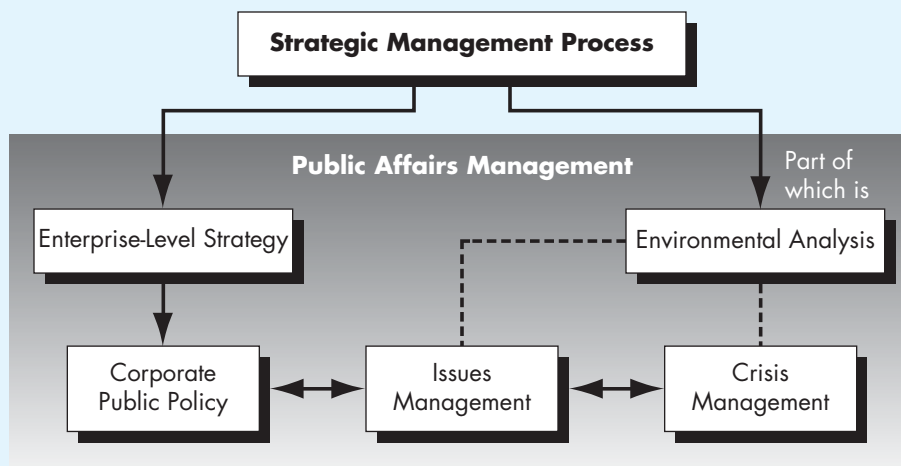
Public Affairs, the following names are often used to represent the public affairs function in companies:⁴¹

- Corporate Public Affairs
- Public Affairs, Policy, and Communications
- Public Policy
- Public Relations and Government Affairs
- Communications and Public Affairs
- Communications and External Affairs
- Government and Public Affairs

Public Affairs as a Part of Strategic Management

In a comprehensive management system, which we have been describing in this chapter, the overall flow of activity would be as follows. A firm engages in strategic management, part of which includes the development of enterprise-level strategy, which poses the question, “What do we stand for?” The answers to this question help the organization to form a corporate public policy, which is a more specific posture on the public, social, or stakeholder environment or specific issues within this environment. Some firms call this a *public affairs strategy*.

Figure 5-7 Relationships Among Key Corporate Public Affairs Concepts



Two important planning approaches in corporate public policy are issues management and, often, crisis management. These two planning aspects frequently are derived from or are related to environmental analysis, which was mentioned earlier. Some companies embrace these processes as part of the corporate public affairs function. These processes are typically housed, from a departmental perspective, in a public affairs department. *Public affairs management* is a term that often describes all these components. Figure 5-7 helps illustrate likely relationships among these processes.

We will now consider how the public affairs function has evolved in business firms, what concerns public affairs departments currently face, and how public affairs thinking might be incorporated into the operating manager's job. This last issue is crucial, because public affairs management, to be most effective, is best thought of as an indispensable part of every manager's job, not as an isolated function or department that alone is responsible for the public issues and stakeholder environment of the firm.

The Corporate Public Affairs Function Today

According to a former Public Affairs Council president, public affairs blossomed in the United States because of four primary reasons: (1) the growing magnitude and impact of government; (2) the changing nature of the political system, especially its progression from a patronage orientation to an issues orientation; (3) the growing recognition by business that it was being outflanked by interests that were counter to its own on a number of policy matters; and (4) the need to be more active in politics outside the traditional community-related aspects, such as the symphony and art museums.⁴²

Thus, the public affairs function as we know it today was an outgrowth of the social activism begun decades ago. Just as significant federal laws were passed in the early 1970s to address such issues as discrimination, environmental protection, occupational health and safety, and consumer safety, corporations responded with a surge of public affairs activities and creation of public affairs departments.⁴³

Today, the Public Affairs Council (PAC), the leading professional organization of executives who do the public affairs work of companies, located in Washington, DC, broadly defines public affairs as

*the management function responsible for interpreting the corporation's non-commercial environment and managing the corporation's response to that environment.*⁴⁴

PUBLIC AFFAIRS ACTIVITIES AND FUNCTIONS

Public affairs as a management function progressed out of isolated company initiatives designed to handle such diverse activities as community relations,

corporate philanthropy and contributions, governmental affairs, lobbying, grass-roots programs, corporate responsibility, and public relations. In some firms, the public relations staff handled issues involving communication with external publics, so it is not surprising that public affairs often evolved from public relations. Part of the confusion between public relations and public affairs is traceable to the fact that some corporate public relations executives changed their titles, but not their functions, to *public affairs*.

Though modern public affairs may have evolved from early public relations efforts and company activities, public affairs today embraces public relations as one of its many functions. According to one major survey of corporate public affairs, 64 percent of the companies surveyed included public relations in the list of activities they performed.⁴⁵

Activities and Functions

According to the Public Affairs Council, the most frequently used titles for the public affairs function are:⁴⁶

- Government affairs/relations
- Public affairs
- Corporate relations/affairs
- Corporate communications
- External affairs/relations

To appreciate what specific activities are typically included in public affairs, it is useful to consider the most recent information on the state of public affairs. This survey asked companies' respondents to indicate whether they included certain activities as parts of their public affairs function. Figure 5-8 lists the most frequent activities and percentages of firms indicating they engaged in those activities. Government relations—federal and state—head the list, along with political action committees, issues management, and local government relations rounding out the top five activities.

Influence of Public Affairs on Corporate Strategy

An important issue in the public affairs function is the influence it has on corporate strategy and planning. If the public affairs function is to be effective in representing the “non-commercial” factors and issues affecting business decision making, it is important that public affairs has influence at the top management level. According to the most recent data from the Public Affairs Council, the following represents the ways in which it has influence at the strategic management level.

Public affairs:

- Identifies/prioritizes public policy issues for senior management, operating units, divisions, and/or departmental levels
- Comments on corporate, operating unit, division, and/or departmental strategic and business plans for sensitivity to emerging political/social trends

Figure 5-8 Public Affairs Activities

Public Affairs Activities	Percentage of Companies
Federal government relations	95%
State government relations	85%
Political action committees	83%
Issues management	82%
Local government relations	79%
Business/trade association oversight/assessment	75%
Direct corporate political contributions	75%
Grassroots/grasstops	75%
Coalitions	71%
Charitable contributions/foundation	59%
Community relations	58%
Public interest group relations	55%
Crisis management	50%
Corporate communications/public relations	47%
Employee communications	45%

Source: Foundation for Public Affairs, *The State of Corporate Public Affairs*, Washington, DC, 2007. Used with permission.

- Provides forecast of political/social trends for senior management and other levels
- Implements the strategic and business planning process at corporate and lower levels
- Is represented on corporate planning committee

Another way for public affairs to have an impact on top management is suggested in what has been called a “new positive model” of public affairs. According to this model, the CEO of the company ought to be the company’s chief public affairs officer. The idea here is that the public affairs function needs a transformation from reacting to proacting and that the best way to make this happen is to place the CEO in charge of the function.⁴⁷ This might not work as a practical reality, but the spirit of the idea is appropriate. It is an excellent idea in terms of elevating the importance of public affairs and its relationship to corporate strategy.

Important Public Affairs Concepts Today

Important public affairs concepts today include “looking out and looking in,” “buffering and bridging,” “tools and techniques,” and the use of ethical guidelines for public affairs professionals. Each of these concepts is useful in terms of successful corporate public affairs.

Looking Out and Looking In

A useful perspective on the public affairs function in organizations today depicts the function as a window:

*The public affairs function serves as a window: Looking out, the organization can observe the changing environment. Looking in, the stakeholders in that environment can observe, try to understand, and interact with the organization.*⁴⁸

When the public affairs function is viewed in this way, it is easy to understand how the “product” of the public affairs department is seen as the smoothing of relationships with external stakeholders and the management of company-specific issues.

Buffering and Bridging

Another important perspective on public affairs is also useful. Corporate public affairs activities can be thought of in terms of two types: activities that “buffer” the organization from the social and political environment and activities that “bridge” the organization with that environment. It has been found that as organizations experienced increased environmental uncertainty, buffering and bridging increased as well. Building bridges with external environmental uncertainty was found to be positively related to top management’s philosophy.⁴⁹ Bridging is a proactive stance that is most likely to be undertaken by companies with a stakeholder orientation.

Tools and Techniques

How do public affairs professionals get their work done? They use a mixture of tools and techniques that have been successful over the years as well as state-of-the-art approaches made possible by technology and experience. Public affairs tools and techniques include the policies, practices, functions, and processes intended to fulfill public affairs objectives.⁵⁰ Among the most useful of these tools and techniques are the following:⁵¹

- Environmental monitoring/scanning (including issue and stakeholder management)
- Working with the grassroots
- Constituency building
- Issue advertising
- Lobbying
- Political action committees
- Corporate social audits
- Web activism
- Coalitions and alliances
- Community investment
- Stakeholder management⁵²

Each of these tools and techniques has an advanced body of literature describing how it is employed by public affairs specialists in the achievement of their objectives.

Ethical Guidelines

A significant challenge today for public affairs professionals is to conduct their functions in an ethical fashion. As public trends push organizations toward more transparency, there are many opportunities for questionable practices, especially in such arenas as political action, government relations, and communications. Therefore, it is encouraging to know that a code of conduct or set of ethical guidelines has been established for individuals working in public affairs. These ethical guidelines are set forth in Figure 5-9. They deserve careful scrutiny.

Figure 5-9 Ethical Guidelines for Public Affairs Professionals

THE PUBLIC AFFAIRS PROFESSIONAL . . .

. . . maintains professional relationships based on honesty and reliable information, and therefore:

Represents accurately his or her organization's policies on economic and political matters to government, employees, shareholders, community interests, and others.

Serves always as a source of reliable information, discussing the varied aspects of complex public issues within the context and constraints of the advocacy role.

Recognizes the diverse viewpoints within the public policy process, knowing that disagreement on issues is both inevitable and healthy.

. . . seeks to protect the integrity of the public policy process and the political system, and he or she therefore:

Publicly acknowledges his or her role as a legitimate participant in the public policy process and discloses whatever work-related information the law requires.

Knows, respects and abides by federal and state laws that apply to lobbying and related public affairs activities.

Knows and respects the laws governing campaign finance and other political activities, and abides by the letter and intent of those laws.

. . . understands the interrelation of business interests with the larger public interests, and therefore:

Endeavors to ensure that responsible and diverse external interests and views concerning the needs of society are considered within the corporate decision-making process.

Bears the responsibility for management review of public policies which may bring corporate interests into conflict with other interests.

Acknowledges dual obligations to advocate the interests of his or her employer, and to preserve the openness and integrity of the democratic process.

Presents to his or her employer an accurate assessment of the political and social realities that may affect corporate operations.

Source: The Public Affairs Council (Washington, DC), <http://www.pac.org/page/ethics/EthicalGuidelines.shtml>. Retrieved June 5, 2007. Reprinted with permission.

INTERNATIONAL PUBLIC AFFAIRS CONTINUES TO GROW

It is essential at this point to provide some specific comments on international public affairs. Thirty-five years ago, the Public Affairs Council identified international PA as a new corporate function and formed a task force to investigate it. Three points seemed to emerge time and again. First, it became obvious that more and more significant public affairs challenges and problems were occurring in the global arena, with greater impacts on the company. Second, the number of firms with effective international PA capacities was small and growing very slowly. Third, the task force found that serious internal and external challenges often made an international PA program more difficult than a domestic program.⁵³ Today, the international dimension of public affairs is expanding due to the following reasons: companies expanding into new markets, changes in sales in existing markets, changes in CEO priorities, changes in regulatory burden, and the acquisition of new business units.⁵⁴

International public affairs, to function properly, must balance externally and internally focused activities. Externally, the central challenge is to manage the company's relations with various host countries where business is conducted. Requirements here include understanding and meeting host-country needs and dealing with diverse local constituencies, audiences, cultures, and governments. Internally, international PA programs must establish and coordinate external programs, educate company officials on PA techniques, and assist wherever possible the company's efforts to improve operations, activities, and image.⁵⁵ International public affairs has been found to be one of the fastest-growing new areas of public affairs activities.⁵⁶

Competencies Needed

As international public affairs continues to grow, it is useful to think in terms of competencies that are needed in the global arena. Competencies include the knowledge, skills, and abilities that are necessary to perform successfully. It has been asserted that the following competencies are needed for successful international public affairs:⁵⁷

- *Development of intercultural competence.* This addresses how the practice of PA works in different nations.
- *Knowing the impact of societal factors on public affairs.* For example, this includes state-to-state relations, level of economic development in different countries, and political ideologies.
- *Understanding local public policy institutions and processes.* This entails understanding other countries' forms of government, legal systems, and political cultures.
- *Nation state-specific applications of PA functions.* This includes knowing how community relations works and all forms of stakeholder relations.

- *Language skills.* The inability to speak multiple languages may put the PA professional at a disadvantage.
- *Understanding global business ethics.* PA managers need to provide leadership in establishing, communicating, and maintaining ethical guidelines of companies at home and abroad.
- *Managing international consultants, alliances, and issue partners.* Sometimes specialized assistance can only come from local experts, groups, or associations.

Public Affairs Strategy

We will not discuss the issue of **public affairs strategy** extensively, but it is useful to report the findings of a major research project that was undertaken by Robert H. Miles and resulted in the classic book titled *Managing the Corporate Social Environment: A Grounded Theory*. Because little work has been done on public affairs strategy, Miles's work deserves recognition. Miles's study focused on the insurance industry, but many of his findings may be applicable to other businesses.⁵⁸

DESIGN OF EXTERNAL AFFAIRS AND CORPORATE SOCIAL PERFORMANCE

Miles studied the external affairs strategies (also called *public affairs strategies*) of major insurance firms in an effort to see what relationships existed between the strategy and design of the corporate external affairs function and corporate social performance. He found that the companies that ranked best in corporate social performance had top management philosophies that were *institution oriented*. That is, top management saw the corporation as a social institution that had a duty to adapt to a changing society and thus needed a collaborative/problem-solving external affairs strategy. The **collaborative/problem-solving strategy** was one in which firms emphasized long-term relationships with a variety of external constituencies and broad problem-solving perspectives on the resolution of social issues affecting their businesses and industries.⁵⁹ Note how similar this is to the stakeholder management view and the bridge-building activity discussed previously.

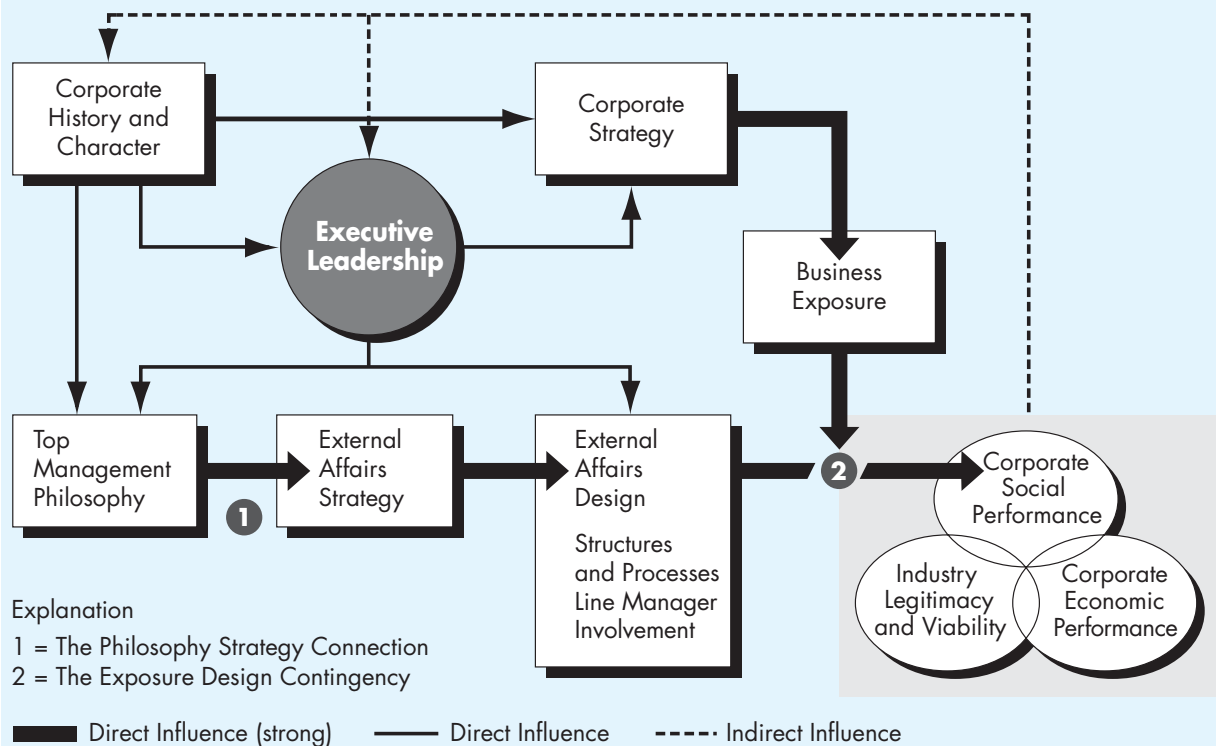
Miles also found that the companies with the worst social performance records employed top management philosophies based on operation of the company as an independent economic franchise. Such philosophies were in sharp contrast with the institution-oriented perspectives of the best social performers. In addition, Miles found that these worst social performers employed an **individual/adversarial external affairs strategy**. In this posture, the executives denied the legitimacy of social claims on their businesses and minimized the significance of challenges they received from external critics. Therefore, they tended to be adversarial and legalistic.⁶⁰

BUSINESS EXPOSURE AND EXTERNAL AFFAIRS DESIGN

On the subject of the external affairs units within firms, Miles found that a contingency relationship existed between what he called business exposure to the social environment and four dimensions of the external affairs design: breadth, depth, influence, and integration. High business exposure to the social environment means that the firm produces products or services that move them into the public arena because of such issues as their availability, affordability, reliability, and safety. In general, consumer products tend to be more “exposed” to the social environment than do commercial or industrial products.⁶¹

Breadth, depth, influence, and integration refer to dimensions of the external affairs unit that provide a measure of sophistication versus simplicity. Units that

Figure 5-10 Miles’s Model of Corporate Social Performance



Source: Robert H. Miles, *Managing the Corporate Social Environment: A Grounded Theory* (Englewood Cliffs, NJ: Prentice-Hall, Inc., 1987), 274. Reprinted with permission.

are high on these dimensions are sophisticated, whereas units low on these dimensions are simple. Miles found that firms with high business exposure to the social environment require more sophisticated units, whereas firms with low business exposure to the social environment could manage reasonably well with simple units.⁶²

It is tempting to overgeneralize Miles's study, but we must note it as a significant finding in the realm of public affairs strategy and organizational design research. The important conclusion seems to be that a firm's corporate social performance (as well as its industry legitimacy and viability and economic performance) is a function of business exposure, top management philosophy, external affairs strategy, and external affairs design. Figure 5-10 presents Miles's theory of corporate social performance, which remains valuable today.

Other initiatives in public relations strategy include integrating public affairs into corporate strategic planning, using strategic management audits for public affairs, building a balanced performance scorecard for public affairs, managing the corporation's reputation, and using core competencies to manage performance.⁶³ Other key variables that have been recognized that require strategic adjustments include responding to industry differences and issue life cycle challenges.⁶⁴

Incorporating Public Affairs Thinking into All Managers' Jobs

In today's highly specialized business world, it is easy for the day-to-day operating managers to let public affairs departments worry about government affairs, community relations, issues management, PR, or any of the numerous other PA functions. It has been argued that organizations ought to incorporate public affairs, or what we would call *public affairs thinking*, into every operating manager's job. Operating managers are vital to a successful PA function, especially if they can identify the public affairs consequences of their actions, be sensitive to the concerns of external groups, act to defuse or avoid crisis situations, and know well in advance when to seek the help of the PA experts. There are no simple ways to achieve these goals, but four specific strategies may be helpful: (1) make public affairs truly relevant, (2) develop a sense of ownership of success, (3) make it easy for operating managers, and (4) show how public affairs makes a difference.⁶⁵ Each of these strategies is briefly discussed.

MAKE PUBLIC AFFAIRS RELEVANT TO ALL MANAGERS

Operating managers often need help in seeing how external stakeholder factors can and do affect them. A useful mechanism is analysis of the manager's job in terms of the likely or potential impacts that her or his decisions may have on the

stakeholder environment and possible developments in the environment that may affect the company or the decision maker. One approach for doing this might be to list the manager's various impacts, the interested or affected strategic stakeholder groups, the potential actions of the groups, and the effects of the groups on jobs or the company.

Another mechanism is linking achievement of the manager's goals to public affairs. A plant manager, for example, can be shown how failure to pay attention to community groups can hinder plant expansion, increased output, and product delivery. Failure to address the affected stakeholders can be shown to be related to extensive delays as these neglected groups seek media attention or pressure local officials.

A third way to make PA relevant is to use the language of the operating manager. Instead of using the jargon of public affairs, every effort should be made to employ language and terms with which the manager is familiar. Thus, terms such as *environment* to mean *local community*, and *stakeholder* to mean *employees and residents* must be used cautiously, because operating managers may not be able to comprehend them fully.⁶⁶

Still another way to make public affairs relevant is to demonstrate to operating managers that several operations areas are affected by public affairs issues. Some of these key areas include marketing, manufacturing, and human resources. Some of the specifics in the manufacturing arena are product safety and quality, energy conservation, water pollution, air pollution, transportation, and raw materials.

A topic of interest today to public affairs managers is that of moving jobs offshore. Many day-to-day managers are being asked to downsize their departments or to eliminate them entirely. This is a good example of a decision managers need to make that has public affairs implications and is quite relevant to today's operating managers.

HELP MANAGERS DEVELOP A SENSE OF OWNERSHIP

It is helpful for operating managers to have participated in planning and goal setting and thus to have had an opportunity to develop a sense of ownership of the public affairs endeavor. Operating managers may be formally or informally enlisted in these planning efforts. At PPG Industries, Inc., operating managers were given the responsibility for coordinating all actions concerning specific issues. As issue managers, they were asked to see to it that issue and environmental monitoring occurred, that strategy was developed, and that actions were implemented at various governmental levels.⁶⁷

At Kroger, Inc., regional public affairs executives worked with the individual operating divisions as they were developing their business plans. A public affairs section was included in each operating division's plan, and it was the division's plan, not the PA department's plan. As a result of these efforts, the divisions began to feel that they had "ownership" of the PA goals in their plans.⁶⁸ This approach

seemed to work much better than having PA executives simply impose goals or expectations on the operating units.

MAKE IT EASY FOR OPERATING MANAGERS

Operating managers have experience in meeting goals and timetables in their own realms. The PA area, however, can often appear nebulous, fuzzy, or inconclusive. Further, operating managers have neither the time for nor the interest in setting up systems or strategies for PA initiatives. This is where the PA professionals can assist them by making their tasks easier. Any procedures, data collection systems, or strategies that PA can supply should be used.

Training in public affairs can be helpful, too. Operating managers can better see the relevance and importance of PA work if carefully chosen topics are put on the agendas of their periodic training sessions. If PA effectiveness is to be monitored, measured, and made a part of performance evaluation systems, care must be taken to make sure that such systems are fair and straightforward, or at least understandable. If PA does not make a careful effort to ensure that its expectations are reasonably met, resistance, resentment, and failure will surely follow.

SHOW HOW PUBLIC AFFAIRS MAKES A DIFFERENCE

Part of what professional PA staff members need to do is to keep track of public affairs successes in such a way that operating managers can see that their specific actions or efforts have led to identifiable successes for the company. A scorecard approach, whereby operating managers can see that their efforts have helped to avoid or prevent serious problems, is useful. The scorecard may be used to reinforce managers' efforts and to help other managers see the potential of the PA function. The scorecard should explicitly state the objectives that have been achieved, the problems that have been avoided, and the friends that have been made for the company.

Obviously, such a scorecard may be of a qualitative nature, but this is necessary in order to describe clearly what has been accomplished. Operating managers need to be shown that there are specific payoffs to be enjoyed from their public affairs efforts. It is up to the PA professionals to document these achievements. If no payoff is demonstrable from PA efforts, operating managers are likely to invest their time elsewhere.⁶⁹

Public affairs is not just a specialized set of management functions to be performed by a designated staff. The nature of the tasks and challenges that characterize public affairs work is such that participation by operating managers is essential. It is likely that PA departments will continue to serve as the backbones of corporate organizations, but true effectiveness will require that operating managers be integrated into the accomplishment of these tasks. The mutual interdependence of these two groups—professionals and operating managers—will produce the best results.

Future of Corporate Public Affairs in the Twenty-first Century

With growing worldwide sensitivity to corporate social performance and business ethics, it is easy to argue that corporate public affairs has a bright future in the twenty-first century. As a result of the tsunami of ethical crises in corporations in the early 2000s, public affairs specialists have an ideal opportunity to solidify their strategic roles and help to transform companies' approaches to handling business and society relationships. Three different opportunities for public affairs executives have been set forth for future consideration.⁷⁰

First, public affairs can help to develop value-based enterprises. Such enterprises actively seek out stakeholders and work cooperatively with them on social issues. An example cited was when Whirlpool reached agreements with the National Resource Defense Council, Friends of the Earth, and the Sierra Club to work together in solving energy-efficiency challenges. By proactively engaging stakeholders, competitive advantages may be created.⁷¹ Second, public affairs executives can assert themselves as thought leaders in their companies. As thought leaders, they should not just toe the company line but actively engage academics, researchers, media, and public opinion formers about the great issues of the day and how companies can best respond to the latest thinking about social and public issues. As public affairs executives increasingly have the ear of top management, they are uniquely positioned to have great influence.

Finally, public affairs specialists have the opportunity to seek alternative arenas of resolution, as they can broaden issues to embrace global considerations while they pay close attention to domestic matters. Today, public issues migrate across geographical boundaries and political jurisdictions, and public affairs executives are in a perfect position to track these issues and employ preemptive initiatives. A case in point might be their opportunities in the global debate over genetically modified organisms, which are controversial in the United Kingdom while being largely ignored in the United States.⁷² In short, the public affairs function within firms is strategically positioned to wield more and better influence in the years ahead to help business build bridges between its strategic management and its corporate social performance.

Summary

Corporate public policy is a firm's posture or stance regarding the public, social, or ethical aspects of stakeholders and corporate functioning. It is a part of strategic management, particularly enterprise-level strategy. Enterprise-level strategy is the broadest, over-

arching level of strategy, and its focus is on the role of the organization in society. A major aspect of enterprise-level strategy is the integration of important core values into company strategy. The other strategy levels include the corporate, business, and functional levels. The strategic

management process entails six stages, and a concern for social, ethical, and public issues may be seen at each stage. In the control stage, the social audit or social performance report is crucial. In recent years, social performance reports or sustainability reports have become more prevalent than social audits.

Public affairs might be described as the management function that is responsible for monitoring and interpreting a corporation's noncommercial environment and managing its response to that environment. Public affairs is intimately linked to corporate public policy, environmental analysis, issues management, and crisis management. The major functions of public affairs departments today include government relations, political action, community involvement/responsibility, issues management, international public affairs, and corporate philanthropy. A continuing growth area is international public affairs.

In terms of public affairs strategy, a collaborative/problem-solving strategy has been shown to

be more effective than one that is individualistic/adversarial. Research has shown that a firm's corporate social performance, as well as its industry legitimacy, viability, and economic performance, is a function of business exposure, top management's philosophy, external affairs strategy, and external affairs design. In addition to being viewed as a staff function, public affairs is important for operating managers. Four specific strategies for incorporating public affairs into operating managers' jobs include make it relevant, develop a sense of ownership, make it easy, and show how it can make a difference.

In the future, public affairs executives are positioned to increase their status and influence as they embark on such challenges as helping to create values-based enterprises, exerting themselves as thought leaders in their companies, and helping to seek alternative arenas of resolution as they broaden issues to embrace global considerations.

Key Terms

business-level strategy (page 157)

collaborative/problem-solving strategy
(page 181)

core values (page 162)

corporate-level strategy (page 157)

corporate public affairs (page 155)

corporate public policy (page 154)

enterprise-level strategy (page 157)

Global Reporting Initiative (GRI) (page 171)

individual/adversarial external affairs strategy
(page 181)

issues and crisis management (page 173)

public affairs (PA) (page 173)

public affairs departments (page 173)

public affairs management (page 173)

public affairs strategy (page 181)

social audit (page 168)

social performance report (page 168)

strategic management (page 155)

strategic management processes (page 153)

value shift (page 164)

Discussion Questions

1. Explain the relationship between corporate public policy and strategic management.
2. Which of the four strategy levels is most concerned with social, ethical, or public issues? Discuss the characteristics of this level.
3. Identify the steps involved in the strategic management process.

4. What is the difference between a social audit and a social performance report? Why are social performance reports increasing in popularity?
5. What is the difference between public relations and public affairs? Why has there been confusion regarding these two concepts?
6. Why do you think international public affairs is a major growth area? Give specific reasons for your answer.
7. Differentiate between a collaborative/problem-solving strategy and an individual/adversarial strategy. Which seems to be more effective in corporate public affairs?
8. What are the major ways in which public affairs might be incorporated into every manager's job? Rank them in terms of what you think their impact might be.

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Issues Management and Crisis Management

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Distinguish between the conventional and strategic approaches to issues management.
- 2 Identify and briefly explain the stages in the issues management process.
- 3 Describe the major components in the issues development process and some of the factors that have characterized issues management in actual practice.
- 4 Define a crisis and identify the four crisis stages.
- 5 List and discuss the major stages or steps involved in managing business crises.

Throughout this book, we will discuss major social and ethical issues that have become controversies in the public domain. Some have been serious events or crises that continue to serve as recognizable code words for business—Love Canal, Three Mile Island, the Tylenol poisonings, the Union Carbide Bhopal tragedy, the Exxon *Valdez* oil spill, the Coca-Cola soft drink recalls in Europe, and the Firestone/Ford tread separation controversy. In September 2001, the attacks on the Twin Towers of the World Trade Center in New York and the Pentagon presented an unprecedented crisis, not only for the businesses located there, but others as well. The shock waves of this terrorist attack on the symbols of global capitalism will be felt for many years to come, and the traumatic event and those that have followed have surely put the topic of crisis management back on the front burner of business's agenda. The term "9/11" now brings to memory a major period of crisis and turmoil for business and society.

Immediately following 9/11, the Enron, WorldCom, Tyco, Arthur Andersen, and other financial scandals started being reported and even today continue to

represent an issue, in general, for the business system. The big issue for business is that of “trust.” Can the public trust business? In the past few years, has business restored the trust of consumers, employees, investors, and the public?

Other continuing issues—employee rights, sexual harassment, product safety, food safety, workplace safety, sweatshops, bribery and corruption, smoking in the workplace, deceptive advertising, and, more recently, terrorism and illegal immigration, remain on page one. To business, these are formidable social and ethical issues that have developed over time and that must be addressed. In the past several years, potential crises have been looming on the horizon. Hurricanes Katrina and Rita created crises for many businesses but also highlighted the need for planning. Fears about a global bird flu pandemic have also put this issue at the top of many companies’ priorities.

Managerial decision-making processes known as **issues management** and **crisis management** are two major ways by which business has responded to these situations. These two approaches symbolize the extent to which the environment has become turbulent and the public has become sensitized to business’s responses to the issues that have emerged from this turbulence. In today’s environment of instantaneous and global communication, no event is too small to get noticed by everyone.

In the ideal situation, issues management and crisis management might be seen as the natural and logical by-products of a firm’s development of enterprise-level strategy and overall corporate public policy, but this has not always been the case. Some firms have not thought seriously about public and ethical issues. For them, these approaches represent first attempts to come to grips with the practical reality of a threatening external environment. When preparedness for issues and crises has occurred, however, it has typically been found that top-level and middle-level managers have a higher readiness than do employees, and thus these functions become vital leadership responsibilities.¹

Many firms have been fortunate that major crises have not materialized to stun them as they did in the Johnson & Johnson Tylenol poisonings, the Union Carbide Bhopal explosion, the Procter & Gamble Rely tampon crisis, the Dow Corning breast implant probe, the crashes of TWA Flight 800 and ValuJet Flight 592, the cyanide-tainted Sudafed capsule crisis that led to two deaths, or the attacks on the World Trade Center. Thus, they have seen what major business crises can do to companies without having experienced such crises themselves. Such firms should now be concerned with issues management and crisis management in preparing for an uncertain future.

As indicated in the previous chapter, many companies place responsibility for issues management and crisis management within their public affairs function. The most recent data show that issues management occurs within public affairs activities 82 percent of the time, and crisis management responsibility rests within public affairs 50 percent of the time.² This shows the close linkage between these

processes, but it also suggests companies are finding other departments in which to place responsibility for these activities.

Like all planning processes, issues management and crisis management have many characteristics in common. They also have differences, and we have chosen to treat them separately for discussion purposes though they are interrelated. One common thread that should be mentioned at the outset is that both processes are focused on improving stakeholder management and enabling the organization to be more ethically responsive to stakeholders' expectations. Issues and crisis management, to be effective, must have as their ultimate objective an increase in the organization's responsiveness to its stakeholders.

They are also related to the extent that effective issues management may enable managements to engage in more effective crisis management. That is, through well-conducted issues management initiatives, some crises may be anticipated and avoided. Many of the crises companies face today arise out of issue categories that are being monitored and prioritized through issues management systems. Thus, the two approaches are often directly related.

Figure 6-1 provides examples of major *issue* categories and specific *crises* that have occurred within these issue categories. A review of this figure should clearly illustrate the relationship between issues and crises.

Issues Management

Issues management is a process by which organizations identify issues in the stakeholder environment, analyze and prioritize those issues in terms of their relevance to the organization, plan responses to the issues, and then evaluate and monitor the results. It is helpful to think of issues management in connection with concepts introduced in the preceding chapter, such as the strategic management process, enterprise-level strategy, corporate public policy, and environmental analysis. The process of strategic management and environmental analysis requires an overall way of managerial thinking that includes economic, technological, social, and political issues. Enterprise-level strategy and corporate public policy, on the other hand, focus on public or ethical issues. Issues management, then, devolves from these broader concepts.

TWO APPROACHES TO ISSUES MANAGEMENT

Thinking about the concepts mentioned here requires us to make some distinctions. A central consideration seems to be that issues management has been thought of in two major ways: (1) narrowly, in which public, or social, issues are the primary focus, and (2) broadly, in which strategic issues and the strategic management process are the focus of attention. Fahey has provided a useful distinction between these two approaches. He refers to (1) the conventional approach and (2) the strategic management approach.³

Figure 6-1 Issue Categories and Specific Crises Within Categories

<i>Issue Categories</i>		
Food, Beverage, & Products	Health-Related Issues	Corporate Fraud and Ethics
<p>Crises</p> <p>Taco Bell: Outbreak of E. coli closed restaurants nationwide (2006).</p> <p>Coke and Pepsi: Allegations that soft drinks in India contained pesticide residue (2004–2007).</p> <p>Coke's Dasani bottled water: High levels of bromate led to recall in Great Britain (2004).</p> <p>Mad Cow Disease crisis: Outbreaks in Europe and Canada have created crises in sales and safety for meat industry (2001–2004).</p> <p>Firestone and Ford: Tire tread separation outbreak (2001–2002).</p> <p>Food Lion: Supermarket chain accused by ABC-TV's <i>Prime Time Live</i> of selling spoiled meat (1992).</p> <p>Safeway Stores: Deli closed when health authorities alleged salmonella in sausages (1997).</p> <p>Sandhurst Farms: Orange juice recalled due to claim of metal fragments found in bottle (1996).</p>	<p>Crises</p> <p>Avian Flu: A possible bird flu pandemic has created a crisis environment for many businesses, including mask makers who are facing short supplies (2006–2007).</p> <p>Banned dietary supplements androstenedione and ephedra by FDA: Crisis for dozens of pharmaceutical and vitamin firms (2004).</p> <p>Tobacco companies: Dangerous products and advertising. Allegations of addictions and death by cancer (1990s–2004).</p> <p>Dow Corning: Silicone breast implants alleged to lead to serious health problems (1994).</p> <p>Johnson & Johnson: Cyanide-tampering Tylenol poisonings (1982).</p> <p>A.H. Robins: Dalkon Shield sales suspended when linked to pelvic inflammatory diseases resulting in spontaneous abortions (1982–1984).</p> <p>Procter & Gamble: Rely tampons recalled when associated with toxic shock syndrome (1980).</p>	<p>Crises</p> <p>Hewlett-Packard: Boardroom information was leaked, causing a governance crisis (2006).</p> <p>Hyundai's CEO arrested and jailed for bribery and slush fund charges (2006).</p> <p>Boeing: Loses CEO and top-level executive to ethics scandals (2004–2005).</p> <p>Enron: Scandal began with off-the-books partnerships, aggressive accounting, and allegations of fraud and bankruptcy (2001–2004).</p> <p>WorldCom: CEO Bernard Ebbers charged with massive accounting fraud (2003–2004).</p> <p>Arthur Andersen: Implicated in Enron scandal, resulting in eventual dissolution of firm (2002).</p> <p>Tyco: CEO Kozlowski and CFO Swartz charged with corrupt practices, looting company, and tax evasion (2003–2004).</p> <p>Martha Stewart: Charged with securities fraud, perjury, and obstruction of justice (2003–2004).</p> <p>HealthSouth: Founder and CEO Scrushy indicted on charges he cooked the books while the board stood by (2003).</p>

Conventional Approach (Narrowly Focused)

This approach to issues management has the following characteristics:⁴

- Issues fall within the domain of public policy or public affairs management.
- Issues typically have a public policy/public affairs orientation or flavor.
- An issue is any trend, event, controversy, or public policy development that might affect the corporation.
- Issues originate in social/political/regulatory/judicial environments.

Strategic Management Approach (Broadly Inclusive)

This approach to issues management has evolved in a small number of companies and is typified by the following:⁵

- Issues management is typically the responsibility of senior line management or strategic planning staff.
- Issues identification is more important than it is in the conventional approach.
- Issues management is seen as an approach to the anticipation and management of external and internal challenges to the company's strategies, plans, and assumptions.

The strategic approach to issues management has also been advocated by such authorities as H. Igor Ansoff⁶ and William R. King.⁷ Figure 6-2 portrays strategic issues management as depicted by Ansoff. Note the "strategic" characteristics—threats/opportunities and strengths/weaknesses—that are normally considered to be a part of the strategic management process.

At the risk of oversimplification, we will consider the primary distinction between the two perspectives on issues management to be that the conventional approach focuses on public/social issues, whereas the strategic approach is broadly inclusive of all issues. In addition, the conventional approach can be used as a "stand-alone" decision-making process, whereas the strategic approach is intimately interconnected with the strategic management process as a whole. Another difference may be whether operating managers, strategic planners, or

http://SEARCH THE WEB WEB

WHAT DOES ISSUES MANAGEMENT MEAN IN PRACTICE?

One of the best ways to understand practically what concepts mean to business is to explore how major consulting firms define the terms. Such is the case with the concept of issues management as seen by the consulting firm Kroll. Kroll claims to be the world's leading risk consulting company. Kroll depicts issues management in the following way:

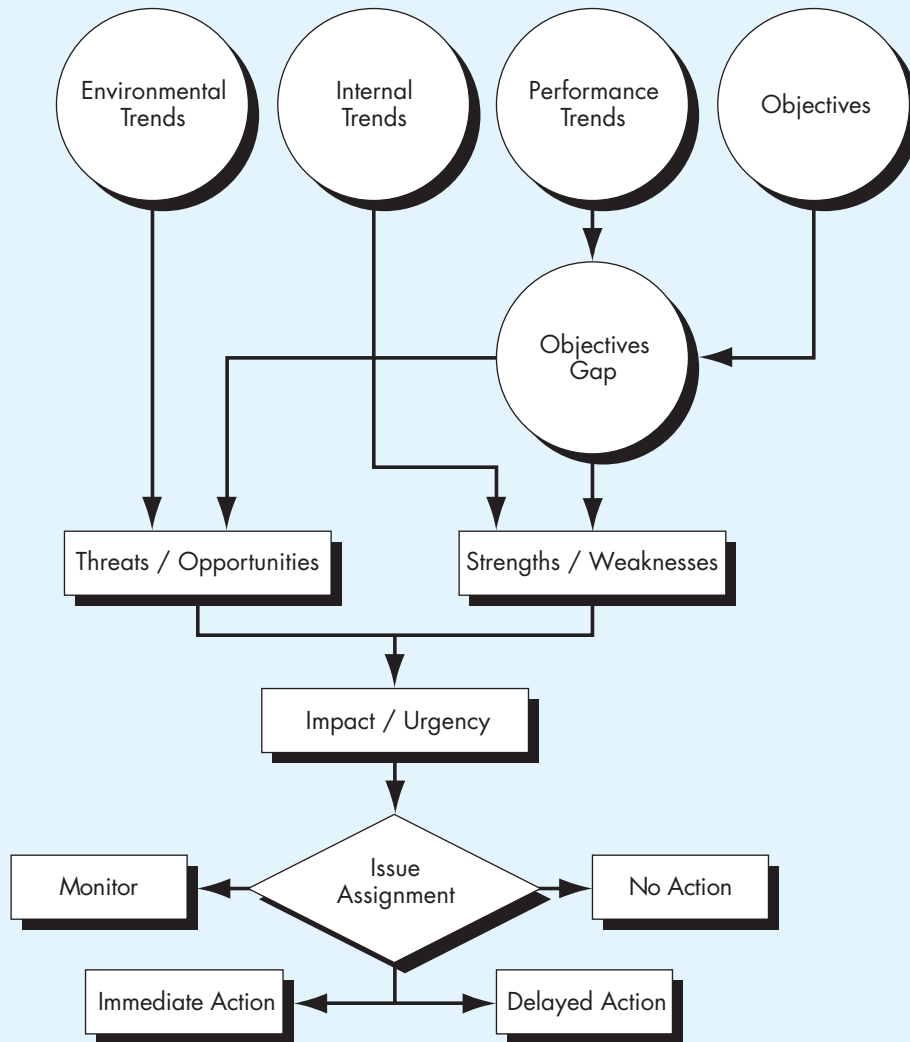
Issues management is a management intervention process for anticipating trends, concerns or evolving events which have the potential to substantially impact a business and its stakeholders. The intervention is followed by developing strategies designed to best position the company, deflect the concern, or mitigate the consequences of the

identified issue. The key to effective issues management is managing the issue rather than reacting to it.

Kroll is quick to point out that a firm's reputation is at stake and, therefore, early identification of an emerging issue that could mature into a crisis gives the organization more flexibility in influencing the direction the issue takes.

For more information about how a consulting firm such as Kroll would help a company design an issues management process, go to the company's website at http://www.kroll.com/services/corp_prep/issues_management/.

Figure 6-2 *Strategic Issue Management*



Source: H. Igor Ansoff, "Strategic Issue Management," *Strategic Management Journal* (Vol. 1, 1980), 137. Reprinted by permission of John Wiley & Sons, Ltd.

public affairs staff members are implementing the system. Beyond these distinctions, the two approaches have much in common.

Our discussion in this chapter will emphasize the conventional approach, because this book focuses on public, social, and ethical stakeholder issues. We

should point out, however, that our purpose in the preceding chapter was to convey the notion that social issues ought to be seen as just one part of the broader strategic management process. There we discussed environmental analysis as a broad phenomenon. Now we emphasize social or ethical issues, although it is obvious that a consideration of these issues is embedded in a larger, more strategically focused process, such as that depicted in Figure 6-2.

Therefore, we are comfortable with both of these perspectives on issues management. We should point out that the conventional approach could be perceived as a subset of the strategic approach. Much of what we say about issues management applies to issues arising from social/ethical domains or strictly business domains. In a sense, the two approaches are highly inseparable, and it is difficult for organizations to operate effectively unless both are addressed in some way. For our purposes, however, the conventional perspective will be emphasized.

THE CHANGING ISSUE MIX

The emergence in the past two decades of new “company issues management groups” and “issues managers” has been a direct outgrowth of the changing mix of issues that managers have had to handle. Economic and financial issues have always been an inherent part of the business process, although their complexity seems to have increased as global markets have broadened and competitiveness has become such a critical issue. The growth of technology, especially the Internet, has presented business with other issues that need to be addressed. The most dramatic growth has been in social, ethical, and political issues—all public issues that have high visibility, media appeal, and interest among special-interest stakeholder groups. We should further observe that these issues become more interrelated over time.

For most firms, social, ethical, political, and technological issues are at the same time economic issues, because firms’ success in handling them frequently has a direct bearing on their financial statuses, reputations, and economic well-being. Over time, there is a changing mix of issues and an escalating challenge that management groups face as these issues create a cumulative effect.

A Portfolio Approach

Many firms get affected by so many issues that one wonders how they can deal with them all. One way is to see no connection between the issues; that is, issues are thought of on an issue-by-issue basis. An alternative to this view is the “**portfolio approach**.”⁸ In this view, experience with prior issues is likely to influence future issues, and therefore a portfolio view is in order. Such a portfolio view provides focus and coherence to the firm’s dealing with the mix of issues it faces. Issues that might show up in Royal Dutch Shell’s issue portfolio, for example, might be stopping climate change, protecting biodiversity, reducing wastewater, and operating in sensitive regions. A company such as Shell might deal with hundreds of issues, but the issue portfolio helps to prioritize and provide focus for the company’s resources. The nonadoption of certain issues into the portfolio does not signal neglect but is part of a rational process of issues management in which strategic priorities are vital.⁹

ISSUE DEFINITION AND THE ISSUES MANAGEMENT PROCESS

Before describing the issues management process, we should briefly discuss what constitutes an issue and what assumptions we are making about issues management. An **issue** may be thought of as a matter that is in dispute between two or more parties. The dispute typically evokes debate, controversy, or differences of opinion that need to be resolved. At some point, the organization needs to make a decision on the unresolved matter, but such a decision does not mean that the issue is resolved. Once an issue becomes public and subject to public debate and high-profile media exposure, its resolution becomes increasingly difficult. One of the features of issues, particularly those arising in the social or ethical realm, is that they are ongoing and therefore require ongoing responses.

Following are some of the characteristics of an “**emerging issue**”:¹⁰

- The terms of the debate are not clearly defined.
- The issue deals with matters of conflicting values and interest.
- The issue does not lend itself to automatic resolution by expert knowledge.
- The issue is often stated in value-laden terms.
- Trade-offs are inherent.

The question of issue definition can be complicated because of the multiple viewpoints that come into play when an issue is considered. There are multiple stakeholders and motivations in any given management situation. Personal stakes frequently can be important factors but often are ignored or not taken into consideration. For example, some of the affected parties may be interested in the issue from a deep personal perspective and will not compromise or give up their positions, even in the face of concrete evidence that clearly refutes them.¹¹ Thus, the resolution of issues in organizations is not easy.

What about the assumptions we make when we choose to use issues management? It has been contended that the following assumptions are typically made:¹²

- Issues can be identified earlier, more completely, and more reliably than in the past.
- Early anticipation of issues widens the organization’s range of options.
- Early anticipation permits study and understanding of the full range of issues.
- Early anticipation permits the organization to develop a positive orientation toward the issue.
- The organization will have earlier identification of stakeholders.
- The organization will be able to supply information to influential publics earlier and more positively, thus allowing them to better understand the issue.

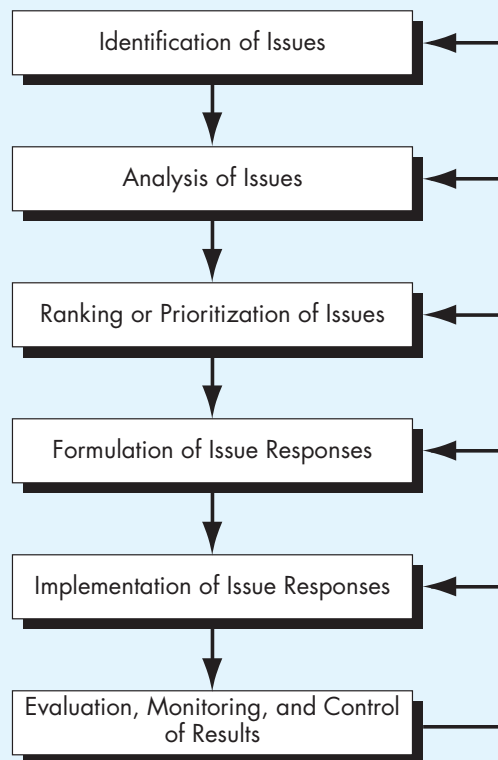
These are not only assumptions of issues management but also benefits in that they make the organization more effective in its issues management process.

Model of the Issues Management Process

Like the strategic management process, which entails a multitude of sequential and interrelated steps or stages, the issues management process has been conceptualized by many different authorities in a variety of ways. Conceptualizations of issues management have been developed by companies, academics, consultants, and associations. The issues management process discussed here has been extracted from many of the conceptualizations previously developed. This process represents the elements or stages that seem to be common to most issues management models. This process is consistent with the stakeholder orientation we have been developing and using.

Figure 6-3 presents a model of the issues management process as we will discuss it. It contains *planning aspects* (identification, analysis, ranking/prioritization of issues, and formulation of responses) and *implementation aspects* (implementation of responses and evaluation, monitoring, and control of results). Although we

Figure 6-3 *The Issues Management Process*



will discuss the stages in the issues management process as though they were discrete, in reality they may be interrelated and overlap one another.

Identification of Issues

Many names have been given to the process of issue identification. At various times, the terms *social forecasting*, *futures research*, *environmental scanning*, and *public issues scanning* have been used. Similarly, many techniques have been employed. All of these approaches/techniques are similar, but each has its own unique characteristics. Common to all of them, however, is the need to scan the environment and to identify emerging issues or trends that might later be determined to have some relevance to or impact on the organization. In recent years, examples of identified issues that may have widespread ramifications for many organizations include natural disasters (e.g., Hurricane Katrina), acts of terrorism (e.g., World Trade Center), and potential pandemics (e.g., bird flu outbreaks).

Issue identification, in its most rudimentary form, involves the assignment to some individuals in the organization the tasks of continuously scanning a variety of publications—newspapers, magazines, specialty publications, the World Wide Web, blogs—and developing a comprehensive list of potentially relevant issues. Often, this same person or group is instructed to review public documents, records of congressional hearings, and other such sources of information. One result of this scanning is an internal report or a newsletter that is circulated throughout the organization. The next step in this evolution may be for the company to subscribe to a trend information service or newsletter that is prepared and published by a private individual or consulting firm that specializes in environmental or issue scanning.¹³

Two popular trend-spotting services have been (1) the author/consultant John Naisbitt, who was thrust into public recognition by his bestseller *Megatrends*, and (2) DYG, Inc., the New York-based social research firm founded by Daniel Yankelovich. DYG is a recognized leader in the field of social research and is distinguished by its expertise in the analysis and interpretation of social/cultural trends and human motivation.¹⁴ On a fee basis, these professionals provide firms with materials they have assembled.¹⁵ Among the services offered by such firms are newsletters, short weekly or monthly reports, telephone bulletins, and quarterly visits to discuss what the trends mean. Trend spotters do not claim clairvoyance, but they do say that they have less psychological resistance than their clients to seeing impending change.¹⁶

John Naisbitt has claimed to be different from many trend spotters. His original approach, which has been controversial, was based on the belief that trends start with isolated local events. As Naisbitt once stated, “The really important things that happen always start somewhere in the countryside. Taken together, what’s going on locally is what’s going on.” Thus, according to Naisbitt, it is what people are doing, not what they are saying, that provides the most reliable pictures of issues. Naisbitt has continued his identification of public issues with *Megatrends 2000: Ten New Directions for the 1990s*, *Global Paradox*, *Megatrends Asia*, and *High*

Tech/High Touch.¹⁷ Naisbitt's most recent book is *Mind Set! Re-Set your Thinking and See the Future* (2007). In *Mind Set!*, Naisbitt makes several surprising predictions for the twenty-first century.¹⁸

- There will be no “Next Big Thing” for decades. The world will be busy fine-tuning discoveries from the twentieth century.
- Industries are becoming global “economic domains.” They will add more to the global economy than national economies.
- China may never reach global business dominance, especially as soon as many Westerners fear.
- Europe will continue to be plagued by political battles, high taxes, restrictive labor laws, falling exports, and weak productivity.

Though John Naisbitt is the most well-known futurist, other futurists have been around for decades and have contributed to the body of knowledge that has helped issue identification. Futurist T. Graham Molitor, now president of Public Policy Forecasting, a firm specializing in assessing political, social, and technological trends, has long been a consultant on futures research. Molitor proposed that there are five leading forces as predictors of social change.¹⁹

- Leading events
- Leading authorities/advocates
- Leading literature
- Leading organizations
- Leading political jurisdictions

If these five forces are monitored closely, impending social change can be identified and, in some cases, predicted. Figure 6-4 presents Molitor's five leading forces, as well as examples that might be thought to illustrate his points. The attacks on the World Trade Center in New York and the Pentagon in Washington in 2001 and the wars in Afghanistan and Iraq have doubtlessly added the issue of “preparation for terrorism” to future lists of leading events portending significant social change. National security and business security are now vital issues for managers today.

Molitor, who is also vice president of the World Future Society, estimates that he buys one thousand books a year to add to the thirty thousand books filling his personal library. He says he scans some 60 publications each day, trying to identify trends or issues that may have implications for businesses and governments. Molitor has assembled an amazing reservoir of knowledge as he has spent four decades advising hundreds of *Fortune* 500 companies and institutions on how the world might change the next day, the next decade, even the next millennium, and how to make the most of these changes.²⁰

Companies vary considerably in their willingness to spend tens or hundreds of thousands of dollars for the kinds of professional services we have described, but some rely almost exclusively on these kinds of sources for issue identification. Others use less costly and more informal means.

Figure 6-4 Examples of Forces Leading Social Change

Leading Forces	Examples	Public Issue Realm
Events	E. coli outbreak	Food safety
	Avian flu outbreaks	Public health/safety
	Enron, WorldCom, Arthur Andersen	Corporate governance, fraud
	World Trade Center attacks	Security against terrorism
	Destruction of World Trade Center	Terrorism as public threat
	Three Mile Island/Chernobyl nuclear plant explosions	Nuclear plant safety
	Bhopal explosion	Plant safety
	Earth Day	Environment
	Tylenol poisonings	Product tampering
	Love Canal	Toxic waste-environment
	Rely tampons	Product safety
	Ivan Boesky scandal	Insider trading abuses
	Thomas hearings	Sexual harassment
	Valdez oil spill	Environment
Authorities/Advocates	Ralph Nader	Consumerism
	Rachel Carson	Pesticides and genetic engineering
	Rev. Martin Luther King	Civil rights
	Rev. Jesse Jackson	Blacks' rights
	General Colin Powell	Volunteerism
Literature	<i>Global Warming</i> (John Houghton)	Global warming
	<i>Unsafe at Any Speed</i> (Ralph Nader)	Automobile safety
	<i>Megatrends</i> (John Naisbitt)	Issues identification
Organizations	Friends of the Earth	Environment
	Sierra Club	Environment
	Action for Children's Television (ACT)	Children's advertising
	People for the Ethical Treatment of Animals (PETA)	Animal rights
	Mothers Against Drunk Driving (MADD)	Highway safety, alcohol abuse
Political Jurisdictions	State of Michigan—Whistle-Blower Protection Act	Employee freedom of speech
	State of Delaware	Corporate governance
	States of Massachusetts, Vermont, California	Gay marriage, civil unions

Issues Selling and Buying

Though the source of all issues is the external environment, the internal perception of and managerial treatment of issues greatly affects the issue identification process. The key in issue identification is getting the people who are regularly

confronted with issues in touch with top managers who can do something about them. This process has two aspects. First is **issues selling**. This relates to middle managers exerting upward influence in organizations as they try to attract the attention of top managers to issues that are salient to them and the organization.²¹ In other words, they have to sell top management on the importance of the issue. The second part of this process is **issue buying**. This involves top managers adopting a more open mind-set for the issues that matter to their subordinates.²² In short, the issue identification process is significantly affected by internal organization members and their assessments as to what is salient to the organization.

Analysis of Issues

The next two steps in the issues management process (analysis and ranking of issues) are closely related. To analyze an issue means to carefully study, dissect, break down, group, or engage in any specific process that helps management better understand the nature or characteristics of the issue. An analysis requires that management looks beyond the obvious manifestations of the issue and strives to learn more of its history, development, current nature, and potential for future relevance to the organization. A series of key questions that focus on stakeholder groups in attempting to analyze issues has been proposed:²³

- Who (which stakeholders) is affected by the issue?
- Who has an interest in the issue?
- Who is in a position to exert influence on the issue?
- Who has expressed opinions on the issue?
- Who ought to care about the issue?

In addition to these questions, the following key questions have been proposed to help with issue analysis:²⁴

- Who started the ball rolling? (Historical view)
- Who is now involved? (Contemporary view)
- Who will get involved? (Future view)

Answers to these questions place management in a better position to rank or prioritize the issues so that it will have a better sense of the urgency with which the issues need to be addressed.

Ranking or Prioritization of Issues

Once issues have been carefully analyzed and are well understood, it is necessary to rank them in some form of a hierarchy of importance or relevance to the organization. We should note that some issues management systems place this step before analysis. This is done especially when it is desired to screen out those issues that are obviously not relevant and deserving of further analysis.

The prioritization stage may range from a simple grouping of issues into categories of urgency to a more elaborate or sophisticated scoring system. Two

examples will serve to illustrate the grouping technique. Xerox has used a process of categorizing issues into three classifications:

1. *High priority* (issues on which management must be well informed),
2. *Nice to know* (issues that are interesting but not critical or urgent), and
3. *Questionable* (issues that may not be issues at all unless something else happens).

PPG Industries has grouped issues into three priorities:

Priority A (critical issues that warrant executive action and review),

Priority B (issues that warrant surveillance by the division general manager or staff),
and

Priority C (issues that have only potential impact and warrant monitoring by the public affairs department).²⁵

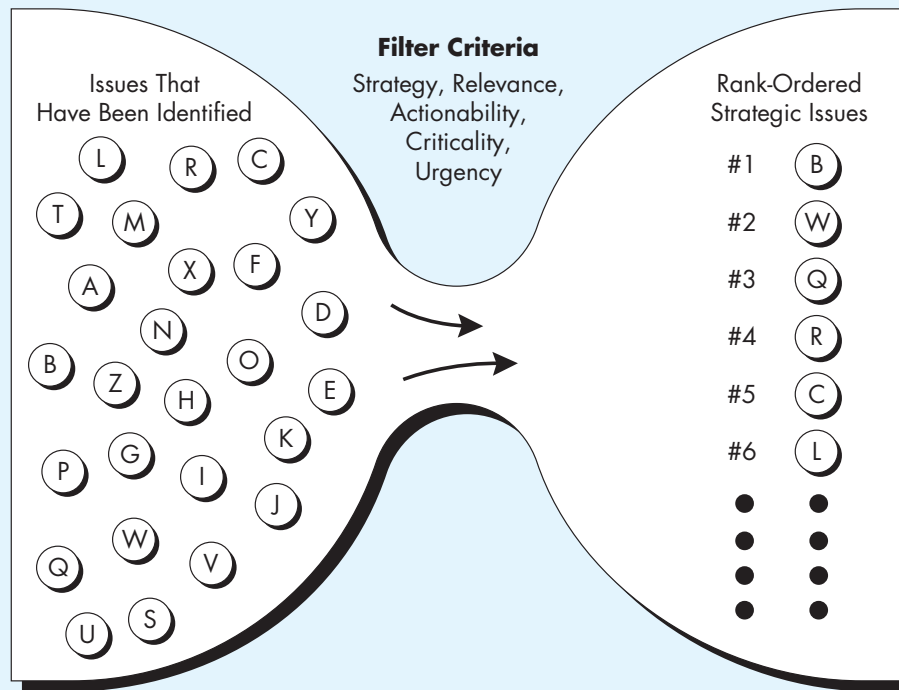
A somewhat more sophisticated approach uses a **probability-impact matrix** requiring management to assess the *probability of occurrence* of an issue (high, medium, or low) on one dimension and its *impact on the company* (high, medium, or low) on the other dimension. In using such an approach, management would place each issue in the appropriate cell of the matrix, and the completed matrix would then serve as an aid to prioritization. As a variation on this theme, management could rank issues by considering the mathematical product of each issue's impact (for example, on a scale from 1 to 10) and probability of occurrence (on a scale from 0 to 1).

A more refined issues-ranking scheme recommends that issues be screened on five filter criteria: strategy, relevance, actionability, criticality, and urgency.²⁶ Once each issue has been scored on a 10-point scale on each criterion, issues are then ranked according to their resulting point totals. Figure 6-5 illustrates this filtering/ranking process.

Other techniques that have been used in issues identification, analysis, and prioritization include polls/surveys, expert panels, content analysis, the Delphi technique, trend extrapolation, scenario building, and the use of precursor events or bellwethers.²⁷ Teams of company experts are also used. For example, Baxter International, a U.S.-based healthcare and biotech firm, uses multidisciplinary teams, because its main issues are in bioethics, and expertise in this subject cuts across a number of different knowledge-based lines of business.²⁸

Earlier we described a simple issues identification process as involving an individual in the organization or a subscription to a newsletter or trend-spotting service. The analysis and ranking stages could be done by an individual, but more often the company has moved up to the next stage of formalization. This next stage involves assignment of the issues management function to a team, often as part of a public affairs department, which begins to specialize in the issues management function. This group of specialists can provide a wide range of issues management activities, depending on the commitment of the company to the process.

Figure 6-5 *The Filtering and Ranking of Issues*



Source: William R. King, "Strategic Issue Management," in William R. King and David I. Cleland (eds.) *Strategic Planning and Management Handbook* (New York: Van Nostrand Reinhold, 1987), 257. Reprinted with permission.

A number of companies have created issues management units or managers to alert management to emerging trends and controversies and to help mobilize the companies' resources to deal with them. In the past, firms such as Arco, Monsanto, and Sears have used such units. At Monsanto, an issues manager organized a committee of middle managers to help do the work. At Arco, the group monitored hundreds of publications, opinion polls, and think-tank reports. It then prepared its own daily publication called *Scan*, which summarized considerable data for more than 500 company middle managers and top executives. The group tracked more than 140 issues in all.²⁹ Today, companies such as Anheuser-Busch, BASF, Coca-Cola, ExxonMobil, IBM, Pfizer, and Shell use issues managers and an issues management function in their organizations.³⁰

Formulation and Implementation of Responses

Formulation and implementation of responses are two steps in the issues management process that are combined here for discussion purposes. We should

observe that the formulation and implementation stages in the issues management process are quite similar to the corresponding stages we discussed in the preceding chapter, which pertained to the strategic management process as a whole.

Formulation in this case refers to the response design process. Based on the analysis conducted, companies can then identify options that might be pursued in dealing with the issues, in making decisions, and in implementing those decisions. Strategy formulation refers not only to the formulation of the actions that the firm intends to take but also to the creation of the overall strategy, or degree of aggressiveness, employed in carrying out those actions. Options might include aggressive pursuit, gradual pursuit, or selective pursuit of goals, plans, processes, or programs.³¹ All of these more detailed plans are part of the strategy formulation process.

Once plans for dealing with issues have been formulated, *implementation* becomes the focus. There are many organizational aspects that need to be addressed in the implementation process. Some of these include the clarity of the plan itself, resources needed to implement the plan, top management support, organizational structure, technical competence, and timing.³²

Evaluation, Monitoring, and Control

These recognizable steps in the issues management process were also treated as steps in the strategic management process in Chapter 5. In the current discussion, they mean that companies should continually evaluate the results of their responses to the issues and ensure that these actions are kept on track. In particular, this stage requires careful monitoring of stakeholders' opinions. A form of stakeholder audit—something derivative of the social audit discussed in Chapter 5—might be used. The information that is gathered during this final stage in the issues management process is then fed back to the earlier stages in the process so that changes or adjustments might be made as needed. Evaluation information may be useful at each stage in the process.

The issues management process has been presented as a complete system. In actual practice, companies apply the stages in various degrees of formality or informality as needed or desired. For example, because issues management is more important in some situations than in others, some stages of the process may be truncated to meet the needs of different firms in different industries. In addition, some firms are more committed to issues management than others.

ISSUES DEVELOPMENT PROCESS

A vital attribute of issues management is that issues tend to develop according to an evolutionary pattern. This pattern might be thought of as a developmental or growth process or, as some have called it, a life cycle. It is important for managers to have some appreciation of this **issues development process** so that they can recognize when an event or trend is becoming an issue and also because it might affect the strategy that the firm employs in dealing with the issue. Companies may take a variety of courses of action depending on the stage of the issue in the process.

One early view of the issues development process held that issues tend to follow an eight-year curve, although it is very difficult to generalize about the time frame, especially in today's world of instantaneous global communications. For the first five years or so of this hypothetical period, a nascent issue emerges in local newspapers, is enunciated by public-interest organizations, and is detected through public-opinion polling. According to a former director of corporate responsibility at Monsanto, the issue is low key and flexible at this stage.³³ During this time, the issue may reflect a felt need, receive media coverage, and attract interest-group development and growth. A typical firm may notice the issue but take no action at this stage. More issues-oriented firms may become more active in their monitoring and in their attempts to shape or help "define the issue."³⁴ Active firms have the capacity to prevent issues from going any further, through either effective responses to the issues or effective lobbying.

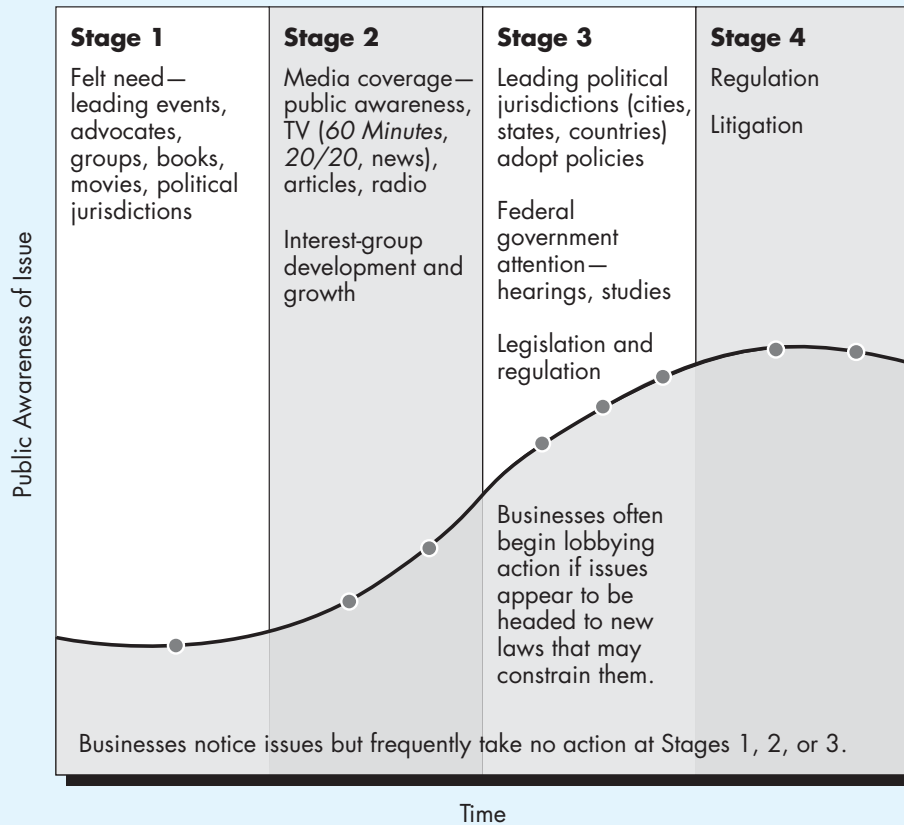
In the fifth or sixth year of the cycle, national media attention and leading political jurisdictions (for example, cities, states, countries) may address the issue. In the United States, issues managers have identified several "precursor" or bellwether states where national issues frequently arise first. Some experts think these states include California, Oregon, Florida, Michigan, and Connecticut.³⁵ Quite often, federal government attention is generated in the form of studies and hearings; legislation, regulation, and litigation follow. Today, it would be common for issues to mature much more quickly than the eight-year model just described. Figure 6-6 presents a simplified view of what this issue development life cycle process might look like.

The stages in the process, especially the early stages, might occur in a different sequence or in an iterative pattern. Further, not all issues complete the process; some are resolved before they reach the stage of legislation or regulation. Thomas G. Marx takes the view that issues go from social expectations to political issues to legislation and finally to social control.

Illustrations of Issue Development

This evolution may be illustrated through two examples. First, consider the issue of environmental protection. The social expectation was manifested in Rachel Carson's book *Silent Spring* (1963); it became a political issue in Eugene McCarthy's political platform (1968); it resulted in legislation in 1971–1972 with the creation of the Environmental Protection Agency (EPA); and it was reflected in social control by emissions standards, pollution fines, product recalls, and environmental permits in later years. Today, the issue of sustainability can be traceable to these early roots. The second example involves product/consumer safety. The social expectation was manifested in Ralph Nader's book *Unsafe at Any Speed* (1964); it became a political issue through the National Traffic Auto Safety Act and Motor Vehicle Safety Hearings (1966); it resulted in legislation in 1966 with the passage of the Motor Vehicle Safety Act and mandatory seat belt usage laws in four states (1984); and it was reflected in social control through the ordering of seat belts in all cars (1967), defects litigation, product recalls, and driver fines. Today, product safety is an institutionalized issue that all companies must address.³⁶

Figure 6-6 *Issue Development Life Cycle Process*



Finally, we are reminded that “issues do not necessarily follow a linear, sequential path, but instead follow paths that reflect the intensity and diversity of the values and interests stakeholders bring to an issue and the complexity of the interaction among” all the variables.³⁷ This should serve as a warning not to oversimplify the issues development process.

ISSUES MANAGEMENT IN PRACTICE

Issues management in practice today has very much become a subset of activities performed by the public affairs departments of major corporations. As stated earlier, 82 percent of companies report that issues management is one of the activities of their public affairs units.³⁸ Today, there is greater use of interdepartmental issues teams, with the public affairs department serving as coordinator and strategist but with appropriate line and staff executives charged with ultimate accountability for

implementation. In practice, therefore, it can be seen that issues management does not function as a stand-alone activity but has been subsumed into a host of functions for which modern public affairs departments take responsibility.³⁹

Issues management faces a serious challenge in business today. From the standpoint of the turbulence in the stakeholder environment, issues management may be needed. To become a permanent part of the organization, however, issues management will have to prove itself continuously. We can talk conceptually about the process with ease, but the field still remains somewhat nebulous even though it is struggling to become more scientific and legitimate. Managers in the real world want results, and if issues management cannot deliver those results, it will lose its status as a management process. A practitioner of issues management recently warned that issues management “often attracts excessive process at the expense of real progress.”⁴⁰

Research has shown that companies that adopted issues management processes developed better overall reputations and better issue-specific reputations, and performed better financially in both the short and longer terms than organizations that do not practice issues management.⁴¹ Tying issues management in with stakeholder management, it was also found that the most successful companies used stakeholder integration techniques in their implementation. This means that the firms actively sought to establish close-knit ties with a broad range of external and internal stakeholders and successfully incorporated their values and interests into management decisions.⁴²

ISSUES MANAGEMENT IS A BRIDGE TO CRISIS MANAGEMENT

Ideally, firms use issues management to assist them in planning for and preventing crises that then require crisis management. Effective issues management represents careful planning that may head off impending crises. This is because many crises are embedded in issues or erupt from issues that could have been anticipated and analyzed in carefully designed issues management processes.

Figure 6-1 illustrated the kinds of crises that may emanate from issue categories.

An illustration of issues management anticipating and planning for crises may be seen in the example of “Wall Street West,” located in the Poconos region of northeastern Pennsylvania. Ever since the 9/11 attacks in 2001, regulators have urged the financial firms on Wall Street to build emergency backup facilities where trading can continue in the event of another terrorist attack.⁴³ The Poconos area is only 90 miles west of Manhattan and is on a separate electrical grid. Thus, it may be an ideal spot for the New York financial industry to locate their backup and disaster recovery systems.

It turns out that Wall Street West is a partnership of more than two dozen economic development agencies and has received funding from federal and state sources to prepare for the next disaster, should it occur.⁴⁴ In this case, the “issue” is the integrity and survival of the banking and trading system in New York, and the response has been to prepare for future “crises” by establishing this safe

retreat from the metropolis that is outside New York City's theoretical nuclear blast zone but close enough to be linked by high-speed data links to Wall Street. As of 2007, the Wall Street West retreat was still in its developmental stages, but it appropriately illustrates how planning for crises grows out of issues management.⁴⁵

Therefore, issues management may be seen as a form of precrisis planning. It is intended to help organizations anticipate and plan for possible crisis eruptions. Not all crises can be planned for, of course, but many can be anticipated through effective issues management programs. It has been suggested that one of the most effective ways for keeping a crisis plan "living" is issues management.⁴⁶ Thus, we can see how issues and crisis management are different but intimately related. Because of this relationship, issues management may be seen as a bridge to crisis management.

Crisis Management

Crisis management as a management concept is largely a product of the past two decades or so. This has been the era of the mega-crisis: Union Carbide's Bhopal disaster, which killed more than two thousand people in India; Johnson & Johnson's Tylenol poisonings, which resulted in numerous deaths; Procter & Gamble's Rely tampon crisis, in which that product was associated with toxic shock syndrome; and the terrifying events of September 11, 2001, that killed approximately three thousand people at the World Trade Center, at the Pentagon, and in Shanksville, Pennsylvania. More recently, mad cow disease, tainted salmon, and hepatitis spread by green onions have caused consumers alarm. There have been a variety of other significant crises:

- The shootings at Virginia Tech raised questions about personal safety anywhere.
- The Minneapolis bridge collapse has affected businesses in the Twin Cities.
- Hurricanes Katrina and Rita devastated homes and businesses throughout the New Orleans area and the Southeast.
- Coke and Pepsi were implicated in tainted products in India.
- JetBlue's snowstorm disaster left passengers stranded for hours on the tarmac.
- Enron, WorldCom, Arthur Andersen, Tyco, and other companies were accused of financial scandals and malfeasance.
- ValuJet's Flight 592 crashed in the Florida Everglades, killing all 110 people on board.
- Schwan's ice cream company was charged as the responsible party in a salmonella outbreak in 39 states.
- Star-Kist Foods was charged with shipping rancid and decomposing tuna.
- Dow Corning was targeted in an FDA silicone breast implant probe.
- Sudafed capsules were tainted with cyanide, leading to two deaths.

- Perrier's benzene contamination incident led to product recalls.
- Twenty-four customers of Luby's Cafeteria in Killeen, Texas, were shot to death during a lunch-hour massacre.
- Coca-Cola experienced a crisis when its soft drinks were associated with illnesses in Belgium, France, and India.
- Firestone and Ford were implicated in massive tire recalls due to faulty tires causing tread separations and deaths.

It has been said by a number of observers that the Tylenol poisoning incident in 1982 was the case that put crisis management "on the map." That is, it was the case that marked the beginning of the new corporate discipline known as crisis management because Johnson & Johnson's voluntary recall of some 31 million Tylenol capsules was the first important example of an organization assuming responsibility for its products without being forced to do so.⁴⁷

It should be apparent from the list of crises presented earlier that there is a major distinction between issues management, discussed in the preceding section, and crisis management, the subject of this section. Issues typically evolve gradually over a period of time and represent a dormant category of concern. Issues management is a process of identifying and preparing to respond to potential issues. Crises, on the other hand, occur abruptly. They cannot always be anticipated or forecast. Some crises occur within an issue category considered; many do not. Issues and crisis management are related, however, in that they both

<http://SEARCHTHEWEB.WEB>

INSTITUTE FOR CRISIS MANAGEMENT (ICM)

ICM defines a crisis as:

Any problem or disruption that triggers negative stakeholder reactions that could impact the organization's financial strength and ability to do what it does.

There are four basic causes of a business crisis:

- Acts of God (storms, earthquakes, volcanic action, etc.)
- Mechanical problems (ruptured pipes, metal fatigue, etc.)
- Human errors (the wrong valve was opened, miscommunication about what to do, etc.)
- Management decisions/indecision (the problem is not serious, nobody will find out)

Most of the crises ICM has studied fall in the last category and are the result of management not taking action when they were told about a problem that would eventually grow into a crisis.

Planning for Bird Flu Pandemic:

On its website, ICM has an open letter to managements warning about a possible crisis related to bird flu. According to ICM, companies put much time and effort into planning for the expected Y2K crisis at the turn of the millennium, but a bird flu pandemic poses a far greater risk to the world and to companies and so crisis planning should be under way now.

To learn more about crisis management, check out the ICM's website at <http://www.crisisexperts.com>.

Ethics in Practice Case

JOHNSON & JOHNSON'S TYLENOL RESPONSE IS THE GOLD STANDARD IN CRISIS MANAGEMENT

The Tylenol poisonings case put “crisis management” permanently into the management lexicon. The facts are legendary. In the fall of 1982, a murderer added 65 milligrams of cyanide to some Tylenol capsules while they were on store shelves. Seven people were killed, including three people in one family. Johnson & Johnson (J&J), makers of Tylenol, quickly recalled and destroyed 31 million capsules at an expense of about \$100 million. James Burke, the company CEO, made numerous high-profile appearances in TV ads and in news conferences notifying consumers of the actions the company was taking. Tamper-resistant packaging was quickly introduced, and the sales of Tylenol swiftly snapped back to near precrisis sales levels. The perpetrator of this crime was never found.

Many continue to hold the Tylenol case up as the classic response to a crisis. Experts argue that fessing up and taking corrective action quickly is the best form of crisis management. A major lesson to come out of the Tylenol crisis is that companies can take action quickly and effectively and prosper in spite of extreme adversity that befalls them.

Even today, more than 25 years later, J&J's response in the Tylenol scandal remains the gold

standard in crisis management. The Tylenol case is still taught at the Harvard Business School and other business schools as a relevant lesson in effective crisis control.

1. Some say it was easy for J&J to take this action because the crisis did not originate within the company. Did this fact set the stage for the company's quick recovery? Would things have been different had the company been at fault?
2. How is the Tylenol case similar to or different from Ford and Firestone's linkage with dangerous tires or WorldCom, Tyco, Enron, and Health-South's malfeasance, which resulted in company leaders being accused of scheming to enrich themselves at the injury of others?
3. Was J&J really being socially responsible or were they acting quickly in their own best financial interests? Does their motivation matter?

Source: Eric Dezenhall, “Tylenol Can't Cure All Crises,” *USA Today* (March 18, 2004), 15A. Copyright © 2004 by Dezenhall Resources; Jia Lynn Yang, “Getting a Handle on a Scandal,” *Fortune* (May 28, 2007), 26.

are concerned about organizations becoming prepared for uncertainty in the stakeholder environment.

THE NATURE OF CRISES

There are many kinds of crises. Those mentioned here have all been associated with major stakeholder groups and have achieved high-visibility status. Hurt or killed customers, hurt employees, injured stockholders, and unfair practices are the concerns of modern crisis management. Not all crises involve such public or ethical issues, but these kinds of crises almost always ensure front-page status.

Major companies can be seriously damaged by such episodes, especially if the episodes are poorly handled.

What is a crisis? Dictionaries state that a **crisis** is a “turning point for better or worse,” an “emotionally significant event,” or a “decisive moment.” We all think of crises as being emotion charged, but we do not always think of them as turning points for better or for worse. The implication here is that a crisis is a decisive moment that, if managed one way, could make things worse but, if managed another way, could make things better. Choice is present, and how the crisis is managed can make a difference.

From a managerial point of view, a line needs to be drawn between a problem and a crisis. Problems, of course, are common in business. A crisis, however, is not as common. Here’s a useful way to think about a crisis:

*A crisis is a major, unpredictable event that has potentially negative results. The event and its aftermath may significantly damage an organization and its employees, products, services, financial condition, and reputation.*⁴⁸

Another definition is also helpful in understanding the critical aspects of a crisis:

*An organizational crisis is a low-probability, high-impact event that threatens the viability of the organization and is characterized by ambiguity of cause, effect, and means of resolution, as well as by a belief that decisions must be made swiftly.*⁴⁹

Consider, for a moment, the classic case referred to earlier wherein Star-Kist Foods, a subsidiary of H.J. Heinz Co., faced a management crisis. Gerald Clay was appointed general manager of the Canadian subsidiary and was given the mandate to develop a five-year business strategy for the firm. Just after his arrival in Canada, the crisis hit: The Canadian Broadcasting Corporation accused his company of shipping 1 million cans of rancid and decomposing tuna. Dubbed “Tunagate” by the media, the crisis dragged on for weeks. With guidance from Heinz, Clay chose to keep quiet, even as the Canadian prime minister ordered the tuna seized. The silence cost plenty. According to Clay’s boss, “We were massacred in the press.” The company, which used to have half the Canadian tuna market, watched revenues plunge by 90 percent. At one point, Clay’s boss observed that the company’s future was in doubt.⁵⁰ As it turned out, the company bounced back, as so often is the case in crises of this type, but the company’s losses were significant. Tunagate was such a classic crisis management scandal, however, that even to this day it has its own entry in Wikipedia, the online encyclopedia.⁵¹

Figure 6-7 presents a “how not to do it” case in crisis management as experienced by Dick Grasso, former chairman of the New York Stock Exchange. Grasso was under fire for taking \$8.4 million in severance pay on top of his controversial \$140 million compensation.

Being prepared for crises has become a primary activity in a growing number of companies. A recent survey by the Foundation for Public Affairs found that 81 percent of the companies surveyed indicated they had a formalized crisis management plan.⁵² Today, most companies may be prepared for crises, but their degree of preparedness varies widely.

Figure 6-7 Crisis Management: How Not to Do It

Dick Grasso, chairman of the New York Stock Exchange (NYSE), was under fire for his compensation level and bonuses he would receive in severance pay. Grasso was forced out under pressure on revelations that NYSE directors had agreed to give him nearly \$140 million, mostly deferred compensation and retirement pay. Supporters say he deserved this under contracts entered into. Detractors thought that this was unethical and should have been investigated further and the propriety of the compensation process be validated. Grasso was implicated in the series of controversies that raged over executive compensation and CEO malfeasance.

The news of Grasso's controversial \$140 million compensation created a media firestorm. He then proceeded to make some of the same crisis and PR blunders that others had recently made, according to McCarthy and Shell, writers for *USA Today*. Instead of making things better by what he said and did, he made them worse. According to Robin Cohn, author of *The PR Crisis Bible*, he got isolated in his ivory tower and just did not realize that now was not the time to take the money. It is argued that Grasso and his team botched this crisis and that its handling may end up in PR textbooks detailing *how a crisis should not be handled*. Three big mistakes were made.

- *Minimizing the issue.* Grasso made the mistake of trying to minimize the fuss over his huge paycheck. Eric Dezenhall, crisis management expert, said, "My career has been filled with clients who want people to be thrilled about their obscene wealth. I've never succeeded."
- *Stonewalling.* Rather than giving the media as much information as possible, Grasso retreated and isolated himself and developed a bunker mentality.
- *Too little, too late.* It is possible that Grasso might have saved his job if he had performed an act of good will, such as giving away some of his money to charity or agreeing to take it spread out over a period of years. It was believed, however, that he did too little, too late, and thus exited in an adverse way.

Source: Gary Strauss, "Severance Pay Could Add to Grasso's Pile of Cash," *USA Today* (September 19, 2003), 6B. Michael McCarthy and Adam Shell, "Others Can Learn from Grasso's Blunders," *USA Today* (September 19, 2003), 6B.

Types of Crises

Situations in which the companies studied thought they were vulnerable to crises included industrial accidents, environmental problems, union problems/strikes, product recalls, investor relations, hostile takeovers, proxy fights, rumors/media leaks, government regulatory problems, acts of terrorism, and embezzlement.⁵³ Other common crises include product tampering, executive kidnapping, work-related homicides, malicious rumors, and natural disasters that destroy corporate offices or information bases.⁵⁴ Since September 11, 2001, we have had to add terrorism to this list.

It has been suggested that crises may be grouped into seven families:⁵⁵

- *Economic crises* (recessions, hostile takeovers, stock market crashes)
- *Physical crises* (industrial accidents, product failures, supply breakdown)

- *Personnel crises* (strikes, exodus of key employees, workplace violence)
- *Criminal crises* (product tampering, kidnappings, acts of terrorism)
- *Information crises* (theft of proprietary information, cyberattacks)
- *Reputational crises* (rumor-mongering/slander, logo tampering)
- *Natural disasters* (earthquakes, floods, fires)

Of the major crises that have recently occurred, the majority of the companies reported the following outcomes: the crises escalated in intensity, were subjected to media and government scrutiny, interfered with normal business operations, and damaged the company's bottom line. As a result of the horrific attacks on the World Trade Center, companies experienced major power shifts among executives as some bosses fumbled with their responsibilities and didn't handle the crisis well. Those bosses who handled the crisis well garnered more responsibility while others lost responsibilities.⁵⁶

Four Crisis Stages

There are a number of ways to describe the stages through which a crisis may progress. One view is that a crisis may consist of as many as four distinct stages: (1) a **prodromal crisis stage**, (2) an **acute crisis stage**, (3) a **chronic crisis stage**, and (4) a **crisis resolution stage**.⁵⁷

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CRISIS MANAGEMENT: THE NEW CORPORATE DISCIPLINE

An article in *Time* magazine called crisis management the "new corporate discipline." Every company today, large or small, runs the risk of a crisis. Forward-looking companies practice crisis management and either develop their own in-house crisis management programs or avail themselves of the many consulting firms that provide crisis management consulting. One consulting firm that specializes in crisis management is Lexicon Communications Corporation. Among its many services, Lexicon provides crisis management training seminars, workshops, and full-blown crisis simulations to help executives hone the skills they may need to serve on crisis management teams or to respond to the media in a crisis-filled atmosphere.

To learn more about which topics might be covered in such seminars, check out the Lexicon website at <http://www.crisismanagement.com>.

Another major consulting firm that specializes in crisis management is The Wilson Group. Whether it's a chemical spill, a plant explosion, a plant closing, or another crisis, The Wilson Group offers personalized crisis management and media training workshops, crisis communication plans, community relations programs, and on-the-scene counsel. Part of the group's intense training includes on-camera media training for executives in a mock disaster context. To learn more about crisis management, visit The Wilson Group website at <http://www.wilson-group.com>.

Prodromal Crisis Stage. This is the warning stage. (“Prodromal” is a medical term that refers to a previous notice or warning.) This warning stage could also be thought of as a symptom stage. Although it could be called a “precrisis” stage, this presupposes that one knows that a crisis is coming. Many experts suggest that a possible outbreak of avian flu would be in this stage. It is believed that crises “send out a repeated trail of early warning signals” that managers can learn to recognize.⁵⁸ Perhaps management should adopt this perspective: Watch each situation with the thought that it could be a crisis in the making. Early symptoms may be quite obvious, such as in the case where a social activist group tells management it will boycott the company if a certain problem is not addressed. On the other hand, symptoms may be more subtle, as in the case where defect rates for a particular product a company makes start edging up over time.

Acute Crisis Stage. This is the stage at which the crisis actually occurs. There is no turning back; the incident has occurred. Damage has been done at this point, and it is now up to management to handle or contain the damage. If the prodromal stage is the precrisis stage, the acute stage is the *actual* crisis stage. The crucial decision point at which things may get worse or better has been reached.

Chronic Crisis Stage. This is the lingering period. It may be the period of investigations, audits, or in-depth news stories. Management may see it as a period of recovery, self-analysis, or self-doubt. In one survey of major companies, it was found that crises tended to linger as much as two-and-a-half times longer in firms without crisis management plans than in firms with such plans.

Crisis Resolution Stage. This is the final stage—the goal of all crisis management efforts. When an early warning sign of a crisis is noted, the manager should seize control swiftly and determine the most direct and expedient route to resolution. If the warning signs are missed in the first stage, the goal is to speed up all phases and reach the final stage as soon as possible.

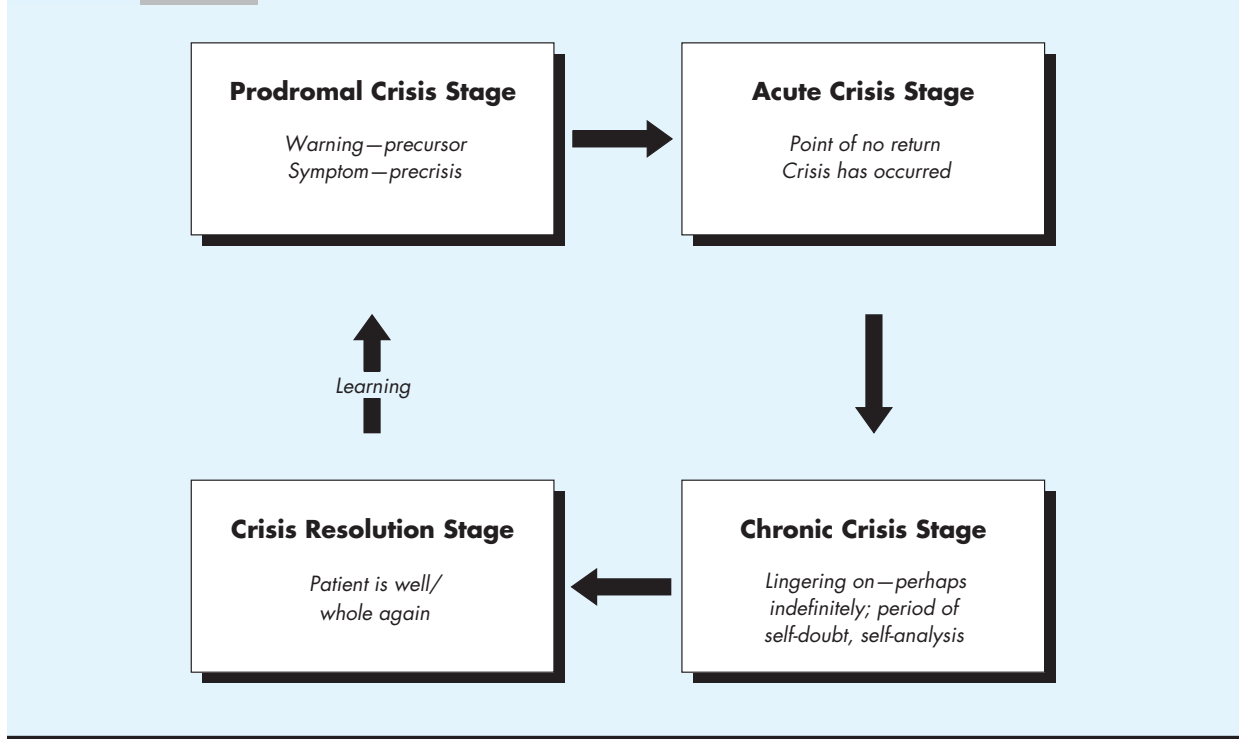
Figure 6-8 presents one way in which these four stages might be depicted. It should be noted that the phases may overlap and that each phase varies in intensity and duration. It is expected that management will learn from the crisis and thus will be better prepared for, and better able to handle, any future crisis.

Poorly Managed Crises

Other views of crises and crisis management may be taken. A former corporate executive and a consultant on crisis management, and others lay out the scenario for a poorly managed crisis, which typically follows a predictable pattern.⁵⁹ The pattern is as follows:

- Early indications that trouble is brewing occur.
- Warnings are ignored/played down.
- Warnings build to a climax.
- Pressure mounts.
- Executives are often overwhelmed or can't cope effectively.

Figure 6-8 *Four Stages in a Management Crisis*



- Quick-fix alternatives look appealing. Hasty moves create trouble.
- Clamming-up versus opening-up options present themselves.
- Most firms choose the former.
- A siege mentality prevails.

Visualizing the attributes or pattern of a poorly managed crisis is valuable because it illustrates how not to do it—a lesson that many managers may find quite valuable.

MANAGING BUSINESS CRISES

Three-Stage Model

There are many suggestions for managing a crisis, although they cannot be reduced to a cookbook recipe. Steven Fink presents a simple model by arguing that there are three vital stages in crisis management:

1. *identifying* the crisis,
2. *isolating* the crisis, and
3. *managing* the crisis. All should be done quickly.⁶⁰

Five Practical Steps in Managing Crises

A more complete view of crisis management holds that a series of five steps must be taken. These five steps, synthesized by *BusinessWeek* magazine from the actual experiences of companies experiencing crises, are discussed next and are summarized in Figure 6-9.⁶¹

First: Identifying Areas of Vulnerability. In this first step, some areas of vulnerability are obvious, such as potential chemical spills, whereas others are more subtle. The key seems to be in developing a greater consciousness of how things can go wrong and get out of hand. At Heinz, after the “Tunagate” incident, a vice president set up brainstorming sessions. He said, “We’re brainstorming about how we would be affected by everything from a competitor who had a serious quality problem to a scandal involving a Heinz executive.”⁶² A key to identifying areas of vulnerability is “recognizing the threat.” The most skilled executives often fail at this stage because they are oblivious to emerging threats.⁶³

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Here are some ways that companies can identify areas of vulnerability:⁶⁴

- *Scenario planning.* Create scenarios for crises that could occur over the next two years.
- *Risk analysis.* Estimate the probabilities and costs/benefits of estimated future events.
- *Incentives.* Reward managers for information sharing.
- *Networks.* Build formal coalitions to mobilize internal and external information suppliers.

Second: Developing a Plan for Dealing with Threats. A plan for dealing with the most serious crisis threats is a logical next step. One of the most crucial issues is communications planning. After a Dow Chemical railroad car derailed near Toronto, forcing the evacuation of a quarter-million people, Dow Canada prepared information kits on the hazards of its products so that executives would be knowledgeable enough to respond properly if a similar crisis were to arise in the future. Dow Canada also trained executives in interviewing techniques. This effort paid off several years later when an accident caused a chemical spill into a river that supplied drinking water for several nearby towns. The company's emergency response team arrived at the site almost immediately and established a press center that distributed information about the chemicals. In addition, the company recruited a neutral expert to speak on the hazards and how to deal with them. Officials praised Dow for its handling of this crisis.⁶⁵

A former CEO of Monsanto Company has offered the following *10 R's for the effective handling of public policy crises*. These steps should be part of an overall crisis plan:⁶⁶

- Respond early.
- Recruit a credible spokesperson.
- Reply truthfully.
- Respect the opposition's concerns.
- Revisit the issue with follow-up.
- Retreat early if it's a loser.
- Redouble efforts early if it's a critical company issue.
- Reply with visible top management.
- Refuse to press for what is not good public policy.
- Repeat the prior statement regularly.

Some of these steps may not apply to every crisis situation, but many may be useful as part of a crisis management plan. Getting an entire organization trained to deal with crises is difficult and expensive, but the CEO paraphrases what a car repairman once said in a TV commercial: "You can pay now or pay a lot more later." Most of us would believe that now is infinitely better for everyone.⁶⁷

Third: Forming Crisis Teams. Another step that can be taken as part of an overall planning effort is the formation of **crisis teams**. Such teams have played key roles in many well-managed disasters. A good example is the team formed at Procter & Gamble when its Rely tampon products were linked with the dreaded disease toxic shock syndrome. The team was quickly assembled, a vice president was appointed to head it, and after one week the decision was made to remove Rely from marketplace shelves. The quick action earned the firm praise, and it paid off for P&G in the long run.

Another task in assembling crisis teams is identifying managers who can cope effectively with stress. Not every executive can handle the fast-moving, high-pressured, ambiguous decision environment that is created by a crisis, and early identification of executives who can is important. We should also note that it is not always the CEO who can best perform in such a crisis atmosphere.

Despite the careful use of crisis teams, crises can often overwhelm a carefully constructed plan. When ValuJet's Flight 592 crashed in the Florida Everglades, for example, ValuJet flawlessly executed a three-pronged, team-based crisis management plan calling for the company to (1) show compassion, (2) take responsibility, and (3) demonstrate that the airline learned from the crisis. Experts have said that the company handled the crisis well. However, a close look at the tragedy revealed that a series of complicating factors turned the crisis into something even more difficult than a well-scripted, perfectly executed crisis management plan could handle.⁶⁸

Fourth: Simulating Crisis Drills. Some companies have gone so far as to run crisis drills in which highly stressful situations are simulated so that managers can "practice" what they might do in a real crisis. As a basis for conducting crisis drills and experiential exercises, a number of companies have adopted a software package known as *Crisis Plan wRiter (CPR)*. This software allows companies to centralize and maintain up-to-date crisis management information and allows company leaders to assign responsibilities to their crisis team, target key audiences, identify and monitor potential issues, and create crisis-response processes.⁶⁹

Fifth: Learning from Experience. The final stage in crisis management is learning from experience. At this point, managers need to ask themselves exactly what they have learned from past crises and how that knowledge can be used to advantage in the future. Part of this stage entails an assessment of the effectiveness of the firm's crisis-handling strategies and identification of areas where improvements in capabilities need to be made. Without a crisis management system of some kind in place, the organization will find itself reacting to crises after they have occurred. If learning and preparation for the future are occurring, however, the firm may engage in more proactive behavior.⁷⁰

Six Stages of Crisis Management

As an alternative to the previous steps in crisis management, Norman Augustine, former president of Lockheed Martin Corporation, distinguished among six stages

of crisis management. To some extent, these overlap and embrace the steps, but it is useful to see an alternative conceptualization of the steps that should be taken in crisis management. Augustine's list begins with the idea that the crisis should be avoided.⁷¹

1. Stage 1: Avoiding the Crisis
2. Stage 2: Preparing to Manage the Crisis
3. Stage 3: Recognizing the Crisis
4. Stage 4: Containing the Crisis
5. Stage 5: Resolving the Crisis
6. Stage 6: Profiting from the Crisis

It is important to note that effective crisis management requires a program that is tailored to a firm's specific industry, business environment, and crisis management experience. Effective crisis managers will understand that there are major crisis management factors that may vary from situation to situation, such as the type of crisis (e.g., natural disaster or human induced), the phase of the crisis, the systems affected (e.g., humans, technology, culture), and the stakeholders affected. Managers cannot eliminate crises. However, they can become keenly aware of their vulnerabilities and make concerted efforts to understand and reduce these vulnerabilities through continuous crisis management programs.⁷²

CRISIS COMMUNICATIONS

An illustration of crisis management without effective communications occurred during the Jack in the Box hamburger disaster a few years ago. There was an outbreak of E. coli bacteria in the Pacific Northwest area, resulting in the deaths of four children. Following this crisis, the parent company, San Diego-based Foodmaker, entered a downward spiral after lawsuits by the families of victims enraged the public and franchisees. Foodmaker did most of the right things and did them quickly. The company immediately suspended hamburger sales, recalled suspect meat from its distribution system, increased cooking time for all foods, pledged to pay for all the medical costs related to the disaster, and hired a food safety expert to design a new food-handling system. But it forgot to do one thing: communicate with the public, including its own employees.⁷³

The company's **crisis communications** efforts were inept. It waited a week before accepting any responsibility for the tragedy, preferring to point fingers at its meat supplier and even the Washington state health officials for not explaining the state's new guidelines for cooking hamburgers at higher temperatures. The media pounced on the company. The company was blasted for years even though within the company it was taking the proper steps to correct the problem. The company suffered severe financial losses, and it took at least six years before the company really felt it was on the road to recovery. "The crisis," as it was called around company headquarters, taught the firm an important lesson. CEO Robert Nugent was quoted later as saying "Nobody wants to deal with their worst nightmare, but we should have recognized you've got to communicate."⁷⁴

Virtually all crisis management plans call for effective crisis communications, but they are not always effectively executed. There are a number of different stakeholder groups with whom effective communications are critical, especially the media and those immediately affected by the crisis. Many companies have failed to manage their crises successfully because of inadequate or failed communications with key stakeholder groups. Successful communications efforts are crucial to effective crisis management. It is axiomatic that *prepared* communications will be more helpful than *reactive* communications. **Ten steps of crisis communication** that are worth summarizing include:⁷⁵

1. Identify your crisis communications team.
2. Identify key spokespersons who will be authorized to speak for the organization.
3. Train your spokespersons.
4. Establish communications protocols.
5. Identify and know your audience.
6. Anticipate crises.
7. Assess the crisis situation.
8. Identify key messages you will communicate to key groups.
9. Decide on communications methods.
10. Be prepared to ride out the storm.

A brief elaboration on the importance of identifying key messages that will be communicated to key groups is useful (point 8). It is important that you communicate with your internal stakeholders first, because rumors are often started there and uninformed employees can do great damage to a successful crisis management effort. Internal stakeholders are your best advocates and can be supportive during a crisis. Prepare news releases that contain as much information as possible, and get this information out to all media outlets at the same time. Communicate with others in the community who have a need to know, such as public officials, disaster coordinators, stakeholders, and others. Uniformity of response is of vital importance during a crisis. Finally, have a designated “release authority” for information (point 2). The first 24 hours of a crisis can make or break the organization, and how these key spokespersons work is of vital importance to handling the crisis.⁷⁶

Components of Crisis Plans

The importance of communication in crisis management is clearly seen in a 2005 survey of companies that were asked about the components of their crisis management plans. Following is the list of the most mentioned components, along with the percentage of companies currently having that component:⁷⁷

- Media communications 99%
- Employee communications 98%

- Crisis management team 94%
- Communications with elected officials (local, state, national) 86%
- CEO/senior executive involvement/active participation 82%
- Documentation/written policy manual and/or handbook 81%
- Website communications 77%

Ethics in Practice Case

CRISIS MANAGEMENT: WHEN TO REPENT? WHEN TO DEFEND?

When facing a crisis, especially one in which the organization is implicated, many experts on crisis management take the approach that management or the firm needs to repent of its malfeasance or wrongdoing quickly, ask for forgiveness, and promise to do better in the future. This soft approach argues for engaging in careful communications and apologizing, if necessary. This approach it is believed is the best route to limiting damage and restoring the public's confidence in the company and its leaders.

In a new book, *Damage Control: Why Everything You Know About Crisis Management Is Wrong* (2007), authors Eric Dezenhall and John Weber argue that this soft approach is often wrong. According to the authors, if you are facing a lawsuit, a sex scandal, a defective product, or allegations of insider trading, experts may tell you to stay positive, get your message out, and everything will be just fine. But, Dezenhall and Weber conclude, this kind of cheery talk does not help much during a real crisis, and it's easy to lose sight of your genuine priorities. If your case goes to trial, for example, you might want the public to think you're a wonderful company, but all that matters is what the jury thinks.

The authors support a political model of crisis management, which means you may have to fight back and defend yourself. When the company has

done wrong, repentance is in order. When the company has been wronged, a strong defense is recommended. The authors recommend not admitting guilt and meeting each accusation with a counterclaim. They say this is how Martha Stewart turned her public image around after serving a jail sentence. In another example, they say this is how Merck, the pharmaceutical company, recovered from legal defeats and bad press as it began to portray plaintiffs as selfish opportunists. They also cite how successful the mobile phone industry was in mounting a defense against the consumer complaints that the phones were causing brain tumors. The key, they say, is determining when to be conciliatory and when to defend aggressively.

1. What are the relevant issues/criteria in this debate over the best response to a crisis?
2. Is it best to apologize, repent, and move on, or to stand firm and defend aggressively?
3. What is the downside risk of mounting a vigorous defense?

Source: Eric Dezenhall and John Weber, *Damage Control: Why Everything You Know About Crisis Management Is Wrong*, Portfolio Hardcover, 2007; Richard Evans, "Crisis Management for a Vindictive Age," *Financial Times* (April 24, 2007), 12.

Be First, Be Right, and Be Credible

The Centers for Disease Control and Prevention (CDC) states as part of its crisis communications training that the first 48 hours of a crisis are the most important. The program's mantra is reported as "be first, be right, be credible."⁷⁸ **Being first** means getting your message out first, which allows you to control its accuracy and content. If a company is late in getting its message out, the media and others will fill in the blanks, and they might include rumors, their own speculations, misunderstandings, or bias. **Being right** means saying and doing the right thing. This is the ethical dimension of communications. This is done after management has gathered all the facts and understands exactly what has happened in the crisis. **Being credible** means being open, honest, and speaking with one consistent voice. Mixed messages from mixed sources can lead to disaster. The company's spokesperson should be sincere, express empathy, be accountable, demonstrate competence, expertise, and consistent facts.⁷⁹ For all this to happen, of course, careful crisis communications must be a priority in the crisis plan.

SUCCESSFUL CRISIS MANAGEMENT

Benefits of Crisis Management

There are many benefits of effective crisis management for both society and the affected organizations. For society, if crises are handled well then there are fewer disruptions to everyday life for consumers, employees, and citizens. In recent years, there is no better example of the benefits to business firms, government, and society than how many well-prepared business enterprises responded to the Hurricane Katrina disaster in 2005. Many companies were applauded for their readiness and execution of disaster plans as the devastating hurricane hit the Southeast, but especially the New Orleans and Gulf Coast region of the country. Companies that stood out in their preparedness and assistance included Wal-Mart and Home Depot.

These two companies had anticipated the impact of the hurricane, gotten their act together days beforehand, and implemented their plans to the benefit of thousands of affected residents. Some experts even observed that FEMA and the Red Cross, both agencies whose mission it is to respond to crises, learned a lot from these companies and others.⁸⁰ Because of the types of products and supplies they sell, these two companies and other big box stores always seem to play key roles in natural disasters such as hurricanes, tornadoes, and other weather-related crises. Another major company that helped the government solve transportation and communication problems was FedEx. One of FedEx's radio antennae in New Orleans became the key communication link for FEMA as it sought to establish a communication system in the area.⁸¹ Many corporate CEOs admitted that coping with Katrina taught them a lot about preparing for crises and disasters. Major lessons learned included the following: take care of your employees, keep communication lines open, and get ready for the next disaster.⁸²

Another benefit from crisis management is that preparing for one type of crisis may be beneficial when other types of crises strike. A case in point was that of

Childs Capital in New York City, a company that provides economic development in poor countries. The company's CEO, Donna Childs, put a disaster plan in place for business disruptions such as a subway fire, a scaffolding accident, a brownout, or some other smaller-scale business disruption. She had made arrangements by developing a communications plan and a method for continuous functioning off-site should the need arise. As a result of her crisis management for one type of disaster, she was back up and running one week after the collapse of the World Trade Center in New York. One result of her experience is that she is now giving weekly seminars on disaster preparedness, and she has written a book titled *Prepare for the Worst, Plan for the Best: Disaster Preparedness and Recovery for Small Businesses*.⁸³

A Successful Crisis Management Example

It is enlightening to conclude this chapter with an illustration of a successful crisis management case study of one company. Earlier, we presented the handling of the J&J Tylenol crisis as a success story. This success story started with the kind of phone call every company dreads—"Your product is injuring people; we're announcing it at a press conference today." Schwan's Sales Enterprises, Inc., got such a call from the Minnesota Department of Health at about noon one fateful day. The Health Department reported that it had found a statistical link between Schwan's ice cream and confirmed cases of salmonella. Thousands of people in at least 39 states became ill with salmonella after eating tainted Schwan's ice cream, potentially setting the company up for a decade's worth of litigation. Instead, in a little more than a year after the outbreak, the vast majority of claims had been handled outside the legal system through direct settlements or as part of a class action in Minneapolis.⁸⁴

Schwan's knew that its image of the smiling man in the sunshine-yellow Schwan's truck (with a swan on the side) busily hand-delivering ice cream to grateful consumers was one of its major assets. Before the company was sure of the Health Department's findings, it halted sales and production, shut down, and invited the state health department, the Department of Agriculture, and the FDA into the plant to investigate. It also notified all its sales offices nationwide. Also, within the first 24 hours of the crisis, the company set up a hotline to answer consumer questions, contacted employees and managers to staff the hotline, prepared for a product recall, and began working with its insurer.⁸⁵

By placing consumer safety as its number-one priority, Schwan's was able to resolve the crisis much more quickly than ever would have been possible without a carefully designed crisis management plan. Whether by coincidence or preparedness, the manager of public affairs and the company's general counsel had completed a review and rewriting of the company's crisis management manual just two months before the outbreak. One vital component of the plan was a crisis management team, which went to work immediately when the news came. The crisis management team quickly set up a process for handling consumers who had been affected. The team, working with its insurance company, quickly helped customers get medical treatment and get their bills paid. Settlements to customers who suffered from salmonella symptoms included financial damages, medical expenses, and other costs, such as reimbursement for workdays missed.⁸⁶

How did the ice cream get contaminated with salmonella? After a month's investigation that kept the Marshall, Minnesota, plant closed, it was determined that the ice cream mix supplied by a few vendors was the culprit. The mix of cream, sugar, and milk had been shipped in a tanker truck that had previously held raw, unpasteurized eggs that had the bacteria. Schwan's quietly sought and received legal damages from the suppliers but stayed focused on its customers throughout the crisis.

What did Schwan's learn from this crisis? Previously, Schwan's did not repasteurize its ice cream mix once the mix arrived at the Marshall plant. Within a few weeks of the outbreak, however, the company had broken ground to build its own repasteurization plant. The company also leased a dedicated fleet of tanker trucks to deliver the ice cream mix from the suppliers to the plant, set up a system for testing each shipment, and delayed shipping the final product until the test results were known. In summary, Schwan's planning, quick response, and customer-oriented strategy combined to retain customer loyalty and minimize the company's legal exposure.⁸⁷ It was a case of good, effective crisis management.

Undoubtedly, in the years to come, stories will be told of successful crisis management in the aftermath of major traumatic events in the lives of organizations and society. Sadly, preparation for acts of terrorism is now a vital national and business issue. Clearly, the events of the past few years have made crisis management a priority topic in boardrooms and among managers.

Summary

Issues management and crisis management are two key approaches by which companies may plan for the turbulent stakeholder environment. Both these approaches are frequently found housed in a company's department of public affairs. Issues management is a process by which an organization identifies issues in the stakeholder environment, analyzes and prioritizes those issues in terms of their relevance to the organization, plans responses to the issues, and then evaluates and monitors the results. There are two approaches to issues management: the conventional approach and the strategic management approach. Issues management requires a knowledge of the changing mix of issues, the issues management process, the issues development process, and how companies might implement issues management in practice. Issues management serves as a bridge to crisis management.

Crisis management, like issues management, is not a panacea for organizations. In spite of well-intended efforts by management, not all crises will be resolved in the company's favor. Nevertheless, being prepared for the inevitable makes sense, especially in today's world of instantaneous global communications and obsessive media coverage. Whether we are thinking about the long term, the intermediate term, or the short term, managers need to be prepared to handle crises. A crisis has a number of different stages, and managing crises requires a number of key steps before, during, and after the crisis. These steps include identifying areas of vulnerability, developing a plan for dealing with threats, forming crisis teams, using crisis drills, and learning from experience. Crisis communications is critical for successful crisis management. When used in tandem, issues and crisis management can help managers fulfill their economic, legal, ethical, and philanthropic responsibilities to stakeholders.

Key Terms

acute crisis stage (page 215)

being credible (page 224)

being first (page 224)

being right (page 224)

chronic crisis stage (page 215)

crisis (page 213)

crisis communications (page 221)

crisis management (page 192)

crisis resolution stage (page 215)

crisis teams (page 220)

emerging issue (page 198)

issue (page 198)

issue buying (page 203)

issues development process (page 206)

issues management (page 192)

issues selling (page 203)

portfolio approach (page 197)

probability-impact matrix (page 204)

prodromal crisis stage (page 215)

ten steps of crisis communication (page 222)

Discussion Questions

1. Which of the major stages in the issues management process do you think is the most important? Why?
2. Following the approach indicated in Figure 6-1, identify a new issue category not listed in Figure 6-1. Identify several examples of “crises” that have occurred in recent years under each issue category.
3. Identify one example, other than those listed in Figure 6-4, of each of the leading force categories: events, authorities/advocates, literature, organizations, and political jurisdictions.
4. Identify a crisis that has occurred in your life or in the life of someone you know, and briefly explain it in terms of the four crisis stages: prodromal, acute, chronic, and resolution.
5. Do research on the impacts on business organizations of the attacks on the World Trade Center in New York and the scandals of the early to mid-2000s. What have been successful and unsuccessful examples of crisis management that have come out of this research? Is terrorism a likely crisis for which business may prepare? How does preparation for terrorism (which comes from without) compare with preparation for ethical scandals (which come from within)?

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Part 3

Business Ethics and Management

CHAPTER 7 | *Business Ethics Fundamentals*

CHAPTER 8 | *Personal and Organizational Ethics*

CHAPTER 9 | *Business Ethics and Technology*

CHAPTER 10 | *Ethical Issues in the Global Arena*



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Business Ethics Fundamentals

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Describe how the public regards business ethics.
- 2 Define business ethics and appreciate the complexities of making ethical judgments.
- 3 Explain the conventional approach to business ethics.
- 4 Analyze economic, legal, and ethical aspects by using a Venn model.
- 5 Enumerate and discuss the four important ethics questions.
- 6 Identify and explain three models of management ethics.
- 7 Describe Kohlberg's three levels of developing moral judgment.
- 8 Identify and discuss the elements of moral judgment.

Public interest in business ethics has never been higher than it is currently. In considering the past thirty years of business ethics experiences, two conclusions may be drawn. First, interest in business ethics has heightened during each of the past three decades. Second, the interest in business ethics seems to have been spurred by major headline-grabbing scandals. Certainly, there has been an ebb and flow of interest on society's part, but lately this interest has grown to a preoccupation or, as some might say, an obsession. With the ethics scandal tsunami of the early 2000s, beginning with Enron, we witnessed the birth and accelerated maturation of the "ethics industry."¹ The impact of the Enron scandal was so great on business ethics that it has been dubbed the "Enron Effect."² The effects and lessons learned from the Enron scandal have been so colossal that business will never be the same.

Recent History. In the 1990s, several business ethics scandals piqued the public's attention. It should not have come as a surprise that the U.S. Sentencing Commission in 1991 created new federal sentencing guidelines designed to deter corporate crime by creating incentives for corporations to report and accept responsibility for unlawful behavior.

Business ethics scandals occurred throughout the 1990s and into the 2000s. One noticeable change during this time was the significant extent to which ethics, morals, and values came to characterize the general public debate concerning business in the United States. In the second half of the 1990s, many of the ethical scandals found in business involved massive charges of racial discrimination and sexual harassment. Among the well-known companies that experienced such allegations were Home Depot, Mitsubishi, Coca-Cola, and Texaco. The Texaco case involved a \$196 million settlement in a class-action race discrimination lawsuit brought by employees fighting for equal pay and a chance for promotions. Bari-Ellen Roberts, lead plaintiff in the case against the oil company, revealed a dark side of corporate America in her 1998 book, *Roberts vs. Texaco: A True Story of Race and Corporate America*.³

Another industry that attracted widespread criticism in the late 1990s was the tobacco industry. The Food and Drug Administration's (FDA's) crackdown on tobacco, along with Congress's 1998 attempts to draft and pass landmark tobacco legislation, caused tobacco executives to begin thinking in settlement terms that would have been unthinkable in years past.⁴ This issue continues today.

The ethics scandal that has come to define modern times came to light in 2001—the Enron scandal. Enron and several of its leaders—Andrew Fastow, former CFO; Jeffrey Skilling, former CEO; and then-CEO Kenneth Lay—were implicated in massive allegations of corporate fraud, financial misdealings, and various charges of criminal misconduct.⁵ The Enron scandal unleashed an avalanche of fraud and corruption investigations and eventual bankruptcy. On the tails of the Enron scandal, the major accounting firm Arthur Andersen was implicated, and its complicity led to its eventual demise. Other scandals followed: WorldCom, Global Crossing, Tyco, Adelphia, and HealthSouth, just to mention a few. Figure 7-1 summarizes some of the major business ethics scandals that occurred beginning in 2001 and that continue to the present day. Many of these companies and executives have proclaimed their innocence, and allegations and trials are at various stages of completion. Some have been convicted and sent to prison.

We would be remiss if we did not mention that the ethics scandals today have even touched higher education, especially the business schools. Surveys have demonstrated time and again that college students cheat and that business students rank among the highest. One survey revealed that 56 percent of business school graduates admitted to collaborating on tests.⁶ The most recent single evidence of this issue was witnessed in the huge cheating scandal reported at Duke University's business school. In April 2007, the dean had the unpleasant task of having to announce to the public that nearly 10 percent of the class of 2008 had been caught cheating on a take-home exam. To Duke's credit, the school took strong disciplinary actions in dealing with the 34 MBA students implicated.⁷ What these surveys and incidents reveal, of course, is that the ethics issue that has become so prominent today touches not only the business community but education, government, nonprofits, and other organizations as well.

Figure 7-1 *Recent Ethics Scandals*

Companies Implicated	Executives Implicated	Legal/Ethical Charges & Convictions
Enron	Andrew Fastow, Jeffrey Skilling, Kenneth Lay, Richard Causey, Ben Glissan, treasurer	Securities fraud, conspiracy to inflate profits, corrupt corporate culture
WorldCom	Scott Sullivan, CFO; Bernard J. Ebbers, CEO	Accounting fraud, lying, filing false financial statements
Arthur Andersen	Entire firm; David Duncan, lead auditor for Enron	Accounting fraud, criminal charges, obstruction
Tyco	Mark Schwartz, CFO; Dennis Kozlowski, CEO	Sales tax evasion, stealing through corruption, stock fraud, unauthorized bonuses and loans
Adelphia	John Rigas; sons Timothy and Michael; Michael Mulcahey; James Brown	Accounting fraud, looting the company, using it as "personal piggy bank"
Global Crossing	Gary Winnick, chairman	Misleading "swap" transactions
Dynegy	Jamie Olis, sr. dir. tax planning; Gene S. Foster; Helen C. Sharkey, accountant	Accounting fraud
HealthSouth	Richard Scrushy, CEO	Found not guilty in company scandal but was later convicted of bribery, conspiracy, and mail fraud
Boeing	Michael Sears, CFO; Harry Stonecipher, CEO	Unethical behavior, violating company policy, misconduct
Martha Stewart	Martha Stewart	Conspiracy, securities fraud, and obstruction of justice
Parmalat (Italy)	Calisto Tanzi, chairman and CEO, and others	Flawed corporate governance
Computer Associates	Sanjay Kumar, CEO	Pleaded guilty to fraud

To gain an appreciation of the kinds of issues that are important under the rubric of business ethics, Figure 7-2 presents an inventory of business ethics issues compiled by the Josephson Institute of Ethics. Here, we see business ethics issues categorized on the basis of stakeholder relationships. Against this backdrop, we plan to begin our business ethics discussion, specifically, in this chapter and the next three chapters. In this chapter, we will introduce fundamental business ethics background and concepts. In Chapter 8, we will consider personal and organizational ethics. Chapter 9 addresses newly emerging technology and business ethics issues. Finally, in Chapter 10, our attention will turn to the international sphere as we discuss ethical issues in the global arena.

Figure 7-2 An Inventory of Ethical Issues in Business

This checklist is designed to stimulate thought and discussion on important ethical concerns in your company and the larger business community.

For each of the following issues, indicate whether ethical problems are
 5 = Very serious; 4 = Serious; 3 = Not very serious; 2 = Not a problem; 1 = No opinion.

Column I = In the business world in general **Column II** = In your company

Employee–Employer Relations

- | | | |
|-------|-------|---|
| _____ | _____ | Work ethic—giving a full day’s work for a full day’s pay |
| _____ | _____ | Petty theft (i.e., supplies, telephone, photocopying, etc.) |
| _____ | _____ | Cheating on expense accounts |
| _____ | _____ | Employee acceptance of gifts or favors from vendors |
| _____ | _____ | Distortion or falsification of internal reports |
| _____ | _____ | Cheating or overreaching on benefits (sick days, insurance, etc.) |

Employer–Employee Relations

- | | | |
|-------|-------|--|
| _____ | _____ | Sexual or racial discrimination in hiring, promotion, or pay |
| _____ | _____ | Sexual harassment |
| _____ | _____ | Invasions of employee privacy |
| _____ | _____ | Unsafe or unhealthy working conditions |
| _____ | _____ | Discouragement of internal criticism re: unfair, illegal, or improper activities |
| _____ | _____ | Unfair demands on or expectations of paid staff |
| _____ | _____ | Inadequate recognition, appreciation, or other psychic rewards to staff |
| _____ | _____ | Inappropriate blame-shifting or credit-taking to protect or advance personal careers |
| _____ | _____ | Unhealthy competition among employees about “turf,” assignments, budget, etc. |

Company–Customer Relations

- | | | |
|-------|-------|--|
| _____ | _____ | Unfair product pricing |
| _____ | _____ | Deceptive marketing/advertising |
| _____ | _____ | Unsafe or unhealthy products |
| _____ | _____ | Unfair and/or legalistic handling of customer complaints |
| _____ | _____ | Discourtesy or arrogance toward customers |

Company–Shareholder Relations

- | | | |
|-------|-------|--|
| _____ | _____ | Excessive compensation for top management |
| _____ | _____ | Self-protective management policies (golden parachutes, poison pills, greenmail) |
| _____ | _____ | Mismanagement of corporate assets or opportunities |
| _____ | _____ | Public reports and/or financial statements that distort actual performance |

(continues)

Figure 7-2 (Continued)
Company–Community/Public Interest

_____	_____	Injury to the environment
_____	_____	Undue influence on the political process through lobbying, PACs, etc.
_____	_____	Payoffs, “grease,” or bribes in foreign countries
_____	_____	Doing business in countries with inhumane or anti-American policies

Source: Reprinted with permission © Josephson Institute of Ethics, *Ethics: Easier Said Than Done* (Vol. 2, No. 1, 1989).

The Public’s Opinion of Business Ethics

The public’s view of business ethics has never been very high. Anecdotal evidence suggests that many citizens see business ethics as essentially a contradiction in terms, an oxymoron, and think that there is only a fine line between a business executive and a crook.

Over the past several years, public opinion polls have revealed the public’s and employees’ concerns about ethics in society and in the workplace. According to the Barna Research Group, a poll of American adults revealed that three in four are worried about morality in the United States. This is a commentary on general ethical trends in society.⁸

Beyond such general assessments of ethics in society, the public’s opinion of business ethics may be reported on two levels. At a broad level is the general perception of business ethics among institutions, and at a narrower level are specific perceptions as to what is going on inside organizations. On the more general level, a study reported by McKinsey consultants revealed that there is a “trust gap” between the public and business. When asked how much they trusted various institutions in society, European and American consumers placed the large corporation at the bottom of the list.⁹ There can be no doubt that the endless stream of ethical scandals following Enron contributed significantly to this trust gap.

Surveys also report a mixture of employee perceptions about business ethics and of what is going on inside these organizations. In a survey by Public Agenda, a nonpartisan opinion research organization, insights about the public’s views on business ethics were revealed. Some of the findings of Public Agenda were as follows:

- The most egregious violators of business ethics were corrupt executives who protected their own wealth while driving their companies to bankruptcy and forcing employees out of jobs.

http://SEARCH THE WEB WEB

THE FRAUD MUSEUM

The long history of business fraud now has its own museum. Created by the Association of Certified Fraud Examiners (ACFE) in 2006, the collection traces the history of fraud in business and presents business memorabilia related to famous scandals. The early pioneers of fraud set the stage with money laundering, forgery, false accounting, and investment scams. How did the frauds of yesterday morph into the sophisticated frauds of today? The chairman and founder of the Fraud Museum says that “public education about fraud is our mandate.”

The ACFE Fraud Museum brings historic frauds to life, from the most famous to the most obscure. From highly recognizable documents like Enron, WorldCom, and Adelphia stock certificates to unique exhibits like a check signed by legendary inside trader Ivan Boesky, the ACFE Fraud Museum offers something for everyone.

Though the Fraud Museum is physically located in Austin, Texas, you may take a tour of its many features at the ACFE’s website: <http://www.acfe.com/about/museum-info.asp>.

- Greed for money and power and a weakening sense of personal values has been behind the recent ethics scandals.
- Though people are concerned about business ethics, they define it in broad terms and are especially concerned with how it has affected them—lack of job security and employee and consumer treatment.
- Many participants thought it was possible for executives to be both ethical and successful.
- The media and financial press are not regarded as vigilant watchdogs protecting the public interest.¹⁰

In terms of what is going on in companies, the LRN Ethics Study survey of working adults published in 2007 reported how ethical lapses (failures, mistakes) and questionable behaviors were distracting workers. LRN is a company dedicated to helping clients develop ethical, sustainable, and profitable cultures. Some of the key findings of this survey of business ethics included the following:¹¹

- Three out of four employees surveyed reported encountering ethical lapses on the job, and more than one in three said they were distracted by such incidents.
- More than one in three respondents who encountered such ethical lapses said these incidents happen at least once a week.
- Ten percent of those surveyed believed that a current issue in their company could create a business scandal or disruption if discovered.
- Younger workers (ages 18–34) reported higher levels of witnessing ethical lapses and being distracted by them than middle-aged and older workers.

In connection with these ethical lapses, a director of compliance for United Technologies noted that any type of ethical lapse in a company ultimately erodes its culture. The director stated: “Questionable behavior by one employee can demotivate others, and an accumulation of small incidents detracts from productivity and job satisfaction.”¹²

The upshot of these surveys seems to be that business ethics problems continue in the post-Enron period even though some progress has been made. In spite of ups and downs, the consensus seems to be that we are in an era of fraud and corruption and that serious steps need to be taken to get business back on track.

It appears that the society of the first decade of the 2000s is clamoring for a renewed emphasis on values, morals, and ethics and that the business ethics debate of this period is but a subset of this larger societal concern. Whether the business community will be able to close the trust gap and ratchet up its reputation to a new plateau remains to be seen. One thing is sure: there is a renewed interest in business ethics, and the proliferation of business ethics courses in colleges and universities, along with the revitalized interest on the part of the business community, paints an encouraging picture for the “ethics industry” of the future.

HAS BUSINESS ETHICS REALLY DETERIORATED?

There is no scientific way to determine whether or not business ethics has really deteriorated. Max Ways’s description of a statistical analysis (modern society’s favorite kind of investigation) aimed at answering the question “How widespread is corporate misconduct?” is enlightening. He says that to describe such a project would demonstrate its impossibility. He argues that the researcher would have to count the transgressions publicly exposed in a certain period of time. Then the

<http://SEARCHTHEWEB.WEB>

ETHICS & COMPLIANCE OFFICER ASSOCIATION

What is going on in the world of business ethics? One way to find out is to check out what the Ethics & Compliance Officer Association (ECO) is doing. The ECOA website is located at <http://www.theeco.org/>. The organization’s purpose is stated as follows: “The Ethics & Compliance Officer Association (ECO) is a non-consulting, member-driven association exclusively for individuals who are responsible for their organization’s ethics, compliance, and business con-

duct programs. The only organization of its kind, it is the largest group of business ethics and compliance practitioners in the world.” The ECOA website has a wealth of information about what the professional practitioners of compliance and business ethics are doing. You may find out about their mission, vision, values, and programs. You may also see what companies belong to the ECOA. It also has links to other useful business ethics websites.

total number of known misdeeds would have to be correlated with the trillions and trillions of business transactions that occur daily. He concludes:

If we assume (recklessly) that a believable estimate of total transactions could be made, then the sum of the publicly known malfeasances almost certainly would be a minute fraction of the whole. At this point the investigator would have to abandon the conclusion that the incidence of business misconduct is so low as to be insignificant.¹³

In fact, no such study has ever been attempted. Public opinion polls might be our best way to gather data about the current state of business ethics, but such polls are hardly definitive. The polls have reported mixed results in recent years, but we must consider some other factors that affect the public's opinions, such as media reporting and society's expectations of business's ethics.

ARE THE MEDIA REPORTING ETHICS MORE VIGOROUSLY?

There is no doubt that the media are reporting ethical problems more frequently and fervently. Spurred on by the Enron and other scandals of the past few years, the media have found business ethics and, indeed, ethics questions among all institutions to be subjects of growing and sustaining interest. The Martha Stewart trial during 2003–2004 took on monumental proportions as the media turned it into the proverbial media circus that most felt exceeded its merit as a business ethics issue. Many believed that the charges against Stewart were much less severe than most of the other companies and executives summarized in Figure 7-1, but because she was an entertainment personality, the media coverage was nonstop.

Of particular interest in recent years has been the in-depth investigative reporting of business ethics on such TV shows as *60 Minutes*, *20/20*, *Dateline NBC*, *Primetime Live*, and *FRONTLINE*, as well as the growing number of such programs. Such investigations keep business ethics in the public eye and make it difficult to assess whether public opinion polls are reflecting the actual business ethics of the day or simply the reactions to the latest scandals covered on a weekly basis. In addition to TV coverage, Internet coverage in the form of webpages and blogs has expanded in recent years; even websites such as YouTube.com carry their share of ethics scandals.

IS IT THAT SOCIETY IS ACTUALLY CHANGING?

We would definitely make this argument here, as we did in Chapter 1. Many business managers subscribe to this belief. W. Michael Blumenthal, one-time U.S. Secretary of the Treasury and chief executive officer of the Bendix Corporation, was one of the leading advocates of this view. He argued:

It seems to me that the root causes of the questionable and illegal corporate activities that have come to light recently . . . can be traced to the sweeping

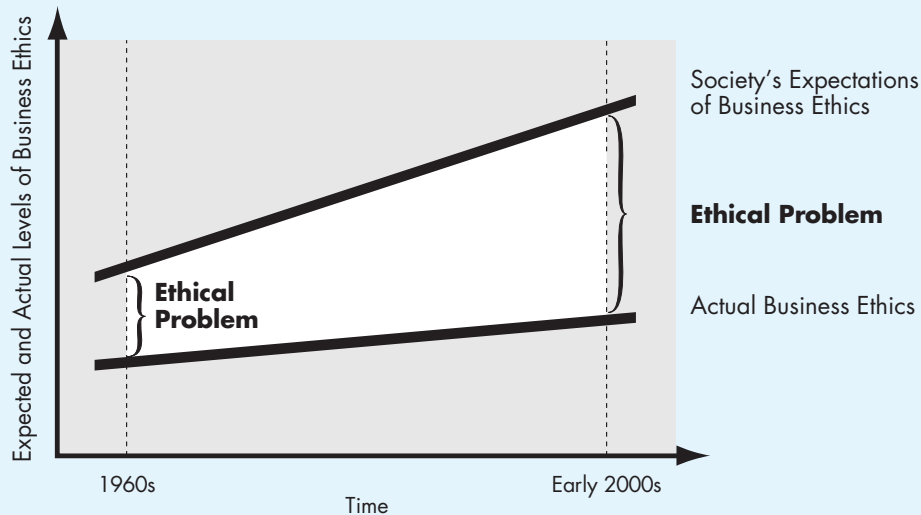
*changes that have taken place in our society and throughout the world and to the unwillingness of many in business to adjust to these changes.*¹⁴

He goes on to say, “People in business have not suddenly become immoral. What has changed are the contexts in which corporate decisions are made, the demands that are being made on business, and the nature of what is considered proper corporate conduct.”¹⁵

Although it would be difficult to prove Blumenthal’s thesis, it is an intuitively attractive one. You do not have to make a lengthy investigation of some of today’s business practices to realize that a good number of what are now called unethical practices were at one time considered acceptable. Or, it may be that the practices never really were acceptable to the public but that, because they were not known, they were tolerated, thus causing no moral dilemma in the mind of the public. In spite of this analysis, one cannot help but believe that the greed by top-level business executives that has been exposed in this first decade of the new millennium has elevated the ethics issue to new heights. Executive lying has contributed to the problem. Though corporate governance has gotten better in recent years, lack of careful oversight of top-echelon executives has been a problem as well. Corporate boards, in some cases, have fallen down in their duties to monitor top executive behavior, and one consequence has been the continuing stream of ethics scandals.

Figure 7-3 illustrates how the magnitude of the ethics problem may be more detectable today than it once was as a result of the public’s expectations of

Figure 7-3 *Business Ethics Today versus Earlier Periods*



business's ethical behavior rising more rapidly than actual business ethics. Note in the figure that actual business ethics is assumed to be improving but not at the same pace as public expectations are rising. The magnitude of the current ethics problem, therefore, is seen here partially to be a function of rapidly rising societal expectations about business behavior.

Business Ethics: What Does It Really Mean?

In Chapter 2, we discussed the ethical responsibilities of business in an introductory way. We contrasted ethics with economics, law, and philanthropy. To be sure, we all have a general idea of what business ethics means, but here we would like to probe the topic more deeply. To understand business ethics, it is useful to comment on the relationship between ethics and morality.

Ethics is the discipline that deals with what is good and bad and with moral duty and obligation. Ethics can also be regarded as a set of moral principles or values. **Morality** is a doctrine or system of moral conduct. "Moral conduct" refers to that which relates to principles of right and wrong in behavior. For the most part, then, we can think of ethics and morality as being so similar to one another that we may use the terms interchangeably to refer to the study of fairness, justice, and right and wrong behavior in business.

Business ethics, therefore, is concerned with good and bad or right and wrong behavior and practices that take place within a business context. Concepts of right and wrong are increasingly being interpreted today to include the more difficult and subtle questions of fairness, justice, and equity.

Descriptive vs. Normative Ethics

Two key branches of moral philosophy, or ethics, are descriptive ethics and normative ethics. It is important to distinguish between the two because they each take a different perspective.

Descriptive ethics is concerned with describing, characterizing, and studying the morality of a people, an organization, a culture, or a society. It also compares and contrasts different moral codes, systems, practices, beliefs, and values.¹⁶ In descriptive business ethics, therefore, our focus is on learning what is occurring in the realm of behavior, actions, decisions, policies, and practices of business firms, managers, or, perhaps, specific industries. The public opinion polls cited earlier give us glimpses of descriptive ethics—what people believe to be going on based on their perceptions and understandings. Descriptive ethics focuses on "what is" the prevailing set of ethical standards in the business community, specific organizations, or on the part of specific managers. A real danger in limiting our attention to descriptive ethics is that some people may adopt the view that "if everyone is doing it," it must be acceptable. For example, if a survey reveals that 70 percent of employees are padding their expense accounts, this describes what is

taking place, but it does not describe what *should* be taking place. Just because many are participating in this questionable activity doesn't make it an appropriate practice. This is why normative ethics is important.

Normative ethics, by contrast, is concerned with supplying and justifying a coherent moral system of thinking and judging. Normative ethics seeks to uncover, develop, and justify basic moral principles that are intended to guide behavior, actions, and decisions.¹⁷ Normative business ethics, therefore, seeks to propose some principle or principles for distinguishing what is ethical from what is unethical in the business context. It deals more with “what ought to be” or “what ought not to be” in terms of business practices. Normative ethics is concerned with establishing norms or standards by which business practices might be guided or judged.

In our study of business ethics, we need to be ever mindful of this distinction between descriptive and normative perspectives. It is tempting to observe the prevalence of a particular practice in business (for example, discrimination or deceptive advertising) and conclude that because so many are doing it (descriptive ethics), it must be acceptable behavior. Normative ethics would insist that a practice be justified on the basis of some ethical principle, argument, or rationale before being considered acceptable. Normative ethics demands a more meaningful moral anchor than just “everyone is doing it.” Normative ethics is our primary frame of reference in this book, though we will frequently compare “what ought to be” with “what is (really going on in the real world).”

Three Major Approaches to Business Ethics

In this chapter and continuing into Chapter 8, we will introduce three major approaches to thinking about business ethics:

1. Conventional approach (Chapter 7)—based on how normal society today views business ethics
2. Principles approach (Chapter 8)—based upon the use of ethics principles or guidelines to direct behavior, actions, and policies
3. Ethical tests approach (Chapter 8)—based on short, practical questions to guide ethical decision making and behavior

We will discuss the conventional approach to business ethics in this chapter and the other two approaches in Chapter 8.

THE CONVENTIONAL APPROACH TO BUSINESS ETHICS

The **conventional approach to business ethics** is essentially an approach whereby we compare a decision, practice, or policy with prevailing norms of acceptability. We call it the conventional approach because it is believed that this is the way that conventional or general society thinks. The major challenge of this approach is answering the questions “Whose norms do we use?” in making the ethical

judgment, and “What norms are prevailing?” This approach may be depicted by highlighting the major variables to be compared with one another:

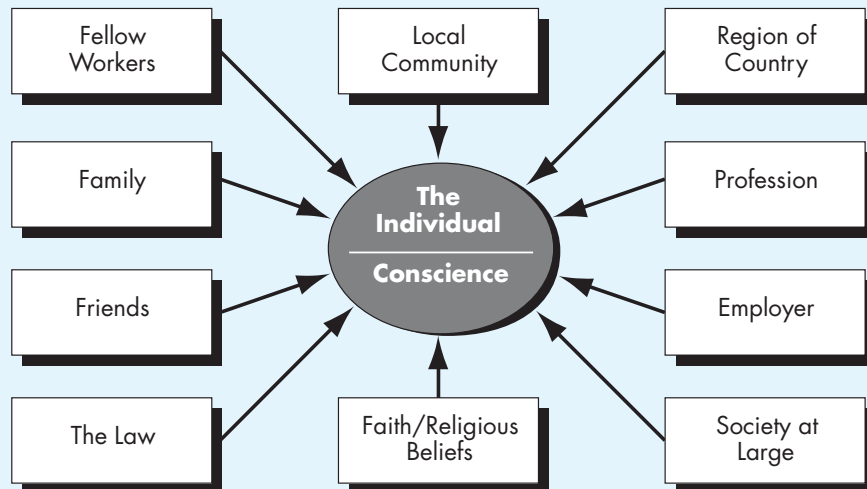
Decision or Practice \longleftrightarrow Prevailing Norms of Acceptability

There is considerable room for variability on both of the questions. With respect to whose norms are used as the basis for ethical judgments, the conventional approach would consider as legitimate those norms emanating from family, friends, religious beliefs, the local community, one’s employer, law, the profession, and so on.

In addition, one’s conscience, or one’s self, would be seen by many as a legitimate source of ethical norms. Two classic “Frank & Ernest” comic strips poke fun at the use of one’s conscience. In the first, a sign on the wall reads “Tonight’s Lecture: Moral Philosophy.” Then it shows Frank saying to Ernest, “I’d let my conscience be my guide, but I’m in enough trouble already!” In a second comic strip, Frank says to Ernest, while they are standing at a bar, “I always use my conscience as my guide. But, fortunately, it has a terrible sense of direction.” These comic strips reveal the often limiting nature of using one’s conscience.

Figure 7-4 illustrates some of the sources of norms that come to bear on the individual and that might be used in various circumstances and, over time, under the conventional approach. These sources compete in their influence on what constitutes the “prevailing norms of acceptability” for today.

Figure 7-4 *Sources of Ethical Norms Communicated to Individuals*



In some circumstances, the conventional approach to ethics may be useful and applicable. What does a person do, however, if norms from one source conflict with norms from another source? Also, how can we be sure that societal norms are really appropriate or defensible? Our society's culture sends us many and often conflicting messages about what is appropriate ethical behavior. We get these messages from television, movies, books, music, and other sources in the culture.

Recently, TV shows such as *Survivor* and *The Apprentice* have run episodes in which questionable ethics have been depicted and sometimes celebrated. On *Survivor*, the participants are forever creating alliances and then breaking them in the interest of winning the game. *The Apprentice* was one of the first reality shows with a business focus. Sixteen participants vie for Donald Trump's favor as they are broken into teams to compete to become Trump's "apprentice" and go to work for \$250,000 on one of Trump's projects. A number of these episodes portrayed questionable ethics passed off as business as usual. As the women's team managed Planet Hollywood for a day, they resorted to using their sexuality to increase sales. The attractive women became "The Shooter Girls" (similar to the "Hooters" girls) and tried to sell shots to the admiring male customers, using whatever tactics worked. In one scene, while participant Amy was out on the streets trying to give away coupons, she observed, "I feel like I'm pimping."¹⁸ In other episodes, they were out on the streets of New York giving away kisses to the men who bought their products, while they flaunted their sexuality in skimpy, revealing outfits.

One of the most questionable tactics portrayed on *The Apprentice* was when the men's team was pushing to increase sales at Planet Hollywood by selling merchandise. The men's team started hawking miniature basketballs while shouting "Get a Kwame Jackson autograph," as they had one of their own team members sitting at a table selling the basketballs while autographing them for buyers. They never told anyone that Kwame was not a well-known NBA basketball star, but many little kids bought the basketballs anyway, thinking he was some famous star. Obviously, they had deceived many customers into thinking Kwame was an all-star. This episode created a lot of finger-pointing on the show, with participants divided over the ethics of deceiving customers in this way.¹⁹ It is just possible that an impressionable young person might see this and hundreds of other references like it and conclude that dishonesty is a standard in business.

Another example of the conflicting messages people get today from society occurs in the realm of sexual harassment in the workplace. On the one hand, today's television, movies, advertisements, and music are replete with sexual innuendo and the treatment of women and men as sex objects. This would suggest that such behavior is normal, acceptable, even desired. On the other hand, the law and the courts are stringently prohibiting sexual gestures or innuendo in the workplace. As we will see in Chapter 19, it does not take much sexual innuendo to constitute a "hostile work environment" and a sex discrimination charge under Title VII of the Civil Rights Act. In this example, we see a norm that is prevalent in culture and society clashing with a norm evolving from employment law and

business ethics. These examples serve to illustrate how views of ethics that are acceptable to many in conventional society would not be accepted in more rigorous forms of ethical analysis.

ETHICS AND THE LAW

We have made various references to ethics and the law. In Chapter 2, we said that ethical behavior is typically thought to reside above behavior required by the law. This is the generally accepted view of ethics. We should make it clear, however, that in many respects the law and ethics overlap. To appreciate this, you need to recognize that the law embodies notions of ethics. That is, the law may be seen as a reflection of what society thinks are minimal standards of conduct and behavior. Both law and ethics have to do with what is deemed appropriate or acceptable, but law reflects society's *codified* ethics. Therefore, if a person breaks a law or violates a regulation, she or he is also behaving unethically. We should be open to the possibility, however, that in some rare cases the law may not be ethical, in which case standing up to the law might be the principled course of action. A case in point might be when Rosa Parks, a black woman, stood up to the authorities and refused to move to the back of the bus.

In spite of this frequent overlap between law and ethics, we continue to talk about desirable ethical behavior as behavior that extends beyond what is required by law. The *spirit* of the law often extends beyond the *letter* of the law. Viewed from the standpoint of minimums, we would certainly say that obedience to the law is generally regarded to be a minimum standard of ethical behavior.

There are two good examples in which the confusion between law and ethics led to disastrous results. In one analysis, the Enron case was said to have been all about the difference between the letter of the law and the spirit of the law, often regarded as ethics. Interestingly, the fraud at Enron was accompanied by obsessive and careful attention to the letter of the law. One observer stated that "the people who ran Enron did back flips and somersaults as they tried to stay within the law's lines."²⁰ But, Ken Lay and Jeffrey Skilling apparently missed the main point of securities laws, which is that CEOs and other high-level officials should not get rich while their shareholders go broke. So, the source of all their crimes was the basic dishonesty of trying to keep Enron's stock afloat so that they could make money.²¹ Their focus on the law to the neglect of ethics was a significant part of their downfall.

In another ethics scandal in 2006 involving Hewlett-Packard (HP), the focus on law rather than ethics became problematic. HP was experiencing leaks of information from its board meetings and started an investigation in to who was leaking what information. In the process, they began to use some questionable, though possibly legal, techniques for gathering information. The company used a technique known as "pretexting," which employs deceit, to get phone record information from workers at phone companies. The company's lawyers had concluded that pretexting was legal but did not pay much attention to whether the technique was ethical. A former advisor of HP's, while analyzing what went on, admitted that there was a lack of balance given to ethical considerations in the

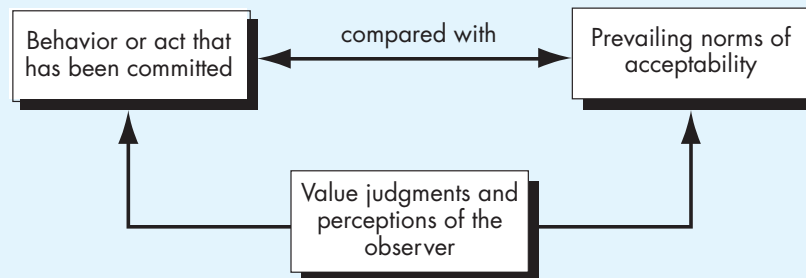
company's quest to trace the leaks from its board in 2005 and 2006. The advisor went on to say that "doing it legally should not be the test; that is a given . . . you have to ask what is appropriate and what is ethical," and this is where the firm failed.²²

In addition, we should make note of the fact that the law does not address all realms in which ethical questions might be raised. Thus, there are clear roles for both law and ethics to play.²³ It should be noted that research on illegal corporate behavior has been conducted for some time. Illegal corporate behavior, of course, comprises business practices that are in direct defiance of law or public policy. Research has focused on two dominant questions: (1) why do firms behave illegally, or what leads them to engage in illegal activities; and (2) what are the consequences of behaving illegally?²⁴ We will not deal with these studies of lawbreaking in this discussion; however, we should view this body of studies and investigations as being closely aligned with our interest in business ethics because it represents a special case of business ethics (illegal behavior).

MAKING ETHICAL JUDGMENTS

When a decision is made about what is ethical (right, just, fair) using the conventional approach, there is room for variability on several counts (see Figure 7-5). Three key elements compose such a decision. First, we observe the *decision, action, or practice* that has been committed in the workplace setting. Second, we *compare the practice with prevailing norms of acceptability*—that is, society's or some other standard of what is acceptable or unacceptable. Third, *we must recognize that value judgments are being made* by someone as to what really occurred (the actual behavior) and what the prevailing norms of acceptability really are. This means that two different people could look at the same behavior or practice, compare it with their beliefs of what the prevailing norms are, and reach different conclusions as to whether the behavior was ethical or not. This becomes quite complex as perceptions of what is ethical inevitably lead to the difficult task of ranking different values against one another.

Figure 7-5 Making Ethical Judgments



If we can put aside for a moment the fact that perceptual differences about an incident do exist, and the fact that we might differ among ourselves because of our personal values and philosophies of acceptable behavior, we are still left with the problematic task of determining society's prevailing norms of acceptability of business practice. As a whole, members of society generally agree at a very high level of abstraction that certain behaviors are wrong. However, the consensus tends to disintegrate as we move from general to specific situations.

Let us illustrate with a business example. We might all agree with the general saying "You should not steal someone else's property." As a general precept, we probably would have consensus on this. But as we look at specific situations, our consensus may tend to disappear. Is it acceptable to take home from work such things as pencils, pens, paper clips, paper, staplers, computer discs, adding machines, and calculators? Is it acceptable to use the company telephone for personal long-distance calls? Is it acceptable to use company gasoline for private use or to pad expense accounts? Is it acceptable to use company computers for personal e-mail? What if everyone else is doing it?

What is interesting in these examples is that we are more likely to reach consensus in principle than in practice. Some people who would say these practices are not acceptable might privately engage in them. Furthermore, a person who would not think of shoplifting even the smallest item from a local store might take pencils and paper home from work on a regular basis. A comic strip depicting the "Born Loser" illustrates this point. In the first panel, the father admonishes his son Wilberforce in the following way: "You know how I feel about stealing. Now tomorrow I want you to return every one of those pencils to school." In the second panel, Father says to Wilberforce, "I'll bring you all the pencils you need from work." This is an example of the classic double standard, and it illustrates how actions may be perceived differently by the observer or the participant.

Thus, in the conventional approach to business ethics, determinations of what is ethical and what is not require judgments to be made on at least three counts:

1. What is the *true nature* of the practice, behavior, or decision that occurred?
2. What are society's (or business's) *prevailing norms* of acceptability?
3. What *value judgments* are being made by someone about the practice or behavior, and what are that person's *perceptions* of applicable norms?

The human factor in the situation thus introduces the problem of perception and values and makes the decision process complicated.

The conventional approach to business ethics can be valuable, because we all need to be aware of and sensitive to the total environment in which we exist. We need to be aware of how society regards ethical issues. It has limitations, however, and we need to be cognizant of these as well. The most serious danger is that of falling into an **ethical relativism** where we pick and choose which source of norms we wish to use based on what will justify our current actions or maximize our freedom. A recent comic strip illustrates this point. In a courtroom, while being sworn in, the witness stated, "I swear to tell the truth . . . as I see it."

In the next chapter, we will argue that a principles approach is needed to augment the conventional approach. The principles approach looks at general guidelines to ethical decision making that come from moral philosophy. We will also present the ethical tests approach, which is more of a practical approach, in the next chapter.

Ethics, Economics, and Law: A Venn Model

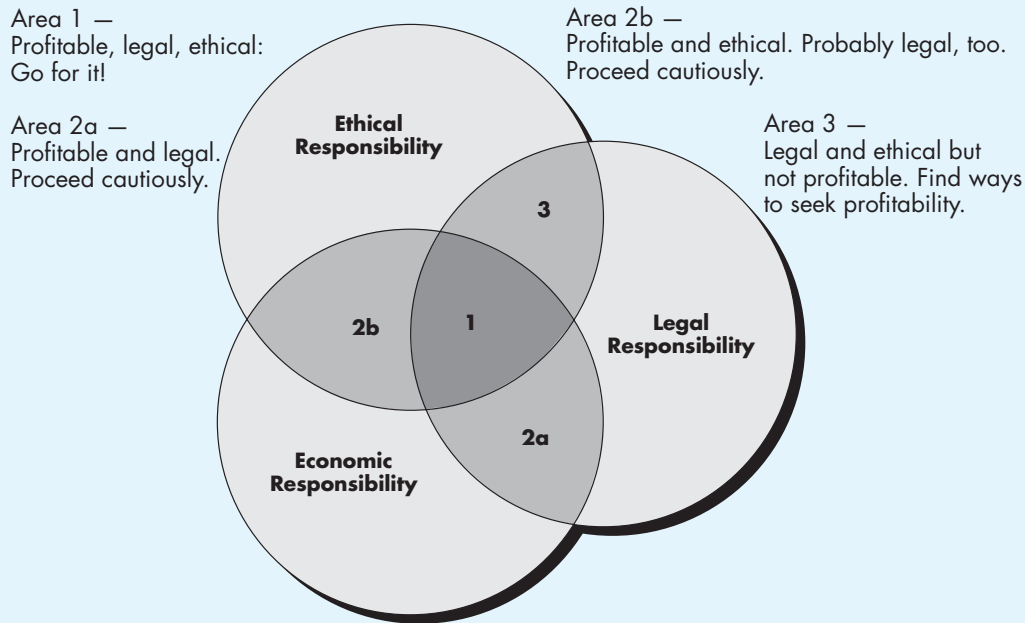
When we focus on ethics and ethical decision making, it is useful to consider the primary forces that come into tension while making ethical judgments. In Chapter 2, these were introduced as part of the four-part definition of corporate social responsibility, and they were depicted in the Pyramid of CSR. When we are discussing a firm's CSR, philanthropy definitely enters the discussion. This is because philanthropic initiatives are the primary way many companies display their CSR in the community—through good and charitable works. In ethical decision making, however, we tend to set aside philanthropic expectations and focus on ethical expectations and, especially, those forces that primarily come into tension with ethics—economics (the quest for profits) and law. Thus, in most decision-making situations, ethics, economics, and law become the central expectations that must be considered and balanced against each other in the quest to make wise decisions.

A firm's economic, legal, and ethical responsibilities can be depicted in a Venn diagram model illustrating how certain actions, decisions, or policies fulfill one, two, or three of these responsibility categories. Figure 7-6 presents this Venn diagram model, illustrating the overlapping potential of these three responsibility categories.

In Area 1, where the decision, action, or practice fulfills all three responsibilities, the management prescription is to “go for it.” That is, the action is profitable, in compliance with the law, and represents ethical behavior. In Area 2a, the action under consideration is profitable and legal, but its ethical status may be uncertain. The guideline here is to “proceed cautiously.” In these kinds of situations, the ethics of the action needs to be carefully considered. In Area 2b, the action is profitable and ethical, but perhaps the law does not clearly address the issue or is ambiguous. If it is ethical, there is a good chance it is also legal, but the guideline again is to proceed cautiously. In Area 3, the action is legal and ethical but not profitable. Therefore, the strategy here would be to avoid this action or find ways to make it profitable. However, there may be a compelling case to take the action if it is legal and ethical and, thus, represents the right thing to do. Schwartz and Carroll have presented a three-domain approach to CSR that employs a Venn diagram format such as that presented in Figure 7-6. They provide corporate examples to illustrate each section of the Venn diagram.²⁵

By taking philanthropy out of the picture, the ethics Venn model serves as a useful template for thinking about the more immediate expectations that society

Figure 7-6 A Venn Diagram Model for Ethical Decision Making



has on business in a situation in which the ethical dimension plays an important role. It illustrates clearly that many business decisions boil down to trade-offs between the influences of economics, law, and ethics.

Four Important Ethics Questions

There are other ways to get at the “big picture” perspective of ethics in general or of business ethics in particular. Philosophers have concepts and terminology that are more academic, but let us approach this broad perspective by recalling four simple but really different kinds of questions that help us frame the business ethics challenge:²⁶

1. What is?
2. What ought to be?
3. How do we get from what is to what ought to be?
4. What is our motivation in all this?

These four questions capture the core of what ethics is all about. They force an examination of *what really is* (descriptive ethics) going on in a business situation,

Ethics in Practice Case

ETHICS IN THE MAILROOM

To make some extra money during college, I got a part-time job in a mailroom at a rather large business. This business would send out hundreds of pieces of mail each day, all going through the mailroom. Our job as the staff of the mailroom was to package this mail to be shipped, put the proper amount of postage on it, and then take it to the post office. To put the postage on the items, we used a postage meter that was in the mailroom. The postage meter would weigh the mail and then stamp it with the correct amount of postage; my employers would pay the postage costs in lump sums periodically throughout the year.

Occasionally, my boss would run some of his personal mail along with the business mail. When I asked him if sending personal mail through the meter was basically stealing money from the company, he justified it by saying that he only used the meter to mail his bills, and he would never use it for anything that cost more than 60 cents. He also said that he had been working there for 13 years, and he compensated for his low pay by being able to send

out the occasional bill or letter. I figured that a few cents here and there would not hurt the company and looked the other way.

1. Define “what is” and “what ought to be” in this case.
2. Was my boss’s practice ethical? Does working for a company for 13 years justify sending out personal mail that the company pays for?
3. Does my boss’s low pay justify his using company resources to send out personal mail to compensate for the low pay? After all, isn’t it just “balancing things out”?
4. Is there any reasonable way to get from “what is” to “what ought to be” without getting fired?
5. Did I do the right thing by looking the other way, or should I have turned my boss in for stealing company money, even though it was just a few cents here and there? What should I have done?

Contributed Anonymously

what ought to be (normative ethics), how we might *close the gap* between what is and what ought to be (practical question), and what our *motivation* is for doing all this.

Before we discuss each question briefly, let us suggest that these four questions may be asked at five different levels: the level of the individual (the personal level), the level of the organization, the level of the industry or profession, the societal level, and the global or international level. By asking and then answering these questions, a greater understanding and resolution of a business ethics dilemma may be achieved.

WHAT IS? THE DESCRIPTIVE QUESTION

The “what is?” question forces us to identify the reality of what is actually going on in an ethical sense in business or in a specific decision or practice. Ideally, it is a factual, scientific, or descriptive question. Its purpose is to help us understand the

reality of the ethical behavior we find before us in the business environment. As we discussed earlier when we were describing the nature of making ethical judgments, it is not always simple to state exactly what the “real” situation is. This is because we are humans and thus make mistakes when we “sense” what is happening. Also, we are conditioned by our personal beliefs, values, and biases, and these factors affect what we sense is going on. Or, we may perceive real conditions for what they are but fail to think in terms of alternatives or in terms of “what ought to be.” Think of the difficulty you might have in attempting to describe “what is” with respect to business ethics at the personal, organizational, industry/professional, societal, or global levels. Relevant questions then become:

- What are your personal ethics?
- What are your organization’s ethics?
- What are the ethics of your industry or profession?
- What are society’s ethics?
- What are global ethics?

WHAT OUGHT TO BE? THE NORMATIVE QUESTION

This second question is quite different from the first question and gets to the heart of ethical analysis. It is normative (referring to “what ought to be”) rather than descriptive (referring to “what is”). The “what ought to be?” question seldom gets answered directly, particularly in a managerial setting. Managers are used to identifying alternatives and choosing the best one, but this is seldom done with questions that entail moral content or the “rightness, fairness, or justice” of a decision or practice. The “ought to be” question is often viewed in terms of what management *should do* (in an ethical sense) in a given situation. Examples of this question in a business setting might be:

- How *ought* we treat our aging employees whose productivity is declining?
- How safe *ought* we make this product, knowing full well we cannot pass all the costs on to the consumer?
- How clean an environment *should* we aim for?
- How *should* we treat long-time employees when the company is downsizing or moving the plant to a foreign country?
- *Should* we outsource certain aspects of our production to China or India, even though it might mean fewer jobs at home?

At a corporate planning seminar several years ago, the leader suggested that if you are the president of a large corporation, the place to start planning is with a vision of society, not with where you want to be five or ten years into the future. What kind of world do you want to have? How does your industry or your firm fit into that world? An executive cannot just walk into the office one day and say, “I had a vision last night,” and expect many adherents.²⁷ But this does not make the

question or the vision invalid. It simply suggests that we must approach the “what ought to be?” questions at a more practical level. There are plenty of issues to which this question can be applied in the everyday life of a manager. Therefore, such lofty, visionary exercises are not necessary.

HOW TO GET FROM WHAT IS TO WHAT OUGHT TO BE: THE PRACTICAL QUESTION

This third question represents the challenge of bridging the gap between *where we are* and *where we ought to be* with respect to ethical practices. It is a practical question for management. We may discuss endlessly where we “ought” to be in terms of our own personal ethics or the ethics of our firm, of our industry, or of society. As we move further away from the individual level, we have less control or influence over the “ought to be” question.

When faced with these challenges as depicted by our “ought to be” questions, we may find that from a practical point of view we cannot achieve our ideals. This does not mean we should not have asked the question in the first place. Our “ought to be” questions become goals or aspirations for our ethical practices. They form the normative core of business ethics. They become moral benchmarks that help us to motivate and measure progress.

In all managerial situations, we are faced with this challenge of balancing what we *ought to do* with what we *must or can do*. The ideas of Leslie Weatherhead, described in his book *The Will of God*, could be adapted to our discussion here. He refers to God’s intentional will, circumstantial will, and ultimate will.²⁸ Looking at these concepts from a managerial or an ethics point of view, we might think in terms of what we *intend* to accomplish, what circumstances *permit* us to accomplish, and what we ultimately are *able* to accomplish. These ideas interject a measure of realism into our efforts to close the gap between where we are and where we want to be in a business ethics application.

This is also the stage at which managerial decision making and strategy come into play. The first step in managerial problem solving is identifying the problem (what “is”). Next comes identifying where we want to be (the “ought” question). Then comes the managerial challenge of closing the gap. “Gap analysis” sets the stage for concrete business action.

WHAT IS OUR MOTIVATION? A QUESTION OF AUTHENTICITY

Pragmatic businesspeople do not like to dwell on this fourth question, which addresses the motivation for being ethical, because sometimes it reveals some manipulative or self-centered motive. At one level, is it perhaps not desirable to discuss motivation, because isn’t it really actions that count? If someone makes a \$100 contribution to a charitable cause, is it fair to ask whether the person did it (1) because she or he really believes in the cause (altruistic motivation) or (2) because she or he just wanted a tax deduction or (3) wanted to “look” benevolent in

the eyes of others (selfish motive)? Most of us would agree that it is better for a person to make a contribution rather than not make it, regardless of the motive.

Ideally, we would hope that people would be ethical because they intrinsically see that being ethical is a better way to live or manage. What kind of world (or organization) would most people prefer: one in which people behave ethically because they have selfish or instrumental reasons for doing so, or a world in which they behave ethically because they really believe in what they are doing? We will accept the former, but the latter is more desirable. We will be better off in the long run if “right” managerial practices are motivated by the knowledge that there is inherent value in ethical behavior.

This can be compared to the organizational situation in which managers are attempting to motivate their workers. If a manager is interested only in greater productivity and sees that being “concerned” about employees’ welfare will achieve this goal, she or he had better be prepared for the fact that employees may see through the “game playing” and eventually rebel against the manager’s effort. On the other hand, employees can see when management is genuinely concerned about their welfare, and they will be responsive to such well-motivated efforts. This is borne out in practice. You can examine two companies that on the surface appear to have identical human resource policies. In one company, the employees know and feel they are being manipulated; in the other company, there is confidence that management really does care.²⁹ In essence, the difference is one of managements’ authenticity of motive.

Although we would like to believe that managers are appropriately motivated in their quest for ethical business behavior and that motivations are important, we must continue to understand and accept the observation that we live in a “messy world of mixed motives.” Therefore, managers do not typically have the luxury of making abstract distinctions between altruism and self-interest but must get on with the task of designing structures, systems, incentives, and processes that accommodate the “whole” employee, regardless of motivations.³⁰

Three Models of Management Ethics

In attempting to understand the basic concepts of business ethics, it is useful to think in terms of key ethical models that might describe different types of management ethics found in the organizational world.³¹ These models should provide some useful base points for discussion and comparison. The media have focused so much on immoral or unethical business behavior that it is easy to forget or not think about the possibility of other ethical styles or types. For example, scant attention has been given to the distinction that may be made between those activities that are *immoral* and those that are *amoral*; similarly, little attention has been given to contrasting these two forms of behavior with ethical or *moral* management.

Believing that there is value in discussing descriptive models for purposes of clearer understanding, here we will describe, compare, and contrast three models or types of ethical management:

- Immoral management
- Moral management
- Amoral management

A major goal is to develop a clearer understanding of the gamut of management approaches in which ethics or morality is a defining characteristic. By seeing these approaches come to life through description and example, managers will be in an improved position to assess their own ethical approaches and those of other organizational members (supervisors, subordinates, and peers).

Another important objective is to identify more completely the amoral management model, which often is overlooked in the human rush to classify things as good or bad, moral or immoral. In a later section, we will discuss the elements of moral judgment that must be developed if the transition to moral management is to succeed. A more detailed development of each management model is valuable in coming to understand the range of ethics that leaders may intentionally or unintentionally display. Let us consider the two extremes first—immoral and moral management—and then amoral management.

IMMORAL MANAGEMENT

Using *immoral* and *unethical* as synonyms, **immoral management** is defined as an approach that not only is devoid of ethical principles or precepts but also implies a positive and active opposition to what is ethical. Immoral management decisions, behaviors, actions, and practices are discordant with ethical principles. This model holds that management's motives are selfish and that it cares only or principally about its own or its company's gains. If management's activity is actively opposed to what is regarded as ethical, this suggests that management understands right from wrong and yet chooses to do wrong. Thus, its motives are deemed greedy or selfish. According to this model, management's goals are profitability and organizational success at virtually any price. Management does not care about others' claims to be treated fairly or justly.

What about management's orientation toward the law, considering that law is often regarded as an embodiment of minimal ethics? Immoral management regards legal standards as barriers that management must avoid or overcome in order to accomplish what it wants. Immoral management would just as soon engage in illegal activity as in immoral or unethical activity.

Operating Strategy

The operating strategy of immoral management is focused on exploiting opportunities for corporate or personal gain. An active opposition to what is moral would suggest that managers cut corners anywhere and everywhere it

Figure 7-7 Characteristics of Immoral Managers

- These managers intentionally do wrong.
- These managers are *self-centered* and *self-absorbed*.
- They care only about self or organization's profits/success.
- They actively oppose what is right, fair, or just.
- They *exhibit no concern* for stakeholders.
- These are the "bad guys."
- An ethics course probably would not help them.

appears useful. Thus, the key operating question guiding immoral management is, "Can we make money with this action, decision, or behavior, *regardless of what it takes?*" Implicit in this question is that nothing else matters, at least not very much. Figure 7-7 summarizes some of the major characteristics of immoral managers.

Illustrative Cases of Immoral Management

Examples of immoral management abound.

Enron. No business scandal in recent times stands out as an example of immoral management as much as Enron. Books and even a movie have been made about the Enron scandal. The two major players in the Enron scandal were CFO Jeffrey Skilling and CEO Ken Lay. Though Enron imploded in 2001, it wasn't until 2006 that these two individuals were brought to justice and convicted.³² Ken Lay, founder and CEO of Enron, died on July 5, 2006, before he had a chance to serve his prison sentence, which would have taken him to the end of his life.³³ Because of a legal fine point, Ken Lay's felony conviction was vacated after his death.

Lay and Skilling were both convicted of securities fraud and conspiracy to inflate profits, along with a number of other charges. They used off-the-books partnerships to disguise Enron's debts, and then they lied to investors and employees about the company's disastrous financial situation while selling their own company shares.³⁴ In addition, Enron traders manipulated California's energy market to create phony shortages. This forced the state to borrow billions to pay off artificially inflated power bills. Voters in California were so fearful of brownouts, skyrocketing power bills, and rising state debt that they recalled Governor Gray Davis and replaced him with Arnold Schwarzenegger.³⁵

Enron's collapse and eventual bankruptcy erased as much as \$60 billion worth of investors' stock value and left 5,600 employees jobless and facing retirements with no nest eggs.³⁶ In a retrospective examination of Kenneth Lay's life, one writer argued that to the public, his greatest crime was in advising employees, as the firm was crashing, to keep their Enron stock, and even to buy more, while he

was selling his own.³⁷ His lies destroyed the lives and savings of thousands. One writer summed up Enron with the following equation: “Exaggerate + spin + lie = Enron.”³⁸ After the dust has settled, it appears that this equation was an understatement of what Lay, Skilling, and their associates did to those directly affected and to the public’s trust in the business system.

Computer Associates. After an investigation, three former high-ranking executives of Computer Associates pleaded guilty to charges of securities fraud. In their pleas, the executives depicted a wide-ranging conspiracy to falsify the company’s books and hide the falsifications from federal prosecutors. The three executives said they met to discuss the company’s sales for the previous quarter and noted that the sales fell short of Wall Street’s forecasts. In response, the executives decided to continue to book new sales as if they had taken place in the previous quarter. Then, to hide the backdated sales from auditors, employees of the firm deleted time stamps showing when the contracts had actually been faxed to the company. It was revealed that more than 20 percent of the company’s revenue came from backdated contracts. The former chief financial officer later confessed, “I knew my conduct was wrong at the time.” He faces up to 20 years in federal prison.³⁹

Procter & Gamble. In another case, Procter & Gamble (P&G) admitted to corporate espionage after some of its employees had rummaged through the trash cans outside the Chicago offices of Unilever, the British–Dutch Company that makes Lipton tea, Dove soap, and several brands of shampoo. Agents of P&G retrieved about 80 pages of Unilever’s confidential plans. In its defense, P&G said its agents did not violate the law but did violate the company’s own ethics policies, which prohibit rummaging through garbage to acquire information on competitors. P&G agreed to pay Unilever \$10 million in the spying case and agreed to an unusual third-party audit to monitor the product development and marketing plans of the company. P&G’s chairman pledged that he had taken steps to ensure that the acquired material would not be used by his company.⁴⁰

Survey Results. In the “Deloitte & Touche USA 2007 Ethics & Workplace” survey, respondents identified a number of questionable behaviors observed in the workplace that they thought were unacceptable. This list reveals everyday practices that would likely correspond with the model of immoral management described above:⁴¹

- Stealing petty cash
- Cheating on expense reports
- Taking credit for another person’s accomplishments
- Lying on time sheets about hours worked
- Coming into work hungover
- Telling a demeaning (e.g., racist) joke
- Taking office supplies for personal use

In this same Deloitte & Touche survey, respondents provided what they considered to be other unethical behaviors.⁴² These practices would also be characterized as immoral management:

- Showing preferential treatment toward certain employees
- Rewarding employees who display wrong behaviors
- Harassing a fellow employee (e.g., verbally, sexually, racially)

All of these are examples of immoral management wherein executives' decisions or actions were self-centered, actively opposed to what is right, focused on achieving organizational success at whatever the cost, and cutting corners where it was useful. These decisions were made without regard to the possible consequences of such concerns as honesty or fairness to others. What is apparent from the Deloitte & Touche survey findings is that immoral management can occur on an everyday basis and does not need to be in the league of the megascandals such as Enron, Tyco, and WorldCom to be unacceptable behavior.

MORAL MANAGEMENT

At the opposite extreme from immoral management is **moral management**. Moral management conforms to the highest standards of ethical behavior or professional standards of conduct. Although it is not always crystal clear what level of ethical standards prevail, moral management strives to be ethical in terms of its focus on elevated ethical norms and professional standards of conduct, motives, goals, orientation toward the law, and general operating strategy.

In contrast to the selfish motives in immoral management, moral management aspires to succeed, but only within the confines of sound ethical precepts—that is, standards predicated on such norms as fairness, justice, respect for rights, and due process. Moral management's motives, therefore, likely would be termed fair, balanced, or unselfish. Organizational goals continue to stress profitability, but only within the confines of legal obedience and sensitivity to and responsiveness to ethical standards.

Moral management pursues its objectives of profitability, legality, and ethics as both required and desirable. Moral management would not pursue profits at the expense of the law and sound ethics. Indeed, the focus here would be not only on the letter of the law but on the spirit of the law as well. The law would be viewed as a minimal standard of ethical behavior, because moral management strives to operate at a level above what the law mandates.

Operating Strategy of Moral Management

The operating strategy of moral management is to live by sound ethical standards, seeking out only those economic opportunities that the organization or management can pursue within the confines of ethical behavior. The organization assumes a leadership position when ethical dilemmas arise. The central question guiding moral management's actions, decisions, and behaviors is, "Will this action, decision,

behavior, or practice be fair to all stakeholders involved as well as to the organization?"

Integrity Strategy. Lynn Sharp Paine has proposed an “integrity strategy” that closely resembles the moral management model.⁴³ The **integrity strategy** is characterized by a conception of ethics as the driving force of an organization. Ethical values shape management’s search for opportunities, the design of organizational systems, and the decision-making process. Ethical values in the integrity strategy provide a common frame of reference and serve to unify different functions, lines of business, and employee groups. Organizational ethics, in this view, helps to define what an organization is and what it stands for. Some common features of an integrity strategy include the following,⁴⁴ which are all consistent with the moral management model:

- Guiding values and commitments make sense and are clearly communicated.
- Company leaders are personally committed, credible, and willing to take action on the values they espouse.
- Espoused values are integrated into the normal channels of management decision making.
- The organization’s systems and structures support and reinforce its values.
- All managers have the skills, knowledge, and competencies to make ethically sound decisions on a daily basis.

Ethics Criteria. For many years, *Business Ethics* magazine (now *CRO: Corporate Responsibility Officer*) gave its Annual Business Ethics Awards. Considering the criteria for these awards is useful, because these criteria are representative of moral management as we have been describing it. *Business Ethics’* award criteria required a company to meet many, although not necessarily all, of the following criteria:⁴⁵

- Be a leader in the company’s field, showing the way ethically.
- Sponsor programs or initiatives in responsibility that demonstrate sincerity and ongoing vibrancy, and reach deep into the company.
- Be a significant presence on the national scene, so the company’s ethical behavior sends a loud signal.
- Stand out in at least one area; a company need not be perfect, nor even exemplary, in all areas.
- Demonstrate the ability to face a recent challenge and overcome it with integrity.

Note that *Business Ethics* did not expect companies to be perfect in all their actions. Likewise, the moral management model acknowledges that a firm may exhibit moral management by overcoming a challenge with integrity.

Habits of Moral Leaders. Closely related to moral management is the topic of moral leadership. Carroll has set forth what he refers to as the “Seven Habits of

Highly Moral Leaders.”⁴⁶ Borrowing from the language used by Stephen Covey in his best-selling book *The Seven Habits of Highly Effective People*,⁴⁷ these qualities would need to be so prevalent in the leader’s approach that they become habitual as a leadership approach. Helping to further flesh out what constitutes a moral manager, the seven habits of highly moral leaders have been set forth as follows:

1. They have a passion to do right.
2. They are morally proactive.
3. They consider all stakeholders.
4. They have a strong ethical character.
5. They have an obsession with fairness.
6. They undertake principled decision making.
7. They integrate ethics wisdom with management wisdom.⁴⁸

Figure 7-8 summarizes the important characteristics of moral managers.

Positive Ethical Behaviors. Drawing on the Deloitte & Touche USA 2007 Ethics & Workplace survey cited earlier, the following are examples of positive ethical behaviors identified by the survey respondents.⁴⁹ These represent everyday ways that managers may display moral management:

- Giving proper credit where it is due
- Always being straightforward and honest when dealing with other employees
- Treating all employees equally
- Being a responsible steward of company assets (e.g., no lavish entertainment)
- Resisting pressure to act unethically
- Recognizing and rewarding ethical behavior of others
- Talking about the importance of ethics and compliance on a regular basis

Figure

7-8

Characteristics of Moral Managers

- These managers conform to a *high level of ethical or right behavior* (moral rectitude).
- They conform to a high level of personal and professional *standards*.
- *Ethical leadership* is commonplace—they search out where people may be hurt.
- Their goal is to succeed but only within confines of *sound ethical precepts* (fairness, due process).
- *High integrity* is displayed in *thinking, speaking, and doing*.
- These managers embrace letter and *spirit* of the law. Law is seen as a *minimal* ethical level. They prefer to operate *above* legal mandates.
- They possess an acute “*moral sense*” and *moral maturity*.
- Moral managers are the “good guys.”

Illustrative Cases of Moral Management

Several cases of moral management illustrate how this model of management is played out in actual practice.

3M Company. An excellent example of moral management was provided by the 3M Company in an action it took with respect to company practices. While conducting some blood scans of its factory workers, 3M discovered that the tests were revealing trace amounts of a chemical that 3M had made for nearly 40 years. They also found evidence that the chemical was showing up in people's bloodstreams in various parts of the United States. The chemical was perfluorooctane sulfonate (PFO). How the PFOs got into people's bloodstreams, whether it could pose a health risk, and what should be done about it were all questions the company had to face. Although they could not come up with answers to these questions, company executives decided to take action anyway.

On its own, 3M decided to phase out PFOs and products containing related chemicals. The most important product to be affected was Scotchgard, the company's fabric protector. Because no replacement chemical is yet available, the company faces a potential loss of \$500 million in annual sales. Given that 3M was under no mandate to act, it makes the company's actions especially noteworthy. In complimenting 3M, Carol Browner, administrator of the EPA, said that "3M deserves great credit for identifying this problem and coming forward voluntarily."⁵⁰

McCulloch. Another excellent example of moral management taking the initiative in displaying ethical leadership was provided by McCulloch Corporation, a manufacturer of chain saws. Chain saws are notoriously dangerous. The Consumer Product Safety Commission one year estimated that there were one hundred and twenty-three thousand medically attended injuries involving chain saws, up from seventy-one thousand five years earlier. In spite of these statistics, the Chain Saw Manufacturers Association fought mandatory safety standards. The association claimed that the accident statistics were inflated and did not offer any justification for mandatory regulations. Manufacturers support voluntary standards, although some of them say that when chain brakes—major safety devices—are offered as an option, they do not sell. Apparently, consumers do not have adequate knowledge of the risks inherent in using chain saws.

McCulloch became dissatisfied with the Chain Saw Manufacturers Association's refusal to support higher standards of safety and withdrew from it. Chain brakes have been standard on McCulloch saws since 1975 and are mandatory for most saws produced in Finland, Britain, and Australia. A Swedish company, Husqvarna, Inc., now installs chain brakes on saws it sells in the United States. Statistics from the Quebec Logging Association and from Sweden demonstrate that kickback-related accidents were reduced by about 80 percent after the mandatory installation of safety standards, including chain brakes.⁵¹

McCulloch is an example of moral management. After attempting and failing to persuade its association to adopt a higher ethical standard that would greatly reduce injuries, it took a courageous action and withdrew from the association. This is a prime example of moral leadership.

Merck. Another well-known case of moral management occurred when Merck & Co., the pharmaceutical firm, invested millions of dollars to develop a drug for treating “river blindness,” a third world disease that was affecting almost 18 million people. Seeing that no government or aid organization was agreeing to buy the drug, Merck pledged to supply the drug for free forever. Merck’s recognition that no effective mechanism existed to distribute the drug led to its decision to go far beyond industry practice and organize a committee to oversee the drug’s distribution.⁵²

We should stress at this time that not all organizations now engaging in moral management have done so all along. These companies sometimes arrived at this posture after years or decades of rising consumer expectations, increased government regulations, lawsuits, and pressure from social and consumer activists. We must think of moral management, therefore, as a desirable posture that in many instances has evolved over periods of several years. If we hold management to an idealistic, 100 percent historical moral purity test, no management will fill the bill. Rather, we should consider moral those managements that now see the enlightened self-interest of responding in accordance with the moral management model rather than alternatives.

Ethics in Practice Case

WHAT THEY DON’T KNOW WON’T HURT THEM

During my last two years in college, I worked for an animal hospital in my hometown. In my time there, many animals passed away in their sleep or for unknown reasons. It was not uncommon. In these situations, our facility would offer the owners the service of an autopsy. An autopsy is a procedure in which the doctor would surgically open up the animal to check for any signs of what might have caused the animal’s death.

Mrs. Johnson, a client of ours, brought in her dog that had unfortunately passed away while she was at work. Her dog was only five years old, and the owners were not aware of any health problems. No one, including the doctor, could figure out what had caused the death of Mrs. Johnson’s dog. Mrs. Johnson was asked if she would give her consent for the doctor to perform an autopsy on her dog so they might be able to answer the many questions surrounding his death.

Mrs. Johnson did not want this procedure to be done; she just wanted our facility to take care of her dog’s remains. The office manager at the animal hospital told the doctor she should let the vet students, who were doing their rotations at our hospital, go ahead and perform an autopsy as a learning experiment. The office manager mentioned that the owner would never know, because we were in charge of the disposal, so it wouldn’t be a problem.

1. Is it ethical for the doctor to allow the vet students to perform the autopsy?
2. Should the fact that the owner would never know if the autopsy was performed affect the doctor’s decision?
3. What would you do in this situation? Why?

Contributed Anonymously

AMORAL MANAGEMENT

Amoral management is not just a middle position on a continuum between immoral and moral management. Conceptually, it has been positioned between the other two, but it is different in nature and kind from both. There are two kinds of **amoral management: intentional and unintentional.**

Intentional Amoral Management

Amoral managers of this type do not factor ethical considerations into their decisions, actions, and behaviors, because they believe business activity resides outside the sphere to which moral judgments apply. These managers are neither moral nor immoral. They simply think that different rules apply in business than in other realms of life. Intentionally amoral managers are in a distinct minority today. At one time, however, as managers first began to think about reconciling business practices with sound ethics, some managers adopted this stance. A few intentionally amoral managers are still around, but they are a vanishing breed in today's ethically conscious world.

Unintentional Amoral Management

Like intentionally amoral managers, unintentionally amoral managers do not think about business activity in ethical terms. These managers are simply casual about, careless about, or inattentive to the fact that their decisions and actions may have negative or deleterious effects on others. These managers lack ethical perception and moral awareness; that is, they blithely go through their organizational lives not thinking that what they are doing has an ethical dimension or facet. These managers are well intentioned but are either too insensitive or too self-absorbed to consider the effects of their behavior on others. These managers normally think of themselves as ethical managers, but they are frequently overlooking these unintentional, subconscious, or unconscious aspects.

Unconscious Biases. Sometimes these managers may be unconscious of hidden biases that prevent them from being objective. Recently, researchers have found that many businesspeople go through life deluded by the illusion of objectivity. Unconscious or implicit biases can run contrary to our consciously held, explicit beliefs.⁵³ Though most managers think they are ethical, sometimes even the most well-meaning person unwittingly allows unconscious thoughts and biases to influence what appears to be objective decisions. Four sources of unintentional, or unconscious, influences include implicit forms of prejudice, bias that favors one's own group, conflict of interest, and a tendency to overclaim credit.⁵⁴

Unconscious biases have been believed to be at work among accountants in some of the recent accounting scandals. Three *structural aspects* of accounting bias include ambiguity, attachment, and approval. When ambiguity exists, people tend to reach self-serving conclusions. For example, subjective interpretations of what constitutes a deductible expense may be made in a self-serving

fashion. Attachment occurs when auditors, motivated to stay in their clients' good graces, approve things they might otherwise not approve. With respect to approval, external auditors may be reviewing the work of internal auditors, and self-serving biases may become even stronger when other people's biases are being endorsed or approved, especially if those judgments align with one's own biases.⁵⁵

In addition, three aspects of human nature may amplify unconscious biases: familiarity, discounting, and escalation. With *familiarity*, it is noted that people may be more willing to harm strangers (anonymous investors) than individuals they know (clients). *Discounting* refers to the act of overlooking or minimizing decisions that may not have immediate consequences. Finally, *escalation* occurs when an accountant or businessperson allows small judgments to accumulate and become large and then decides to cover up the unwitting mistakes through concealment. Thus, small indiscretions escalate into larger ones, and unconscious biases grow into conscious corruption.⁵⁶

Amoral management pursues profitability as its goal but does not cognitively attend to moral issues that may be intertwined with that pursuit. If there is an ethical guide to amoral management, it would be the marketplace as constrained by law—the letter of the law, not the spirit. The amoral manager sees the law as the parameters within which business pursuits take place.

Operating Strategy of Amoral Management

The operating strategy of amoral management is not to bridle managers with excessive ethical structure but to permit free rein within the unspoken but understood tenets of the free enterprise system. Personal ethics may periodically or unintentionally enter into managerial decisions, but it does not preoccupy management. Furthermore, the impact of decisions on others is an afterthought, if it ever gets considered at all.

Amoral management represents a model of decision making in which the managers' ethical mental gears, to the extent that they are present, are stuck in neutral. The key management question guiding decision making is, "Can we make money with this action, decision, or behavior?" Note that the question does not imply an active or implicit intent to be either moral or immoral.

Compliance Strategy. Paine has articulated a "compliance strategy" that is consistent with amoral management. The **compliance strategy**, as contrasted with her integrity strategy discussed earlier, is more focused on obedience to the law as its driving force. The compliance strategy is lawyer-driven and is oriented not toward ethics or integrity but more toward compliance with existing regulatory and criminal law. The compliance approach uses deterrence as its underlying assumption. This approach envisions managers as rational maximizers of self-interest, responsive to the personal costs and benefits of their choices, yet indifferent to the moral legitimacy of those choices.⁵⁷

Figure 7-9 presents the major characteristics of amoral managers.

Figure 7-9 Characteristics of Amoral Managers

Intentionally Amoral Managers

These managers don't think ethics and business should "mix."

Business and ethics are seen as existing in *separate* spheres. Ethics is seen as too "Sunday schoolish."

These managers are a vanishing breed. There are very few managers like this left in the world.

Unintentionally Amoral Managers

These managers just don't consider the *ethical dimension* of decision making.

They just don't "*think ethically*."

They may lack *ethical perception* or awareness; they have no "ethics buds" that help them sense the ethical dimension.

They are well-intentioned but morally casual or careless; may be morally *unconscious*.

Their ethical gears, if they exist, are in *neutral*.

Illustrative Cases of Amoral Management

There are perhaps more examples of unintentionally amoral management than any other kind.

Numerous Examples. When police departments first stipulated that recruits must be at least five feet nine inches tall and weigh at least 180 pounds, they were making an amoral decision, because they were not considering the harmful exclusion this would impose on women and other ethnic groups who do not, on average, attain that height and weight. When companies decided to use scantily clad young women to advertise autos, men's cologne, and other products, these companies were not thinking of the degrading and demeaning characterization that would result from what they thought was an ethically neutral decision. When firms decided to do business in South Africa years ago, their decisions were neither moral nor immoral, but a major, unanticipated consequence of these decisions was the appearance of capitalistic (or U.S.) approval of apartheid.

Nestlé. Nestlé's initial decision to market infant formula in third world countries (see Chapter 10) could have been an amoral decision. Nestlé may not have considered the detrimental effects such a seemingly innocent business decision would have on mothers and babies in a land of impure water, poverty, and illiteracy.

Video-Game Industry. It could be argued that the video-game industry has been unintentionally amoral, because it has developed games that glorify extreme violence, sexism, and aggression without paying much attention to how these

games impact the young people who become addicted to them. In *Mortal Kombat*, for example, players rip out an opponent's still-beating heart or bloody spinal cord. In *Night Trap*, ninja-like vampires stalk minimally dressed, cowering coeds and drill through their necks with power tools. These "games" have changed significantly since Atari introduced the popular video game *Pong* in 1972, a digital version of Ping-Pong consisting of a square ball and two rectangular paddles.⁵⁸

Today's video games have plenty of critics—educators, psychologists, politicians—who worry about the multitude of themes that are bloodthirsty and sexist and have foul language. About the only response from the game makers has been to introduce an age-based rating system similar to that now used in the movie industry. The game makers' view seems to be that their games are legal and harmless and that little else is left to say.

Sears. A final useful illustration of unintentionally amoral management involves the case of Sears, Roebuck and Co. and its automotive service business, which spanned much of the 1990s. Paine described how consumers and attorneys general in 40 states accused the company of misleading consumers and selling them unneeded parts and services.⁵⁹ In the face of declining revenues and a shrinking market share, Sears' executives put into place new goals, quotas, and incentives for auto-center service personnel. Service employees were told to meet product-specific and service-specific quotas—sell so many brake jobs, batteries, and front-end alignments—or face consequences such as reduced working hours or transfers. Some employees spoke of the pressure they felt to generate business.

Although Sears' executives did not set out to defraud customers, they created a commission system that led to Sears' employees feeling pressured to sell products and services that consumers did not need. Soon after the complaints against Sears occurred, CEO Edward Brennan acknowledged that management had created an environment in which mistakes were made, although no intent to deceive consumers had existed. Fortunately, Sears eliminated its quota system as a partial remedy to the problem.⁶⁰

The Sears case is a classic example of unintentionally amoral management—a well-intentioned company drifting into questionable practices because it just did not think ethically. The company simply did not think through the impacts that its strategic decisions would have on important stakeholders.

Figure 7-10 provides a summary of the major characteristics of amoral management and the other two models that have been identified and discussed. It compares the three in terms of ethical norms, motives, goals, orientation toward the law, and operating strategy.

TWO HYPOTHESES REGARDING THE MORAL MANAGEMENT MODELS

There are numerous other examples of amoral management, but the ones presented here should suffice to illustrate the point. A thorough study has not been conducted to ascertain precisely what proportions of managers each model represents in the

Figure 7-10 *Three Approaches to Management Ethics*

	Immoral Management	Amoral Management	Moral Management	
Organizational Characteristics	Ethical Norms	Management decisions, actions, and behavior imply a positive and active opposition to what is moral (ethical). Decisions are discordant with accepted ethical principles. An active negation of what is moral is implied.	Management is neither moral nor immoral, but decisions lie outside the sphere to which moral judgments apply. Management activity is outside or beyond the moral order of a particular code. May imply a lack of ethical perception and moral awareness.	Management activity conforms to a standard of ethical, or right, behavior. Conforms to accepted professional standards of conduct. Ethical leadership is commonplace on the part of management.
	Motives	Selfish. Management cares only about its or the company's gains.	Well-intentioned but selfish in the sense that impact on others is not considered.	Good. Management wants to succeed but only within the confines of sound ethical precepts (fairness, justice, due process).
	Goals	Profitability and organizational success at any price.	Profitability. Other goals are not considered.	Profitability within the confines of legal obedience and ethical standards.
	Orientation Toward Law	Legal standards are barriers that management must overcome to accomplish what it wants.	Law is the ethical guide, preferably the letter of the law. The central question is what we can do legally.	Obedience toward letter and spirit of the law. Law is a minimal ethical behavior. Prefer to operate well above what law mandates.
	Strategy	Exploit opportunities for corporate gain. Cut corners when it appears useful.	Give managers free rein. Personal ethics may apply but only if managers choose. Respond to legal mandates if caught and required to do so.	Live by sound ethical standards. Assume leadership position when ethical dilemmas arise. Enlightened self-interest.

Source: Archie B. Carroll, "In Search of the Moral Manager," *Business Horizons* (March/April 1987), 8. Copyright © 1987 by the Foundation for the School of Business at Indiana University. Used with permission.

total management population. However, two possible hypotheses regarding the moral management models may be set forth.

Population Hypothesis

One hypothesis is that the distribution of the three models might approximate a normal curve, with the amoral group occupying the large middle part of the curve and the moral and immoral categories occupying the smaller tails of the curve. It is difficult to research this question. If you asked managers what they thought they were or what others thought they were, a self-serving bias would likely enter in and you would not get an accurate, unbiased picture. Another approach would be to observe management actions. This would be nearly impossible, because it is not possible to observe all management actions for any sustained period of time. Therefore, the supposition remains a hypothesis based on one person's judgment of what is going on in the management community.

Individual Hypothesis

Equally disturbing as the belief that the amoral management style is common among managers today is an alternative hypothesis that, within the average manager, these three models may operate at various times and under various circumstances. That is, the average manager may be amoral most of the time but may slip into a moral or an immoral mode on occasion, based on a variety of impinging factors. Like the population hypothesis, this view cannot be empirically supported at this time, but it does provide an interesting perspective for managers to ponder. This perspective would be somewhat similar to the situational ethics argument that has been around for some time. Is the individual hypothesis more likely than the population hypothesis? Could it be that both may exist at the same time?

Amoral Management as a Serious Organizational Problem

With the exception of the major ethics scandals witnessed in the past few years, it could be argued that the more serious ethical problem in organizations today seems to be the group of well-intended managers who for one reason or another subscribe to or live out the amoral ethic. These are managers who are driven primarily by profitability or a bottom-line ethos, which regards economic success as the exclusive barometer of organizational and personal achievement. These amoral managers are basically good people, but they essentially see the competitive business world as ethically neutral. Until this group of managers moves toward the moral management ethic, we will continue to see American business and other organizations criticized as they have been in the past two decades.

To connect the three models of management morality with concepts introduced earlier, we show in Figure 7-11 how the components of corporate social responsibility (Chapter 2) would likely be viewed by managers using each of the three models of management morality.

Figure 7-11 *Three Models of Management Morality and Emphases on CSR*

Models of Management Morality	<i>Components of the CSR Definition</i>			
	Economic Responsibility	Legal Responsibility	Ethical Responsibility	Philanthropic Responsibility
Immoral management	XXX	X		X
Amoral management	XXX	XX	X	X
Moral management	XXX	XXX	XXX	XXX

Weighing Code:

X = token consideration (appearances only)

XX = moderate consideration

XXX = significant consideration

Figure 7-12 *The Moral Management Models and Acceptance or Rejection of Stakeholder Thinking (SHT)*

<u>Moral Management Model</u>	<u>Acceptance of Stakeholder Thinking (SHT)</u>	<u>Stakeholder Thinking Posture Embraced</u>
Immoral management	SHT rejected: management is self-absorbed	SHT rejected, not deemed useful. Accepts profit maximization model but does not really pursue it.
Amoral management	SHT accepted: narrow view (minimum number of stakeholders considered)	Instrumental view of SHT prevails. How will it help management?
Moral management	SHT enthusiastically embraced: wider view (maximum number of stakeholders considered)	Normative view of SHT prevails. SHT is fully embraced in all decision making.

We illustrate in Figure 7-12 how managers using the three models would probably embrace or reject the stakeholder concept or stakeholder thinking (Chapter 3). It is hoped that these depictions of the interrelationships among these concepts will make them easier to understand and appreciate.

Making Moral Management Actionable

The characteristics of immoral, moral, and amoral management discussed in this chapter should provide some useful benchmarks for managerial self-analysis, because self-analysis and introspection will ultimately be the way in which managers will recognize the need to move from the immoral or amoral ethic to the moral ethic. Numerous others have suggested management training for business ethics; therefore, this prescription will not be further developed here, although it has great potential. Ethics training will be discussed more fully in Chapter 8. However, until senior management fully embraces the concepts of moral management, the transformation in organizational culture that is so essential for moral management to blossom, thrive, and flourish will not take place. Ultimately, senior management has the leadership responsibility to show the way to an ethical organizational climate by leading the transition from amoral to moral management, whether this is done by business ethics training and workshops, codes of conduct, mission/vision statements, ethics officers, tighter financial controls, more ethically sensitive decision-making processes, or leadership by example.

Underlying all these efforts, however, needs to be the fundamental recognition that amoral management exists and that it is an undesirable condition that can be surely, if not easily, remedied. Most notably, organizational leaders must

acknowledge that amoral management is a morally vacuous condition that can be quite easily disguised as just an innocent, practical, bottom-line philosophy—something to take pride in. Amoral management is, however, and will continue to be, the bane of the management profession until it is recognized for what it really is and until managers take steps to overcome it. Managers are not all “bad guys,” as they so frequently are portrayed, but the idea that managerial decision making can be ethically neutral is bankrupt and no longer tenable in the society of the new millennium.⁶¹

Developing Moral Judgment

It is helpful to know something about how individuals, whether they are managers or employees, develop moral (or ethical) judgment. Perhaps if we knew more about this process, we could better understand our own behavior and the behavior of those around us and those we manage. Further, we might be able to better design reward systems for encouraging ethical behavior if we knew more about how employees think about ethics. A good starting point is to come to appreciate what psychologists have to say about how we as individuals develop morally. The major research on this point is **Kohlberg’s levels of moral development**.⁶² After this discussion, we will consider other sources of a manager’s values, especially those emanating from both societal sources and from within the organization itself.

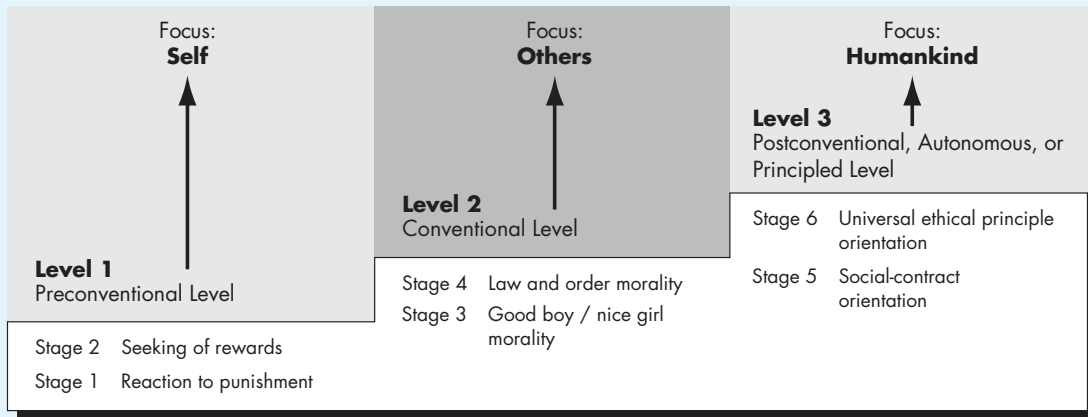
LEVELS OF MORAL DEVELOPMENT

The psychologist Lawrence Kohlberg has done extensive research into the topic of **moral development**. He concluded, on the basis of more than 20 years of research, that there is a general sequence of three levels (each with two stages) through which individuals evolve in learning to think or develop morally. Although his theory is not universally accepted, there is widespread practical usage of his levels of moral development, and this suggests a broad if not unanimous consensus. Figure 7-13 illustrates Kohlberg’s three levels and six stages.

Level 1: Preconventional Level

At the preconventional level of moral development, which is typically descriptive of how people behave as infants and children, the focus is mainly on *self*. As an infant starts to grow, his or her main behavioral reactions are in response to punishments and rewards. Stage 1 is the *reaction-to-punishment stage*. If you want a child to do something (such as stay out of the street) at a very early age, spanking or scolding is often needed. The orientation at this stage is toward avoidance of pain.

As the child gets a bit older, rewards start to work. Stage 2 is the *seeking-of-rewards stage*. The child begins to see some connection between being “good” (that is, doing what Mom or Dad wants the child to do) and some reward that may be forthcoming. The reward may be parental praise or something tangible, such as candy, extra TV time, or a trip to the movies. At this preconventional level, children do not really understand the moral idea of “right” and “wrong” but

Figure 7-13 Kohlberg's Levels of Moral Development

rather learn to behave according to the consequences—punishment or reward—that are likely to follow.

Though we normally associate the preconventional level with the moral development of children, many adults in organizations are heavily influenced by rewards and punishments. Consequently, the preconventional level of motivation may be observed in adults as well as children and is relevant to a discussion of adult moral maturity. Like children, adults in responsible positions react to punishments (organizational sanctions) or seek rewards (approval).

Level 2: Conventional Level

As the child gets older, she or he learns that there are “others” whose ideas or welfare ought to be considered. Initially, these others include family and friends. At the conventional level of moral development, the individual learns the importance of conforming to the conventional norms of society.

The conventional level is composed of two stages. Stage 3 has been called the “good boy/nice girl” morality stage. The young person learns that there are some rewards (such as feelings of acceptance, trust, loyalty, or warmth) for living up to what is expected by family and peers, so the individual begins to conform to what is generally expected of a good son, daughter, sister, brother, friend, and so on.

Stage 4 is the *law-and-order morality stage*. Not only does the individual learn to respond to family, friends, the school, and the church, as in Stage 3, but the individual now recognizes that there are certain norms in society (in school, in the theater, in the mall, in stores, in the car, waiting in line) that are expected or needed if society is to function in an orderly fashion. Thus, the individual becomes socialized or acculturated into what being a good citizen means. These rules for

living include not only the actual laws (don't run a red light, don't walk until the "Walk" light comes on) but also other, less official norms (don't break into line, be sure to tip the server, turn your cell phone off in restaurants). At Stage 4, the individual sees that she or he is part of a larger social system and that to function in and be accepted by this social system requires a considerable degree of acceptance of and conformity to the norms and standards of society. Therefore, many organizational members are strongly influenced by society's conventions as manifested both in Stages 3 and 4 as described.

Level 3: Postconventional, Autonomous, or Principled Level

At this third level, which Kohlberg argues few people reach (and those who do reach it have trouble staying there), the focus moves beyond those "others" who are of immediate importance to the individual to *humankind* as a whole. At the postconventional level of moral development, the individual develops a concept of right and wrong that is more mature than the conventionally articulated notion. Thus, it is sometimes called the level at which moral principles become self-accepted, not because they are held by society but because the individual now perceives and embraces them as "right."

Kohlberg's third level seems to be easier to understand as a whole than when its two individual stages are considered. Stage 5 is the *social-contract orientation*. At this stage, right action is thought of in terms of general individual rights and standards that have been critically examined and agreed upon by society as a whole. There is a clear awareness of the relativism of personal values and a corresponding emphasis on processes for reaching consensus.

Stage 6 is the *universal-ethical-principle orientation*. Here, the individual uses his or her conscience in accord with self-chosen ethical principles that are anticipated to be universal, comprehensive, and consistent. These universal principles (such as the Golden Rule) might be focused on such ideals as justice, human rights, and social welfare.

Kohlberg suggests that at Level 3 the individual is able to rise above the conventional level where "rightness" and "wrongness" are defined by societal institutions and that she or he is able to defend or justify her or his actions on some higher ethical basis. For example, in our society, the law tells us we should not discriminate against minorities. A Level 2 manager might not discriminate because to do so is to violate the law. A Level 3 manager would not discriminate but might offer a different reason—for example, it is wrong to discriminate because it violates universal principles of human justice. Part of the difference between Levels 2 and 3, therefore, is traceable to the motivation for the course of action taken. This takes us back to our earlier discussion of motivation as one of the important ethics questions.

The discussion to this point may have suggested that we are at Level 1 as infants, at Level 2 as youths, and, finally, at Level 3 as adults. There is some approximate correspondence between chronological age and Levels 1 and 2, but the important point should be made that Kohlberg thinks many of us as adults never get beyond Level 2. The idea of getting to Level 3 as managers or employees

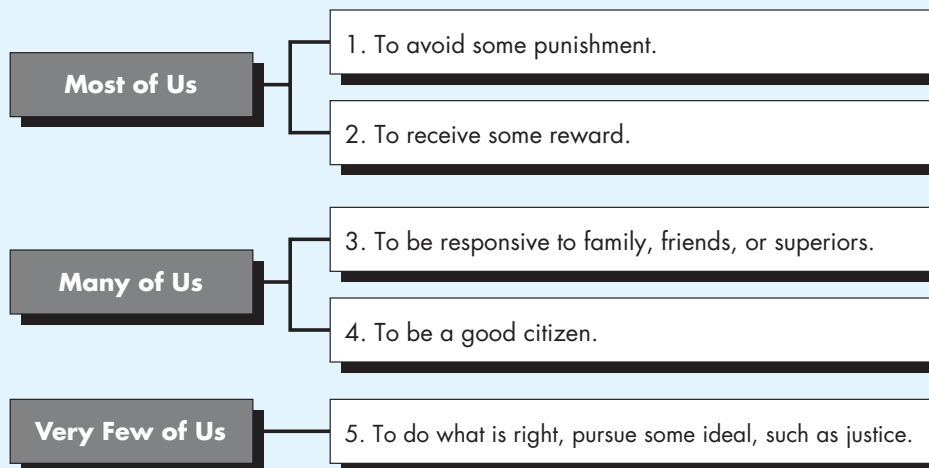
is desirable, because it would require us to think about people, products, and markets at a level higher than that generally attained by conventional society. However, even if we never get there, Level 3 urges us to continually ask “What ought to be?” The first two levels tell us a lot about moral development that should be useful to us as managers. There are not many people who consistently operate according to Level 3 principles. Sometimes a manager or employee may dip into Level 3 on a certain issue or for a certain period of time. Sustaining that level, however, is quite challenging.

If we state the issue in terms of the question, “Why do managers and employees behave ethically?” we might infer conclusions from Kohlberg that look like those in Figure 7-14.

Ethics of Care Alternative to Kohlberg

One of the major criticisms of Kohlberg’s research was set forth by Carol Gilligan, who argued that Kohlberg’s conclusions may accurately depict the stages of moral development among men, whom he used as his research subjects, but that his findings are not generalizable to women.⁶³ According to Gilligan’s view, men tend to deal with moral issues in terms that are impersonal, impartial, and abstract. Examples might include the principles of justice and rights that Kohlberg argues are relevant at the postconventional level. Women, on the other hand, perceive themselves to be part of a network of relationships with family and friends and thus are more focused on *relationship maintenance* and *hurt avoidance* when they confront moral issues. For women, then, morality is often more a matter of caring

Figure 7-14 *Why Managers and Employees Behave Ethically*



and showing responsibility toward those involved in their relationships than in adhering to abstract or impersonal principles, such as justice. This alternative view of ethics has been called the ethics of care.

According to Gilligan, women move in and out of three moral levels.⁶⁴ At the first level, the *self* is the sole object of concern. At the second level, the chief desire is to *establish connections and participate* in social life. In other words, maintaining relationships or directing one's thoughts toward others becomes dominant. Gilligan says that this is the conventional notion of women. At the third level, women recognize their own needs and the *needs of others*—those with whom they have relationships. Gilligan goes on to say that women never settle completely at one level. As they attain moral maturity, they do more of their thinking and make more of their decisions at the third level. This level requires care for others as well as care for oneself. In this view, morality moves away from the legalistic, self-centered approach that some say characterizes traditional ethics.

Some research does not show that moral development varies by gender in the fashion described by Gilligan. However, it does support Gilligan's claim that a different perspective toward moral issues is sometimes used. Apparently, both men and women sometimes employ an impartial or impersonal moral-rules perspective, and sometimes they employ a care-and-responsibility perspective. This "care perspective" is still at an early stage of research, but it is useful to know that perspectives other than those found by Kohlberg are being considered.⁶⁵ More will be said about the ethics of caring in the next chapter.

DIFFERENT SOURCES OF A PERSON'S VALUES

In addition to considering the levels of moral development as an explanation of how and why people behave ethically, it is also useful to look at the different *sources of a manager's (employee's) values*. Ethics and values are intimately related. We referred earlier to ethics as the rightness or wrongness of behavior. Ethics is also seen as the set of moral principles or values that drives behavior. Thus, the rightness or wrongness of behavior really turns out to be a manifestation of the ethical beliefs held by the individual. Values, on the other hand, are the individual's concepts of the relative worth, utility, or importance of certain ideas. Values reflect what the individual considers important in the larger scheme of things. One's values, therefore, shape one's ethics. Because this is so, it is important to understand the many different value-shaping forces that influence employees and managers.

The increasing pluralism of the society in which we live has exposed managers to a large number of values of many different kinds, and this has resulted in ethical diversity. One way to examine the sources of a manager's values is by considering both forces that originate from outside the organization to shape or influence the manager and those that emanate from within the organization. This, unfortunately, is not as simply done as we would like, because some sources are difficult to pinpoint. It should lend some order to our discussion, however.

Ethics in Practice Case

FLOWERS VS. EYES: WHEN WOULD YOU HAVE PAID?

It is human nature to think that ethical behavior is more likely provoked when a person is being observed. But, what if the eyes doing the observing are not real? In an interesting experiment, some fascinating results followed. Apparently, a psychology department of a university in the United Kingdom, less than three hours from London, was experiencing a problem. Like most departments, there was a coffee station where faculty and staff could help themselves to coffee and then leave their money in the tray (approximately \$1). However, many noticed that a number of people were helping themselves to coffee and not paying.

One of the professors came up with an idea. He initiated an experiment. For ten weeks, he and his assistants alternately taped two poster signs above the coffee station. One week, the poster displayed a picture of flowers. Another week, the poster displayed a picture of “staring eyes.” They wondered whether the different posters, or pictures, would evoke different responses in terms of whether people honestly paid for their coffee.

After some weeks, the researchers noted an interesting pattern. When the “eyes poster” was displayed above the coffee station, the coffee and tea drinkers contributed 2.76 times more money than when the “flower poster” was displayed. The researchers surmised that the sensation of “being

watched,” though the eyes were not real, motivated people to be more honest about paying for their coffee or tea. The originator of the idea admitted that the results were more dramatic than the slight effect expected.

Later, officers in a police department in Birmingham, England, read a paper about this experiment and were impressed. They decided to slap posters of staring eyes all around the city. They named their venture “We’ve Got Our Eyes on Criminals.” Only time will tell whether the program will have the intended effect on vandalism and other crimes.

1. Was it unethical for the professor to conduct such an experiment on his colleagues without announcing it?
2. Are you surprised at the results?
3. Evaluate the above experiment using Kohlberg’s levels of moral development. Does the experiment support or refute Kohlberg’s research? Would it make a difference whether the coffee drinkers were men or women?
4. Do you think the police department scheme will work? Why or why not?

Source: This case was inspired by Clive Thompson, “The Eyes of Honesty,” *New York Times Magazine*, December 10, 2006, 48.

Sources External to the Organization: The Web of Values

The external sources of a person’s values refer to those broad sociocultural values that have evolved in society over a long period of time. Although current events (fraud, deception, bribery) seem to affect these historic values by bringing specific ones into clearer focus at a given time, these values are rather enduring and

change slowly. Quite often they emanate from major institutions or institutional themes in society.

George Steiner once stated that “every executive resides at the center of a web of values” and that there are five principal repositories of values influencing businesspeople. These five include religious, philosophical, cultural, legal, and professional values.⁶⁶

Religious Values. Religion has long been a basic source of morality in American society, as in most societies. Religion and morality are so intertwined that William Barclay relates them for definitional purposes: “Ethics is the bit of religion that tells us how we ought to behave.”⁶⁷ The biblical tradition of Judeo-Christian theology forms the core for much of what Western society believes today about the importance of work, the concept of fairness, and the dignity of the individual. Other religious traditions likewise inform management behavior and action.

Philosophical Values. Philosophy and various philosophical systems are also external sources of the manager’s values. Beginning with preachments of the ancient Greeks, philosophers have claimed to demonstrate that *reason* can provide us with principles or morals in the same way it gives us the principles of mathematics. John Locke argued that morals are mathematically demonstrable, although he never explained how.⁶⁸ Aristotle with his Golden Rule and his doctrine of the mean, Kant with his categorical imperative, Bentham with his pain and pleasure calculus, and modern-day existentialists have shown us time and again the influence of various kinds of reasons for ethical choice. Today, the strong influences of moral relativism and postmodernism affect some people’s values.

Cultural Values. Culture is that broad synthesis of societal norms and values emanating from everyday living. Culture has also had an impact on the manager’s and employees’ thinking. Modern examples of culture include music, movies, television, and the Internet. The melting-pot culture of the United States is a potpourri of norms, customs, and rules that defy summarization. In recent years, it has become difficult to summarize what messages the culture is sending people about ethics. In a recent book, *Moral Freedom: The Search for Virtue in a World of Choice*, by Alan Wolfe, the author argues that the United States, like other Western nations, is undergoing a radical revolution in morals and is now, morally speaking, a new society.⁶⁹ Wolfe thinks the traditional values that our culture has looked upon with authority (churches, families, neighborhoods, civic leaders) have lost the ability to influence people like they once did.

Wolfe goes on to say that as more and more areas of life have become democratized and open to consumer “choice,” people have come to assume that they have the right to determine for themselves what it means to lead a good and virtuous life. He says that a key element in this new moral universe is nonjudgmentalism, which pushes society to suspend judgment on much immoral behavior or interpret immoral behavior as not the fault of the perpetrator. Thus, although many people may uphold the old virtues in principle, they turn them

into personal “options” in practice.⁷⁰ This clearly is a departure from the past, and it is probably impacting the way managers perceive the world of business. Employees, likewise, share these same perspectives, and this creates challenges for managers.

Legal Values. The legal system has been and continues to be one of the most powerful forces defining what is ethical and what is not for managers and employees. This is true even though ethical behavior generally is that which occurs over and above legal dictates. As stated earlier, the law represents the codification of what the society considers right and wrong. Although we as members of society do not completely agree with every law in existence, there is typically more consensus for law than for ethics. Law, then, “mirrors the ideas of the entire society.”⁷¹ Law represents a minimum ethic of behavior but does not encompass all the ethical standards of behavior. Law addresses only the grossest violations of society’s sense of right and wrong and thus is not adequate to describe completely all that is acceptable or unacceptable. Because it represents our official consensus ethic, however, its influence is pervasive and widely accepted.

In recent years, it has become an understatement to observe that we live in a litigious society. This trend toward suing someone to bring about justice is clearly having an impact on management decision making. Whereas the threat of litigation may make managers more careful in their treatment of stakeholders, the threat of losing tens or hundreds of millions of dollars has distorted decision making and caused many managers and companies to run scared—never knowing what exactly is the best or fairest course of action to pursue. Therefore, it is easy to see how laws and regulations are among the most influential drivers of business ethics.⁷²

Professional Values. These include those emanating, for the most part, from professional organizations and societies that represent various jobs and positions. As such, they presumably articulate the ethical consensus of the leaders of those professions. For example, the Public Relations Society of America has a code of ethics that public relations executives have imposed on themselves as their own guide to behavior. The National Association of Realtors adopted its “Rules of Conduct” in 1913. Compliance with the code was first recommended for voluntary adoption and then made a condition of membership as long ago as 1924.⁷³ Professional values thus exert a more particularized impact on the manager than the four broader values discussed earlier.

In sum, several sources of values that are external to the organization come to bear on the manager and employees. In addition to those mentioned, people are influenced by family, friends, acquaintances, and social events and trends of the day. Thus, people come to the workplace with personal philosophies that are truly a composite of numerous interacting values that have shaped their views of the world, of life, and of business.

Sources Internal to the Organization

The external forces constitute the broad background or milieu against which a manager or an employee behaves or acts. They affect a person's personal views of the world and of business and help the person to formulate what is acceptable and unacceptable. There are, in addition, a number of less remote and more immediate factors that help to channel the individual's values and behavior; these grow out of the specific organizational experience itself. These internal sources of a manager's values (within the business organization) constitute more immediate and direct influences on one's behavior and decisions.

When an individual goes to work for an organization, a socialization process takes place in which the individual comes to assume the predominant values of that organization. The individual learns rather quickly that, to survive and to succeed, certain norms must be perpetuated and revered. According to Kohlberg's analysis, this socialization would likely result from Level 1 and especially from Level 2 thinking. Several of these norms that are prevalent in business organizations include:

- Respect for the authority structure
- Loyalty to bosses and the organization
- Conformity to principles and practices
- Performance counts above all else
- Results count above all else

Each of these norms may assume a major role in a person who subordinates her or his own standard of ethics to those of the organization. In fact, research suggests that these internal sources play a much more significant role in shaping business ethics than do the host of external sources we considered first.

Respect for the authority structure, loyalty, conformity, performance, and results have been historically almost synonymous with survival and success in business. When these influences are operating together, they form a composite business ethic that is remarkably influential in its impact on individual and group behavior. These values form the central motif of organizational activity and direction.

Underlying the first three norms is the focus on performance and results. This has been called the "calculus of the bottom line."⁷⁴ One does not need to study business organizations for long to recognize that the bottom line—profits—is the sacred instrumental value that seems to take precedence over all others. "Profits now" rather than later seems to be the orientation that spells success for managers and employees alike. Respect for authority, loyalty, and conformity become means to an end, although one could certainly find organizations and people who see these as legitimate ends in themselves. Only recently are some managers and organizations starting to respond to the "multiple bottom line" or "triple bottom line" perspective introduced in Chapter 2.

Elements of Moral Judgment

A good way to close out this chapter is to consider what it takes for moral or ethical judgment to develop. For growth in moral judgment to take place, it is useful to appreciate the key elements involved in making moral judgments. This is a notion central to the transition from the amoral management condition to the moral management condition. Powers and Vogel have suggested that there are six major elements or capacities that are essential to making moral judgments: (1) moral imagination, (2) moral identification and ordering, (3) moral evaluation, (4) tolerance of moral disagreement and ambiguity, (5) integration of managerial and moral competence, and (6) a sense of moral obligation.⁷⁵ Each reveals an essential ingredient in developing moral judgment, which then forms the basis for personal and organizational ethics to be examined in the next chapter.

Figure 7-15 summarizes the six elements of moral judgment identified by Powers and Vogel as they might be perceived by amoral and moral managers. The contrast between the two perspectives should be helpful in understanding each element of moral judgment.

MORAL IMAGINATION

Moral imagination refers to the ability to perceive that a web of competing economic relationships is, at the same time, a web of moral or ethical relationships. Business and ethics are not separate topics but occur side by side in organizations. Developing moral imagination means not only becoming sensitive to ethical issues in business decision making but also developing the perspective of searching out subtle places where people are likely to be harmfully affected by decision making or behaviors of managers. This is a necessary first step but is extremely challenging because of prevailing methods of evaluating managers on bottom-line results. Moral imagination requires the manager to rise above the everyday stress and confusion and properly identify the ethical issues and problems that exist in the organization. This is an essential step before anything else can happen.

MORAL IDENTIFICATION AND ORDERING

Moral identification and ordering refers to the ability to discern the relevance or nonrelevance of moral factors that are introduced into a decision-making situation. Are the moral issues real or just rhetorical? The ability to see moral issues as issues that can be dealt with is at stake here. Once moral issues have been identified, they must be ranked, or ordered, just as economic or technological issues are prioritized during the decision-making process. A manager must not only develop this skill through experience but also finely hone it through repetition. It is only through repetition that this skill can be developed. In this prioritizing process, a manager may conclude that worker safety is more important than worker privacy, though both are important qualities.

Figure 7-15 Elements of Moral Judgment in Amoral and Moral Managers

Amoral Managers	Moral Managers
Moral Imagination	
See a web of competing economic claims as just that and nothing more.	Perceive that a web of competing economic claims is simultaneously a web of moral relationships.
Are insensitive to and unaware of the hidden dimensions of where people are likely to get hurt.	Are sensitive to and hunt out the hidden dimensions of where people are likely to get hurt.
Moral Identification and Ordering	
See moral claims as squishy and not definite enough to order into hierarchies with other claims.	See which moral claims being made are relevant or irrelevant; order moral factors just as economic factors are ordered.
Moral Evaluation	
Are erratic in their application of ethics if it gets applied at all.	Are coherent and consistent in their normative reasoning.
Tolerance of Moral Disagreement and Ambiguity	
Cite ethical disagreement and ambiguity as reasons for forgetting ethics altogether.	Tolerate ethical disagreement and ambiguity while honestly acknowledging that decisions are not precise like mathematics but must finally be made nevertheless.
Integration of Managerial and Moral Competence	
See ethical decisions as isolated and independent of managerial decisions and managerial competence.	See every evolving decision as one in which a moral perspective must be integrated with a managerial one.
A Sense of Moral Obligation	
Have no sense of moral obligation and integrity that extends beyond managerial responsibility.	Have a sense of moral obligation and integrity that holds together the decision-making process in which human welfare is at stake.

Source: Archie B. Carroll, "In Search of the Moral Manager," *Business Horizons* (March/April 1987), 15. Copyright © 1987 by the Foundation for the School of Business at Indiana University. Used with permission.

MORAL EVALUATION

Once issues have been identified and ordered, evaluations must be made. *Moral evaluation* is the practical, decision phase of moral judgment and entails essential skills, such as coherence and consistency, that have proved to be effective principles in other contexts. What managers need to do here is to understand the importance of clear principles, develop processes for weighing ethical factors, and develop the ability to identify what the likely moral as well as economic outcomes of a decision will be. Important here is the foresight of likely consequences of different courses of action.

The real challenge in moral evaluation is to integrate the concern for others into organizational goals, purposes, and legitimacy. In the final analysis, though, the manager may not know the “right” answer or solution, although moral sensitivity has been introduced into the process. The important point is that amorality has not prevailed or driven the decision process.

TOLERANCE OF MORAL DISAGREEMENT AND AMBIGUITY

An objection managers often have to ethics discussions is the amount of disagreement generated and the volume of ambiguity that must be tolerated in thinking ethically. This must be accepted, however, because it is a natural part of ethics discussions. To be sure, managers need closure and precision in their decisions. But the situation is seldom clear in moral discussions, just as it is in many traditional and more familiar decision contexts of managers, such as introducing a new product based on limited test marketing, choosing a new executive for a key position, deciding which of a number of excellent computer systems to install, or making a strategic decision based on instincts. All of these are risky decisions, but managers have become accustomed to making them in spite of the disagreements and ambiguity that prevail among those involved in the decision or within the individual.

In a real sense, the *tolerance of moral disagreement and ambiguity* is simply an extension of a managerial talent or facility that is present in practically all decision-making situations managers face. But managers are more unfamiliar with this special kind of decision making because of a lack of practice.

INTEGRATION OF MANAGERIAL AND MORAL COMPETENCE

The *integration of managerial and moral competence* underlies all that we have been discussing. Moral issues in management do not arise in isolation from traditional business decision making but right smack in the middle of it. The scandals that major corporations face today did not occur independently of the companies’ economic activities but were embedded in a series of decisions that were made at various points in time and culminated from those earlier decisions.

Therefore, moral competence is an integral part of managerial competence. Managers are learning—some the hard way—that there is a significant corporate, and in many instances personal, price to pay for their amorality. The amoral manager sees ethical decisions as isolated and independent of managerial decisions and competence, but the moral manager sees every evolving decision as one in which an ethical perspective must be integrated. This kind of future-looking view is an essential executive skill.

A SENSE OF MORAL OBLIGATION

The foundation for all the capacities we have discussed is a *sense of moral obligation* and integrity. This sense is the key to the process but is the most difficult to

acquire. This sense requires the intuitive or learned understanding that moral fibers—a concern for fairness, justice, and due process to people, groups, and communities—are woven into the fabric of managerial decision making and are the integral components that hold systems together.

These qualities are perfectly consistent with, and indeed are essential prerequisites to, the free-enterprise system as we know it today. One can go back in history to Adam Smith and the foundation tenets of the free-enterprise system and not find references to immoral or unethical practices as being elements that are needed for the system to work. The late Milton Friedman, our modern-day Adam Smith, even alluded to the importance of ethics when he stated that the purpose of business is “to make as much money as possible while conforming to the basic rules of society, both those embodied in the law and *those embodied in ethical custom.*”⁷⁶ The moral manager, then, has a sense of moral obligation and integrity that is the glue that holds together the decision-making process in which human welfare is inevitably at stake. Indeed, the sense of moral obligation is what holds society and the business system together.

Summary

Business ethics has become a serious challenge for the business community over the past several decades. The major ethics scandals of the early 2000s have affected the public’s trust of executives and major business institutions. Polls indicate that the public does not have a high regard for the ethics of managers. It is not easy to say whether business’s ethics have declined or just seem to have done so because of increased media coverage and rising public expectations. Business ethics concerns the rightness, wrongness, and fairness of managerial behavior, and these are not easy judgments to make. Multiple norms compete to determine with which standards business behavior should be compared.

The conventional approach to business ethics was introduced as an initial way in which managers might think about ethical judgments. One major problem with this approach is that it is not clear which standards or norms should be used, and thus the conventional approach is susceptible to ethical relativism.

A Venn diagram model was presented as an aid to making decisions when economics, law, and ethics expectations compete with each other and are

in tension. Four important ethics questions are (1) What is? (descriptive question), (2) What ought to be? (normative question), (3) How can we get from what is to what ought to be? (practical question), and (4) What is our motivation in this transition? (question of authenticity). Answering these questions helps one in an ethical analysis of a situation.

Three models of management ethics are (1) immoral management, (2) moral management, and (3) amoral management. Amoral management is further classified into intentional and unintentional categories. There are two hypotheses about the presence of these three moral types in the management population and in individuals.

A generally accepted view is that moral judgment develops according to the pattern described by Lawrence Kohlberg. His three levels of moral development are (1) preconventional, (2) conventional, and (3) postconventional, autonomous, or principled. Some have suggested that men and women use different perspectives as they perceive and deal with moral issues.

In addition to moral maturity, managers’ ethics are affected by sources of values originating from external to the organization and from sources

within the organization. This latter category includes respect for the authority structure, loyalty, conformity, and a concern for financial performance and results.

Finally, six elements in developing moral judgment were presented. These six elements include

moral imagination, moral identification and ordering, moral evaluation, tolerance of moral disagreement and ambiguity, integration of managerial and moral competence, and a sense of moral obligation. If the moral management model is to be realized, these six elements need to be developed.

Key Terms

amoral management (page 263)

amoral management: intentional (page 263)

amoral management: unintentional (page 263)

business ethics (page 242)

compliance strategy (page 264)

conventional approach to business

ethics (page 243)

descriptive ethics (page 242)

ethical relativism (page 248)

ethics (page 242)

immoral management (page 255)

integrity strategy (page 259)

Kohlberg's levels of moral development
(page 270)

moral development (page 270)

morality (page 242)

moral management (page 258)

normative ethics (page 243)

Discussion Questions

1. Give a definition of ethical business behavior, explain the components involved in making ethical decisions, and give an example from your personal experience of the difficulties involved in making these determinations.
2. To demonstrate that you understand the three models of management ethics—moral, immoral, and amoral—give an example, from your personal experience, of each type. Do you agree that amorality is a serious problem? Explain.
3. Give examples, from your personal experience, of Kohlberg's Levels 1, 2, and 3. If you do not think you have ever gotten to Level 3, give an example of what it might be like.
4. Compare your motivations to behave ethically with those listed in Figure 7-14. Do the reasons given in that figure agree with your personal assessment? Discuss the similarities and differences between Figure 7-14 and your personal assessment.
5. From your personal experience, give an example of a situation you have faced that would require one of the six elements of moral judgment.

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Personal and Organizational Ethics

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Understand the different levels at which business ethics may be addressed.
- 2 Differentiate between consequence-based and duty-based principles of ethics.
- 3 Enumerate and discuss principles of personal ethical decision making and ethical tests for screening ethical decisions.
- 4 Identify the factors affecting an organization's moral climate and provide examples of these factors at work.
- 5 Describe and explain actions, strategies, or "best practices" that management may take to improve an organization's ethical climate.

The ethical issues on which managers must make decisions are numerous and varied. The news media tend to focus on the major ethical scandals involving well-known corporate names. Therefore, Enron, WorldCom, Tyco, Boeing, Arthur Andersen, Martha Stewart, and other such high-visibility firms attract considerable attention. The consequence of this is that many of the everyday, routine ethical dilemmas that managers face in medium-sized and small organizations are often overlooked.

In addition to the mega-scandals of the Enron era, managers encounter day-to-day ethical dilemmas in such arenas as conflicts of interest, sexual harassment, inappropriate gifts to corporate personnel, unauthorized payments, customer dealings, evaluation of personnel, and pressure to compromise personal standards.

Unfortunately, many managers face these ethical quandaries on a daily basis but have no background or training in business ethics or ethical decision making to help them. An experience from a training program conducted by one of the authors illustrates this point well. The training session was in a continuing-education program, and the topic was business ethics. The 62 managers in attendance were asked how many of them had had formal business ethics training

before—in college or in a company-sponsored program. Not one hand went up. This situation is changing, but it is changing slowly.

People today face ethical issues in a variety of settings, but our concerns in this chapter are personal and organizational ethics. Regarding these two, David Callahan published a high-impact book in 2004 titled *The Cheating Culture: Why More Americans Are Doing Wrong to Get Ahead*.¹ Callahan never clearly defines what “cheating” means, but synonyms that are commonly accepted in society today include *dishonest*, *immoral*, *unethical*, and *corrupt*—all terms characterizing the threats we are addressing in this chapter. He argues that we have more cheating in society today for four essential reasons: new pressures on people, bigger rewards for winning, temptation, and trickle-down corruption. Each of these factors influences personal and organizational ethics and thus frames the issue that needs to be addressed at these levels.

The ethics challenge in business is, indeed, a serious one, and progress on this front is vital to successful business. An ethics officer for a large corporation once said that there were three types of organizations: those that *have had* ethics problems, those that *are having* ethics problems, and those that *will have* ethics problems. Ethical issues cut through all levels of management in organizations of all sizes.

A study of managers’ desired leadership qualities was conducted by consultant and writer Lee Ellis, and he concluded that *integrity* is the quality most sought after in leaders.² A recently retired corporate executive, Bill George, former CEO at Medtronic, has argued that we need corporate leaders with integrity.³ But how does one get personal integrity, and, as a manager, how do you instill it in your organization and create an ethical organizational climate? These are significant challenges. How, for example, do you keep your own personal ethics focused in such a way that you avoid immorality and amorality? What principles, concepts, or guidelines are available to help you to be ethical? What specific strategies, approaches, or best practices might be emphasized to bring about an ethical culture in your company or organization?

Levels at Which Ethics May Be Addressed

As individuals and as managers, we experience ethical pressures or dilemmas in a variety of settings. These pressures or dilemmas occur on different levels. These levels include the individual or personal level, the organizational level, the industry level, the societal level, and the global level. These levels cascade out from the individual to the global. Some observers believe that “ethics are ethics,” regardless of whether they are applied at the personal or the organizational level. To help understand the types of decision situations that are faced at the various

levels, however, it is worth considering them in terms of the types of issues that may arise in the different contexts.

PERSONAL LEVEL

First, we all experience *personal-level* ethical challenges. These challenges include situations we face in our personal lives that are generally outside the work context. Questions or dilemmas that we might face at the personal level include:

- Should I cheat on my income tax return by overstating my charitable contributions?
- Should I tell the professor I need this course to graduate this semester when I really don't?
- Should I download music from the Internet although I realize it is someone's intellectual property?
- Should I skip out on my share of the apartment rent because I'm graduating and leaving town?
- Should I tell the cashier that she gave me change for a \$20 bill when all I gave her was a \$10 bill?
- Should I connect this TV cable in my new apartment and not tell the cable company?

Wanda Johnson of Savannah, Georgia, faced a personal-level ethical dilemma upon finding money. Johnson, a 34-year-old single mother of five, found temptation knocking in the form of a bag that contained \$120,000. Johnson, a \$7.88-an-hour custodian at a local hospital, was on her lunch break when she witnessed a bag of money falling off an armored truck. Johnson could have surely used the money. She was behind in her bills and had recently pawned her television set, trying to come up with enough cash to keep the bill collectors at bay. The bag contained small bills, and nobody saw her find the bag. What should she do?

Johnson later admitted that she knew she had to turn it in. After consulting with her pastor, Johnson turned in the money to the police. Johnson said that her religious upbringing had taught her what was the right thing to do. Johnson was later rewarded when SunTrust Banks promised her a reward of \$5,000, and she received a promise of an unspecified sum by EM Armored Car Company.⁴ Would all individuals react to this ethical dilemma in the same fashion as Johnson?

ORGANIZATIONAL LEVEL

People also confront ethical issues at the *organizational level* (or firm level) in their roles as managers or employees. Certainly, many of these issues are similar to those we face personally. However, these issues may carry consequences for the company's reputation and success in the community and also for the kind of ethical environment or culture that will prevail on a day-to-day basis at the office.

In addition, how the issue is handled may have serious organizational consequences. Some of the issues posed at the organizational level might include:

- Should I set high production goals for my work team to benefit the organization, even though I know it may cause them to cut corners to achieve such goals?
- Should I over-report the actual time I worked on this project, hoping to get overtime pay?
- Should I overlook the wrongdoings of my colleagues and subordinates in the interest of harmony in the company?
- Should I authorize a subordinate to violate company policy so that we can close the deal and both be rewarded by month's end?
- Should I make this product safer than I'm required to by law, because I know the legal standard is grossly inadequate?
- Should I misrepresent the warranty time on this product in order to get the sale?

One August, it was revealed that months before people began dying nationwide, managers at a Sara Lee Corp.-owned plant in Michigan knew they were shipping tainted hot dogs and deli meats. This was an organization-level ethical dilemma. A national outbreak of listeriosis killed 15, caused six miscarriages, and sickened 101 people. Employees of the Bil Mar plant later came forward and revealed that several employees, as well as management, were aware of the contaminated meat but shipped it anyway. According to a report, a USDA worker had told a Bil Mar employee at the time that the plant was running a risk of getting into trouble if it shipped contaminated foods, but the worker said "they would never know it was our product since [listeria] has about a two-week incubation period." Before these latest revelations, the company had pleaded guilty to a federal misdemeanor charge, paid a \$200,000 fine, and made a \$3 million grant to Michigan State University for food safety research.⁵

When thinking about the organizational level of ethics, the presence or absence of unethical practices goes a long way toward revealing the state of ethics that exists within that organization. To illustrate the types of unethical practices that may be evident in organizations, the results of a recent survey conducted by the Ethics Resource Center reveal what managers and employees are up against. In this survey of employees, the following were some of the types of misconduct observed and reported, along with the percentage of time these items were mentioned:⁶

- Abusive or intimidating behavior toward employees (23 percent)
- Misreporting actual time or hours worked (20 percent)
- Lying to employees, customers, vendors, or the public (19 percent)
- Withholding needed information from employees, customers, vendors, or the public (18 percent)

- Discriminating on the basis of race, color, gender, age, or similar categories (13 percent)
- Stealing, theft, or related fraud (12 percent)
- Sexual harassment (11 percent)
- Falsifying financial records and reports (5 percent)
- Giving or accepting bribes, kickbacks, or inappropriate gifts (4 percent)

Each of these categories reveals the types of questionable practices that employees today face in their work lives.

INDUSTRY LEVEL

A third level at which a manager or organization might influence business ethics is the *industry level*. The industry might be stock brokerage, real estate, insurance, manufactured homes, financial services, telemarketing, automobiles, or a host of others. Related to the industry might be the profession of which an individual is a member—accounting, engineering, pharmacy, medicine, or law. Examples of questions that might pose ethical dilemmas at this level include the following:

- Is this practice that we stockbrokers have been using for years with prospective clients really fair and in their best interests?
- Is this safety standard we electrical engineers have passed really adequate for protecting the consumer in this age of do-it-yourselfers?
- Is this standard contract we mobile-home sellers have adopted really in keeping with the financial disclosure laws that have recently been strengthened?
- Is it ethical for telemarketers to make cold calls to prospective clients during the dinner hour when we suspect they will be at home?

Not too long ago, an industry-level group of 14 Wall Street firms endorsed a set of ethical practices for the industry, covering broad areas such as analysts' compensation, personal ownership of stocks by analysts, and the objectivity of reports. The action was taken by major firms such as Goldman Sachs, Merrill Lynch, and Morgan Stanley Dean Witter to counter the growing belief among many investors that Wall Street research is biased, obfuscating, or untrustworthy. The move was designed to shore up the ethical and professional standards of their investment analysts and other employees.⁷ This action illustrates an industry-level problem that was addressed by the group of leading firms.

Another example of an ethical issue at the industry level is the extent to which consumer products companies should advertise sugar-laden products to children. In an initiative to persuade critics the industry does not need government regulation, 11 big food companies, including McDonald's, PepsiCo, and Campbell Soup, agreed in 2007 to stop advertising to children under 12 products that do not meet certain minimal nutritional standards. Other companies, such as Coca-Cola,

have already withdrawn all such commercials, and others, such as General Mills, have said they would withdraw them over the next year or so.⁸

SOCIETAL AND GLOBAL LEVELS

At the *societal and global levels*, it becomes very difficult for the individual manager to have any direct effect on business ethics. However, managers acting in concert through their companies and trade and professional associations can definitely bring about high standards and constructive changes. Because the industry, societal, and global levels are quite removed from the actual practicing manager, we will focus our attention in this chapter primarily on the personal and organizational levels. The manager's greatest impact can be felt through what he or she does personally or as a member of the management team.

An example of a major issue that companies are facing today that has industry, societal, and global ethical implications is that of moving jobs offshore—outsourcing work to less expensive regions of the world, such as China and India. In the past few years, outsourcing has included not only manufacturing jobs, but increasingly it is including technical and professional jobs as well. In a 2007 *BusinessWeek* article titled “The Real Cost of Offshoring,” the impact on domestic workers is documented to be a social issue.⁹ Another ethical issue that has widespread implications is business's support for hiring illegal immigrants.

In Chapter 10, we will deal with global ethics more specifically—a crucial topic that is increasing in importance as global capitalism comes to define our commercial world.

Personal and Managerial Ethics

In discussing personal and managerial ethics, it is the assumption that the individual wants to behave ethically or to improve his or her ethical behavior in personal and/or managerial situations. Keep in mind that each individual is a stakeholder of someone else. Someone else—a friend, a family member, an associate, or a businessperson—has a stake in your behavior; therefore, your ethics are important to them also. What we discuss here is aimed at those who desire to be ethical and are looking for help in doing so. All the difficulties with making ethical judgments that we discussed in the previous chapter are applicable in this discussion as well.

Personal and managerial ethics, for the most part, entails making decisions. Decision situations typically confront the individual with a conflict-of-interest situation. A conflict of interest is usually present when the individual has to choose between her or his interests and the interests of someone else or some other group (stakeholders). What it boils down to in the final analysis is answering the question, “What is the right thing to do in this situation?”

In answering this question, more often than not it seems that individuals think about the situation briefly and then go with their instincts. There are, however,

guidelines to ethical decision making that one could turn to if she or he really wanted to make the best ethical decisions. What are some of these guidelines?

In Chapter 7, we indicated that there are three major approaches to ethics or ethical decision making: (1) the conventional approach, (2) the principles approach, and (3) the ethical tests approach. In Chapter 7, we discussed the conventional approach, which entailed a comparison of a decision or a practice with prevailing norms of acceptability. We discussed some of the challenges inherent in that approach. In this chapter, we discuss the other two approaches and other ethical principles and concepts as well.

PRINCIPLES APPROACH TO ETHICS

The principles approach to ethics or ethical decision making is based on the idea that managers desire to anchor their decisions on a more solid foundation than the conventional approach to ethics. The conventional approach to ethics, you may recall, depended heavily on what people thought and what the prevailing standards were at the time. Several principles of ethics have evolved over time as moral philosophers and ethicists have attempted to organize and codify their thinking.

What Is an Ethics Principle?

This raises the question of what constitutes a principle of business ethics and how it might be applied. From a practical point of view, a principle of business ethics is an ethical concept, guideline, or rule that, if applied when you are faced with an ethical decision or practice, will assist you in taking the ethical course.¹⁰ Principles or guidelines have been around for centuries. The Golden Rule has been around for several millennia. In the 1500–1600s, Miguel de Cervantes, the Spanish novelist and author of *Don Quixote*, uttered an important ethics principle that is still used today: *Honesty is the best policy.*

Types of Ethical Principles or Theories

Moral philosophers customarily divide ethical principles or theories into two categories: teleological and deontological. **Teleological theories** focus on the *consequences* or results of the actions they produce. Utilitarianism is the major principle in this category. **Deontological theories** focus on *duties*. For example, it could be argued that managers have a duty to tell the truth when they are doing business. The ethical theory known as the *categorical imperative* formulated by Immanuel Kant best illustrates duty theory. The principle of rights and the principle of justice, two major ethics theories we will discuss, seem to be non-teleological in character.¹¹ **Aretaic theories** are a third, less-known category of ethics. A theory of virtue ethics was put forth by Aristotle, and it was known as an aretaic theory. *Arete* is from the Greek and means “goodness” [of function], “excellence” [of function], or “virtue.” Aristotle saw the individual as essentially a member of a social unit and a moral virtue as a habit of behavior, a trait of character that is both socially and morally valued. Virtue theory is the best

example of an aretaic theory.¹² Other principles, such as caring, the Golden Rule, and servant leadership, reflect concerns for duty, consequences, and virtue, or a combination of several.

There are many different principles of ethics, but we must limit our discussion to those that have been regarded as most useful in business settings. Therefore, we will concentrate on the following major principles: utilitarianism (consequences-based), rights, and justice (duty-based). In addition, we will consider the principles of care, virtue ethics, servant leadership, and the Golden Rule—views that are also popular and relevant today. The basic idea behind the principles approach is that managers may improve their ethical decision making if they factor into their proposed actions, decisions, behaviors, and practices a consideration of certain principles or concepts of ethics. We will conclude this section with a brief consideration of how we might reconcile ethical conflicts that might arise in the use of these principles.

Principle of Utilitarianism

Many ethicists have held that the rightness or fairness of an action can be determined best by looking at its results or consequences. If the consequences are good, the action or decision is considered good. If the consequences are bad, the action or decision is considered wrong. The **principle of utilitarianism** is, therefore, a *consequential* principle, or as stated earlier, a *teleological* principle. In its simplest form, **utilitarianism** asserts that “we should always act so as to produce the greatest ratio of good to evil for everyone.”¹³ Another way of stating utilitarianism is to say that one should take that course of action that represents the “greatest good for the greatest number.” Two of the most influential philosophers who advocated this consequential view were Jeremy Bentham (1748–1832) and John Stuart Mill (1806–1873).

The attractiveness of utilitarianism is that it forces the decision-maker to think about the general welfare. It proposes a standard outside of self-interest by which to judge the value of a course of action. To make a cost–benefit analysis is to engage in utilitarian thinking. Utilitarianism forces us to think in stakeholder terms: What would produce the greatest good in our decision, considering stakeholders such as owners, employees, customers, and others, as well as ourselves? Finally, it provides for latitude in decision making in that it does not recognize specific actions as inherently good or bad but rather allows us to fit our personal decisions to the complexities of the situation.

A weakness of utilitarianism is that it ignores actions that may be inherently wrong. A strict interpretation of utilitarianism might lead a manager to fire minorities and older workers because they do not fit in or take some other drastic action that contravenes public policy and other ethics principles. In utilitarianism, by focusing on the ends (consequences) of a decision or an action, the means (the decision or action itself) may be ignored. Thus, we have the problematic situation where one may argue that the end justifies the means, using utilitarian reasoning. Therefore, the action or decision is considered objectionable only if it leads to a lesser ratio of good to evil. Another problem with the principle of utilitarianism is

that it may come into conflict with the idea of justice. Critics of utilitarianism say that the mere increase in total good is not good in and of itself because it ignores the distribution of good, which is also an important issue. Another stated weakness is that, when using this principle, it is very difficult to formulate satisfactory rules for decision making. Therefore, utilitarianism, like most ethical principles, has its advantages and disadvantages.¹⁴

Kant's Categorical Imperative

Immanuel Kant's **categorical imperative** is a duty-based principle of ethics, or as stated earlier, it is a deontological principle.¹⁵ A duty is an obligation; that is, it is an action that is morally obligatory. The duty approach to ethics refers both to the obligatory nature of particular actions and to a way of reasoning about what is right and wrong.¹⁶ Kant's categorical imperative argues that a sense of duty arises from *reason* or *rational nature*, an internal source. By contrast, the *Divine Command* principle maintains that God's law is the source of duties. Thus, we can conceptualize both internal and external sources of duty.

Kant proposed three formulations in his theory or principle. The categorical imperative is best known in the following form: "Act only according to that maxim by which you can at the same time *will* that it should become a universal law." Stated another way, Kant's principle is that one should act only on rules (or maxims) that you would be willing to see everyone follow.¹⁷ Kant's second formulation, referred to as the *principle of ends*, is "so act to treat humanity, whether in your own person or in that of any other, in every case as an *end* and never as merely a means." This has also been referred to as the *respect for persons principle*.¹⁸ This means that each person has dignity and moral worth and should never be exploited or manipulated or merely used as a means to another end.¹⁹

The third formulation of the categorical imperative invokes the *principle of autonomy*. It basically holds that "every rational being is able to regard oneself as a maker of universal law. That is, we do not need an external authority—be it God, the state, our culture, or anyone else—to determine the nature of the moral law. We can discover this for ourselves."²⁰ Kant argues that this view is not inconsistent with Judeo-Christian beliefs, his childhood heritage, but one must go through a series of logical leaps of faith to arrive at this point.²¹ Like all ethical principles, Kant's principles have strengths and weaknesses and supporters and detractors. In the final analysis, it is his emphasis on duty, as opposed to consequences, that merits its treatment here. Further, the notion of universalizability and respect for persons are key ideas. The principles of rights and justice, which we discuss next, seem more consistent with the duty-based perspective than the consequences-based perspective.

Principle of Rights

One major problem with utilitarianism is that it does not handle the issue of **rights** very well. That is, utilitarianism implies that certain actions are morally right (i.e., they represent the greatest good for the greatest number) when in fact they may violate another person's rights.²² **Moral rights** are important, justifiable claims or

entitlements. Moral rights do not depend on a legal system to be valid. They are rights that we ought to have based on moral reasoning. The right to life or the right not to be killed by others is a justifiable claim in our society. The Declaration of Independence referred to the rights to life, liberty, and the pursuit of happiness. John Locke earlier had spoken of the right to property. Today we speak of human rights. Some of these are **legal rights** and some are moral rights.

The basic idea undergirding the **principle of rights** is that rights cannot simply be overridden by utility. A right can be overridden only by another, more basic or important right. Let us consider the problem if we apply the utilitarian principle. For example, if we accept the basic right to human life, we are precluded from considering whether killing someone might produce the greatest good for the greatest number. To use a business example, if a person has a right to equal treatment (not to be discriminated against), we could not argue for discriminating against that person so as to produce more good for others.²³ However, some people would say that this is precisely what we do when we advocate affirmative action.

The rights principle expresses morality from the point of view of the individual or group of individuals, whereas the utilitarian principle expresses morality in terms of the group or society as a whole. The rights view forces us in our decision making to ask what is due each individual and to promote individual welfare. The rights view also limits the validity of appeals to numbers and to society's aggregate benefit.²⁴ However, a central question that is not always easy to answer is: "What constitutes a legitimate right that should be honored, and what rights or whose rights take precedence over others?"

Figure 8-1 provides an overview of many of the types of rights that are being claimed in our society today. Some of these rights are legally protected, whereas

Figure 8-1 *Some of the Legal Rights and Claimed Moral Rights in Society Today*

Civil rights	Smokers' rights
Minorities' rights	Nonsmokers' rights
Women's rights	AIDS victims' rights
Disabled people's rights	Children's rights
Older people's rights	Fetal rights
Religious affiliation rights	Embryo rights
Employee rights	Animals' rights
Consumer rights	Right to burn the American flag
Shareholder rights	Right of due process
Privacy rights	Gay rights
Right to life	Victims' rights
Criminals' rights	Rights Based on Appearance

others are claimed as moral rights but are not legally protected. Managers are expected to be attentive to both legal and moral rights, but there are no clear guidelines available to help one sort out which claimed moral rights should be protected, to what extent they should be protected, and which rights should take precedence over others.

There are two types of rights: negative rights and positive rights.²⁵ A **negative right** is the right to be left alone. It is the right to think and act free from the coercion of others. For example, freedom from false imprisonment, from illegal search and seizure, and freedom of speech are all forms of negative rights.²⁶ A **positive right** is a right to something, such as a right to food, to health care, to clean air, to a certain standard of living, or to education. In business, as in all walks of life, both negative and positive rights are played out in both legal and morally claimed forms.

In recent years, some have argued that we are in the midst of a rights revolution in which too many individuals and groups are attempting to urge society to accept their wishes or demands as rights. The proliferation of rights claims has the potential to dilute or diminish the power of more legitimate rights. If everyone's claim for special consideration is perceived as a legitimate right, the rights approach will lose its power to help management concentrate on the morally justified rights. A related problem has been the politicization of rights in recent years. As our lawmakers bestow legal or protected status upon rights claims for political reasons rather than moral reasons, managers may become blinded to which rights or whose rights really should be honored in a decision-making situation. As rights claims expand, the common core of morality may diminish, and decision-makers may find it more and more difficult to balance individuals' interests with the public interest.²⁷

Principle of Justice

Just as the utilitarian principle does not handle well the idea of rights, it does not deal effectively with justice either. One way to think about the **principle of justice** is to say that it involves the fair treatment of each person. The principle of justice is often called the "fairness principle." Most would accept that we have a duty to be fair to employees, consumers, and other stakeholders. But how do you decide what is fair to each person? How do you decide what each person is due? Sometimes it is hard to say because people might be given what they are due according to their type of work, their effort expended, their merit, their need, and so on. Each of these criteria might be appropriate in different situations. At one time, the view prevailed that married heads of households ought to be paid more than single males or women. Today, however, the social structure is different. Women have entered the workforce in significant numbers, some families are structured differently, and a revised concept of what is due people has evolved. The fair action now is to pay everyone more on the basis of merit than needs.²⁸

To use the principle of justice, we must ask, "What is meant by justice?" There are several kinds of justice. **Distributive justice** refers to the distribution of benefits and burdens. **Compensatory justice** involves compensating someone for

a past injustice. **Procedural justice** refers to fair decision-making procedures, practices, or agreements.²⁹

Ethical Due Process. Procedural justice, or ethical due process, is especially relevant to business organizations. Employees, customers, owners, and all stakeholders want to be treated fairly. They want to believe that they have been treated carefully and equally in decision situations. They want their side of the issue to be heard, and they want to believe that the managers or decision-makers took all factors into consideration and weighed them carefully before a decision was made. Whether the decision was who should be hired (or fired), who should get what promotion or raise, or who should get a choice assignment, employees want to know that fairness prevailed and not favoritism or some other inappropriate factor. People want to know that their performance has been evaluated according to a fair process. **Ethical due process**, then, is simply being sure that fairness characterizes the decision-making process. It should be noted, too, that ethical due process is as important, if not more so, than outcome fairness. In other words, people can live with an outcome that was not their preferred outcome if they believe that the method, system, or procedure used in making the decision was fair.

The term **process fairness** has also been used to describe ethical due process.³⁰ Three factors affecting whether process fairness has been achieved have been identified. First, have employees been given input into the decision process? The more this occurs, the more fair the process is perceived. Second, do employees believe the decisions were made and implemented in an appropriate manner? Employees are looking for consistency based on accurate information. They are looking to see whether mistakes are being corrected. They are looking to see that the decision-making process was transparent. Third, employees are watching to see how the managers behave. Do they provide explanations when asked? Do they treat others respectfully? Do they actively listen to comments being made?³¹ Ethical due process, or process fairness, works effectively with all stakeholders, whether they are employees, customers, owners, or others. Everyone responds positively to being treated fairly.

Rawls Principle of Justice. John Rawls, a political philosopher who died in 2002 at the age of 81, has presented his own version of ethical due process.³² John Rawls provides what some have referred to as a comprehensive principle of justice.³³ His theory is based on the idea that what we need first is a fair method by which we may choose the principles through which conflicts will be resolved. The two principles of justice that underlie his theory are as follows:³⁴

1. Each person has an equal right to the most extensive basic liberties compatible with similar liberties for all 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.

Under Rawls's first principle, each person is to be treated equally. It holds that each person should enjoy equally a full array of basic liberties.³⁵ The second principle is more controversial. This is often interpreted to mean that public policy should raise as high as possible the social and economic well-being of society's worst-off individuals. It is criticized by both those who argue that the principle is too strong and those who think the principle is too weak. The former think that, as long as we have equal opportunity, there is no injustice when some people benefit from their own work, skill, ingenuity, or assumed risks. Therefore, such people deserve more and should not be required to produce benefits for the least advantaged. The latter group thinks that the inequalities that may result may be so great as to be clearly unjust. Therefore, the rich get richer and the poor get only a little less poor.³⁶

In developing further his second principle, Rawls imagined people gathered behind a "*veil of ignorance*," unaware of whether they, personally, were rich or poor, talented or incompetent. He then asked what kind of society would they build? He reasoned that the rule everyone would be able to agree on would be to maximize the well-being of the worst-off person, partially out of fear that anyone could wind up at the bottom.³⁷ This view, of course, had its critics.

Supporters of the principle of justice claim that it preserves the basic values—freedom, equality of opportunity, and a concern for the disadvantaged—that have become embedded in our moral beliefs. Critics object to various parts of the theory and would not subscribe to Rawls's principles at all. Utilitarians, for example, think the greatest good for the greatest number should reign supreme.

Ethic of Care

It is useful to introduce the **ethic of care**, or principle of caring, right after our discussion of utilitarianism, rights, and justice, because this alternative view is critical of many traditional views. Some traditional views, it has been argued, embrace a masculine approach to perceiving the world. The "care" perspective builds on the work of Carol Gilligan, whose criticisms of Kohlberg's theory of moral development were discussed in the previous chapter. Gilligan found that women often spoke in "a different voice" that was more based on responsibility to others and on the continuity of interdependent relationships.³⁸

The care perspective maintains that traditional ethics like the principles of utilitarianism and rights focus too much on the individual self and on cognitive thought processes. In the traditional view, "others" may be seen as threats, so rights become important. Resulting moral theories then tend to be legalistic or contractual.

Caring theory is founded on wholly different assumptions. Proponents who advocate this perspective, for example, view the individual person as essentially relational, not individualistic. These persons do not deny the existence of the self but hold that the self has relationships that cannot be separated from the self's existence. This view emphasizes the relationships' moral worth and, by extension, the responsibilities inherent in those relationships, rather than in rights, as in traditional ethics.³⁹

Several writers have argued that caring theory is consistent with stakeholder theory, or the stakeholder approach, in that the focus is on a more cooperative, caring type of relationship. In this view, firms should seek to make decisions that satisfy stakeholders, leading to situations in which all parties in the relationship gain. Robbin Derry elaborates: “In the corporate environment, there is an increasing demand for business to be attentive to its many stakeholders, particularly customers and employees, in caring ways. As organizations attempt to build such relationships, they must define the responsibilities of initiating and maintaining care. The ethics of care may be able to facilitate an understanding of these responsibilities.”⁴⁰

Jeanne Liedtka, on the other hand, has questioned whether organizations can care in the sense in which caring theory proposes. Liedtka contends that to care in this sense, an organization would have to care in a way that is:

- Focused entirely on people, not quality, profits, or other such ideas that today use “care talk”
- Undertaken with caring as an end, not merely as a means to an end (such as quality or profits)
- Essentially personal, in that the caring reflects caring for other individuals
- Growth enhancing for the cared-for, in that the caring moves the cared-for toward the development and use of their capacities

Liedtka takes the position that caring people could lead to a caring organization that offers new possibilities for simultaneously enhancing the effectiveness and the moral quality of organizations.⁴¹ The principle of caring offers a different perspective to guide ethical decision making—a perspective that clearly is thought provoking and valuable.

Virtue Ethics

The major principles just discussed have been more action-oriented. That is, they were designed to guide our actions and decisions. Another ethical tradition, often referred to as **virtue ethics**, merits consideration even though it is not a principle per se. Virtue ethics, rooted in the thinking of Plato and Aristotle, focuses on the individual becoming imbued with virtues (e.g., honesty, fairness, truthfulness, benevolence, nonmalfeasance).⁴² Virtue ethics is sometimes referred to as an aretaic theory of ethics.⁴³

Virtue ethics is a system of thought that is centered in the heart of the person—in our case, the manager. This is in contrast to the principles we have discussed, which see the heart of ethics in actions or duties. Action-oriented principles focus on *doing*. Virtue ethics emphasizes *being*. The assumption, of course, is that the actions of a virtuous person will also be virtuous. Traditional ethical principles such as utilitarianism, rights, and justice focus on the question, “What should I do?” Virtue ethics focuses on the question, “What sort of person should I *be* or *become*?”⁴⁴

Programs that have developed from the notion of virtue ethics have sometimes been called *character education*, because this particular theory emphasizes character

development. Many observers think that one reason we have moral decline in business and society today is because we have failed to teach our young people universal principles of good character.

VF Corporation, the Josephson Institute of Ethics, and the Ethics Resource Center in Washington all have launched character education programs. It has been argued that character education is needed not only in schools, but in corporations as well. Corporate well-being demands character, and business leaders are a vital and necessary force for putting character back into business.⁴⁵

Virtue ethicists have brought back to the public debate the idea that virtues are important whether they be in the education of the young or in management training programs. Virtues such as honesty, integrity, loyalty, promise keeping, fairness, and respect for others are completely compatible with the major principles we have been discussing. The principles, combined with the virtues, form the foundation for effective ethical action and decision making. Whether the virtues are seen as character traits or as principles of decision making is not our major concern at this point. That they be used, whatever the motivation, is our central concern here. It has been strongly argued that the ethics of virtue in business is an idea whose time has arrived.⁴⁶

Servant Leadership

An increasingly popular approach to organizational leadership and thinking today is **servant leadership**. Though not an ethical principle per se, servant leadership is an approach to ethical leadership and decision making based on the moral principle of serving others first. Can these two roles—servant and leader—be fused in one person—a manager? What are the basic tenets of servant leadership?

Servant leadership is a model of ethical management—an approach to ethical decision making—based on the idea of serving others such as employees, customers, community, and other stakeholders as the first priority. According to Robert Greenleaf, “It begins with the natural feeling that one wants to serve, to serve first.” Next, a conscious choice brings one to “aspire to lead.” The model manifests itself in the care taken by the leader to make sure that others’ needs are being served.⁴⁷

The modern era of servant leadership is marked primarily by the works of Robert K. Greenleaf, known today as the father of this movement. Greenleaf spent his 38-year career working for AT&T. Upon his retirement, he founded the Center for Applied Ethics, which was renamed the Greenleaf Center for Servant Leadership; it is housed in Indianapolis. Greenleaf’s “second career” lasted until shortly before his death in 1990. During his time, he became influential in leadership circles as a thinker, writer, consultant, and speaker to many organizations.⁴⁸

In his book *Servant Leadership*, Greenleaf gives credit to the ministry of Jesus of Nazareth as symbolically embodying the concept.⁴⁹ Though inspired by the teachings and life of Jesus, Greenleaf says he was led to crystallize his idea of servant leadership after reading Hermann Hesse’s short novel, *Journey to the East*.

In Hesse's story, a band of men take a mythical journey. The central figure in the story is Leo, who accompanies the party as the "servant" who does the menial chores but who also sustains the men with his spirit and song. Leo is a person with extraordinary presence. All goes well until Leo disappears. Then the group falls into disarray, and their journey is abandoned. They can't make it without their servant, Leo.

The story's narrator, one of the party, finds Leo after some years of wandering. The narrator is taken into the Order that had sponsored the journey. There he discovers that Leo, whom he had known as "servant," was actually the titular head of the Order—its guiding spirit—a great and noble "leader." The main point Greenleaf took from this story is that the great leader is seen as servant first, and this is the key to his greatness. Leo was actually the leader all the time, but he was servant first because that was his deep internal person.

Greenleaf summarizes that the servant leader is "servant first," just as Leo was portrayed. The role begins with the natural sentiment that one first wants to serve, and then comes forth as a conscious aspiration to lead. This kind of person is distinctively different from one who is a "leader first," perhaps because of the need to gratify a power drive or acquisitiveness for material possessions. Of course, the servant-first and the leader-first are two extreme types, and there are a number of shadings and blends in between these two models. They define a useful range for thinking about leadership.

Larry Spears, CEO of the Greenleaf Center for Servant Leadership, has deliberated on Greenleaf's original writings and has culled from these writings a set of 10 key characteristics that are essential for the development of servant leaders. Each of these is worth listing because, together, they paint a portrait of servant leadership in terms of leader behaviors and characteristics. The 10 characteristics of servant leaders are as follows:⁵⁰

- Listening
- Empathy
- Healing
- Persuasion
- Awareness
- Foresight
- Conceptualization
- Commitment to the growth of people
- Stewardship
- Building community

Each of these 10 characteristics of servant leaders is based on the ethical principle of putting the other person first—whether that other person is an employee, a customer, or some other important stakeholder. Some of these characteristics could be stated as virtues and some as behaviors. Thus, servant leadership embraces a number of the ethical perspectives discussed earlier.

Servant leadership builds a bridge between the ideas of business ethics and the ideas of leadership. Joanne Ciulla has observed that people follow servant leaders because they can trust them, and this invokes the ethical dimension.⁵¹ And, James Autry, the top-selling leadership author, argues that servant leadership is the right way, a better way of being a manager and part of organizational life. He adds, “it will enhance productivity, encourage creativity, and benefit the bottom line.”⁵²

The Golden Rule

The **Golden Rule** merits discussion because of its popularity as a basic and strong principle of ethical living and decision making. A number of studies have found it to be the most powerful and useful to managers.⁵³ The Golden Rule—“Do unto others as you would have them do unto you”—is a fairly straightforward, easy-to-understand principle. Further, it guides the individual decision-maker to behavior, actions, or decisions that she or he should be able to express as acceptable or not based on some direct comparisons with what she or he would consider ethical or fair.

The Golden Rule argues that, if you want to be treated fairly, treat others fairly; if you want your privacy protected, respect the privacy of others. The key is impartiality. According to this principle, we are not to make an exception of ourselves. In essence, the Golden Rule personalizes business relations and brings the ideal of fairness into business deliberations.⁵⁴

The popularity of the Golden Rule is linked to the fact that it is rooted in history and religious tradition and is among the oldest of the principles of living. Further, it is universal in the sense that it requires no specific religious belief or faith. Almost since time began, religious leaders and philosophers have advocated the Golden Rule in one form or another. It is easy to see, therefore, why Martin Luther said that the Golden Rule is a part of the “natural law,” because it is a moral rule that anyone can recognize and embrace without any particular religious teaching. In three different studies, when managers or respondents were asked to rank ethical principles according to their value to them, the Golden Rule was ranked first.⁵⁵

Leadership expert John C. Maxwell published a book recently titled *There’s No Such Thing as “Business” Ethics: There’s Only One Rule for Making Decisions*. The one rule Maxwell advocates is the Golden Rule. According to Maxwell, there are four reasons why decision-makers should adopt the Golden Rule:

1. The Golden Rule is accepted by most people.
2. The Golden Rule is easy to understand.
3. The Golden Rule is a win-win philosophy.
4. The Golden Rule is a compass when you need direction.⁵⁶

In addition to the ethical principles and theories that we have chosen to discuss in some detail, Figure 8-2 provides a brief sketch of several ethical principles that have evolved over the years.

Figure 8-2 A Brief Sketch of Ethical Principles

- **The Categorical Imperative:** Act only according to that maxim by which you can at the same time “will” that it should become a universal law. In other words, one should not adopt principles of action unless they can, without inconsistency, be adopted by everyone else.
- **The Conventionalist Ethic:** Individuals should act to further their self-interests so long as they do not violate the law. It is allowed, under this principle, to bluff (lie) and to take advantage of all legal opportunities and widespread practices and customs.
- **The Disclosure Rule:** If the full glare of examination by associates, friends, family, newspapers, television, etc., were to focus on your decision, would you remain comfortable with it? If you think you would, it probably is the right decision.
- **The Golden Rule:** Do unto others as you would have them do unto you. It includes not knowingly doing harm to others.
- **The Hedonistic Ethic:** Virtue is embodied in what each individual finds meaningful. There are no universal or absolute moral principles. If it feels good, do it.
- **The Intuition Ethic:** People are endowed with a kind of moral sense with which they can apprehend right and wrong. The solution to moral problems lies simply in what you feel or understand to be right in a given situation. You have a “gut feeling” and “fly by the seat of your pants.”
- **The Market Ethic:** Selfish actions in the marketplace are virtuous because they contribute to efficient operation of the economy. Decision-makers may take selfish actions and be motivated by personal gain in their business dealings. They should ask whether their actions in the market further financial self-interest. If so, the actions are ethical.
- **The Means-Ends Ethic:** Worthwhile ends justify efficient means—i.e., when ends are of overriding importance or virtue, unscrupulous means may be employed to reach them.
- **The Might-Equals-Right Ethic:** Justice is defined as the interest of the stronger. What is ethical is what an individual has the strength and power to accomplish. Seize what advantage you are strong enough to take without respect to ordinary social conventions and laws.
- **The Organization Ethic:** The wills and needs of individuals should be subordinated to the greater good of the organization (be it church, state, business, military, or university). An individual should ask whether actions are consistent with organizational goals and what is good for the organization.
- **The Professional Ethic:** You should do only that which can be explained before a committee of your peers.
- **The Proportionality Principle:** I am responsible for whatever I “will” as a means or an end. If both the means and the end are good in and of themselves, I may ethically permit or risk the foreseen but unwilled side effects if, and only if, I have a proportionate reason for doing so.
- **The Revelation Ethic:** Through prayer or other appeal to transcendent beings and forces, answers are given to individual minds. The decision-makers pray, meditate, or otherwise commune with a superior force or being. They are then apprised of which actions are just and unjust.
- **The Utilitarian Ethic:** The greatest good for the greatest number. Determine whether the harm in an action is outweighed by the good. If the action maximizes benefit, it is the optimum course to take among alternatives that provide less benefit.

Source: T. K. Das, “Ethical Preferences Among Business Students: A Comparative Study of Fourteen Ethical Principles,” *Southern Management Association* (November 13–16, 1985), 11–12. For further discussion, see T. K. Das, “How Strong Are the Ethical Preferences of Senior Business Executives?” *Journal of Business Ethics* (Vol. 56, 2005), 69–80.

Ethics in Practice Case

PROMISE VERSUS LIE

During the spring, I worked in the billing department of a large organization as a student worker. All of the secretaries who worked in the billing department were close and would talk to each other about almost anything. One of the topics we enjoyed talking about the most was the office manager of the billing department and how much we would like to find another job to get away from her, because we did not like working with her. While I was working in the department, I became very close friends with the senior secretary, who worked with me in the front office.

During the same spring, my friend was offered a very prestigious job at the company. She told a few of us about having applied for the job, but she did not want us to let the office manager know that she was applying for it in case she did not get it. I was her friend, so I was not going to say anything about the situation. After a few weeks of waiting to find

out if she got the job or not, she was offered the job and took it immediately. After she knew she had the new job, she told the office manager that she had been offered another job and was giving her two weeks' notice. All was well until the office manager came up to me one day and asked me if I had known anything about the secretary planning to leave. I was not sure what to say. I did not want to lie to the office manager, but I also did not want to break a promise I made to a good friend. What was I to do?

1. Is this ethical dilemma at the personal level or the organizational level?
2. What ethical principles are at stake in this situation? Rights? Justice? Caring? Others?
3. What should the person who faces this ethical situation do?

Contributed by Erika Carlson-Durham

There is no single principle that is recommended to be always used. As one gets into each principle, one encounters a number of problems with definitions, with measurement, and with generalizability. The more one gets into each principle, the more one realizes how difficult it would be for a person to use each principle consistently as a guide to decision making. On the other hand, to say that an ethical principle is imperfect is not to say that it has not raised important issues that must be addressed in personal or business decision making. The major principles and approaches we have discussed have raised our consciousness to the importance of the collective good, individual rights, caring, character, and fairness.

Reconciling Ethical Conflicts

What does a manager do when using some of the ethical principles and guidelines we have been discussing and she or he finds that there are conflicts between and among the principles? For example, what if the manager perceives that one employee's right to safety conflicts with another's right to privacy? How should this conflict be resolved? There is no unqualified way to reconcile ethical principles;

however, some brief discussion may be helpful. It has been argued that three common concerns must be addressed in conflict situations: obligations, ideals, and effects.⁵⁷ We will tie these concepts into our current discussion.

First, we enter into *obligations* as a part of our daily organizational lives. An example might be a verbal or written contract to which we have agreed. Principles of justice, rights, and virtue would hold that we should honor obligations. Second, as managers, we might hold certain *ideals*. Such an ideal may be some morally important goal, principle, virtue, or notion of excellence worth striving for. A quest for justice, protection of rights, and balancing of individual versus group goals might be examples. Third, we are interested in the *effects*, or consequences, on stakeholders of our decisions or actions.⁵⁸ Hopefully, we can see how obligations, goals, and effects are all aspects of the ethical principles we have been discussing.

The question now arises as to how we might handle a situation wherein our obligations, goals, and effects conflict or produce mixed effects. Three rough guidelines have been proposed:⁵⁹

1. When two or more moral obligations conflict, *choose the stronger one.*
2. When two or more ideals conflict, or when ideals conflict with obligations, *honor the more important one.*
3. When the effects are mixed, choose the action that produces the greater good or less harm.

These guidelines are tricky, because they do not precisely answer the question of which obligations or ideals should take precedence over others. However, they do give us a general approach or process for raising the issue of how such conflicts might be resolved. In the final analysis, the manager will need to consider carefully which values or obligations are more important than others.

In summary, the principles approach to ethics focuses on guidelines, ideas, or concepts that have been created to help people and organizations make wise, ethical decisions. Two ethical categories include the teleological (ends-based) and the deontological (duty-based). Both duty and consequences are important ethical concepts. In our discussion, we have treated the following as important components of the principles-based approach: utilitarianism, rights, justice, caring, virtue, servant leadership, and the Golden Rule. Such principles, or principle-based approaches, ought to cause us to think deeply and to reflect carefully on the ethical decisions we face in our personal and organizational lives. For the most part, these principles are rooted in moral philosophy, logic, and religion. On a more pragmatic level, we turn now to a series of ethical tests that constitute our third major approach to ethics.

ETHICAL TESTS APPROACH

In addition to the ethical principles approach to guiding personal and managerial decision making, a number of practical **ethical tests** might be set forth, too. Whereas the principles have almost exclusively been generated by moral philosophers, the ethical tests we discuss here have been culled from the experiences of

many people. The ethical tests are more practical in orientation and do not require the depth of moral thinking that the principles do. No single test is recommended as a universal answer to the question, "What action or decision should I take in this situation?" However, each person may find one or several tests that will be useful in helping to clarify the appropriate course of action in a decision situation.

To most students, the notion of a test invokes the thought of questions posed that need to be answered. Indeed, each of these tests for personal ethical decision making requires the thoughtful deliberation of a central question that gets to the heart of the ethics issue. The answer to the question should help the decision-maker decide whether the course of action, practice, or decision should be pursued or not.

Test of Common Sense

With this first test, the individual simply asks, "Does the action I am getting ready to take really make sense?" When you think of behavior that might have ethical implications, it is logical to consider the practical consequences. If, for example, you would surely get caught engaging in a questionable practice, the action does not pass the test of common sense. Many unethical practices have come to light when one is led to ask whether a person really used her or his common sense at all. This test has severe limitations. For example, if you conclude that you would not get caught engaging in a questionable practice, this test might lead you to think that the questionable practice is an acceptable course of action, when in fact it is not. In addition, there may be other commonsense aspects of the situation that you have overlooked.

Test of One's Best Self

Psychologists tell us that each person has a self-concept. Most people could construct a scenario of themselves *at their best*. This test requires the individual to pose the question, "Is this action or decision I'm getting ready to take compatible with my concept of myself *at my best*?" This test addresses the notion of the esteem with which we hold ourselves and the kind of person we want to be known as. Naturally, this test would not be of much value to those who do not hold themselves in high esteem. To those concerned about their esteem and reputation, however, this could be a powerful test.

Test of Making Something Public

This is one of the most powerful tests.⁶⁰ It is sometimes called the "disclosure rule," as seen in Figure 8-2. If you are about to engage in a questionable practice or action, you might pose the following questions: "How would I feel if others knew I was doing this? How would I feel if I knew that my decisions or actions were going to be featured on the national evening news tonight for all the world to see?" This test addresses the issue of whether your action or decision can withstand public disclosure and scrutiny. How would you feel if all your friends, family, and colleagues knew you were engaging in this action? If you feel

comfortable with this thought, you are probably on solid footing. If you feel uncomfortable with this thought, you might need to rethink your position.

The concept of public exposure is quite powerful. Several years ago, a poll of managers was taken, asking whether the Foreign Corrupt Practices Act would stop bribes abroad. Many of the managers said it would not. When asked what would stop bribes, most managers thought that public exposure would be most effective. "If the public knew we were accepting bribes, this knowledge would have the best chance of being effective," they replied. This idea gives further testimony to the strength of the transparency movement that is permeating business today.

Test of Ventilation

The idea of ventilation is to "expose" your proposed action to others and get their thoughts on it. This test works best if you get opinions from people who you know might not see things your way. The important point here is that you do not isolate yourself with your dilemma but seek others' views. After you have subjected your proposed course of action to other opinions, you may find that you have not been thinking clearly. In other words, ventilate, or share, your ethical quandary; don't keep it to yourself. Someone else may say something of value that will help you in making your decision.

Test of the Purified Idea

An idea or action might be thought to be "purified"—that is, made right—when a person with authority says it is appropriate. Such a person might be a supervisor, an accountant, or a lawyer. The central question here is, "Am I thinking this action or decision is right just because someone with appropriate authority or knowledge says it is right?" If you look hard enough, you always can find a lawyer or an accountant to endorse almost any idea if it is phrased right.⁶¹ However, neither of them is the final arbiter of what is right or wrong. Similarly, just because a superior says an action or a decision is ethical does not make it so. The decision or course of action may still be questionable or wrong, even though someone else has sanctioned it. This is one of the most common ethical errors people make, and they must constantly be reminded that they themselves ultimately will be held accountable if the action is indefensible.⁶²

Watch Out for the Big Four

Another test of your ethical behavior is to "watch out for the big four." The Big Four are four characteristics of decision making that may lead you astray or toward the wrong course of action. They include *greed*, *speed*, *laziness*, and *haziness*.⁶³ Greed is the drive to acquire more and more in your own self-interest. Speed refers to the tendency to rush things and cut corners because you are under the pressure of time. Laziness may lead you to take the easy course of action that requires the least amount of effort. Haziness may lead you to act or react without a clear idea of what is going on. All four of these factors represent temptations that, if succumbed to, might lead to unethical behavior.⁶⁴

Gag Test

This test was provided by a judge on the Louisiana Court of Appeals. He argued that a manager's clearest signal that a dubious decision or action is going too far is when you simply gag at the prospect of carrying it out.⁶⁵ Admittedly, this test can only capture the grossest of unethical behaviors, but there are some managers who may need such a general kind of test. Actually, this test is intended to be more humorous than serious, but a few might be helped by it. Figure 8-3 summarizes the practical ethical guidelines that may be extracted from these ethical tests.

None of the previously mentioned tests alone offers a perfect way to determine whether a decision, act, or practice is ethical. If several tests are used together, especially the more powerful ones, they do provide a means of examining proposed actions before engaging in them. To repeat, this assumes that the individual really wants to do what is right and is looking for assistance. To the fundamentally unethical person, however, these tests would not be of much value.

Based on a five-year study of ethical principles and ethical tests, Phillip Lewis asserted that there is high agreement on how a decision-maker should behave when faced with a moral choice. He concludes:

In fact, there is almost a step-by-step sequence. Notice: One should (1) look at the problem from the position of the other person(s) affected by a decision; (2) try to determine what virtuous response is expected; (3) ask (a) how it would feel for the decision to be disclosed to a wide audience and (b) whether the decision is consistent with organizational goals; and (4) act in a way that is (a) right and just for any other person in a similar situation and (b) good for the organization.⁶⁶

Implicit in Lewis's conclusion is evidence of stakeholder theory, virtue theory, the Golden Rule, the disclosure rule, and Rawls's principle of justice.

Figure 8-3 *Practical Guidelines Derived from Key Ethical Tests*

Ethical Test	Practical Ethical Guideline
Common Sense	If proposed course of action violates your "common sense," don't do it.
One's Best Self	If the proposed course of action is not consistent with your perception of yourself at your "best," don't engage in it.
Making Something Public	If you would not be comfortable with people knowing you did something, don't do it.
Ventilation	Expose your proposed course of action to others' opinions. Don't keep your ethical dilemma to yourself. Get a second opinion.
Purified Idea	Don't think that others, such as an accountant or lawyer, can "purify" your proposed action by saying they think it is okay. You will still be held responsible.
Big Four	Don't compromise your action or decision by greed, speed, laziness, or haziness.
Gag Test	If you "gag" at the prospect of carrying out a proposed course of action, don't do it.

Managing Organizational Ethics

To this point, our discussion has centered on principles and approaches to personal or managerial decision making. Clearly, ethical decision making is at the heart of business ethics, and we cannot stress enough the need to sharpen decision-making skills if amorality is to be prevented and moral management is to be achieved. Now we shift our attention more to the *organizational level*, where we find the context in which decision making occurs. Actions and practices that take place within the organization's culture, or climate, are just as vital as decision making in bringing about ethical business practices and results. As a result of his research, Craig VanSandt has concluded that "understanding and managing an organization's ethical work climate may go a long way toward defining the difference between how a company does and what kind of organization it is."⁶⁷

To manage ethics in an organization, a manager must appreciate that the organization's ethical climate is just one part of its overall corporate culture. When McNeil Laboratories, a subsidiary of Johnson & Johnson, voluntarily withdrew Tylenol from the market immediately after the reports of tainted, poisoned products, some people wondered why they made this decision as they did. An often-cited response was, "It's the J & J way."⁶⁸ This statement conveys a significant message about the firm's ethical work climate or corporate culture. It also raises the question of how organizations and managers should deal with, understand, and shape business ethics through actions taken, policies established, and examples set. The organization's moral climate is a complex entity, and we can discuss only some facets of it in this section.⁶⁹

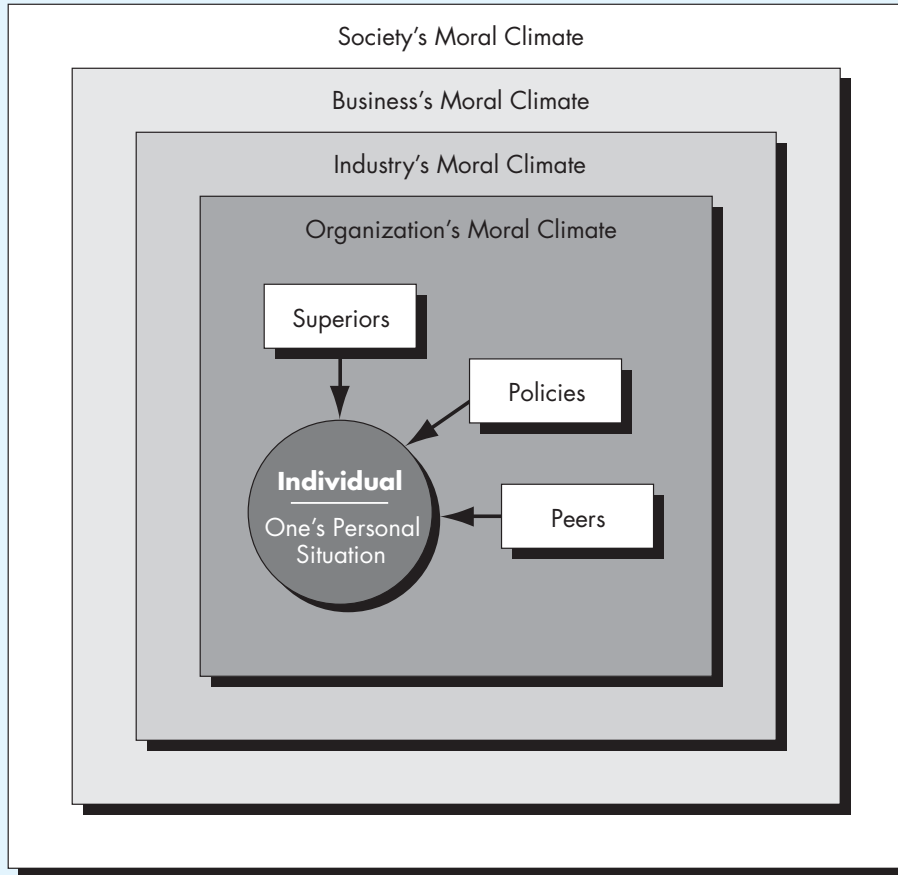
Figure 8-4 illustrates several levels of moral climate and some of the key factors that may come to bear on the manager as he or she makes decisions. What happens in organizations, as Figure 8-4 depicts, is nested in industry's, business's, and society's moral climate. Our focus in this section is on the organization's moral climate. Regardless of the ethics of individuals, organizational factors prove to be powerful in shaping ethical or unethical behavior and practices. Two major questions need to be considered:

1. What factors contribute to ethical or unethical behavior in the organization?
2. What actions, strategies, or best practices might management use to improve the organization's ethical climate?

FACTORS AFFECTING THE ORGANIZATION'S MORAL CLIMATE

For managers to be in a position to create an ethical work climate, they must first understand the factors at work in the organization that influence whether or not other managers and employees behave ethically. More than a few studies have been conducted that have sought to identify and to rank the sources of ethical behavior in organizations.

Figure 8-4 *Factors Affecting the Morality of Managers and Employees*



One of the earliest studies on this topic involved a survey of more than 1,500 *Harvard Business Review* readers (executives, managers).⁷⁰ One of the questions asked was to rank several factors that the managers thought influenced or contributed to unethical behaviors or actions. The factors found in his study, in descending order of frequency of mention, were:

1. Behavior of superiors
2. The ethical practices of one's industry or profession
3. Behavior of one's peers in the organization

4. Formal organizational policy (or lack thereof)
5. Personal financial need

A later replication of this early study was conducted using more than 1,200 *Harvard Business Review* readers. One additional factor was added to the list: society's moral climate.⁷¹ Yet another survey considered the opinions of more than 1,400 managers, again asking them to rank the list of six factors in terms of their influence or contribution to unethical behavior.⁷² Figure 8-5 presents the findings of these three landmark, baseline studies.

Although there is some variation in the rankings of the three studies, several findings are worthy of note:

- *Behavior of superiors* was ranked as the number-one influence on unethical behavior in all three studies. In other words, the influence of bosses is real.
- *Behavior of one's peers* was ranked high in two of the three studies. People do pay attention to what their peers are doing and expecting.
- *Industry or professional ethical practices* ranked in the upper half in all three studies. These context factors are influential.
- *Personal financial need* ranked last in all three studies. But, let's not assume it does not matter.

Figure

8-5

Factors Influencing Unethical Behavior Question: "Listed below are the factors that many believe influence unethical behavior. Rank them in order of their influence or contribution to unethical behaviors or actions by managers."^a

Factor	Posner & Schmidt Study ^b (N = 1,443)	Brenner & Molander Study ^c (N = 1,227)	Baumhart Study ^d (N = 1,531)
Behavior of superiors	2.17(1)	2.15(1)	1.9(1)
Behavior of one's organizational peers	3.30(2)	3.37(4)	3.1(3)
Ethical practices of one's industry or profession	3.57(3)	3.34(3)	2.6(2)
Society's moral climate ^e	3.79(4)	4.22(5)	
Formal organizational policy (or lack thereof)	3.84(5)	3.27(2)	3.3(4)
Personal financial need	4.09(6)	4.46(6)	4.1(5)

^aRanking is based on a scale of 1 (most influential) to 6 (least influential).

^bBarry Z. Posner and Warren H. Schmidt, "Values and the American Manager: An Update," *California Management Review* (Spring 1984), 202-210.

^cSteve Brenner and Earl Molander, "Is the Ethics of Business Changing?" *Harvard Business Review* (January/February 1977).

^dRaymond C. Baumhart, "How Ethical Are Businessmen?" *Harvard Business Review* (July/August 1961), 6ff.

^eThis item not included in 1961 study.

What stands out in these studies from an organizational perspective is the influence of the behavior of one's superiors and peers. Also notable about these findings is that quite often it is assumed that society's moral climate has a lot to do with managers' morality, but this factor was ranked low in the two studies in which it was considered. Apparently, society's moral climate serves as a background factor that does not have a direct and immediate impact on organizational ethics. Furthermore, it is enlightening to know that personal financial need ranked so low. But, we should not assume that personal needs are irrelevant. What these findings suggest is that there are factors at work over which managers can exercise some discretion. Thus, we begin to see the managerial dimension of business ethics.

Pressures Exerted on Employees by Superiors

One major consequence of the behavior of superiors and peers is that sometimes pressure is placed on subordinates and/or other organizational members to compromise their ethics. In one early national study of this topic, managers were asked to what extent they agreed with the following proposition: "Managers today feel under pressure to compromise personal standards to achieve company goals."⁷³ It is insightful to consider the management levels of the 64.4 percent of the respondents who agreed with the proposition. The results were:

- Top management: 50 percent agreed
- Middle management: 65 percent agreed
- Lower management: 85 percent agreed

This study revealed that the perceived pressure to compromise ethics seems to be felt most by those in lower management, followed by those in middle management. In a later study, Posner and Schmidt also asked managers whether they sometimes had to compromise their personal principles to conform to organizational expectations.⁷⁴ Twenty percent of the top executives agreed, 27 percent of the middle managers agreed, and 41 percent of the lower managers agreed. In other words, the same pattern prevailed in this other study.

What is particularly insightful about these findings is the pattern of response. It seems that the lower a manager is in the hierarchy, the more that manager perceives pressures toward unethical conduct. Although there are several plausible explanations for this phenomenon, one explanation seems particularly attractive based on experience. This explanation is that top-level managers do not fully understand how strongly their subordinates perceive pressures to go along with their bosses.

These varying perceptions at different levels in the managerial hierarchy suggest that higher-level managers may not be tuned in to how pressure is perceived at lower levels. There seems to be a gap in the understanding of higher managers and lower managers regarding the pressures toward unethical behavior that exist, especially in the lower echelons. This breakdown in understanding, or lack of sensitivity by top management to how far subordinates will go to please them, can be conducive to lower-level subordinates behaving unethically out of a

real or perceived fear of reprisal, a misguided sense of loyalty, or a distorted concept of their jobs.

A later study of the sources and consequences of workplace pressure was conducted by the American Society of Chartered Life Underwriters & Chartered Financial Consultants and the Ethics Officer Association.⁷⁵ The findings of this study were consistent with the studies reported earlier and provided additional insights into the detrimental consequences of workplace pressure. Among the key findings of this study were the following:

- The majority of workers (60 percent) felt a substantial amount of pressure on the job. More than one out of four (27 percent) felt a “great deal” of pressure.
- Nearly half of all workers (48 percent) reported that, due to pressure, they had engaged in one or more unethical and/or illegal actions during the past year. The most frequently cited misbehavior was cutting corners on quality control.
- The sources most commonly cited as contributing to workplace pressure were “balancing work and family” (52 percent), “poor internal communications” (51 percent), “work hours/workload” (51 percent), and “poor leadership” (51 percent).

The National Business Ethics Survey conducted by the Ethics Resource Center found that the percentage of employees reporting feeling pressure to compromise their standards has remained almost constant over the past seven years.⁷⁶ In a different study, they also found some other insights regarding pressure perceived:⁷⁷

- First-line supervisors and employees were the groups most “at risk” to feel pressure.
- Organizational transitions such as mergers, acquisitions, and restructurings are associated with increased pressure of employees to compromise organizational ethics standards.
- Employees who observe unethical actions more frequently in their organization tend to feel pressure to compromise their ethical standards.
- Employees whose organizations have in place key elements of formal ethics programs feel less pressure to compromise standards.

In addition to the studies that document the extent to which managers feel pressure to perform, even if it leads to questionable activities, several actual business cases demonstrate the reality of cutting corners to achieve high production goals.

Examples of Pressure. In a glass container plant in Gulfport, Mississippi, the plant manager began to fear that top management might close the aging facility because its output was falling behind those of other plants. So, the plant manager secretly started altering records and eventually inflated the value of the plant’s production by 33 percent. Top management learned of this when a janitor acquired documents and reported this bogus information to company auditors.

Ethics in Practice Case

HIGHER GOALS, MORE PRESSURE, LOWER ETHICS?

Recently, I held a position as an inside sales representative for a multinational *Fortune* 500 phone company. My job was to place unsolicited phone calls to people and convince them to switch their local and long-distance calling carrier to my company. As I went through training, I was taught to “sell, sell, sell!” We were told that once we got a customer on the line, we were to not hang up unless we sold him or her a phone package.

There was also a big emphasis on meeting daily sales goals that were set by the company. As soon as I got out of training and on the phone lines, I began to encounter elderly people who had no use for the product. One day, my supervisor noticed that I was not selling the product to everyone that I talked to, and she thought this was the reason I was not meeting my sales goal.

She soon asked why I did not “push” the product more. I told her that the people I was letting off the hook were too old to need anything that the company offered and that they did not even understand half of what I was talking about. She told me that

I should just sell them the product and that the customer service representatives would fix it later.

I asked my mentor what he did in these situations, and he said he just tells the older people that they are getting a smaller package and then “adds on” other features without them noticing. The next time I got an elderly person on the phone, I just told her to have a nice day and then I hung up.

1. What are the ethical issues facing the company and me in this case?
2. Does this illustrate personal-, organizational-, or industry-level ethical issues?
3. Should I succumb to the pressure to meet company goals in these situations?
4. Is it an ethical practice for my company to raise goals continually and expect that people in my position will just “sell” and let customer service “fix” the problems?

Contributed by Joe Popkowski

The plant manager was fired. He was not willing to discuss the matter, but his wife said her husband was under “constant pressure” to raise the plant’s production and that he believed that he and the other employees would have jobs as long as he was able to do so. Later, the company’s president said he had no intention of firing the plant manager for failing to meet the production goal.⁷⁸

Another interesting case involved a big Chevrolet truck plant in Flint, Michigan. Three plant managers installed a secret control box in a supervisor’s office so that they could override the control panel that governed the speed of the assembly line. The plant managers claimed they felt pressure to do this, because top management did not understand that high absenteeism, conveyor breakdowns, and other problems were preventing them from reaching their goals. Once they began using the hidden controls, they began meeting their production goals and winning praise from their superiors. The plant managers claimed they thought top management knew that the plant managers were speeding up the line

and that what the plant managers were doing was unethical. However, top management never said anything, and therefore it was thought that the practice was accepted. The executives denied any knowledge of the secret box. The speed-up was in violation of GM's contract with the United Auto Workers' union. Once it was exposed, the company had to pay \$1 million in back pay to the affected UAW members.⁷⁹

The motive behind managers putting pressure on subordinates to perform, even at the sacrifice of their ethical standards, seems to be driven by the "bottom-line" mentality that places economic success above all other goals. Employees frequently find themselves making compromises as a result of the pressure coupled with the socialization process that emphasizes compliance with the authority structure, the need to conform to their superiors' wishes, and the expectation of loyalty.

Figure 8-6 presents a summary of questionable behaviors and practices of superiors and/or peers that may contribute to an unethical organizational culture.

Figure 8-6 Questionable Behaviors and Practices of Superiors or Peers

Other behaviors of one's superiors and/or peers that create a questionable organizational culture include:

- **Unethical acts, behaviors, or practices.** Some managers simply are not ethical themselves, and this influence wears off on others. Employees watch their superiors' behavior carefully and take cues from them as to what is acceptable.
- **Acceptance of legality as a standard of behavior.** Some managers think that if they are strictly abiding by the law, they are doing the most they ought to do.
- **"Bottom-line" mentality and expectations of loyalty and conformity.** This focus places little value on doing what is right and on being sensitive to other stakeholders.
- **Absence of ethical leadership.** This is a global indicator of sorts that includes some of the other points already mentioned. In addition, management never steps out ahead of the pack and assumes a leadership role in doing what is right. This reflects an absence of moral management.
- **Objectives and evaluation systems that overemphasize profits.** If management sets unrealistic goals or does not take ethics into consideration in evaluating employees, it is creating a potentially destructive environment.
- **Insensitivity toward how subordinates perceive pressure to meet goals.** This is related to several of the previous points. Management must be constantly vigilant of the directives and expectations it is making on employees. The manager might always ask, "How might this goal, directive, or expectation be misread or misunderstood in terms of how far I want people to go to achieve it?"
- **Inadequate formal ethics policies.** Problems here might include inadequate management controls for monitoring and compliance, unreasonable reimbursement/expense policies, and the absence of a clear code of conduct.
- **Amoral decision making.** This includes managers who themselves fail to factor ethical considerations into their actions, decisions, and behaviors. The result of this is a vacuous leadership environment.

IMPROVING THE ORGANIZATION'S ETHICAL CULTURE

Because the behavior of managers has been identified as the most important influence on the ethical behavior of organization members, it should come as no surprise that most actions and strategies for improving the organization's ethical culture must originate from top management and other management levels as well. The process by which these kinds of initiatives have taken place is often referred to as "institutionalizing ethics" into the organization.⁸⁰

Today, the emphasis is not just on institutionalizing ethics programs, however. It is more about creating an ethical organizational culture or climate, one in which ethical behavior and policies are displayed, promoted, and rewarded. If ethics initiatives are not supported by the surrounding organizational culture, they have less of a chance of succeeding. One of the key findings of the 2005 National Business Ethics Survey was that formal ethics and compliance programs do have an impact, but the organization's culture is more influential in producing results.⁸¹ "Organizational culture" refers to shared values, beliefs, behaviors, and ways of doing things.⁸² Part of the culture is driven by formal systems, but much of it is carried on by informal systems. One fact is certain: an ethical culture can only be created and survive if it has the endorsement and leadership of top management, and today, this embraces the board of directors as well.

Compliance vs. Ethics Orientation

An organization with a culture of ethics today is most likely a mixture of an emphasis on compliance and on such values as integrity or ethics. Early efforts of companies were to avert corporate crime. Compliance emphases took a huge step forward when the Organizational Sentencing Guidelines were introduced in 1991 and revised in 2004. The Sentencing Guidelines began a partnership between companies and the federal government to prevent and deter corporate illegal/unethical practices.⁸³ The Sentencing Guidelines were created by the U.S. Sentencing Commission, which is an independent agency of the judicial branch of the federal government. The guidelines gave companies incentives for creating strong compliance and ethics programs. It is little wonder, then, that we have seen such programs grow and become vital parts of companies' corporate cultures.

Today there is an ongoing discussion as to whether a compliance-orientation or an ethics-orientation should prevail in companies' ethics programs. Historically, there has been more emphasis placed on legal compliance than ethics. Recently, however, there has been much concern raised with the restrictiveness of a compliance focus. Several concerns articulated about the compliance focus have been set forth.⁸⁴ First, a pure compliance focus could undermine the ways of thinking or habits of mind that are needed in ethics thinking. Ethics thinking is more philosophical or principles-based while compliance thinking is more rule-bound. Second, it has been argued that compliance can squeeze out ethics. An organization can become so focused on following the law that ethics considerations no longer get factored into discussions. Third, the issue of "false consciousness" has been raised. This means that managers may become accustomed to addressing

issues in a mechanistic, rule-based way, and this may cause them to not consider tougher issues that a more ethics-focused approach might require.⁸⁵

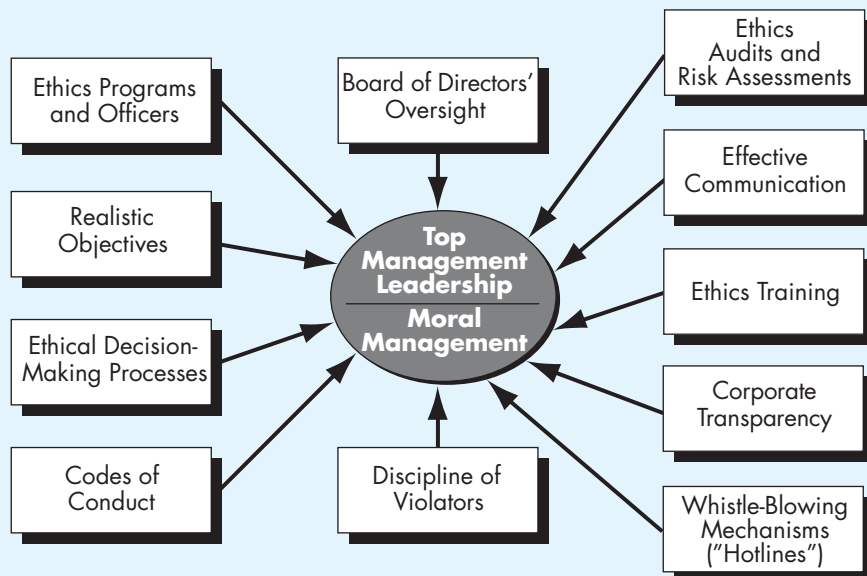
Because of the rule of law and growing litigation, a compliance focus cannot be eliminated. The current trend, however, is toward developing organizational cultures and programs that aspire to be ethics-focused. The importance of both was emphasized in the observation that the ethics perspective is needed to give a compliance program “soul,” while compliance features may be necessary to give ethics programs more “body.”⁸⁶ In short, both are essential.

In this section, we will consider some of the best practices that managers have concluded are vital to improving their organizations’ ethical culture or climate. Figure 8-7 depicts a number of best practices for creating such an ethical organization. Top management leadership is at the hub of these initiatives, actions, or practices. Board of director oversight has become especially vital in the post-Enron business climate.

Top Management Leadership (Moral Management)

It has become a cliché, but this premise must be established at the outset: *The moral tone of an organization is set by top management.* A recent poll of communication professionals found that more than half believed that top management is an organization’s conscience.⁸⁷ This is because managers and employees look to their bosses at the highest levels for their cues as to what is acceptable practice.

Figure 8-7 *Best Practices for Improving an Organization’s Ethical Climate or Culture*



Ethics in Practice Case

THE ANONYMOUS CEO: STRONG OR WEAK ETHICAL LEADER?

John Mackey, CEO of Whole Foods, the country's No. 1 natural and organic grocery store chain, was exposed in July 2007 of having written more than 1,300 anonymous postings on a web-based Yahoo! Finance stock forum between 1999 and 2006. His messages on the discussion forum bashed competitors and praised his own company.

Whole Foods is a giant firm, with thirty-nine thousand employees spread over 196 stores in the United States, Canada, and the United Kingdom. At the end of fiscal 2006, the company's gross profit margin was 35 percent, compared with 24 percent at Kroger and 29 percent at Safeway. It had sales of \$5.6 billion.

Mackey, who took on the pseudonymous name "Rahodeb" (an anagram of his wife's name, Deborah), was "outed" by an FTC court filing in July 2007. The Securities and Exchange Commission began an examination of the CEO's postings to determine if he broke any laws. Interestingly, Mackey's alter ego was exposed by the FTC, which filed a lawsuit seeking to block Whole Foods' planned purchase of Wild Oats, its main competitor, on antitrust grounds.

Mackey apologized to the Whole Foods' board for his actions. The board announced it would begin an internal investigation of the matter.

In some postings, Mackey (as Rahodeb) bashed Wild Oats, criticizing their former CEO for lack of vision, while noting that it wasn't a profitable company. In a February 2005 posting, Rahodeb apparently wrote with some delight that Wild Oats was going to have to restate its earnings. Rahodeb went on to say that OATS had been misleading its investors for years and that the company was headed for shareholder litigation. He also questioned OATS leadership by raising questions about its competence and integrity. In spite of these comments, Whole Foods began an effort to acquire Wild Oats, its main rival, in February 2007, but the FTC was seeking to block this purchase on antitrust grounds.

In a public statement posted on Whole Food's website, Mackey claimed that his anonymous postings did not reflect his or his company's policies or beliefs and that some of the views of Rahodeb did not even match his own beliefs.

A few antitrust experts say that some of Mackey's Yahoo! messages could hurt his company's case and be used against him if they support the view that the health-food market is a distinct market, separate from the mainstream grocery market. The FTC was trying to argue that the health-food market was distinct and that the acquisition would increase concentration in that narrow market and drive up prices. Some experts on corporate governance and others who serve as image consultants have held that Mackey's exposure may cause the company's board to question his leadership abilities. It was announced in August 2007 that Whole Foods Market had completed its acquisition of Wild Oats, after months of delays by the antitrust authorities.

Mackey explained that he had made the online comments anonymously because he had fun doing it. Some of his defenders have said that his comments were never intended to disclose insider information or to move stock prices.

1. Were Mackey's actions more representative of a strong, moral leader or a weak, uncertain leader? What insights into his character are revealed by this episode? Is it ethical for a CEO to engage in such deceptions?
2. Do you see Mackey's actions as positive, negative, or indifferent in terms of setting a strong ethical tone for his company?
3. Were Mackey's deceptions just a harmless, fun activity, or do they have harmful implications for Whole Foods in the future?

Sources: David Kesmodel and Jonathan Eig, "A Grocer's Brash Style Take Unhealthy Turn," *Wall Street Journal* (July 20, 2007), A1; Greg Farrell and Paul Davidson, "Whole Foods' CEO was a Busy Guy Online," *USA Today* (July 12, 2007); Shelly Banjo, "For Regulars Posters on Whole Foods Board, A Dramatic Twist," *Wall Street Journal* (July 18, 2007).

A former chairman of a major steel company stated it well: “Starting at the top, management has to set an example for all the others to follow.”⁸⁸ Top management, through its capacity to set a personal example and to shape policy, is in the ideal position to provide a highly visible role model. The authority and ability to shape policy, both formal and implied, forms one of the vital aspects of the job of any leader in any organization. This aspect of becoming a moral manager has been referred to as “role modeling through visible action.” Effective moral managers recognize that they live in a fishbowl and that employees are watching them for cues about what’s important.⁸⁹ There are ample examples of both weak and strong ethical leadership in business practice today.

Weak Ethical Leadership. An example of weak ethical leadership (or role modeling) was found in one of the authors’ consulting experiences, in which a long-time employee in a small company was identified as having embezzled about \$20,000 over a 15-year period. When the employee was approached and questioned as to why she had done this, she explained that she thought it was all right because the president of the company had led her to believe it was by his actions. She further explained that any time during the fall, when the leaves had fallen in his yard and he needed them raked, he would simply take company personnel off their jobs and have them do it. When the president needed cash, he would take it out of the company’s petty cash box or get the key to the soft drink machine and raid its coin box. When he needed stamps to mail his personal Christmas cards, he would take them out of the company stamp box. The woman’s perception was that it was all right for her to take the money because the president did it frequently. Therefore, she thought it was an acceptable practice for her as well.

Strong Ethical Leadership. An example of positive ethical leadership may be seen in the case of a firm that was manufacturing vacuum tubes. One day, the plant manager called a hurried meeting to announce that a sample of the tubes in production had failed a critical safety test. This meant that the batch of ten thousand tubes was of highly questionable safety and performance. The plant manager wondered out loud, “What are we going to do now?” Ethical leadership was shown by the vice president for technical operations, who looked around the room at each person and then declared in a low voice, “Scrap them!” According to a person who worked for this vice president, that act set the tone for the corporation for years, because every person present knew of situations in which faulty products had been shipped under pressures of time and budget.⁹⁰

Each of these cases provides a vivid example of how a leader’s actions and behavior communicated important messages to others in the organization. In the absence of knowing what to do, many employees look to the behavior of leaders for their cues as to what conduct is acceptable. In the second case, another crucial point is illustrated. When we speak of management providing ethical leadership, it is not just restricted to top management. Vice presidents, plant managers, supervisors, and, indeed, all managerial personnel share the responsibility for ethical leadership.

Two Pillars of Leadership. It has been argued that a manager's reputation for ethical leadership is founded on two pillars: perceptions of the manager as both a moral person *and* as a moral manager. Being a *moral person* is composed of three major attributes: traits, behaviors, and decision making. Important traits are stable personal attributes such as integrity, honesty, and trustworthiness. Critical behaviors—what you do, not what you say—include doing the right thing, showing concern for people, being open, and being personally moral. Decision making of the moral person needs to reflect a solid set of ethical values and principles. In this activity, the manager would hold to values, be objective/fair, demonstrate concern for society, and follow ethical decision rules.⁹¹

The second pillar is being a *moral manager*, a concept we developed in the previous chapter. According to researchers, moral managers recognize the importance of proactively putting ethics at the forefront of their ethical agenda. This involves three major activities. First, the moral manager must engage in *role modeling* through visible action. An emphasis is placed on visible action—action that can be witnessed by others. Second, the moral manager *communicates about ethics and values*. This is to be done in a way that explains the values that guide important actions. Third, the moral manager needs to *use rewards and discipline effectively*. This is a powerful way to send signals about desirable and undesirable conduct.⁹²

In a period in which the importance of a sound corporate culture has been strongly advocated, ethical leaders must stress the primacy of integrity and morality as vital components of the organization's culture. There are many different ways and situations in which management needs to do this. In general, management needs to create a climate of moral consciousness. In everything it does, it must stress the importance of sound ethical principles and practices.

Ethical Leadership Characteristics. Following are 10 facets of strong ethical leadership that have been put forth by Ed Freeman and Lisa Stewart as a framework for understanding what ethical leadership should mean in organizations.

Ethical leaders should:⁹³

- Articulate and embody the purpose and values of the organization
- Focus on organizational success rather than on personal ego
- Find the best people and develop them
- Create a living conversation about ethics, values, and the creation of value for stakeholders
- Create mechanisms of dissent
- Take a charitable understanding of others' values
- Make tough calls while being imaginative
- Know the limits of the values and ethical principles they live
- Frame actions in ethical terms
- Connect the basic value proposition to stakeholder support and societal legitimacy

The leader must infuse the organization's climate with values and ethical consciousness, not just run a one-person show. This point is made vividly clear in the following observation: "Ethics programs which are seen as part of one manager's management system, and not as a part of the general organizational process, will be less likely to have a lasting role in the organization."⁹⁴ In short, ethics is about leadership as much or more than it is about programs.

Effective Communication

Management also carries a heavy burden in terms of providing ethical leadership in the area of effective communication. We have seen the importance of communicating through acts, principles, and organizational climate. We will discuss further the communication aspects of setting realistic objectives, codes of conduct, and the decision-making process. Here, however, we want to stress the importance of communication principles, techniques, and practices.

Conveying the importance of ethics through communication includes both written and verbal forms of communication. In each of these settings, management should operate according to certain key ethical principles. Candor, fidelity, and confidentiality are three very important principles. *Candor* requires that a manager be forthright, sincere, and honest in communication transactions. In addition, it requires the manager to be fair and free from prejudice and malice in the communication. *Fidelity* in communication means that the communicator should be faithful to detail, should be accurate, and should avoid deception or exaggeration. *Confidentiality* is a final principle that ought to be stressed. The ethical manager must exercise care in deciding what information she or he discloses to others. Trust can be easily shattered if the manager does not have a keen sense of what is confidential in a communication.

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BUSINESS ETHICS AT TEXAS INSTRUMENTS

Among business ethics professionals, Texas Instruments (TI) is recognized as an outstanding leader. The TI Ethics Office volunteers its own experience and expertise in helping other ethics offices in their start-up. Members of the TI Ethics Office have been very active in professional ethics organizations.

The Director of Ethics at TI makes sure that all of the company guidelines remain aligned with ethical standards. The director's reporting chain is through an oversight group, the TI Ethics Committee, which reports to the Audit Committee of the Board of

Directors. The TI Ethics Director is also responsible for updating the TI Ethics Committee, the Audit Committee of the Board of Directors, and the president and CEO on a regular basis.

On its webpage, TI summarizes for everyone to see its statement of values and ethics, its code of business conduct, and its compliance procedures, policies, and rules.

To learn more about business ethics at TI, check out its webpage at: <http://www.ti.com/corp/docs/company/citizen/ethics/index.shtml>.

Ethics Programs and Ethics Officers

In recent years, many companies have begun creating **ethics programs** within their organizations. These programs frequently embrace both compliance and ethics. Ethics programs are typically organizational units that have been assigned the responsibility for ethics initiatives in the organization. According to national surveys conducted, ethics programs typically include the following features:⁹⁵

- written standards of conduct,
- ethics training,
- mechanisms to seek ethics advice or information,
- methods for reporting misconduct anonymously,
- disciplinary measures for employees who violate ethical standards, and the
- inclusion of ethical conduct in the evaluation of employee performance.

A key finding of the 2005 National Business Ethics Survey conducted by the Ethics Resource Center was that ethics programs are increasing in number and that they do make a difference. The survey disclosed that the impact of ethics programs depends somewhat on the culture in which they are implemented. The study found that the more formal program elements, the better; formal programs make more of a difference in weak ethical cultures; and, once a strong culture has been established, the formal programs do not have as much impact on results.⁹⁶

Figure 8-8 summarizes the elements that ought to exist in companies' ethics programs in order to comply with the U.S. Sentencing Commission's Organizational Guidelines. Two major benefits accrue to organizations that follow these guidelines. First, following the guidelines mitigates severe financial and oversight penalties. Second, some prosecutors are choosing not to pursue some actions when the companies in question already have sound programs in place if they follow these guidelines.⁹⁷

Ethics Officers. Ethics programs are often headed by an **ethics officer** who is in charge of implementing the array of ethics initiatives of the organization. In some cases, the creation of ethics programs and designation of ethics officers have been in response to the Federal Sentencing Guidelines, which reduced penalties to those companies with ethics programs that were found guilty of ethics violations.⁹⁸ More recently, companies have created ethics programs and ethics officers because of the 2002 Sarbanes-Oxley law.

Many companies started ethics programs as an effort to centralize the coordination of ethics initiatives in those companies. Many ethics programs and ethics officers initially got started with compliance issues. Only later, in some cases, did ethics or integrity become a focal point of the programs. As suggested earlier, most ethics programs and ethics officers have major corporate responsibility for both legal compliance and ethics practices, and there is some debate whether they should be called compliance programs or ethics programs.⁹⁹ Major companies that do a lot of their business with the government, such as the defense

Figure**8-8****Key Elements of Effective Ethics Programs**

The U.S. Sentencing Commission has identified eight key elements that companies must have in their ethics programs to satisfy the commission's regulatory review. If a company has these key elements in its ethics program, it will be dealt with less harshly should violations arise. Benefits should extend beyond compliance to ethics.

Compliance Standards. Companies are expected to have established compliance standards, which are a key part of detecting and preventing violations of the law. The development of a code of conduct is an initial step in this process. A set of ethical principles that guide decision making will strengthen these standards.

High-Level Ethics Personnel. Companies must assign compliance and ethics programs to senior executives. This person, perhaps called an *ethics officer*, must have the authority, responsibility, and resources to achieve ethics goals.

Avoidance of Delegation of Undue Discretionary Authority. Companies have a responsibility to make sure they do not delegate undue discretionary authority (e.g., access to company funds, investor information, authority to bind the company to contracts) to individuals who cannot be trusted with such authority. Someone convicted of a previous felony involving company funds would be an example. Background checks are, thus, becoming much more essential in screening employees.

Effective Communication. Standards and procedures must be effectively communicated. The company has a responsibility to make sure all personnel are aware of ethics codes, standards, policies, and practices. One major way to achieve this communication is through the conduct of ethics training programs.

Systems for Monitoring, Auditing, and Reporting. Companies are expected to have systems and procedures in place for assessing compliance. This may involve a variety of monitoring and auditing systems and reporting systems as well. In other words, companies must take reasonable steps to ensure that compliance is taking place.

Enforcement. Companies are expected to have systems in place to ensure the consistent enforcement of compliance standards. The purpose here is to make sure that everyone is following standards. A high-level executive cannot be treated differently than a low-level executive.

Detecting Offenses, Preventing Future Offenses. Once an offense has been detected, several actions need to happen. If there is an actual violation of the law, the company is expected to self-report the offense and actions taken to resolve the issue. The company needs to take further reasonable measures to prevent a similar offense from occurring in the future. The responsible person should be disciplined appropriately. Finally, the company is expected to accept responsibility for the offense as part of good corporate citizenship efforts.

Keeping Up with Industry Standards. Companies are expected, through ethics offices or programs, to keep up with industry practices and standards. This can be done by membership in national or local organizations. At the national level, an example would be the Ethics Officer Association (<http://www.eoa.org>). Many large cities also have their own such organizations. These organizations have as their major purpose the advancement of sound compliance and ethics programs.

Source: U. S. Sentencing Commission Guidelines (<http://www.uscc.gov>).

contractors, continue to emphasize compliance. Others have more of a balance between compliance and ethics.

Just as ethics programs have proliferated in companies, the number of ethics officers occupying important positions in major firms has grown significantly.

There are now two major professional organizations that ethics officers may join: Ethics & Compliance Officer Association (ECO) and the Society of Corporate Compliance & Ethics (SCCE). The nearby Search the Web feature provides further information about each.

Ethics officers have proliferated in the post-Enron era and with the passage of the Sarbanes-Oxley Act of 2002.¹⁰⁰ According to recent data, ethics officers are now in place at 62 percent of the *Fortune* 500 companies.¹⁰¹ Since the passage of the Sarbanes-Oxley Act, the Ethics & Compliance Officer Association claims its membership has doubled to more than 1,250.¹⁰² It has become fairly fashionable these days for companies to add ethics officers to their list of management positions, but unfortunately these new positions are little more than window dressing in some companies.¹⁰³

http://SEARCH THE WEB WEB

MAJOR PROFESSIONAL ORGANIZATIONS FOR ETHICS OFFICERS

Two major organizations serve companies that have ethics programs and ethics officers. The first is the Ethics & Compliance Officer Association (ECO). The second is the Society of Corporate Compliance & Ethics (SCCE).

ETHICS & COMPLIANCE OFFICER ASSOCIATION (ECO)

The Ethics & Compliance Officer Association is a non-consulting, member-driven association exclusively for individuals who are responsible for their organization's ethics, compliance, and business conduct programs. According to its webpage, the ECO is committed to:

- Being the leading provider of ethics, compliance, and corporate governance resources to ethics and compliance professionals worldwide.
- Providing members with access to an unparalleled network of ethics and compliance professionals and a global forum for the exchange of ideas and strategies.

The ECO claims more than 1,300 members. To learn more about it, check out its webpage: <http://www.theecoa.org>.

SOCIETY OF CORPORATE COMPLIANCE & ETHICS (SCCE)

According to its webpage, the Society of Corporate Compliance & Ethics (SCCE) is dedicated to improving the quality of corporate governance, compliance, and ethics. SCCE's roles include:

- Facilitating the development and maintenance of compliance programs;
- Providing a forum for understanding the complicated compliance environment; and
- Offering tools, resources, and educational opportunities for those involved with compliance.

SCCE claims a membership base of nearly 600 U.S. and International members. More information about SCCE may be found on its webpage: <http://www.corporatecompliance.org/>.

Raising the Status of Ethics Officers. One concern that has been noted by some ethics officers has been the tendency of some companies to slide the ethics officer down the organization chart so that direct access to the highest levels of organizational leadership has been decreasing. In other words, the organizational status of the ethics officer has been diminished in some organizations. Another trend has been for the focus of the ethics officer in some organizations to be “downward”; that is, spending little time working with or helping to manage the ethics of their superiors, but rather focusing on the ethics of lower-level organizational members, not senior management.¹⁰⁴ To reverse these trends, it has been recommended that the ethics office and the ethics officers’ scope of responsibilities be enlarged to embrace the total organization, including senior management. A phrase has been developed for explaining how the ethics officers would work with their superiors. It is called “managing ethics upward.”¹⁰⁵ In light of the rash of ethical scandals involving senior-level executives, this idea is one that has genuine value.

Two examples of how this goal might be achieved include the “bubble up” strategy and the “survey” strategy. The “bubble up” strategy would involve ethics officers using specific cases and questions that had bubbled up from the employees of the organization to involve the senior leadership meaningfully in a good-faith discussion of appropriate courses of action to take. This would help senior leadership see the strong connection between their words and actions and the conduct of their employees. The “survey” strategy would necessitate that a survey be conducted of the entire population of employees, asking questions about their perceptions of the organization’s ethical culture, as well as their perceptions of senior leadership. Senior leadership could then be briefed on the findings and develop action plans for dealing with the results of the survey.¹⁰⁶ Obviously, managing ethics upward is easier to say than to do, and it would need to be handled with diplomacy. Regardless, it poses a valuable idea for getting senior-level executives more involved in the ethics programs of the company.

An encouraging trend in a few companies is to have the ethics officer serve as a highly placed, influential member of the executive team. Such is the case with Patrick J. Gnazzo, the chief compliance and ethics officer for Computer Associates, Inc. Gnazzo is a high-profile, former government lawyer who has been given unprecedented status in his company and has been given free access to both top management and the board of directors. This new breed of ethics officers, such as Gnazzo, is expected to bring about genuine change in corporate behavior because of their lofty status and influence with company decision-makers. Other companies that recently have appointed high-profile ethics officers such as Gnazzo include AIG, Bear Stearns, Bristol-Myers Squibb, KPMG, and Morgan Stanley.¹⁰⁷

As valuable as ethics programs and ethics officers are, there is a downside danger in their existence. By having individuals and organizational units responsible for the company’s “ethics,” there is some possibility that managers may come to “delegate” to these persons/units the responsibility for the firm’s ethics. Ethics is everyone’s job, however, and specialized units and people should not be used as a substitute for the assumption of ethical responsibility by everyone in leadership positions.

Setting Realistic Objectives

Closely related to all ethics initiatives and programs being implemented by top management is the necessity of managers at all levels setting realistic objectives or goals. A manager may quite innocently and inadvertently create a condition leading to unethical behavior on a subordinate's part. Take the case of a marketing manager setting a sales goal of a 20 percent increase for the next year when a 10 percent increase is all that could be realistically expected, even with outstanding performance. In the absence of clearly established and communicated ethical norms, it is easy to see how a subordinate might believe that she or he should go to any lengths to achieve the 20 percent goal. With the goal having been set too high, the salesperson faces a situation that is conducive to unethical behavior in order to please the superior.

Fred T. Allen, a former executive, reinforces this point:

Top management must establish sales and profit goals that are realistic—goals that can be achieved with current business practices. Under the pressure of unrealistic goals, otherwise responsible subordinates will often take the attitude that “anything goes” in order to comply with the chief executive’s target.¹⁰⁸

The point here is that there are ethical implications to even the most routine managerial decisions, such as goal setting. Managers must be keenly sensitive to the possibility of innocently creating situations in which others may perceive a need or an incentive to cut corners or do the wrong thing.

Ethical Decision-Making Processes

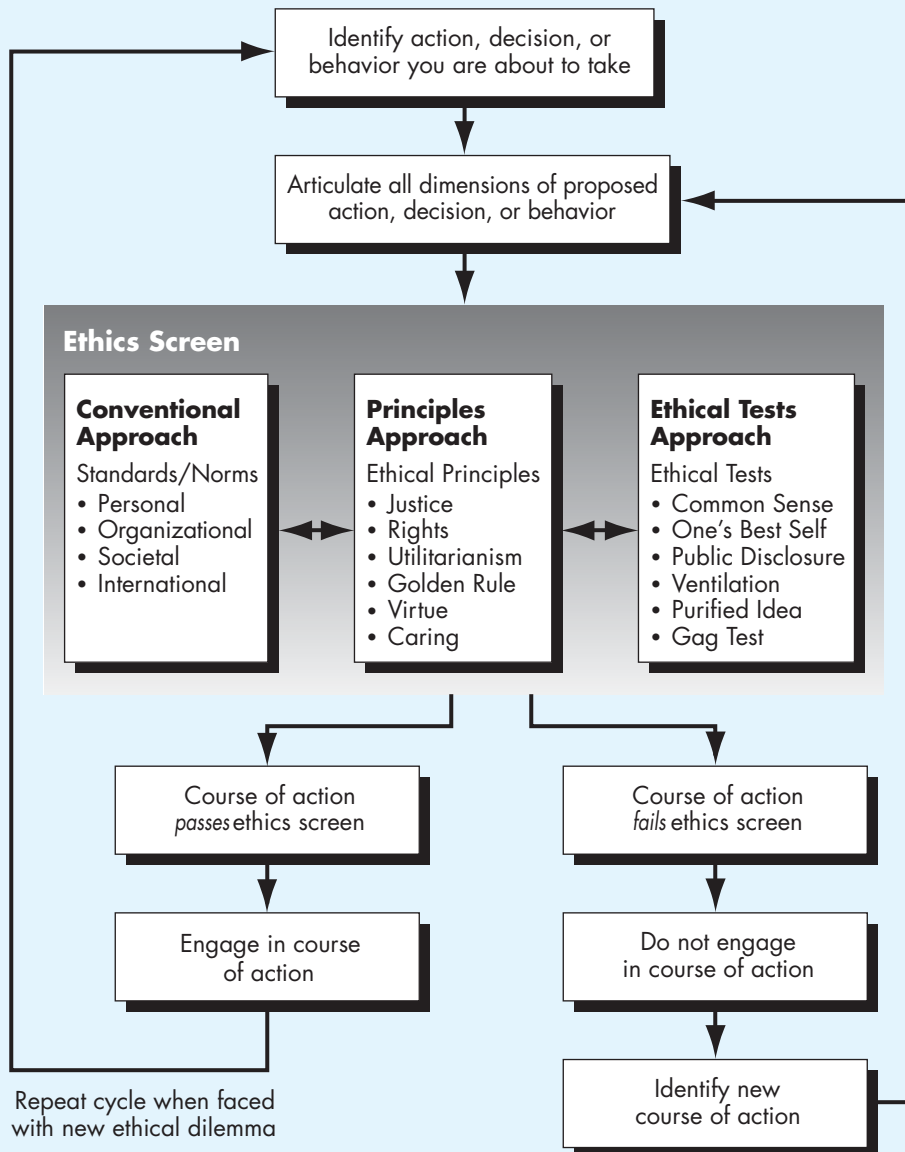
Decision making is at the heart of the management process. If there is any practice or process that is synonymous with management, it is decision making. Decision making usually entails a process of stating the problem, analyzing the problem, identifying the possible courses of action, evaluating these courses of action, deciding on the best alternative, and then implementing the chosen course of action.

Decision making at best is a challenge for management. Many decisions management faces turn out to have ethical implications or consequences. Once we leave the realm of relatively ethics-free decisions (such as which production method to use for a particular product), decisions quickly become complex, and many carry with them an ethical dimension.

Ethical decision making is not a simple process but rather a multifaceted process that is complicated by multiple alternatives, mixed outcomes, uncertain and extended consequences, and personal implications.¹⁰⁹ It would be nice if a set of ethical principles were readily available for the manager to “plug in” and walk away from, with a decision to be forthcoming. However, such was not the case when we discussed principles that help personal decision making, and it is not the case when we think of organizational decision making. The ethical principles we discussed earlier are useful here, but there are no simple formulas revealing easy answers.

Although it is difficult to portray graphically the process of ethical decision making, it is possible as long as we recognize that such an effort cannot totally capture reality. Figure 8-9 presents one conception of the ethical decision-making

Figure 8-9 *A Process of Ethical Decision Making*



process. In this model, the individual is asked to identify the action, decision, or behavior that is being considered and then to articulate all dimensions of the proposed course of action. Next, the individual is asked to subject the course of

action to what we call an *ethics screen*. An ethics screen consists of several select standards against which the proposed course of action is to be compared. The idea is that unethical actions will be “screened out” and that ethical actions will be “screened in.” In the illustrated ethics screen, we reference our earlier discussion of the conventional approach (embodying standards/norms), the principles approach, and the ethical tests approach to ethical decision making. By using all or a combination of these ethical standards, it is expected that more ethical decisions will be made than otherwise.

In this model, it is left up to the individual to determine what mix of guidelines to use as the ethics screen. Normally, some combination of the guidelines contained in the screen would be helpful to the manager who truly is attempting to make an ethical decision. If the proposed course of action *fails* the ethics screen, the decision-maker should not engage in the course of action but should consider a new decision, behavior, or action and submit it to this same process. If the proposed course of action *passes* the screen (the decision-maker has determined it to be an ethical course of action), she or he should engage in the action, decision, or behavior and then repeat the cycle only when faced with a new ethical dilemma.

Another useful approach to making ethical decisions is to ask and answer a series of simple questions systematically. It should quickly be realized that this approach is similar to the ethical tests approach presented earlier in the chapter.

Ethics Check. One well-known set of questions merits mention here because of its popularity in the book *The Power of Ethical Management*.¹¹⁰ The “ethics check” questions are as follows:

1. *Is it legal?* Will I be violating either civil law or company policy?
2. *Is it balanced?* Is it fair to all concerned in the short term as well as the long term? Does it promote win-win relationships?
3. *How will it make me feel about myself?* Will it make me proud? Would I feel good if my decision was published in the newspaper? Would I feel good if my family knew about it?

Ethics Quick Test. Using a brief set of questions to make ethical decisions has become popular in business. For example, Texas Instruments has printed its seven-part “Ethics Quick Test” on a wallet card its employees may carry. The test’s seven questions and reminders are as follows:¹¹¹

1. Is the action legal?
2. Does it comply with our values?
3. If you do it, will you feel bad?
4. How will it look in the newspaper?
5. If you know it’s wrong, don’t do it.
6. If you’re not sure, ask.
7. Keep asking until you get an answer.

Sears' Guidelines. In its Code of Business Conduct, Sears, Roebuck and Co. sets forth its five "Guidelines for Making Ethical Decisions," which are:¹¹²

1. Is it legal?
2. Is it within Sears' shared beliefs and policies?
3. Is it right/fair/appropriate?
4. Would I want everyone to know about this?
5. How will I feel about myself?

These sets of practical questions presented here are intended to produce a process of ethical inquiry that is of immediate use and understanding to a group of employees and managers. Note that many of the items are similar or identical to points raised earlier in the ethical tests approach. These questions help ensure that ethical due process takes place. They cannot tell us for sure whether our decisions are ethical or not, but they can help us be sure that we are raising the appropriate issues and genuinely attempting to be ethical.

Codes of Conduct

Top management has the responsibility for establishing standards of behavior and for effectively communicating those standards to all managers and employees in the organization. One of the traditional ways by which companies and ethics officers have fulfilled this responsibility is through the use of **codes of ethics**, or **codes of conduct**. Codes of ethics are a phenomenon of the past 25 years. More than 95 percent of all major corporations have them today, and the central questions in their usefulness or effectiveness revolve around the managerial policies and attitudes associated with their use.¹¹³

Ethics codes vary considerably from company to company, but research suggests that the larger the company, the more likely it is that it will have a code of conduct. Length is one attribute. Beyond length, ethics codes vary in their focus, level of detail, thematic content, and tone.¹¹⁴ Companies may also develop their codes based upon geography. Levi Strauss and Co. and Caterpillar have worldwide codes of ethics. Johnson & Johnson has a worldwide credo. McDonald's has worldwide standards of best practices. Firms that operate in the domestic market have codes that reflect more local concerns.¹¹⁵

A survey of corporate officers by the Ethics Resource Center, a nonprofit organization based in Washington, DC, revealed several of the *values or benefits* that business organizations received as a result of their codes of ethics. The results achieved and the percentages of executives citing the reasons give us insights into what companies really think they get from corporate ethics codes:¹¹⁶

1. Legal protection for the company (78 percent)
2. Increased company pride and loyalty (74 percent)
3. Increased consumer/public goodwill (66 percent)
4. Improved loss prevention (64 percent)
5. Reduced bribery and kickbacks (58 percent)

6. Improved product quality (14 percent)
7. Increased productivity (12 percent)

According to the Ethics Resource Center, the content of corporate codes typically addresses the following topics:¹¹⁷

- Employment Practices
- Employee, Client, and Vendor Information
- Public Information/Communications
- Conflicts of Interest
- Relationships with Vendors
- Environmental Issues
- Ethical Management Practices
- Political Involvement

There have been both successes and failures reported with organizational codes of conduct, but the acid test seems to be whether or not such codes actually become “living documents,” not just platitudinous public relations statements that are put into a file drawer upon dissemination. Codes may not be a panacea for management, but when properly developed and administered, they serve to raise the level of ethical behavior in the organization by clarifying what is meant by ethical conduct and encouraging moral behavior.

A major study of the effectiveness of corporate codes found that there is a relationship between corporate codes and employee behavior in the workplace, particularly to the degree that employees perceive the codes to be implemented strongly and embedded in the organizational culture. Therefore, when codes are

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AFLAC'S CODE OF CONDUCT

Aflac, a *Fortune* 500 company, is a leading writer of voluntary insurance coverage marketed at the work site in the United States and abroad. In 2007, Aflac was named to *Fortune* magazine's list of the 100 Best Companies to Work For in America for the ninth consecutive year. In March 2007, *Fortune* magazine named Aflac to its list of America's Most Admired Companies for the seventh consecutive year. In May 2007, Aflac was named one of the World's Most Ethical Companies by *Ethisphere* magazine.

According to Aflac's CEO, Dan Amos, the company Code of Business Conduct and Ethics is a formal statement of the ethical and legal conduct, and commonsense standards, that sets the tone for all of Aflac's business activities. The goal is to conduct business in a framework of integrity of which the company can be proud.

To view Aflac's Code of Conduct, check out the company webpage: <http://www.aflac.com>. Follow the path to *Investor Relations*, *Corporate Governance*, and then *Code of Conduct*.

implemented forcefully and embedded strongly in the culture, reports of unethical employee behavior tend to be lower.¹¹⁸

Ways of Perceiving Codes. A major study of corporate codes by Mark Schwartz revealed that there are a number of different ways in which employees perceive or understand codes of conduct.¹¹⁹ Schwartz's research yielded eight themes or metaphors that helped to explain how codes influence behavior within organizations.

1. As a *rule book*, the code acts to clarify what behavior is expected of employees.
2. As a *signpost*, the code can lead employees to consult other individuals or corporate policies to determine the appropriateness of behavior.
3. As a *mirror*, the code provides employees with a chance to confirm whether their behavior is acceptable to the company.
4. As a *magnifying glass*, the code suggests a note of caution to be more careful or engage in greater reflection before acting.
5. As a *shield*, the code acts in a manner that allows employees to better challenge and resist unethical requests.
6. As a *smoke detector*, the code leads employees to try to convince others and warn them of their inappropriate behavior.
7. As a *fire alarm*, the code leads employees to contact the appropriate authority and report violations.
8. As a *club*, the potential enforcement of the code causes employees to comply with the code's provisions.¹²⁰

In summary, the code metaphors provide insights into a number of ways in which codes are perceived or viewed by organizational members.

Disciplining Violators of Ethics Standards

To bring about an ethical climate that all organizational members will believe in, management must discipline violators of its accepted ethical norms and standards. A major reason the general public, and even employees in many organizations, have questioned business's sincerity in desiring a more ethical environment has been business's unwillingness to discipline violators. There are numerous cases of top management officers who behaved unethically and yet were retained in their positions. At lower levels, there have been cases of top management overlooking or failing to penalize unethical behavior of subordinates. These evidences of inaction on management's or the board's part represent implicit approval of the individual's behavior.

It has been argued that an organization should respond forcefully to the individual who is guilty of deliberately or flagrantly violating its code of ethics: "From the pinnacle of the corporate pyramid to its base, there can only be one course of action: dismissal. And should actual criminality be involved, there should be total cooperation with law enforcement authorities."¹²¹

Based on their research, Treviño, Hartman, and Brown have argued that “the moral manager consistently rewards ethical conduct and disciplines unethical conduct at all levels in the organization, and these actions serve to uphold the standards and rules.”¹²² The effort on the part of management has to be complete in communicating to all, by way of disciplining offenders, that unethical behavior will not be tolerated in the organization. It is management’s tacit approval of violations that has seriously undermined efforts to bring about a more ethical climate in many organizational situations.

A recent, highly visible example of this point was the discharge by Boeing Co. of its chief financial officer and another senior manager for engaging in what it called unethical behavior. Michael Sears, a 34-year veteran of the industry, had been considered to be a possible successor to then-chairman and CEO Phil Condit. The company said that Mr. Sears and the other senior manager had been dismissed when they tried to conceal their alleged misconduct from a team of lawyers hired by the firm to investigate their actions. At the time of the firing, the CEO said, “When we determine there have been violations of our standards, we will act swiftly to address them, just as we have today.”¹²³ In another highly visible case, Nortel Networks, North America’s largest telecommunications equipment maker, fired its chief executive officer, chief financial officer, and its controller for their involvement in accounting problems that had been under scrutiny. The accounting irregularities resulted in the company having to restate its earnings.¹²⁴ In the post-Enron period, we have witnessed more and more corporate boards even taking disciplinary action with respect to CEO and top management wrongdoing.

Ethics “Hotlines” and Whistle-Blowing Mechanisms

One problem that frequently leads to the covering up of unethical acts by people in an organization is that they do not know how to respond when they observe a questionable practice. An effective ethical culture is contingent on employees having a mechanism for (and top management support of) “blowing the whistle” on or reporting violators. One corporate executive summarized this point as follows: “Employees must know exactly what is expected of them in the moral arena and how to respond to warped ethics.”¹²⁵

According to the 2006 ethics and compliance benchmarking survey conducted by The Conference Board, 78 percent of companies had anonymous reporting systems, sometimes referred to as “hotlines.” Among companies subject to Sarbanes-Oxley provisions, the percentage was 91 percent.¹²⁶ According to a broad-based survey of employees, employees describe various reasons for reporting or not reporting observed violations of ethics. Those who *did* report observations of misconduct gave the following justifications of their actions:¹²⁷

- I thought it was the right thing to do. (99 percent)
- I felt I could count on the support of my coworkers. (76 percent)
- I believed corrective action would be taken. (74 percent)
- I believed that my report would be kept confidential. (71 percent)

- I felt I could count on the support of my supervisor or manager. (68 percent)
- In this same survey, employees were asked why they did *not* report observations of misconduct. These employees gave the following reasons:¹²⁸
- I didn't believe corrective action would be taken. (70 percent)
 - I didn't trust that my report would be kept confidential. (54 percent)
 - I feared retaliation from my supervisor or manager. (41 percent)
 - I feared retaliation from my coworkers. (30 percent)
 - I didn't know who to contact. (16 percent)

Hotlines, it turns out, are the most frequent way employees blow the whistle on fraud or related infractions. Such hotlines may be telephone-, Web-, or e-mail-based. In addition, they are typically used without alerting anyone in management about the problem ahead of time. One study reported in 2007 tracked incidents at 500 organizations over four years and found that 65 percent of the reports were serious enough to warrant further investigation and 46 percent actually led to some type of action being taken.¹²⁹ One expert on ethics said that such anonymous tips are much more effective than internal audits at shedding light on serious problems. It should also be pointed out that even the best systems won't work if they do not have the support of top management and a corporate culture that is conducive to rooting out wrongdoing.¹³⁰

At both NYNEX Corp. and Northrop, for example, hotlines are used whereby employees may phone in their inquiries about the company's ethics code or report suspected wrongdoing. In one recent year, Northrop reported that about 5 percent of the company's thirty-two thousand employees used its hotline. NYNEX also receives thousands of calls per year. At NYNEX, it was estimated that half the callers were seeking information or clarification about the corporate code, whereas only about 10 percent of the callers made allegations of wrongdoing. Ethics officers see this as a positive indication that employees are proacting and trying to head off potential problems before they occur.¹³¹

Hotlines can have a downside risk, however. Ethicist Barbara Ley Toffler argues that the hotlines may do harm. She suspects that many of the reported wrongdoings are false accusations and that if the company does not handle these issues carefully, it may do a lot of damage to morale.¹³²

Business Ethics Training

For many years there was a debate as to whether business ethics training should be conducted. One school of thought argued that ethics is personal, already embedded within the employee or manager and, hence, not alterable or teachable. A growing school of thought, on the other hand, argues that instruction in business ethics should be made a part of management training, executive development programs, and business school education. Today, it is accepted that business ethics training is an essential component of ethics programs.

According to the 2005 ethics and compliance benchmarking survey conducted by The Conference Board, about 77 percent of publicly traded companies try to

educate their employees on the company's standards and policies through publications and training. A growing number of companies are conducting their training by way of Web-based applications.¹³³

An example of a company that employs ethics training is Sun Microsystems in Santa Clara, California. According to its chief compliance officer, Sun needed to go beyond its code of conduct and its business conduct office. The company was feeling pressure, especially from the implementation of the Sarbanes-Oxley corporate reform law, which is increasingly holding executives responsible for what is going on in the company. At the Sun training sessions, referred to as "ethics boot camps," the training is becoming more important and more intense. Sun is now requiring all managers across the globe to undergo ethics training. At the boot camp, one speaker is the company CEO. Other top managers and board members also address the employees. Most of the content is presented in small group settings, and the executives have to wrestle with dozens of case studies in which it was not clear what to do. Upon completion of the training courses, Sun executives and employees are given a binder that includes information on how to share what they have learned with other employees. Also, all Sun employees are now being required to take online ethics courses, offered in eight languages. As a part of the continuous training, Sun is offering refresher courses on a regular basis and has started offering conference calls in which executives in different parts of the world can discuss the ethical dilemmas they are facing and get feedback from others.¹³⁴

What might be the purposes or objectives of ethics training? Several purposes have been suggested:

1. To increase the manager's sensitivity to ethical problems
2. To encourage critical evaluation of value priorities
3. To increase awareness of organizational realities
4. To increase awareness of societal realities
5. To improve understanding of the importance of public image and public/society relations¹³⁵

To this list, we might add some other desirable goals:

6. To examine the ethical facets of business decision making
7. To bring about a greater degree of fairness and honesty in the workplace
8. To respond more completely to the organization's social responsibilities

Materials and formats typically used by firms in their ethics training include the following: ethics codes (as a training device), lectures, workshops/seminars, case studies, films/discussions, and articles/speeches.¹³⁶ One major firm, Lockheed Martin, introduced some humor into its ethics training by introducing the Dilbert-inspired board game, "The Ethics Challenge," for company-wide ethics training. To play the game, players (employees) move around the board by answering "Case File" questions such as, "You've been selected for a training course in Florida, and you want to go only for the vacation." Among the answers and their respective points are: "Go, but skip the sessions" (0 points), "Ask your supervisor if it would be beneficial" (5 points), and, the Dogbert answer, "Wear mouse ears to

work and hum ‘It’s a Small World After All’ all day.” Sessions for the company’s one hundred and eighty-five thousand employees were led by supervisors, not ethics officers. The chairman of the company kicked off the training by leading the training of those who reported to him directly.¹³⁷

One former ethics officer of a major corporation has criticized much ethics training done by companies. He said that most of this training is being done in the form of a mandatory annual compliance exercise, typically one hour in duration. Often, it is a “check the box” exercise in that management can check off that it is completed for the year. He goes on to say that if such training is not done well, it turns out to be indistinguishable from all the other meetings employees have to attend.¹³⁸

In terms of the effectiveness of ethics training, research has shown that exposure to lengthy programs (for example, 10 weeks) resulted in significant improvements in moral development. Brief exposures to business ethics, however, yielded less encouraging results.¹³⁹

Business Roundtable Institute for Corporate Ethics. One of the major limitations of business ethics training has been that the CEO and other top-level managers have been exempted from it. This is starting to change. The Business Roundtable, an organization of CEOs, announced in 2004 that it was developing a business ethics institute targeted toward CEOs. The 150 CEOs who comprise the Business Roundtable will be involved. The institute is scheduled to be held at the Darden School at the University of Virginia. The goal of the institute is to help restore public confidence in the marketplace in light of the recent scandals in business. Through the institute, there will be research conducted, courses created, and lead executive seminars offered on business ethics. Some skeptics are wondering whether this will truly make a difference or not. Some say that CEOs are pretty set in their ways by the time they reach the pinnacle of their organizations. Optimists are withholding judgment until experience indicates whether the new institute will add value or not.¹⁴⁰ Regardless, it is encouraging that CEOs are finally planning to subject themselves to the same kind of training they have always wanted for their subordinates. If ethical leadership truly begins at the top, the institute should provide a useful resource for these organization leaders.

Ethics Audits and Risk Assessments

In increasing numbers, companies today are beginning to appreciate the need to follow up on their ethics initiatives and programs. Ethics audits are mechanisms or approaches by which a company may assess or evaluate its ethical climate or programs. **Ethics audits** are intended to carefully review such ethics initiatives as ethics programs, codes of conduct, hotlines, and ethics training programs. Ethics audits are similar to social audits, discussed in Chapter 4. In addition, they are intended to examine other management activities that may add to or subtract from the company’s initiatives. This might include management’s sincerity, communication efforts, incentive and reward systems, and other management activities. Ethics audits may employ written instruments, committees, and employee interviews.¹⁴¹

Spurred on by the 2004 federal sentencing guidelines, companies are increasingly designing and conducting risk assessments of their operations. **Risk assessments** are review processes designed to identify and monitor conditions and events that may have some bearing on the company's exposure to compliance/misconduct risk and to review company methods for dealing with these concerns. Risk, in this context, is typically focused on the company's exposure to possible compliance, misconduct, and ethics issues. According to recent surveys, the top five subjects of ethics program risk analyses include internal policies and processes, employee awareness and understanding of compliance and ethics issues, anonymous reporting systems, disciplinary systems as prevention tools, and employee intent or incentives.¹⁴²

In addition to providing benefits for legal reasons, the conduct of periodic risk assessments provides internal benefits to management. Some of these include the following: detecting compliance and ethics threats and permitting companies to correct problems before they occur or become worse. If problems are not detected and corrected, they may be discovered by regulators, investors, the media, or potential plaintiffs.¹⁴³

Corporate Transparency

One of the most recent trends toward the improvement of ethics programs is that of **transparency**. **Corporate transparency** refers to a quality, characteristic, or state in which activities, processes, practices, and decisions that take place in companies become open or visible to the outside world. The opposite of transparency is **opacity**, or an opaque condition in which activities and practices remain obscure or hidden from outside scrutiny and review.

Pressures toward transparency have come both from without and within companies. From the outside, various stakeholders such as consumers, environmentalists, government, and investors want to know more clearly what is going on within the organizations. The recent business scandals have served as an added outside force. Following these, the Sarbanes-Oxley Act now mandates greater transparency. Transparency leads to accountability. From the inside, companies are increasingly seeing how transparency makes sense as an ethical practice. According to Pagano and Pagano in their book *The Transparency Edge: How Credibility Can Make or Break You in Business*, a transparent management approach—“what you see is what you get” code of conduct—will increase your company's credibility in the marketplace, build loyalty, and help you gain the trust and confidence of those with whom you work.¹⁴⁴

Another important recent book on transparency is titled *The Naked Corporation: How the Age of Transparency Will Revolutionize Business*, by Tapscott and Ticoll. They argue that corporate transparency, today, is not optional but inevitable. They say companies should “undress for success.”¹⁴⁵ As companies become more open enterprises, the public and other stakeholders will come to trust them more because more will be exposed to view.

A major example that Tapscott and Ticoll point to is that of Chiquita Brands International, which was exposed for a variety of questionable practices such as

using pesticides despite an environmental agreement, secretly controlling dozens of supposedly independent banana companies, bribery, and lax security, such that company boats were being used to smuggle drugs. Chiquita's reaction to this exposure was to turn the company around through a policy of corporate transparency, especially visible in its corporate social responsibility report. The CSR report began to explain the results of external audits and employee surveys, helped the company get through bankruptcy proceedings, and helped regain public trust. The authors argue a point we have made previously, that it all starts at the top. Open leadership is one of the strongest forces behind transparency.¹⁴⁶

Board of Director Leadership and Oversight

One would think that oversight and leadership of ethics initiatives by the boards of directors of businesses would be a "given." That has not been the case, however, in most instances. The primary impetus for board involvement in and oversight of ethics programs and initiatives has been the mega-scandals of the past five years that have impacted many major companies. This has been coupled with the passage of the Sarbanes-Oxley Act, which has overhauled federal securities laws to improve corporate governance. We covered corporate governance in detail in Chapter 4, but here we should comment on the board's role in oversight of corporate ethics, one of the hottest issues in recent years.

Corporate boards, like top managers, should provide ethical leadership. Former SEC chair William Donaldson said that it is not enough for a company to profess a code of conduct. According to Donaldson, "The most important thing that a board of directors should do is determine the elements that must be embedded in the company's moral DNA."¹⁴⁷ In other words, strong leadership from the board and CEOs is still the most powerful force in improving the company's ethical culture.

Two specific areas covered in the Sarbanes-Oxley Act address the board's role in corporate ethics. First, companies are now required to make provisions for employees to report observed or suspected wrongdoing without fear of retaliation. Companies are now required to protect whistle-blowers, and criminal penalties may be issued to managers who ignore this provision. Companies are expected to have a formal policy that addresses such complaints, and the board should investigate all complaints and rectify issues as necessary.¹⁴⁸ The whistle-blowing mechanisms discussed earlier are now institutionalized by law. Second, the Sarbanes-Oxley Act makes it a crime to alter, destroy, conceal, cover up, or falsify any document to prevent its use in a federal government lawsuit or proceedings. This new provision came about because of the well-publicized Arthur Andersen debacle, which involved document shredding. Document management initiatives have now become critical in companies, and one of the most debated areas is the handling of e-mails.¹⁴⁹ Sarbanes-Oxley introduced other important provisions for bringing about more effective controls and preventing fraud, but the previously mentioned items are especially important in terms of ethics oversight.

According to the 2005 ethics and compliance benchmarking survey conducted by The Conference Board, board involvement in ethics programs has risen to 96 percent of companies surveyed.¹⁵⁰ According to a different survey of 165 company boards, it is reported that although corporate scandals and Sarbanes-Oxley have been strong forces in bringing about more board involvement in ethics, other factors have motivated it as well. In the United States, general legal developments have increased board scrutiny of ethics programs, but in the United Kingdom, India, and Western Europe, “enhancement of reputation” was often cited as a reason for closer board scrutiny of corporate ethics. There is also widespread enthusiasm for training board members in ethics, but such enthusiasm does not often result in action.¹⁵¹

Although we have not touched on all that can be done at the organizational level to improve or manage business ethics, the actions suggested represent best practices that can move management a long way toward improving the organization’s ethical culture and climate. If management takes specific steps as suggested, many behaviors or decisions that might otherwise have been questionable have a greater chance of being in line with leadership’s ethical standards. Thus, ethics can be positively supervised, and managers do not have to treat value concerns as matters totally out of their influence or control. On the contrary, managers can intercede and improve the organization’s ethical climate.¹⁵²

From Moral Decisions to Moral Organizations

In the last two chapters, we have discussed ethical or moral acts, decisions, practices, managers, and organizations. Though the goal of ethics initiatives is to develop moral organizations, sometimes all we get are isolated ethical acts, decisions, or practices, or, if we are fortunate, isolated moral managers. Achieving the status of moral standing is a goal, whatever the level on which it may be achieved. Sometimes all we can do is bring about ethical acts, decisions, or practices. A broader goal is to create moral managers, in the sense in which they were discussed in Chapter 7. Finally, the highest-level goal for managers may be to create moral organizations. To create moral organizations, many of the best practices discussed in this chapter will need to be implemented.

The important point here is to state that the goal is to create moral decisions, moral managers, and, ultimately, moral organizations while recognizing that what we frequently observe in business is the achievement of moral standing at only one of these levels. The ideal is to create a moral organization that is fully populated by moral managers making moral decisions (and practices, policies, and behaviors), but this is seldom achieved. Figure 8-10 depicts the essential characteristics of each of these levels.

Figure 8-10 From Moral Decisions to Moral Organizations

Moral Decision(s)

Single or isolated moral acts, behaviors, policies, practices, or decisions made by a manager or managers of an organization. These are the simplest and most basic form of achieving moral status. The principles of ethical decision making presented should assist in the development of moral decisions.



Moral Manager(s)

A manager or managers who have adopted the characteristics of moral management; this approach dominates all their decision making. These managers manifest ethical leadership and are always occupying the moral high ground. Moral managers will make moral decisions via the use of ethical principles. In addition, they will learn and use the research of ethics in organizations discussed in this chapter.



Moral Organization(s)

An organization that is dominated by the presence of moral managers making moral decisions. Moral management has become an integral part of the culture. Moral management permeates all the organization's decisions, policies, and practices. The organization uses the best practices for achieving a moral management culture. Of special importance are moral leadership provided by board of director oversight and top management leadership.

Summary

The subject of business ethics may be addressed at several different levels: personal, organizational, industrial, societal, and international. This chapter focuses on the personal and organizational levels.

A number of different ethical principles serve as guides to personal decision making. Ethics principles may be categorized as teleological (ends-based) or deontological (duty-based). One of the major deontological principles is the categorical imperative. Major philosophical principles of ethics include utilitarianism, rights, and justice. The Golden Rule was singled out as a particularly powerful ethical principle among various groups studied. Virtue ethics was identified as an increasingly popular concept. Servant leadership was presented as an approach to management that embraced an ethical perspective. A general meth-

od for reconciling ethical conflicts was introduced. Seven practical tests were proposed to assist the individual in making ethical decisions: the test of common sense, the test of one's best self, the test of making something public, the test of ventilation, the test of the purified idea, watch out for the big four, and the gag test.

At the organizational level, factors were discussed that affect the organization's moral climate. It was argued that the behavior of one's superiors and peers and industry ethical practices were the most important influences on a firm's ethical climate. Society's moral climate and personal needs were considered to be less important. Best practices for improving the firm's ethical climate include providing leadership from management, ethics programs and ethics officers, setting realistic objectives, infusing the decision-making process

with ethical considerations, employing codes of conduct, disciplining violators, creating whistleblowing mechanisms or hotlines, training managers in business ethics, using ethics audits and risk assessments, adopting the concept of transparency, and board of director oversight of ethics initiatives.

The goal of ethics initiatives is to achieve a status that may be characterized not just by isolated moral decisions, but by the presence of moral managers and the ultimate achievement of a moral organization.

Key Terms

aretaic theories (page 293)

categorical imperative (page 295)

codes of conduct (page 330)

codes of ethics (page 330)

compensatory justice (page 297)

corporate transparency (page 337)

deontological theories (page 293)

distributive justice (page 297)

ethical due process (page 298)

ethical tests (page 306)

ethic of care (page 299)

ethics audits (page 336)

ethics officer (page 323)

ethics programs (page 323)

Golden Rule (page 303)

legal rights (page 296)

moral rights (page 295)

negative right (page 297)

opacity (page 337)

positive right (page 297)

principle of justice (page 297)

principle of rights (page 296)

principle of utilitarianism (page 294)

procedural justice (page 298)

process fairness (page 298)

rights (page 295)

risk assessments (page 337)

servant leadership (page 301)

teleological theories (page 293)

transparency (page 337)

utilitarianism (page 294)

virtue ethics (page 300)

Discussion Questions

- From your personal experience, give two examples of ethical dilemmas in your life. Give two examples of ethical dilemmas you have experienced as a member of an organization.
- Using the examples you provided for question 1, identify one or more of the guides to personal decision making or ethical tests that you think would have helped you resolve your dilemmas. Describe how it would have helped.
- Which is most important in ethics principles—consequences/results or duty? Discuss.
- Assume that you are in your first real managerial position. Identify five ways in which you might provide ethical leadership. Rank them in terms of importance, and be prepared to explain your ranking.
- What do you think about the idea of codes of conduct? Give three reasons why an organization ought to have a code of conduct, and give three reasons why an organization should not have a code of conduct. On balance, how do you regard codes of conduct?
- A lively debate is going on in this country concerning whether business ethics can or

should be taught in business schools. Do you think business ethics can and should be taught? Be prepared to explain your reasons carefully. Can top managers and board members be taught business ethics?

7. Identify and prioritize the best practices for improving the organization's ethical climate. What are the strengths and weaknesses of each?

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Business Ethics and Technology

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Identify the role that technology plays in our business lives.
- 2 Gain an understanding of the technological environment and the characteristics of technology that influence business ethics and stakeholders.
- 3 Identify the benefits and side effects of technology in business.
- 4 Gain an appreciation of society's intoxication with technology and the consequences of this intoxication.
- 5 Learn to differentiate between information technology and biotechnology and their ethical implications for the management of enterprises.
- 6 Identify the ethical issues involved in biotechnology and present the arguments on both sides of the issues.

We live in an age characterized by advancing technology. Each new generation experiences technological advances that were not seen by previous generations; technology is how we sustain life and make it comfortable. Technology is the core of many businesses, whether it is used to pursue new products or processes or as a means to achieve other worthwhile ends. But, technology, as many have observed, is a two-edged sword. Many positive benefits flow from technological advances. By the same token, however, many new problems or challenges are posed by advancing technology. Futurist John Naisbitt, for example, has questioned whether advancing technology has the potential to be a “liberating” or “destructive” force in society. He has said that, at best, technology supports and improves human life, and at its worst it alienates, isolates, distorts, and destroys.¹

In either case, technology has become such a central part of doing business in the twenty-first century that it cannot be ignored. Moreover, ethical issues for business and for society have arisen as a result of technological advances. Many would argue that technology has developed at a speed that significantly outstrips

the capacity of society, government, or business to grasp its consequences or ethics. In this chapter, we will explore some of these issues, knowing full well that other aspects will be mentioned in ensuing chapters as specific stakeholder groups are considered in more detail.

Recently, a new form of surveillance was in the news. Issues were raised about the camera function now built into the ubiquitous cell phones that we all carry. Private individuals were accused of looking up women's skirts by using their cell-phone cameras to take pictures while no one noticed. This raised the issue of whether cell-phone technology has now taken away all privacy and whether new laws restricting its use should be passed. In another example, cell-phone camera technology was identified to be the source of student cheating on exams in college. In the camera function example, we see how the source of privacy invasion is now in the hands of private individuals. In the exam cheating example, the technology was again used to facilitate unethical behavior.

It is interesting and challenging to brainstorm about what new technologies may have in store for business or with business implications. One of the hot topics in technology these days is social networks. A relevant question is: What possible business applications and implications will tools such as Facebook and MySpace have? They both play a role in social networking. They provide a cyber-meeting space for people wanting to network. Tools such as Facebook provide a place where individuals can describe themselves and connect with others. It has been said that 85 percent of college students have a profile on Facebook and that the majority of them log on at least weekly.²

But how do social networking tools connect with business? According to Albert M. Erisman, executive director of www.ethix.org, there are two important ways. First, social networking tools create successful, innovative businesses. Examples include Facebook, MySpace, Classmates.com, Flickr, and LinkedIn. Second, and this is more speculative regarding the future, are more direct business uses. For example, LinkedIn.com is a network with 11 million users, and it provides a way for each individual to connect his or her network of colleagues to their networks of colleagues, enabling exponential growth for their own network. One function this provides is the sharing of résumés in job searches and recruiting, and it also allows connections for business opportunities in buying and selling.³ One can only speculate what abuses of information might creep into these systems.

Building on this potential, a new entrant in the social network space, Zoodango, has targeted an interesting niche—that of business collaboration. They propose such collaboration in three forms: (1) the creation and management of virtual business teams; (2) the linking of people in a company around a cause (such as a charitable activity that employees can work on); and (3) in connecting business professionals, as LinkedIn does.⁴ According to its website, Zoodango's mission "is to empower people to achieve their professional and life goals by providing the best meeting platform that connects the online and offline world."⁵ It is mind-boggling to think about the potential applications and implications for business ethics that are still not yet fully explored in these types of social networking tools.

Another business issue in the realm of ethics and technology has been the revelation that companies are using video cameras mounted in stores to monitor our every action. We know we are being watched, but do we know how smart these technologies have become? For example, a few Macy's, CVS, and Babies 'R' Us stores are now using a system called the Video Investigator. This advanced surveillance software can monitor a customer's movements and compare their movements between video images and recognize any type of unusual activity. If the shopper removes 10 items at once from a shelf, for example, or opens a case that is normally kept closed and locked, the system alerts security guards of the activity. The system can also predict where a shoplifter is likely to hide (e.g., at the end of aisles, behind floor displays).⁶ We are, indeed, being watched. Much of this is for the good. But there can be possible abuses as well.

Employers and rental car companies have been installing global positioning systems (GPS) on vehicles and tracking people without their knowledge. In one dramatic case, a consumer filed a complaint against a car rental agency when she got her bill of \$1,372.59 for two days of rental. Apparently, she had driven across the border from California to Nevada and was hit with big penalties when the rental company documented her every move while in the rental car. The woman complained that she wasn't told about the out-of-state penalty, and she wasn't told she was being tracked. One recent study revealed that one-fourth of all rental cars in the United States are equipped with tracking devices and that most consumers say they are not told.⁷ With respect to the use of GPS systems as monitoring devices, there are obviously two sides to the story.

In this chapter, we intend to explore the subject of technology and business ethics. Technology has become such an integral aspect of our work lives and consumer lives that special treatment of these topics is warranted. First, we will consider what technology means and some of its benefits and challenges. Second, we will briefly discuss the subject of ethics and technology. Finally, we will consider ethical issues connected with two major realms of technology: computers and information technology, and biotechnology.

Technology and the Technological Environment

Technology means many things to many people. In this chapter, **technology** will refer to the "totality of the means employed to provide objects necessary for human sustenance and comfort." It is also seen as a scientific method used in achieving a practical purpose.⁸ Technology refers to all the ways people use their inventions and discoveries to satisfy their needs and desires. Since time began, people have invented and developed tools, techniques, machines, and materials to sustain life and to improve the quality of life. Sources of power have also been discovered and developed. Taken together, these technological advances have

made work easier and more productive.⁹ It is little surprise, therefore, that businesses have embraced and used technology as much or more than any other sector of society.

In Chapter 1, we discussed the macroenvironment of business and how this total environment was composed of a number of significant and interrelated segments such as the social, economic, political, and technological. The **technological environment**, our current topic of concern, represents the total set of technology-based advancements or progress taking place in society. Pertinent aspects of this segment include new products, processes, materials, states of knowledge, and scientific advancements in both theoretical and applied senses. The rate of change and complexity of the technological environment have made it of special interest to business today. Consider the following examples. An electronic greeting card that today plays “Happy Birthday” holds more computing power than existed in the world before 1950. One of today’s home video cameras wields more processing power than the old IBM 360, the wonder machine that launched the age of mainframe computers. Computers are being used to aid scientists in comprehending the secrets of matter at the atomic level and to create amazing new materials.¹⁰ In both information technology and the burgeoning field of biotechnology, the shape of how we are living, what products we are using, and what processes we are being exposed to are changing at an accelerating pace.

Characteristics of Technology

We have moved from a world characterized by industrial technology to one dominated by information technology and biotechnology. Whatever the technological level of advancement, there are general benefits of technology, undesirable side effects of technology, and ethical challenges inherent in technological advancements. A brief consideration of each is useful.

BENEFITS OF TECHNOLOGY

Few would dispute that we as a society have benefited greatly from technology and innovation. We live better lives today as employees, consumers, and members of the community due to technology. Technology has helped us gain control over nature and to build for ourselves a civilized life. Through the ages, technology has benefited society in four main ways.¹¹ First, it has increased society’s production of goods and services, a benefit attributable chiefly to the business sector. In the mid-1800s, people and animals were the main source of power on farms. In the early 1900s, tractors and other machines powered by gasoline and electricity became commonplace. Today, machines do virtually all the work on farms. These same kinds of results have been achieved in manufacturing, mining, and other industries; the numbers of products available for sale and consumption have increased appreciably.

Second, technology has reduced the amount of labor needed to produce goods and services. Not only has production increased, but productivity has increased.

This has resulted in more leisure time, which has significantly affected lifestyles. Third, technology has not only enabled greater production with a lesser amount of human labor, it has also made labor easier and safer. Fourth, higher standards of living have been a direct result of labor-saving technology. Today, in economies that have been able to take advantage of technology, people are better fed, clothed, and housed, and they enjoy more health and comfort than any other people in history. Even life expectancy has increased as a result of these other factors.¹²

The benefits of technology are too vast to summarize. In an excellent book, *A Culture of Improvement* (2007), Robert Friedel surveys the entire past millennium of technological advancement. He explains how we have moved from horsepower to jet engines, from Gothic vaults to skyscrapers, from Gutenberg to Google. Friedel helps us to see how society has benefited from technological innovation, but he also points out many of the flaws and entanglements that have arisen due to technology.¹³

SIDE EFFECTS AND CHALLENGES OF TECHNOLOGY

Though technologies have benefited people in many ways, there have also been some unanticipated side effects of technology—problems or effects not anticipated before technologies were implemented. One major reason for this is that technologies were often implemented before much thought was given to possible side effects, ethical problems, or downside risks of the technologies. The automobile is a classic example. From the late 1800s to early 1900s, it was believed that automobiles would be quieter and less smelly than horses. As more autos came into use, however, it quickly became obvious that roaring traffic noise exceeded the clatter of horse hoofs. Automobile exhaust became more toxic than the smell of horse manure. Fumes polluted the air with carbon monoxide and other impurities that threatened human health.¹⁴ In addition, we experienced traffic jams, shortages of gasoline, and automobile accidents—some initiated by cell-phone users—and “road rage.”

Four categories of undesirable side effects of technology should be noted. First, there is *environmental pollution*. This ranks as one of the most undesirable side effects of technology. In spite of efforts to address this problem, most industrial nations today face significant air, water, soil, solid waste, and noise pollution. Global warming and climate change effects are an inevitable topic of concern today, due to technology. Second, there is *depletion of natural resources*. The rapid advance of technology continually threatens the supply of natural resources. Fuel shortages and power shortages have become a way of life. Third, there is the issue of *technological unemployment*. The most common form of technological unemployment occurs when machines take the place of humans, as we experienced in the automation phase of industrial development. Another form of technological unemployment is now occurring as technology jobs are being moved offshore to less expensive regions of the world. At an aggregate level, this has not been as

much of a problem as once anticipated. In the short run, and to specific individuals locked into certain jobs with limited skills, however, it remains a serious threat.

Fourth, there has been the *creation of unsatisfying jobs* due to technology. Many jobs in the technological world fail to give the workers a sense of accomplishment. As jobs are broken down into smaller component parts, each individual worker is further removed from the finished product that might provide a greater sense of fulfillment and pride. Monotony and boredom can easily set in when jobs are significantly shaped by certain technological processes.¹⁵

New technologies present many challenges to managers, organizations, and society. Foremost among the challenges is anticipating and avoiding the unwanted side effects. Some side effects cannot be forecast or overcome, of course, but much more could be done than is currently being done. Overcoming the technological determinism that seems to be driving society today would be a step in the right direction. For example, one of the most important issues today in the realm of biotechnology is that of human cloning. It is difficult to get the scientists and researchers to slow down and talk about the possible consequences (practical and ethical) of human cloning. Many of them seem driven by the technological capacities for achieving this instead of asking the important questions concerning ethics and side effects. Another challenge lies in spreading the benefits of technology.

Currently, the benefits of technology are primarily restricted to the developed world. The developing nations enjoy few of the benefits of technology enjoyed in the developed nations.¹⁶ It is anticipated that as multinational corporations increasingly move to developing countries for production or exploration for resources, the opportunities for technology transfer will be greatly enhanced. This is being seen, to some extent, in the case of information and medical technology jobs being moved to India and China. The challenge, however, is to move technologies into other countries in socially responsible ways.

<http://SEARCHTHEWEBWEB>

IS TECHNOLOGY GOOD OR EVIL?

The two founders of the Institute for Business, Technology and Ethics (IBTE) come at the issue of technology from two different sides. One says that technology is good and one says that technology is evil. The two friends came together to create this unique, nonprofit organization that features ethics conversations regarding technology issues.

The mission of IBTE is as follows: to study the interrelationships of business, technology, and ethics. How can business be transformed by advanced

technology and ethical values? Our mission is to promote good business through appropriate technology and sound ethics.

An example of the questions raised is: "What are the primary ethical challenges we must face up to in the bioethics realm?" Web visitors are given the chance to share their opinions.

Visit <http://www.ethix.org> for an enlightening exploration of business and technology ethics.

Ethics and Technology

To be sure, technology has many benefits for humankind. Our perspective at this juncture, however, is to raise the ethical questions that may be related to business development and use of technology and innovation. To do so does not mean that one is against technology. It simply means that one is concerned about the ethical use of and implications of technology. Like management decision making and globalization of business, the actions of the business community with respect to technology have ethical implications that should be identified and discussed. Management's goal should be to avoid immoral and amoral practices with respect to technology and to move toward a moral management posture with respect to this potent business resource.

Applying business ethics to questions involving technology is simply an extension of our discussions of business ethics up to this point. The goal of managers and businesses striving to be ethical should be to do what is right and what is fair, and to avoid harm. In making ethical judgments, the prevailing norms of acceptability regarding technology must be tested by the principles of fairness and justice, protection of rights, and utilitarianism. The goal should be to reconcile and build bridges over the gap between "what is" and "what ought to be."

With respect to the three models of management ethics, the mission should be to avoid immoral technological practices in products, processes, and applications. There is much room for abuse and misinterpretation. Technology is such a godsend for humankind that it is easy to overlook or fail to discern the ethical dimensions of decision making and application. Managers should strive to adhere to high standards of ethical behavior and policies, pay careful attention to what is legal (both that which conforms to the spirit as well as the letter of the law), and display ethical leadership in anticipating and responding to technology-related ethical dilemmas.

Two Key Issues

There are two key ethical issues in the realm of technology that seem to drive everything. First, there is the idea of technological determinism. **Technological determinism** is the imperative that "what *can* be developed *will* be developed." When someone once asked, "Why do we want to put men on the moon?" the answer was always, "Because we *can* put men on the moon." In other words, scientists and those who work with advanced technologies are driven to push back the frontiers of technological development without consideration of ethical issues or side effects. The second important concept is that of ethical lag. **Ethical lag** is a phenomenon that has been noted. Ethical lag occurs when the speed of technological change far exceeds that of ethical development.¹⁷ We will see throughout our consideration of technology and ethics that these two phenomena are at work.

To emphasize the ethical dimension of technology, it is useful to note how society has become obsessed with technology and its power over our lives. Only by fully understanding the magnitude of this love affair we have with technology

can we focus on the ethical aspects of it and the actions that should be taken. One way to appreciate what technology is doing to us is to consider the thoughts of John Naisbitt, Nana Naisbitt, and Douglas Phillips, authors of the book *High Tech/High Touch*. In this book, they discuss our current obsession with technology and described the symptoms of this obsession.¹⁸

SYMPTOMS OF SOCIETY'S INTOXICATION WITH TECHNOLOGY

In *High Tech/High Touch*, Naisbitt calls upon all members of society to understand and question the place of technology in our lives. He and his colleagues argue that our world has changed from a “technologically comfortable place” into a “technologically intoxicated zone.” As Naisbitt analyzes the world, he concludes that there are six symptoms of society’s intoxication with technology.¹⁹ Some of these touch upon our character as a people, and some touch upon the ethical issues business faces with technology. The six symptoms are as follows:

1. We favor the quick fix. This is true whether it relates to nutrition or religion. As we perceive a recurring void, we search for something and we want it quickly. Ironically, he says that technology promises to detoxify us—to simplify our complex lives, relieve our stress, and calm our nerves. However, this Band-Aid culture of the quick fix is ultimately an empty one. We are seduced by the promise of technology.
2. We fear and worship technology. Our behavior moves us from the extremes of worship one moment to fear the next. We accept technology, fearing that we will fall behind our competitors or coworkers. We embrace technology but then feel frustrated and annoyed when it fails to deliver.
3. We blur the distinction between what is real and what is fake. When technology can transform nature, we frequently ask, “Is that real or is that fake?” Is it authentic or simulated?
4. We accept violence as normal. Technology has made it possible for us to package violence in the form of merchandise, often spin-offs from television or movies. This violent material is often targeted at children.
5. We love technology as a toy. As affluence finances play, leisure tends toward diversion—something to fill the time. We live in a culture dominated by consumer technology, where leisure is often passively received. Electronic distractions busy us as we can’t find anything worthwhile to do. The problem is that real leisure is not based on the desire to consume. It requires tranquility, patience, and attentiveness. Technology seldom delivers.
6. We live our lives distanced and distracted. The Internet, cell phones, and wireless technologies promise to connect us to the world, but when is it appropriate and when is it a distraction? Technology’s bells and whistles are seductive, and they distance us and distract us.

Naisbitt’s solution to this intoxication with technology is to find the right balance. That is, we need to embrace technology that preserves our humanity and

reject technology that intrudes upon it. We need to know when we should push back on technology, in our work and our lives, and to affirm our humanity. We need to understand that technology zealots are as shortsighted as technology bashers. We need to question the place of technology in our lives.²⁰

Society's Concern with Ethics of Technology

There is significant evidence that society is becoming concerned with the ethics of technology and the intoxication with technology that Naisbitt has so aptly described. This information should be useful for individuals as well as businesses desiring to use technology in a more ethical manner. Following are three examples of this increased societal concern. First, books are being published on the topic of ethics and technology. One example is *Practical Ethics for a Technological World* by Paul Alcorn.²¹ Another example is *Society, Ethics, and Technology* by Morton Winston and Ralph Edelbach.²² It is encouraging to see books of this nature that attempt to bridge the gap between ethics and technology and to discuss where we are now and where we need to go.

Second, special encyclopedias are being developed, such as *The Concise Encyclopedia of the Ethics of New Technologies*.²³ This encyclopedia, which is devoted to applied ethics, is one of a number that has come out in the past decade. Third, new organizations concerned about ethics and technology are developing. One example is the nonprofit Institute for Business, Technology and Ethics (IBTE), a unique organization dedicated to exploring the mix of business, technology, and ethics. One of the major concerns of one of IBTE's founders is the unintended consequences of technology on people and how these consequences often lead to "damage control" ethics.²⁴

There are a number of arenas in which specific issues of business ethics and technology might be explored. Research over the past few years reveals two broad categories of issues that now merit our consideration. Each is broad and deep, so we can only consider them in an introductory way in this chapter. Each, however, significantly touches business, either directly or indirectly. The two areas are computer-based **information technology** and **biotechnology**. Within each, there are dozens to thousands of technologies that raise ethical questions. Our quest, therefore, will be to focus on a few major ones that give us a representative sample of ethical issues with technology.

Information Technology

Computer-based information technology, or information technology (IT), as it is most often called, touches practically all businesses and stakeholders involved in those businesses. Businesses and people are both affected by technology and are directly involved in pursuits that are based on technology. We will consider them both. We will discuss two broad areas in this section: *electronic commerce* or Web-based marketing, and *computer technology in the workplace*, including telecommunications. These areas overlap significantly and are interdependent, so our separation is to lend some order to the discussion.

ELECTRONIC COMMERCE AS AN EMERGING TECHNOLOGY

Electronic commerce, often referred to as *e-commerce*, *e-business*, or *Web-based marketing*, is one of the most significant technological phenomena of our day. It primarily affects consumer stakeholders and competitors of the e-commerce firm. Most experts today are convinced that the Internet is rapidly reshaping the way business will be conducted around the world. Part of this is firms selling products and services online. Beyond this, companies are integrating the Internet into every aspect of their businesses.

It is hard to track the total dollar sales business experiences via electronic commerce. It is a multitrillion-dollar business, and 90 percent of it comes from business-to-business (B2B) sales. Consumer transactions are huge and growing. Over half of all adults have made purchases online, and the number is growing rapidly. The pull of e-business is powerful, and companies are responding by moving their operations to the Internet. Other areas of Internet growth include knowledge management and customer relationships. Companies are spending billions of dollars linking customers, sales, and marketing over the Web. In short, electronic commerce is a burgeoning business, and the opportunity for questionable practices arises along with this business.

Along with the growth of electronic commerce, business ethics problems have arisen as well. One major category of problems is online scams. According to Internet Fraud Watch, con artists are taking advantage of the Internet's growth in popularity to bilk the unwary. During 2006, for example, the top frauds over the Internet included online auctions, goods misrepresented or not delivered, fake check scams wherein consumers were paid with phony checks and asked to wire money back, Nigerian money offers wherein consumers were promised riches if they would allow money to be wired to their accounts, requests for payments to claim lottery winnings, and advance fee loans wherein customers were promised loans for upfront fees.²⁵ Other scams included credit card fraud, travel and vacation scams, pyramid schemes, and bogus investment opportunities. The average dollar loss due to Internet scams in 2006 was \$1,512.²⁶

CURRENT ISSUES IN E-COMMERCE ETHICS

According to Kracher and Corritore, the key current issues in e-commerce ethics are as follows:²⁷

- Access
- Intellectual property
- Privacy and informed consent
- Protection of children
- Security of information
- Trust

These issues are not restricted to e-commerce. They also occur in brick-and-mortar businesses. The manifestations and scope of these issues, however, differ from that

of traditional businesses. *Access* refers to the difference in computer access between the rich and the poor. *Intellectual property*, in e-commerce, is illustrated by Napster and the ethics of downloading music. *Privacy and informed consent* differ in e-commerce. An illustration is the novel ways companies place cookies on our computers without informed consent. In addition, firms such as DoubleClick collect online information and merge it with off-line information. In addition, personal information is collected online much more often than in traditional businesses. *Protection of children* is an important ethical issue, and it is illustrated in the issue of pornography. E-commerce makes porn more accessible than through traditional businesses. *Security* is such a major issue that even today some are reluctant to do business on the Web for fear their credit card numbers will be intercepted by someone not associated with the e-commerce business. Finally, *trust* is the basis for practically all business transactions, and it is especially crucial in e-commerce.²⁸ We will discuss some of these ethical issues in further detail.

INVASION OF PRIVACY VIA ELECTRONIC COMMERCE

The average person encounters two forms of Internet electronic commerce: business-to-consumer transactions and business-to-business transactions. Most of us are quite familiar with business-to-consumer transactions when we do personal business on the Internet—buying products and services, arranging credit cards, accessing travel websites, and doing financial business such as personal banking. Employees also encounter business-to-business (B2B) transactions. B2B is anticipated to be the greatest area of e-commerce growth in the coming years. One reason for this is the rapid globalization of business. In terms of Web-based marketing to consumers, consumer stakeholders are primarily affected by such issues as database sharing, identity theft, and invasion of privacy. Invasion of privacy is a legitimate concern in all business transactions; however, the special case of electronic commerce or Web-based marketing deserves special attention because of the ease with which data can be stored and transmitted in electronic form.

One illustration of a potential invasion of privacy was that of DoubleClick, Inc., a New York-based Internet advertising company that planned to share customer information with an off-line marketing firm. Consumer advocates were up in arms that DoubleClick would betray such confidential information. Another example occurred when Toysmart.com, Inc., went out of business and offered its online customer list for sale, thus violating privacy agreements or understandings previously made with customers. Questions that arise from such situations include: “What limits should there be on how online businesses use the information they gather about their customers?” and “What responsibility do companies have to publicly disclose such practices?”²⁹

The number-one ethical issue with respect to doing business over the Internet is the question of possible invasions of consumer privacy.³⁰ This is a hot topic for business executives today. According to a survey by The Conference Board, “e-business privacy issues” was the most discussed technology issue at Conference Board meetings.³¹ In general, the consuming public is concerned as well.

A survey on Internet privacy conducted by the *Wall Street Journal* and Harris Interactive revealed that 24 percent of those consumers surveyed were “very concerned” and 49 percent were “somewhat concerned” about threats to their personal privacy on the Internet. Further, about half of those surveyed indicated that concerns about privacy caused them to stop using a website or to forgo an online purchase.³² Figure 9-1 summarizes some of the concerns that privacy advocates and law enforcement experts have about the Internet’s threat to privacy.

Some of the technological means by which companies invade consumers’ privacy include the use of cookies and spam. *Cookies* are those little identification tags that websites drop on our personal computer hard drives so they can recognize repeat visitors the next time we visit their websites.³³ Surveys show that some consumers don’t know what cookies are; others are aware of them but don’t take the time to block them. According to the Pew Internet & American Life Project, only 10 percent of users set their browsers to block cookies. Part of this is due to the fact that 56 percent of Internet users didn’t know what a cookie was.³⁴

Spam is unsolicited commercial e-mail. It is sent through “open-relays” to millions of people. It takes a toll on Internet users’ time, their resources, and the resources of Internet service providers (ISPs). The latest problem is that spammers have begun to send advertisements via text message to cell phones.³⁵ Many consumers interpret the receipt of spam as an invasion of their privacy. Opening our e-mail mailboxes only to find a few dozen unsolicited ads is aggravating, at

Figure 9-1 Potential Threats to Privacy Posed by the Internet

Identity theft	Someone might use the Internet to steal your identity.
Unintentionally revealing information	You may be unintentionally revealing information about yourself as you move through cyberspace.
Lost/stolen personal information	That personal information you just provided to a website might be sold or stolen.
Fake websites	That website on which you just entered your credit card number and personal information may be a fake.
Government distribution of information	The government may be giving out your home address, social security number, and other personal information online.
Broadcasting information over the Internet	Companies and people who do not like you may be broadcasting your private information on the Internet.
Victim of spying—employer or spouse	Your employer or spouse may be using your computer to spy on you.
Victim of spying—strangers	Someone you do not know may be using your computer to spy on you (e.g., hackers).
Cyberstalker	You may have a cyberstalker harassing you.

Source: Summarized from “Internet Insecurity,” *Time* (July 2, 2001), 46–50. For the latest news, go to the Electronic Privacy Information Center at <http://www.epic.org>, retrieved July 30, 2007.

the least, and an invasion of privacy to many. Also, some companies experiment with pulsing background ads that never go away. Interestingly, dozens of companies make programs that protect our e-mail privacy, block cookies, and filter spam and porn, but very few consumers bother to use them.³⁶

One of the most serious invasion of privacy issues with respect to electronic commerce is the collection and use of personal information. Though non-Internet companies have engaged in this practice for years, everything seems magnified in the e-world in which we now live. None of us really knows how much personal information is collected, saved, swapped, or sold in e-commerce. Thousands of retailers, from department stores to catalog companies, collect and store personal information, from asking customers for their zip codes to collecting names, addresses, household income, and purchasing patterns through a store credit card. Retailers also share, exchange, and even sell their customer databases to other companies. In short, the average consumer has very little control over what is done with his or her personal data once it is collected.³⁷ An extreme concern is *identify theft* or tampering with one's financial accounts. Less serious is the inundation of marketing attempts, both online and off-line, that consumers are subjected to as a result of information being distributed.

Government's Involvement in Internet Privacy Protection

The federal government has gotten involved in protecting consumers' privacy, but many observers believe it is not doing enough.³⁸ The Financial Services Modernization Act of 1999 was landmark legislation that permitted banks, insurers, and brokers to join forces. Under the law, it is now possible for consumers to get their credit cards, checking accounts, investments, home loans, and health insurance from one company. This is convenient for consumers. However, the law also empowered these companies to develop exceptionally detailed portraits of their customers just by merging files about their income, assets, debts, health, spending habits, and other personal data. Increasingly, this sensitive data is becoming a public commodity.³⁹

The lawmakers who created this act were concerned about consumers' privacy, so they insisted upon some privacy protection provisions. Special-interest groups concerned about consumers' privacy wanted the law to require that companies get permission from their customers before selling personal data. This was called an "opt-in" approach in which customers would have to specifically "opt-in" to having their personal information used by the company for purposes beyond its original intent. At this point, however, industry lobbyists went to work and proposed an alternative approach: to allow customers to protect themselves by "opting out" from firms using their personal data. The major problem with this was that Congress did not require companies to mail the notices in a standard format or in a separate mailing.

Consequently, since the early 2000s, consumers have been bombarded with dozens of notices, usually stuck in an envelope bundled along with the monthly statement, frequently not being noticed or read and ending up in the trash. Even if the customer did notice the "opt-out" opportunity, the offer was frequently

Figure 9-2 Privacy Agenda of the Federal Trade Commission

The FTC is the nation's primary consumer protection champion. It plays a vital role in protecting consumers' privacy. Its recent initiatives, many of which touch upon information technology, include those listed here.

Creating a National Do-Not-Call List

Consumers who do not want telemarketers calling them can take two actions. First, they can rely on a voluntary system administered by the Direct Marketing Association. Second, they can notify each company separately. The FTC initiative provides a third way: the creation of a national do-not-call list.

Beefing Up Enforcement Against Spam

Fraudulent and deceptive spam promoting chain letters, pyramid schemes, or other kinds of get-rich-quick schemes pose significant burdens on customers. The FTC plans to increase its enforcement activities against these scams.

Helping Victims of Identity Theft

The FTC will use the data it collects from consumers to spot patterns that can help law enforcement agencies prosecute perpetrators and help businesses avoid the financial consequences of ID theft.

Stopping Pretexting

"Pretexting" is the practice of fraudulently obtaining personal financial information like account numbers and balances, often by calling banks under the pretext of being a customer. Pretexting is prohibited under the Gramm-Leach-Bliley Act.

Encouraging Accuracy in Credit Reporting and Compliance with Fair Credit Reporting Act

The FTC plans to step up its efforts to ensure that consumers are notified when information in a credit report is the reason for a denial of credit, insurance, or employment, and to ensure that all participants in the credit reporting system meet their obligations regarding accuracy of consumers' credit information.

Enforcing Privacy Promises

The FTC already has brought a number of cases to enforce the promises in privacy statements. The FTC will also investigate claims touting the privacy and security features of products.

Increasing Enforcement and Outreach on Children's Online Privacy

The FTC will continue its enforcement of the Children's Online Privacy Protection Act of 1998, as well as its business and consumer education activities.

Encouraging Consumers' Privacy Complaints

The FTC receives over 10,000 consumer complaints each week about fraudulent and deceptive business practices related to privacy. Its website is <http://www.ftc.gov>.

Enforcing the Telemarketing Sales Rules

The FTC will increase enforcement of the privacy provisions of the Telemarketing Sales Rule, especially the provisions about harassing calls and the hours during which calls are allowed.

Restricting Use of Pre-acquired Account Information

The FTC will increase its efforts to ensure that telemarketers do not use "pre-acquired account information" to bill consumers for goods or services they do not want.

(continues)

Figure 9-2 (Continued)

Enforcing Gramm-Leach-Bliley Act (GLBA)

The GLBA of 1999 requires financial institutions to provide privacy notices to consumers, and allows consumers, with certain exceptions, to choose whether their financial institutions may share their information with third parties.

Holding Workshops

The FTC will explore holding public workshops on security issues and other ways to encourage security for personal information.

Source: "Privacy Agenda," Federal Trade Commission; <http://www.ftc.gov/opa/2001/10/privacyagenda.shtml>, retrieved July 30, 2007.

written in legalese and set in fine print—violating just about every known guideline about how to make complex policies understandable to the average consumer. Not surprisingly, the opt-out forms are being returned only by about 1 in every 20 consumers. According to Mike France, a *BusinessWeek* writer and former lawyer, some businesses interpreted this to mean that people are not really all that worked up about privacy. The real reason for the low response to the opt-out, he states, is because the notices are designed by the businesses to be ignored.⁴⁰

Over the past several years, a number of different bills designed to protect consumer privacy on the Internet have been filed but not yet voted upon. Many of the legislators have been uncertain whether a broad privacy bill is even needed or what it should look like. Though privacy continues to be a hot-button technology issue in Congress, many lawmakers have indicated they wanted to study the issue before throwing support behind new privacy measures.⁴¹

The Federal Trade Commission (FTC) is the primary government agency concerned with protecting consumers' privacy today. Under the FTC Act, the commission guards against unfairness and deception. The major legislation now governing consumers' privacy include the Financial Services Modernization Act (Gramm-Leach-Bliley Act), concerned with financial privacy; the Fair Credit Reporting Act; and the Children's Online Privacy Protection Act.⁴² Figure 9-2 summarizes the FTC's most recent privacy agenda.

Business Initiatives

There are a number of different ways companies might strive to protect the privacy of their customers in electronic commerce.

Ethical Leadership. First, business needs to recognize the potential ethical issues involved in electronic commerce and be committed to treating customers and all affected stakeholders in an ethical fashion. This commitment and ethical leadership undergird all other initiatives. This ethical leadership must begin with the board of directors, the CEO, and top management.

Privacy Policies. Companies may take the initiative with their own carefully crafted privacy policies designed to protect customers. An example of this might be a company deciding to do more than the law requires. FleetBoston Financial Corporation decided to resolve concerns regarding its use of customer financial data by adopting a new privacy policy requiring a customer's affirmative approval (an "opt-in" policy) prior to the company sharing nonpublic personal information with third parties for marketing purposes. Fleet's privacy policy was a response to the New York attorney general's concern about Fleet sharing customer account information without providing full disclosure to its customers. Under Fleet's policy, the bank would not share customers' personal information without their informed, voluntary, specific, and documented consent.⁴³

A company that has gone to great lengths to explain its privacy policy to customers and guests is Walt Disney Internet Group. At its website, it provides its Privacy Policy and answers to the following types of questions:⁴⁴

- Q1. *What information does this Privacy Policy cover?*
- Q2. *What types of personally identifiable information do we collect about our guests?*
- Q3. *How is your personally identifiable information used and shared?*
- Q4. *What choices do you have about the collection, use, and sharing of your personally identifiable information?*
- Q5. *What kinds of security measures do we take to safeguard your personally identifiable information?*
- Q6. *How can you update your contact information and opt-out choices?*
- Q7. *How can you ask questions, or send us comments, about this Privacy Policy?*
- Q8. *How will you know if we amend this Privacy Policy?*
- Q9. *What additional privacy protections do we provide for children under the age of 13 who visit our sites?*

Microsoft has made one of the most significant advances in privacy policies. Microsoft has decided to amend its privacy policies so that consumers will have greater control over what the company does with information it gathers about their online purchasing behavior. The company plans to allow certain users to decline to receive ads tailored to their Web-surfing habits, and it will also sever the connections recorded between information about a computer and the Web searches carried out from that machine after about a year and a half.⁴⁵ These initiatives on the part of Microsoft are commendable, but they only scratch the surface of the issue on customer privacy.

Chief Privacy Officers. An innovative approach to protecting consumers' privacy has been the designation of a **chief privacy officer (CPO)** in a number of major companies. Companies like American Express, Sony Corporation, Citigroup, and IBM have appointed their own privacy chiefs.⁴⁶ A recent estimate is that there are now two thousand or more such positions around the country, and their numbers may swell in the next few years.⁴⁷ In other companies, these responsibilities are falling under the administration of a chief technology officer.

It is the primary responsibility of the chief privacy officer to keep a company out of trouble, whether in a court of law or the court of public opinion. This includes developing Internet policies, helping their companies avoid consumer litigation, creating methods of handling and resolving consumer complaints, and assessing the risk of privacy invasion of company activities and practices. Because the position is so new at most companies, these newly appointed individuals are still trying to figure out what they need to be doing.⁴⁸ The job is a challenging one. CPOs must balance their customers' right to privacy with the employer's need for information for profit purposes.⁴⁹ Gary Clayton, CEO of the Privacy Council, said it is a new position that he expects most major businesses to have to have in the next two or three years.⁵⁰ CPOs were all the rage in the early 2000s, but the economic downturn has slowed down the movement. As the economy perks back up, CPOs have become popular once again.

One of the latest debates is whether the CPOs will focus on *ethics* or *compliance*. Those in the ethics camp believe that CPOs need to be driven by integrity concerns and should proactively and strategically consider the privacy implications of their company's actions. Those in the compliance camp believe that CPOs should just focus on making sure the company stays out of trouble by not breaking the host of new laws it now faces. Some of these laws with privacy provisions include the Fair Credit Reporting Act, the Gramm-Leach-Bliley Act, and the Sarbanes-Oxley Act. As a result of limited resources, Alan F. Westin, president of Privacy & American Business, a nonprofit organization, has concluded: "Most companies have shifted from a privacy approach that would be based on proactive steps, competitive-edge orientation and customer trust building to a narrow, legal-compliance priority."⁵¹

CPOs also play a role in helping to ensure employee as well as consumer privacy. CPOs are relevant to the next major section of this chapter, and they are brought up again in Chapter 18 when employees' rights to privacy are discussed further.

Data Security. One of the clearest ways companies can protect the privacy of their customers is through data security systems and practices. As an example of what can occur without adequate data security, the experience of the TJX Companies, which owns T.J. Maxx, HomeGoods, Marshalls, and A.J. Wright, is instructive.⁵² TJX holds the record for the leading known case in which theft of credit-card numbers has occurred. Beginning in 2006 and spreading into the next two years, the case started at a Marshalls discount store near St. Paul, Minnesota. Investigators now believe that the intrusive hackers pointed a telescope-shaped antenna toward the store and used a laptop computer to decode data that was streaming through the air between handheld price-checking devices, cash registers, and the store's computers. This helped the hackers to break into the company's central database and steal information about customers.⁵³

It has been concluded that TJX, a \$17.4 billion retailer, had less security than many people have on their home computer networks and that for a year and a half the company had no idea what was going on. The hackers, who still have not been

caught, made away with 45.7 million credit- and debit-card numbers during the period and may have made off with as many as 200 million card numbers over four years. In addition, the TJX hackers got personal information such as driver's license numbers, military IDs, and Social Security numbers of 451,000 customers. The company has apologized for its errors and improved its security system, but the damage has been done due to lack of data security.⁵⁴ The TJX case and many others like it establishes a strong need for proactive data security systems on the part of business to protect privacy on behalf of customers.

Questionable Businesses and Practices

Several questionable businesses and practices have been made possible by electronic commerce and the use of the Internet. Three business categories that are viewed as questionable by many include Web-based pornography, Internet gambling, and Web-based music services such as Napster, MusicNet, Pressplay, and others that raised the question of the protection of intellectual property. Pornography via the Internet is just one aspect of this business. The other is the production and distribution of pornography through video rental stores and through in-room videos in hotels.⁵⁵ Many ethical questions have been raised concerning this. The Internet porn industry has become so controversial that the U.S. Supreme Court is now hearing cases as to whether the industry is violating the Child Pornography Prevention Act of 1996 and the Communications Decency Act.

Song-swapping services made famous by the original Napster and several others have raised the question of the protection of intellectual property, because other people's ideas and music have been so easily acquired via the Internet. Napster has been shut down and made the transition to a paid subscription service in 2003; however, other music services continue to surface and call into question the system's ability to protect intellectual property.⁵⁶ In addition, the illegal downloading of movies continues the threat to intellectual property. The Internet has created situations not anticipated by previous laws. A major issue continues to be defining the public interest and individuals' private interests in the area of intellectual property.⁵⁷

Another practice that has raised questions is the use of technology to monitor consumers as they use the company's products. An example of the monitoring technology is illustrated when an individual rented a vehicle from Acme Rent-a-Car in New Haven, Connecticut, only to find out later that he was the unwitting victim of a global positioning system device planted in the minivan. The surveillance device recorded him speeding in three states at speeds from 78 to 83 mph; each violation, digitally recorded, automatically added a \$150 charge to his bill.⁵⁸

One of the most serious problems in the realm of computer scams against consumers is the scam recently identified as "phishing." An example of this occurred when a Russian who goes by the cybename of Robotector sent an e-mail with the subject line "I still love you" to 3 million people. Within the message had been planted a small computer virus that, if executed, begins to record user names and passwords each time their owner visits more than 30 online banks or payment websites. Then, this information is secretly e-mailed back to Robotector.

This technique is called “phishing” because it lures prey (computer users) with convincing bait into revealing passwords and other private data. The Anti-Phishing Working Group, an industry association, reports that during one month, May 2007, it had received 23,415 reports of phishing and that this was a typical month. During this same one-month period, the group reported it knew of 37,438 unique phishing sites to which these e-mails would direct unaware consumers.⁵⁹ The existence of these kinds of techniques points to the kinds of controversial ethical issues that arise in connection with electronic commerce.

THE WORKPLACE AND COMPUTER TECHNOLOGY

Whereas computer-based information technology creates ethical issues for consumer stakeholders with respect to electronic commerce and Web-based marketing, employee stakeholders also are significantly affected by technology in the workplace. We will discuss some of these issues in more detail, especially employee privacy, in Chapter 18. At this juncture, however, some brief discussion of the types of activities, technologies, and ethical issues that arise merits consideration.

Employees generally have a positive impression of the impact of technology in the workplace. A *USA Today* poll tracked employees’ attitudes toward the benefits of technology in the workplace over a recent five-year period. In four different

http://SEARCH THE WEB WEB

WIPING OUT INTERNET SCAMS AND FRAUD

An organization committed to wiping out Internet scams and fraud is the Anti-Phishing Working Group (APWG), a global pan-industrial and law enforcement association focused on eliminating the fraud and identity theft that result from phishing, pharming, and e-mail spoofing of all types. APWG reports its membership as 2,600 worldwide, including many companies and governments. APWG is especially concerned about phishing and pharming.

Phishing and *pharming* are two of the most dangerous Internet scams. According to APWG’s website, phishing attacks use both social engineering and technical subterfuge to steal consumers’ personal identity data and financial account credentials. Social-engineering schemes use “spoofed” e-mails to

lead consumers to counterfeit websites designed to trick recipients into divulging financial data such as credit-card numbers, account usernames, passwords, and social security numbers. Hijacking brand names of banks, e-retailers, and credit card companies, phishers often convince recipients to respond. Technical subterfuge schemes plant *crimeware* onto PCs to steal credentials directly, often using Trojan keylogger spyware. *Pharming* crimeware misdirects users to fraudulent sites or proxy servers, typically through DNS hijacking or poisoning.

To learn more about APWG, visit its webpage at <http://www.antiphishing.org/index.html>. Retrieved August 11, 2007.

ways, these technology users indicated increasing appreciation of the benefits of technology. They said that technology:⁶⁰

- Expands job-related knowledge
- Increases productivity during normal work hours
- Improves communication with clients and customers
- Relieves job stress

Other benefits of technology in the workplace include improved time management, expanded professional networks, development of a competitive edge, balance of work and family needs, and increased productivity during commuting time.⁶¹

What are some of the technologies that are currently being used in the workplace? Following is a list that is representative of the most popular technologies being used:⁶²

- Desktop computer
- Fax machine
- Answering machine
- Voice mail
- Cellular phone
- Internet
- CD-ROM
- Beeper-pager
- E-mail
- Intranet/network
- Personal electronic organizer
- Videoconferencing
- Robotics
- Global positioning systems

Surveillance

How do ethical issues arise when companies use technology in the workplace? In a word—surveillance. **Surveillance** involves companies electronically watching, monitoring, or checking up on their employees. The major ethical issue, of course, is the question of invasion of privacy. Employees are increasingly concerned about the extent to which their employers are monitoring their work-related activities and possibly their personal lives. Surveillance creates stress. Stress, in turn, may have a detrimental impact on performance or productivity. Thus, surveillance comes with attendant problems. It is useful to consider some of the technologies or ways that companies observe and monitor what their employees are doing on the job. According to a recent American Management Association study that surveyed

policy changes over the period 2001–2005, it was found that companies are increasingly keeping a closer eye on workers.⁶³

In all of the following categories, companies have increased their surveillance of computers, telephone, and video over the five-year period and the trend seems to be continuing. The percentages indicate the proportion of companies now engaging in the practice:⁶⁴

Computers

Monitoring website connections 76%

Storing, reviewing employee computer files 0%

Blocking access to inappropriate websites 65%

Storing and reviewing e-mail 55%

Telephone

Monitoring time spent, numbers called 43%

Taping phone conversations 51%

Video

Video surveillance against theft 51%

Video surveillance to monitor employee performance 16%

Increasingly, companies and managers are monitoring their employees using sophisticated new technologies. One CEO in California caught one of his employees in a lie when the employee phoned in sick. The boss had informed his employees that he had installed Xora, a software program that tracks workers' whereabouts by way of GPS technology on their company cell phones. When the boss logged onto the system, he found that his "sick" employee was not home in bed but heading down the highway to Reno. When the boss phoned him, the employee could only say "you got me."⁶⁵ In another case, a supervisor was wondering about the productivity decline in one of his workers. Using software called SurfControl, he discovered that the man was spending an excessive amount of time on an innocently named website that he later discovered featured pornography.⁶⁶ The manager observed that what employees do at home is their business, "but what they do at work is all my business."⁶⁷

Monitoring E-Mail and Internet Usage

E-mail and Internet usage are frequently abused by employees and are among the most intensely checked activities. It is little wonder why employers do this. There is evidence that employees are spending more and more of their time online in such pursuits as personal e-mail, shopping, running their own businesses, personal communication, and visiting entertainment sites.

One major reason employers check up on their employees is that inexpensive technologies are now available that enable them to do so. Most companies today do not monitor telephone calls or postal mail as much because it is too time-consuming and expensive to do so. However, companies can get software that

monitors Internet usage for less than \$10 per employee. Consequently, employee monitoring has been increasing at almost twice the rate of employees getting Internet access. According to one observer, “It’s an example of the technology cart driving the policy horse.”⁶⁸

Availability of inexpensive technologies is helpful, but companies have other important reasons for monitoring employees’ e-mail. Many of them are required to do so. The Sarbanes-Oxley Act of 2002 and other regulations require publicly traded companies to archive all their e-mail messages. And, legally, employers in the private sector have full authority to monitor e-mail provided they have created a policy and put it into place. Companies monitor e-mail to control the information that employees send through the corporate network, to make sure employees stay on task, and to see how employees are communicating with customers.⁶⁹

An example of the kind of e-mail abuse that plagues companies occurred when a young click-happy financial executive started using his e-mail in a way that eventually led to his dismissal, and this was not even a result of company monitoring. A 24-year-old Princeton graduate moved to Seoul, South Korea, to begin his new assignment for his employer. After being there only a few days, he began to send e-mails to his friends back home in the United States, boasting of his sexual exploits and lavish lifestyle. He sent this message to 11 of his buddies in his former New York office. The message ended up being forwarded to thousands of people on Wall Street and eventually was forwarded to his bosses at his new employer. The young executive was given the option of resigning or being dismissed.⁷⁰

Another example of a company monitoring employee e-mail illustrates the kinds of ethical issues that may arise as a consequence of monitoring.

Man goes to Doctor for a checkup and a battery of tests. Doctor gets results and sends them via e-mail: Man has a life-threatening disease. Meanwhile, Man’s company monitors his e-mail simply to ensure he uses it only for work. Technology officer reads Man’s e-mail and blabs to coworkers about Man’s diagnosis. Human resources gets involved. CEO gets called in, sees very expensive lawsuit looming. Health insurance company finds out about Man’s problem, considers dropping coverage. Big problems for Man. Big problems for Company.⁷¹

According to Joe Murphy, managing director of Interactive Integrity, the Internet has introduced enormous compliance risk and ethical issues for companies. There is the potential for sexual harassment, improper contact with competitors, people using chat rooms, pornography, and employees sending out proprietary information over the Internet. Technology, therefore, has shifted the burden onto companies to monitor the workplace.⁷²

In spite of the potential invasion of privacy issues, companies are monitoring employees’ e-mail and Internet usage as never before. Some of the ways in which this is being done include:⁷³

- Developing policies prohibiting the Internet for personal use
- Using monitoring software

- Restricting website access
- Restricting hours of access

Companies are not only monitoring employee use, but taking actions as well. In a Saratoga Institute/Websense survey of 224 companies, 64 percent said they have disciplined employees for misusing the Net, and one-third fired employees for it.⁷⁴ In one of the most dramatic incidences to date, Mike Soden, CEO of the Bank of Ireland, resigned from his £1 million-a-year position after he was discovered to be viewing pornographic websites on his company's computer. In a routine sweep of company Internet use, it was found that he had breached the company policy by viewing websites of what he called an "adult nature." Soden said he felt he had to resign because the policy was his in the first place.⁷⁵

Monitoring of employee activities has not been limited to their use of computers and the Internet. Increasingly, it is being reported that employers are monitoring employees' whereabouts and use of time through global positioning systems, satellite, implanting employees with microchips (with their knowledge), and hiring investigators to check up on what they are really doing at work.⁷⁶ Other recent technological approaches to monitoring employees include radio frequency ID chips, GPS-enabled cell phones, geofencing technology, and biometric devices.⁷⁷ Like all issues involving technology, there are two sides of the ethical arguments as to whether such practices are acceptable.

Biometrics

After about a decade of talk, the newly emerging field of biometrics is starting to take off, especially in commercial applications. Biometrics is the use of body measurements, such as eye scans, fingerprints, or palm prints for determining and confirming identity. The technology of biometrics typically conjures up images of Big Brother surveillance tactics, and it has met resistance in cases where the government has wanted to use it for identification purposes. What seems to be speeding up its use, however, are commercial applications that provide assistance for consumers.⁷⁸ Resistance to government applications continues to be strong.

Just in the past couple years there has been an explosion of applications in the commercial use of biometrics. In some places now, consumers can scan their fingers or wave their palms over a scanner to gain access to accounts or safe deposit boxes or to make purchases. In Japan, contactless palm-scanners are now being used when people want to withdraw cash from a cash point. In the Netherlands, a Dutch bank will be rolling out a system whereby customers may use their voices through voice analysis technology in a telephone banking system. Already, one can purchase laptop computers and mobile phones that come with built-in finger scanners. Other domestic applications include biometric door locks, garage locks, and safe locks. There are even online services that now respond to the rhythm and other characteristics of a person's typing, using a template of your "keystroke dynamics." There are flash drives that only work when activated by your thumbprint.⁷⁹ In short, biometrics is revolutionizing the way business is conducted and is expected to grow in the future.

Ethics in Practice Case

YAHOO! IN CHINA: IS THERE E-MAIL PRIVACY IN GLOBAL MARKETS?

Yahoo! has come under criticism by human rights groups who allege that the company has helped the Chinese government identify at least four people, including journalist Shi Tao, who have voiced dissent. Shi Tao, a reporter and editor for a Chinese newspaper, claims Yahoo! helped the Chinese government, causing him to be jailed for a decade.

In August 2007, the U.S. Congress began investigating Yahoo!'s role in passing sensitive information to the Chinese authorities. Police in Beijing arrested Tao after Yahoo! provided information about his e-mail account, his Internet Protocol (IP) address, log-on history, and the contents of his e-mails. Yahoo!'s vice president and general counsel admits that the company gave the details to the Chinese authorities but said they did not know why they wanted this information. Another Yahoo! spokesman said that companies doing business in China have no choice but to comply with Chinese law and that they do not know the information may be used to punish political dissidents.

Also in 2007, another Chinese political prisoner, Wang Xiaoning, and his wife, filed suit against Yahoo! under the Alien Tort Claims Act and the Torture Victims Protection Act, claiming the company helped turn him in and that it led to physical

beatings and a 10-year prison sentence. In the suit, Mr. Wang admitted that he was distributing online journal articles calling for democratic reforms and a multiparty system in China. He did this anonymously by posting the articles in a Yahoo! Group. He claims Yahoo! HK, a wholly owned subsidiary of Yahoo!, provided the police information linking him to the postings. Yahoo! HK denies the charges.

Yahoo!, along with Google, Microsoft, and Cisco, argue that issues of human rights and censorship in China are too great for them to handle alone, and they have appealed to the U.S. government to take a leadership role in this issue.

1. Has Yahoo! violated the privacy rights of these Chinese dissidents? What e-mail privacy protection could they reasonably expect from Yahoo!?
2. Does Yahoo! have a responsibility in global markets to go extra lengths to protect e-mail privacy?
3. Should the U.S. government, or any government, take a leadership role in cases like this? If so, what should they do?

Sources: Stephanie Kirchaessner, "Yahoo Faces Fresh Inquiry over Jailing of Chinese Journalist," *Financial Times* (August 8, 2007); Miguel Helft, "Chinese Political Prisoner Sues in U.S. Court, Saying Yahoo Helped Identify Dissidents," *New York Times* (April 19, 2007); Dennis Behrendt, "Yahoo! Beijing! And the Internet," *The Schwarz Report* (July 2007).

Like most technologies, biometrics has many advantages and some possible downside risks. At the moment, the focus has not been on the legal and ethical risks associated with biometrics, but this is an issue that companies, employees, and consumers will want to watch carefully in the future. The potential abuses and invasions of privacy are many and must be watched carefully. It is an issue that top managers and privacy officers will want to monitor closely.

OTHER TECHNOLOGY ISSUES IN THE WORKPLACE

Surveillance extends beyond companies monitoring e-mail and Internet usage. In addition to these activities, other forms of surveillance include monitoring faxes, using video cameras in the workplace, drug testing, doing online background checks, logging photocopies, and recording phone calls. Each of these poses privacy implications that must be considered from an ethical perspective.

The world of security via computers and technology entered a new era on September 11, 2001, as a result of the terrorist attacks on the World Trade Center in New York and the Pentagon in Washington, DC. People's attitudes about privacy changed somewhat as they realized that heightened security checks are needed to guard against terrorist attacks. These added security measures have begun in public institutions (airports, government buildings, large entertainment venues), and they are spilling over into the employment arena as companies become more cautious about their own security. There is already evidence that some use of face-recognition technology, "active" badges that track where you are, and other such technology-driven security measures have landed squarely in the workplace. There is further evidence that 9/11 spurred the development of smarter high-tech tools that are currently and will in the future come to market for business use.⁸⁰

Ethical Implications of Cell Phones and Text Messaging

Although e-mail and the Internet most often create ethical problems in the workplace, the use of company-sponsored cell phones by employees represents one of the fastest growing technologies with significant ethical and legal implications. To many, use of a cell phone is a private matter, but job pressures are leading more and more employees to use the phones while driving. Because companies now make cell phones available to their employees, this issue spills over into the business arena and becomes a business ethics topic.

A case that dramatically brought this issue to public attention was reported in the *Wall Street Journal*. Apparently, Jane Wagner, a San Francisco-based attorney, was working the kind of fast-paced day that is becoming increasingly common. Ms. Wagner was toting up billable hours on her cell phone for her employer while driving to a scheduled 10:00 p.m. meeting with a client. This was typical for Ms. Wagner—continuing to make business calls on her cell phone while driving home. This night was out of the ordinary, however. As she talked, her car swerved and struck a 15-year-old who was walking on the shoulder of the road, throwing her fatally injured body down an embankment. Ms. Wagner later said she didn't even realize she had hit someone. She said it wasn't until morning when she was watching the news while dressing for work that she realized what she had done. She turned herself in and pleaded guilty to hit-and-run—a felony. The victim's family was seeking \$30 million in damages from Ms. Wagner's employer.⁸¹

A trend with huge implications for employers is the growing number of employees—managers, salespeople, consultants, lawyers, ad executives, and

others—who are using cell phones while driving and chalking up sales or billable hours. As of May 2007, 236 million people in the United States alone subscribed to wireless communication devices. There are two primary problems with people using such devices while driving. First, drivers have to take their eyes off the road while driving, and second, they can become so absorbed in their conversations that their concentration is severely impaired. This jeopardizes not only the safety of the vehicle's occupants, but pedestrians and other vehicles as well.⁸²

Some recent statistics about cell phones and text messaging while driving are informative:⁸³

- A 2007 survey of 1,200 drivers found that 73 percent talk on cell phones while driving, and cell phone use was highest among young drivers.
- Regarding text messaging, a survey of teens found that 37 percent thought text messaging was extremely or very distracting.
- Motorists who use cell phones while driving are four times as likely to get into crashes serious enough to injure themselves.
- Many studies have shown that using handheld cell phones while driving constitutes a hazardous distraction, and one study found that talking on a cell phone while driving is as dangerous as driving drunk, even if the phone is a hands-free model.
- Washington became the first state to ban driving while text messaging, and more states are expected to follow.⁸⁴

Plaintiffs are increasingly claiming that the employer is partly to blame because it presses employees to work long hours from distant locations, often encouraging them to use cell phones without setting safety guidelines. Research is increasingly documenting the dangers of cell-phone use while driving. A study by an insurance company found that chatty drivers suffered slower reaction times, took longer to stop, and missed more road signs than drivers who were legally drunk. A new term has already been coined for accidents caused by drivers using cell phones—DWY—Driving While Yakking.⁸⁵

In another major court case, a New York investment banking firm was sued for damages in federal court by the family of a motorcyclist killed when one of its brokers, using a car phone, ran a red light and struck him. Plaintiffs claimed that employer pressure to contact clients after hours contributed to the tragedy, and the company settled the suit for \$500,000. They did not admit any wrongdoing but wanted to avoid a jury trial.⁸⁶ In December 2004, a civil case involving a car crash caused by a driver using a cell phone for business reasons was dismissed when the driver's employer agreed to pay the plaintiff \$5 million.⁸⁷

Cases such as these described here—linked to technology, the cell phone—should raise red flags for employers. Not enough companies have the needed policies on cell-phone use at this time. It appears that as high-tech tools extend the workplace into every nook and corner of life, companies have been leaving the responsibility entirely up to the employees. These cases are tragic examples of what can happen when employees, using technology, become too distracted, pressured, or overfocused on their work.⁸⁸ Businesses are moving slowly to adopt

policies against the use of cell phones while driving. One significant decision was made by the California Association of Employers, when it recommended that all employers develop a cell phone policy that would require employees to pull off the road before conducting business on their cell phones.⁸⁹

Unethical Activities by Employees Related to Technology

In most of the instances described to this point, the employer has had responsibility for the use of technology and its implications. There is a final area that should be mentioned: questionable activities that are the responsibility of the employee. These activities have been aided by computer technologies. In a major study of workers, the following percentages of workers surveyed said they had engaged in this unethical activity during the previous year:⁹⁰

- Created a potentially dangerous situation by using new technology while driving—19 percent
- Wrongly blamed an error the employee made on a technological glitch—14 percent
- Copied the company's software for home use—13 percent
- Used office equipment to shop on the Internet for personal reasons—13 percent
- Used office equipment to network/search for another job—11 percent
- Accessed private computer files without permission—6 percent
- Used new technologies to intrude on coworkers' privacy—6 percent
- Visited porn websites using office equipment—5 percent

Company Actions

Companies have many options for addressing the kinds of ethical issues described to this point. A major survey of *Fortune* 500 nonmanagement employees revealed that management should define ethical computer use for employees. Options for doing this include company management making these decisions, using the Information Systems Society's code of ethics, and involving employees and users in a collaborative attempt to decide computer ethics. Only about one-half of those surveyed indicated that company guidelines were written and well-known.⁹¹ Beyond this, companies should carefully think about the ethical implications of their use of technology and integrate decisions designed to protect employees into their policies and practices, especially their codes of conduct.

The technology we have discussed to this point is computer-driven. Therefore, guidelines for employee computer use would help in many of the arenas described. Several professional societies also offer guidelines for computer use. The Computer Ethics Institute has set forth what it calls its "Ten Commandments of Computer Ethics." These commandments are interesting and useful, and they are summarized in Figure 9-3.

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Biotechnology

The twentieth century's revolution in information technology is merging with the twenty-first century's revolution in biotechnology. Indeed, Walter Isaacson has labeled the 2000s as the "biotech century."⁹² The seeds for this revolution were spawned in 1953 when James Watson blurted out to Francis Crick how four nucleic acids could pair to form the self-copying code of a DNA molecule.⁹³ In recent years, it has been suggested that Rosalind Franklin should get some credit for this discovery.⁹⁴ In the first decade of the 2000s, we are poised for the most significant breakthrough of all time—deciphering the human genome, the one hundred thousand genes encoded by 3 billion chemical pairs in our DNA. Among other achievements, this accomplishment will lead to the next medical revolution, which will not only increase the natural life span of healthy human beings but will also help to conquer cancer, grow new blood vessels, block the growth of blood vessels in tumors, create new organs from stem cells, and certainly much more.⁹⁵

The field of biotechnology carries with it significant implications for business and for business ethics, and we can only touch upon the surface of these issues here. In fact, we now have a new industry—the biotechnology industry. According to Dr. Alison Taunton-Rigby, president and CEO of Aquila Biopharmaceuticals, Inc., a public life sciences company based in Massachusetts, biotechnology involves "using biology to discover, develop, manufacture, market, and sell products and services."⁹⁶ The biotech industry today consists of several

small entrepreneurial start-up companies funded largely by venture capitalists, along with several dozen larger, more established companies. Most of the applications of biotechnology will be in health care, the pharmaceutical industry, and agriculture.⁹⁷

BIOETHICS

A field called **bioethics** has emerged that deals with the ethical issues that are embedded in the use of biotechnology. As new biotech products are developed, thorny ethical issues will undoubtedly arise. In the medical field, for example, you may soon be able to determine the genetic makeup of your baby well before birth. Does this mean that those who control the technology have power over the population? Does it mean that people who can spend the money on customizing their baby's genetic makeup will in turn create an underclass of the genetically less fortunate?⁹⁸ These are just some of the ethical issues that arise as we think about their implications in the commercial sphere.

In recent years, the question has arisen regarding the federal government's role in funding stem cell research. One of the actions President George W. Bush took was to appoint a bioethicist, Dr. Leon Kass, to chair a presidential council on bioethics. Dr. Kass was trained both as a doctor and a biochemist before entering the field of bioethics. According to some, he became obsessed with the downside of biological research.⁹⁹ Kass was quoted as saying, "Where you have technologies that touch so deeply on the nature of our humanity, [decisions about their use] shouldn't be left to a kind of technological fatalism and free markets." Though Kass did not intend to serve as the nation's bioethics cop, "the task that's been assigned to us," he says, "is not to make arrests and catch scientists. The task is to clarify the issues, to lift the public understanding of the human and moral significance of doing what we're doing."¹⁰⁰ By 2007, Dr. Edmund D. Pellegrino had been appointed chair of the President's Council on Bioethics, and the council continues its work.¹⁰¹

On the business front, some biotechnology companies have adopted the idea of bioethics to guide them in their decision making. A question is being continually raised, however, of whether bioethical decision making is really taking place or whether the companies are using the bioethicists for public relations purposes. Companies such as Geron have pioneered the idea of a corporate bioethics advisory board. When the Jones Institute for Reproductive Medicine began its research on human embryos, it talked up the idea of panels of bioethicists. It has been observed that many companies are savvy enough to know that the greatest single obstacle to utilizing their new technologies is the potential for public backlash.¹⁰²

According to William Saletan, who has written extensively about bioethics, the primary tool bioethicists use is *proceduralism*. This involves establishing elaborate protocols that ensure that certain classical safeguards, such as informed consent, are not violated. The focus, in other words, is being sure that appropriate procedures are being followed rather than on the actual ethical content of the decisions. The worry continues, however, over whether corporate executives and

scientists are deceiving their own consciences by focusing on the *how* rather than the *why*, on the *means* rather than the *end*.¹⁰³

Both critics and supporters say that the use of bioethicists lends companies an air of credibility. The real question is this: Can they really be objective if they are on a company's payroll? Supporters say "yes," that they function like a newspaper ombudsperson who gets paid by the paper to criticize coverage and prevent potential conflicts. Detractors say "no," that there's no way around at least the appearance of a conflict of interest if money is changing hands. A real danger is that the participation of bioethicists may be interpreted as a stamp of approval.¹⁰⁴

Charles Colson has observed that "the biotech revolution has surged forward as the defining issue of this new century. On the one hand, it holds out great promise for medical advances enhancing life and health for all humankind. On the other, it raises unprecedented ethical issues." He goes on to conclude that "the biotech revolution is moving like a steamroller, fueled by huge potential profits, crushing everything—including moral restraint—in its path."¹⁰⁵ We may be too early into the biotechnology revolution to know whether this will turn out to be the case; however, it is important to raise the question of the balance between costs and benefits early on.

It is useful to consider two broad realms of biotechnology to appreciate what each represents in terms of challenges in business ethics: **genetic engineering** and **genetically modified foods (GMFs)**. Genetic engineering, primarily of humans, and genetic engineering of agricultural and food products are both part of genetic science. For discussion, however, we will separate them from one another.

Figure 9-4 summarizes a list of several nonprofit bioethics organizations that may be found on the Web.

GENETIC ENGINEERING

Two major areas of genetic engineering, or genetic science, seem to capture the public's imagination today. One is stem cell research, and the second is cloning. Both pose huge and interesting challenges for business and business ethics.

Stem Cell Research

The basic building blocks that are the progenitors of all other cells were isolated in 1998 by scientists at the University of Wisconsin. These **embryonic stem cells** are the raw materials upon which a human body is built. Since their isolation, stem cell research has been proliferating around the world. Though the United States has historically been the world leader in biotechnology, some experts say the United States has fallen behind other countries as debate over ethical implications has slowed progress.¹⁰⁶ According to a member of the President's Council on Bioethics, the debate over stem cell research centers on one basic moral question: the moral status of a human embryo—the product of sperm and egg—and what constitutes a human being.¹⁰⁷

Stem cells come from embryos, and they may be obtained in three ways: frozen embryos, fresh embryos, or cloned embryos. Spare frozen embryos may come

Figure 9-4 Websites of Nonprofit Bioethics Organizations

Bioethics is such an expansive topic that there are many different organizations, especially public action organizations, that provide information regarding specific topics via the World Wide Web. Some of these include the following:

American Society for Bioethics + Humanities (<http://www.asbh.org>)

The American Society for Bioethics and Humanities (ASBH) is a professional society of more than 1,500 individuals, organizations, and institutions interested in bioethics and humanities. This website is intended initially to serve as a source of information about ASBH for members and prospective members. It also will serve as a resource for anyone interested in bioethics and humanities by providing a group of additional online resources and links to aid in finding other related information through the Internet.

The GE Food Alert Campaign Center (<http://www.gefoodalert.org>)

This is a webpage sponsored by the Center for Food Safety. It primarily focuses on genetically engineered foods and issues related to this topic.

Do No Harm: The Coalition of Americans for Research Ethics (<http://www.stemcellresearch.org>)

This organization is a national coalition of researchers, health care professionals, bioethicists, legal professionals, and others dedicated to the promotion of scientific research and health care that does no harm to human life.

Council for Responsible Genetics (<http://www.gene-watch.org>)

The council fosters debate on social, ethical, and environmental implications of new genetic technologies. The council publishes "GeneWATCH," a national bulletin on the implications of biotechnology. The site contains testimony presented to the U.S. Congress and position papers, and functions as a legislative clearinghouse.

Bioethics.net (<http://www.bioethics.net>)

This webpage is quite extensive. It hosts the *American Journal of Bioethics Online* and the Center for Bioethics at the University of Pennsylvania. It has a special section on bioethics for beginners, as well as a special section on cloning and genetics.

National Human Genome Research Institute (<http://www.genome.gov>)

This website describes the Ethical, Legal, and Social Implications (ELSI) Research program. This program supports basic and applied research that identifies and analyzes the ethical, legal, and social issues surrounding human genetics research. The ELSI Research program currently is the largest federal supporter of bioethics research.

from fertility clinics, having been donated by infertile couples who no longer need them for pregnancy. Most ethical guidelines recommend research only on these. Fresh embryos are those that have been specially created for research, usually in a fertility clinic. Embryos can also be created by cloning human cells. In fact, in an example of how stem cell research is outrunning public policy, a Massachusetts company used cloning technology to create human embryos that would yield the cells that might give rise to tissues that would be perfect matches for patients. This technique, known as *therapeutic cloning*, has been the subject of intense debate in Congress, which has been considering legislation to ban such research.¹⁰⁸ The value of stem cells is that they offer the greatest hope for developing treatments for diseases such as cancer, Alzheimer's, Parkinson's disease, and juvenile diabetes.¹⁰⁹ Further, stem cells may be grown into tissues for transplanting into patients who need them for nerve cells, bone cells, or muscle cells.¹¹⁰

In recent years, President Bush has considered the arguments for and against the federal government funding research using stem cells. After much debate, the president decided to proceed, but cautiously. His announced decision was to allow federal government funding for research only on stem cells that have already been harvested. By allowing federally sponsored research only on existing stem cell lines, where “the life-and-death decision had already been made,” the president was able to draw a line on stem cell research that most of the public supported.¹¹¹

In 2004, former president Ronald W. Reagan died after living with Alzheimer’s disease for a decade. His wife, Nancy Reagan, had been speaking out for years, advocating expanded stem cell research. Mrs. Reagan was quoted as saying, “Ronnie’s long journey has finally taken him to a distant place where I can no longer reach him. Because of this, I’m determined to do whatever I can to save other families from this pain.”¹¹²

By 2007, 61 percent of adults polled supported stem cell research and 31 percent opposed it. In terms of using newly created human embryos for stem cell research, 53 percent favored and 41 percent opposed the practice.¹¹³ These data suggest that society is still very much divided over the issue. In spite of public opinion, companies and countries continue to push the issue. Companies want to develop cures for diseases, and countries want to have bragging rights about their technological superiority. This aggressive competition can lead to unethical practices, even fraud, and this is all the more reason why these issues have to be carefully watched.¹¹⁴

In the United States, stem cell research has not been banned, but its progress continues to be subject to competing political and ethical interests. Several states, such as California, have provided stem cell research resources, and several countries continue the pursuit of technological superiority. In the European Union, differing regulations have created some confusion among member states.¹¹⁵

Most of the ethical debate over stem cell research has occurred in the public and political arenas, not business. One gets the distinct impression that businesses are ready to move forward once the societal debate begins to show some clarity. A real danger in the debate over the use of embryonic stem cells is the almost irresistible tendency to treat them as “property” ripe for commercial exploitation. The interested parties are not isolated individuals. The beneficiaries are not just the sick, the aged, or the prematurely infirm. Research universities seeking funding and prestige will benefit; pharmaceutical companies seeking new products and investors will benefit; the government has a stake as countries compete to market therapies for degenerative diseases.¹¹⁶ The pharmaceutical industry is one of the best illustrations of how companies are already moving on research. Companies such as Johnson & Johnson, Eli Lilly, Abbott Laboratories, Schering, and Wyeth have begun conducting regenerative research using adult stem cells.¹¹⁷ A recent revelation on this front is a survey indicating that 60 percent of infertility patients say they are willing to donate their extra embryos to research. This seems to reflect a change of heart among this group.¹¹⁸

Cloning

Stem cell research is well under way. Now, **cloning** is forcing itself into the news. Some scientists say human cloning is a distant project; however, according to some reports, citizens are already lining up to freeze the DNA of their dead loved ones, including pets and racehorses. Several different groups have claimed they are attempting to clone a human being. It is said that the Raelians, a weird but rich and scientifically sophisticated sect from Canada, are trying to “re-create” a dead child at a secret location. The Raelians have chapters all over the world.¹¹⁹

Actually, there are at least two debates surrounding cloning and genetic science. First, there is the issue of cloning human beings. Second, there is the issue of cloning animals and plants and using genetics to identify and fight diseases. This second quest is currently the primary focus of science. But, it is the fascination with duplicating human beings that arouses the most debate and fear. Surveys in the United States have shown that as many as 90 percent of Americans are against human cloning; in 23 other countries around the world and four U.S. states, human cloning has been declared illegal.¹²⁰

Another variation of human cloning is known as **therapeutic cloning**. Therapeutic cloning uses the same laboratory procedures as reproductive cloning, but its aim is not procreation but rather the creation of a source of stem cells whose properties make them a possible source of replacement tissue for a wide range of degenerative diseases. Opponents of therapeutic cloning are opposed to the creation and destruction of human life for utilitarian ends. In addition, opponents fear the exploitation of women, especially in poor countries, for their eggs. On the other side of the issue, supporters want to give therapeutic cloning a chance because of its possible health advantages.¹²¹

The possibility of therapeutic cloning has raised nightmare scenarios in the minds of some. The chemicals in the human body were once estimated to be worth 89 cents. Now, however, according to the authors of a provocative, and some would say shocking, new book, body parts in people and in corpses may be worth millions. In *Body Bazaar: The Market for Human Tissue in the Biotechnology Age*, Lori Andrews and Dorothy Nelkin talk optimistically about the commercialization of the human body in pursuit of new pharmaceuticals, organ transplants, and genetic research on individuals alive or dead. The book has ethicists again asking important questions: Do individuals have “rights” to their blood and tissue? Should body parts be bought and sold? Whose body is it, anyway?¹²²

Andrews and Nelkin write that “whole businesses are developing around the body business. Companies have sprung up, for example, to make commercial products out of corpses’ bones. Some grind up the bones into powder that, when sprinkled on broken live bones, will help them mend.” They argue that body parts from the living and the dead are gold mines for pharmaceutical research. Some of the authors’ writings raise provocative ethical questions that business must face: Who owns the rights to a corpse? What ethical considerations need to be evaluated when a researcher seeks to do genetic testing on long-deceased individuals? What are the ethical considerations associated with the morbid practice of using human body parts as a means of “expression”? An exhibition that has been on tour

(Bodies: The Exhibition) depicts corpses with plasticized body parts, with flaps of skin open to display the anatomical features of the human body. Does this practice debase the sanctity of the human body?¹²³

Where does human cloning lead? For many, the difficulties arise when biotechnologists leap from stopping diseases to adding advantages—enhancing the genes that make you more intelligent or more musical. According to William Galston, “The species should be how we *are*, not how we *might be*.” In *Remaking Eden*, Lee Silver, a Princeton biologist, foresees the possibility of a two-class system, with the rich, genetically enhanced “GenRich” class lording it over the poorer, inferior “Naturals.”¹²⁴ The ethical implications of such potential futures for business are mind-boggling.

In a further insight into where cloning may be heading, a cartoon by Tom Toles depicted a man in an office sticking his head into the office copier; off to the side, there were cloned copies of him coming out of the machine. A sign on the wall stated, “July 2018. The ethical debate, part 2,473,561,” and the question posed beneath the cartoon read: “Should employees be allowed to use the office cloning machine for personal business?”

Cloning Animals for Food

The hottest issue on the cloning front is that of companies wanting to clone animals for food. Scientists and consumer experts in the United States have been debating whether the United States should become the first country in the world to allow food from cloned animals onto supermarket shelves. During early 2007, the Food and Drug Administration (FDA) held an open period for public comment on the issue. Thousands of consumers wrote to the FDA protesting allowing cloned foods into the food supply. One consumer said the thought was “unethical, disturbing, and disgusting.”¹²⁵ Scientists and companies, however, almost completely support cloning for food, indicating they see the technology as an effective, important way to produce higher quality, healthier food. The FDA seems to have discounted emotional appeals and is leaning toward allowing the practice.¹²⁶ A related issue is whether food from cloned animals should be labeled as such. The FDA does not seem to think such labeling is necessary, but opponents say such labels are essential.

Opponents of cloning animals for food come from a large number of different consumer and scientific groups. Consumer advocate organizations such as the Center for Food Safety, Consumers Union, and the Consumer Federation of America, along with environmental and animal welfare groups have protested the idea. They think there is inadequate data regarding the safety of such a practice and that there needs to be more review of the potential consequences of such a decision. A minority of scientists agree with the consumer groups that cloned animals should not enter the food supply.¹²⁷ This is likely to be a hotly debated ethical issue in the months and years to come.

Genetic Testing and Profiling

One of the most significant areas of potential questionable application of biotechnology is **genetic testing**. Genetic testing flows from genetic profiling. It is

said that someday each of us will have a DNA chip that contains all our genetic information. There are positives associated with this. It will help each person manage his or her own personal health risks. It will also help a physician predict how well a patient will respond to various therapies. Future drugs will be developed using genetic information so that the therapy will be coupled with the DNA information. However, **genetic profiling** also provides a perfect means for identifying a person and thus raises questions of privacy and possible discrimination based on genetic factors.¹²⁸

In the early 2000s, the U.S. Equal Employment Opportunity Commission (EEOC) settled its first court action challenging the use of workplace genetic testing under the Americans with Disabilities Act of 1990 (ADA). The EEOC had sought an injunction against Burlington Northern Santa Fe Railway (BNSF) to end genetic testing of employees who filed claims for work-related injuries based on carpal tunnel syndrome. According to the EEOC, the company's genetic testing program was carried out without the knowledge or consent of its employees, and at least one worker was threatened with termination for failing to submit a blood sample for a genetic test.¹²⁹ Under the settlement, BNSF also agreed that it would not analyze blood it had previously obtained, nor would it retaliate against employees who opposed the testing. According to the EEOC, "Our swift action in this case allows Burlington Northern employees to continue to work free of retaliation and future invasions of privacy."¹³⁰

In 2007, the U.S. House of Representatives passed a bill designed to prevent discrimination against persons based on the use of genetic information. The issue then moved on to the Senate, and the bill has not yet been made into law as of this writing. The proposed bill, the Genetic Information Nondiscrimination Act of 2007 (GINA), would prohibit employers from using genetic information when making hiring, firing, promotion, or job assignment decisions. Also, employers would have to treat any genetic information in the same way that they treat other confidential information.¹³¹

In spite of the proposed GINA law, the general opinion seems to be that the federal government is doing very little in the area of regulating genetic testing or the use of these tests. What few regulations that do exist are spread over multiple agencies for their enforcement, and very little inter-agency coordination is taking place.¹³²

GENETICALLY MODIFIED FOODS

Another major category of biotechnology that carries important ethical implications for business is the topic of genetically modified foods. This is especially the case for the multibillion-dollar agribusiness industry. Many wholesalers and retailers, however, are also involved in the distribution of genetically modified foods. Genetically modified foods (GMFs) are also commonly referred to as *genetically engineered foods (GEFs)*. Extreme critics call them "Frankenfoods," calling attention to the parallels with the fictional Dr. Frankenstein's creation. The world today seems to be divided into those who favor GMFs and those who fear them. Also, a significant number of consumers are simply not informed enough to know but are quick to offer their gut-reaction opinions, usually based on fear

rather than facts. Because no one seems to have been “hurt” by GMFs, there is a lot of wild speculation as well as apathy or indifference at work in judging the ethics and implications of GMFs.

Scant information is available to the public as to the actual safety or lack of safety of these products, because field-testing is continuing. According to L. Val Giddings, vice president for food and agriculture at the Biotechnology Industry Organization, “There is still not so much as a single, solitary sniffle or headache positively linked to their consumption.”¹³³ A British research panel concluded in 2003 that there is no evidence that GM crops now in commercial cultivation are more dangerous to human health than conventional foods.¹³⁴ Therefore, the debate seems to hinge on whether the pros or cons of GMFs will win out as the arguments are presented.

One of the most recent major surveys on the public’s knowledge about and concern with GMFs was published in 2006 by the Pew Initiative on Food and Biotechnology.¹³⁵ This survey revealed that Americans’ knowledge of genetically modified foods and animals continues to remain low. Despite continuing concerns about GM foods, consumers do not support banning new uses of the technology, but rather seek an active role from regulators to ensure that new products are safe. Although a majority of respondents are uncomfortable with genetically modifying animals, the most widely favored uses are those that provide protection against disease. When asked about importation of foreign GM products, consumers demonstrated little awareness but clearly favored U.S. regulation.¹³⁶

Two dramatic events introduced the U.S. public’s attention to the topic of genetically modified foods. The first was the discovery in 2000 that genetically engineered animal corn—*potentially* harmful to humans—was found in Taco Bell taco shells. Later, it showed up in Safeway Inc.’s house-brand taco shells. The genetically engineered corn, called *Starlink*, is a product that was altered to make it resistant to pests. It contains a foreign protein that is probably safe for human consumption but has some of the chemical characteristics of a human allergen, a term for substances that can trigger anything from a mild allergic reaction to a fatal case of shock. Animal feed, of course, is not supposed to get into the human food supply, whether it is genetically modified or not. The event apparently happened by accident, but it represents a case where special tracking of biotech crops might have allowed the industry to identify the corn and remove it.¹³⁷

The second event has been the publicity on the widespread objection to GMFs in Europe, especially in the European Union (EU). Vocal European objections to GMFs have been around for five to seven years. In Europe, polls show that a majority of people believe that products made from genetically modified organisms (GMOs) are hazardous to their health.¹³⁸

Though public opinion in Europe seems to be largely in opposition to GMOs, there is recent evidence that even the European Union has been approving genetically modified crops for human consumption while secretly warning about their impact on health and the environment.¹³⁹ Activist groups such as Friends of the Earth and Greenpeace have called for the immediate suspension of the use and sale of all GM foods and crops until the safety issues have been addressed.¹⁴⁰ The new EU regulations require that consumers will need to be notified when a

product contains as little as 0.9 percent genetically modified ingredients. In further steps, the EU will require that farmers and food packagers “track” the ingredients from farm to store and that Europe will soon lift a six-year ban on testing new bioengineered crops for cultivation on European soil.¹⁴¹ In Great Britain, the government has also recently granted permission for a strain of GM maize to be grown commercially as cattle feed.¹⁴²

Americans have been growing and consuming genetically modified foods for years, especially foods such as herbicide-tolerant soybeans and pest-repellent corn, with little evidence of apparent risks to human health or the environment. The U.S. FDA, however, continues to investigate some small number of claims that such consumption has generated allergic reactions.¹⁴³ To date, there have been virtually no actual reports of specific health risks of GMOs to consumers. Their safety is a continuing topic of debate in scientific and environmental circles, but public opinion polls in the United States find that the issue has yet to ignite much interest or concern among the public at large.

Will there be a consumer backlash against biotechnology in food production when the public becomes more familiar with it? Recently, more concern has been expressed about questionable food products, including seafood and vegetables being imported, than GMFs. It is an issue that merits continued close examination.

In spite of public approval or indifference, evidence of some reservations continues. In 2004, for example, Monsanto Co. bowed to resistance from the U.S. food industry and decided not to introduce its new bioengineered wheat. For now, at least, it will not commercialize a type of wheat that can tolerate exposure to its Roundup herbicide, a trait that would make it easier for farmers to kill weeds chemically without harming the wheat itself.¹⁴⁴ Monsanto has met resistance in the past. For example, the company shelved its bug-resistant potato partially

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BENEFITS AND CONTROVERSIES OF GENETICALLY MODIFIED FOODS (GMFS)

Technologies for genetically modifying (GM) foods offer dramatic promise for meeting some areas of challenge for the twenty-first century. Like all new technologies, they also pose some risks, both known and unknown. Controversies surrounding GM foods and crops commonly focus on human and environmental safety, labeling and consumer choice, intellectual property rights, ethics, food security, poverty reduction, and environmental

conservation. To learn more about the benefits and controversies surrounding GMFs, check out this website and think about the implications for business ethics.

Human Genome Project Information, “Genetically Modified Foods and Organisms,” http://www.ornl.gov/sci/techresources/Human_Genome/elsi/gmfood.shtml.

because fast-food giants such as McDonald's did not want its French fries caught up in the biotech debate.¹⁴⁵

In related developments, the debate over whether meat or milk from cloned animals should be sold continues. In the fall of 2003, the FDA released a report saying that cloned animals pose no greater risk to human health than normally bred animals. This is the first time that a regulatory agency has said that such animals are safe to eat, and it increases the likelihood that the FDA will lift its voluntary ban on the sale of meat, milk, and food products made from cloned animals. Balancing this position, the Center for Science in the Public Interest claims that that evidence is in short supply and that the FDA risk assessment made numerous assumptions that the public may not make.¹⁴⁶ By the end of 2006, the FDA was on a course to endorse marketing of the milk and meat for public consumption.¹⁴⁷ In 2007, however, the controversial decision sparked an immediate backlash from public health groups, such as the Center for Food Safety, as well as industry bodies unwilling to see the change unless they became convinced of the science.¹⁴⁸ At this writing, this issue is still unresolved.

Labeling

One of the most frequently discussed issues with respect to GMFs is the topic of labeling. Many consumer activists think that, at a minimum, foods that contain genetically engineered contents ought to be labeled as such. The Consumer Federation of America Foundation, for example, issued a report recommending mandatory labeling and other ways to improve U.S. biotech food regulations. To date, the Food and Drug Administration has not required labeling of GMFs. The FDA has deliberated new rules wherein biotech companies would have to meet with federal regulators before putting a new product on the market, but they would not require special product labels. The FDA has been working on the new guidelines in an attempt to reassure consumers that GMFs are safe. Further, the agency plans to offer guidelines for companies that choose to use labels on a voluntary basis.¹⁴⁹

In spite of inaction on the part of the FDA, the labeling issue will not go away. Proponents of mandatory labeling argue that the consumer has a right to full disclosure about product contents and that the consumers' right to safety argues that such knowledge should be available to them. Related to this, one of the hottest trends in food marketing is the *non-GMO label*, which stands for "nongenetically modified organisms." Just a few years ago, this was unknown in the United States. Now, however, it is popping up frequently as companies attempt to take strategic advantage of their products that do not contain GMOs. The non-GMO label is now being seen on hundreds of products ranging from pasta, produce, and breakfast cereals to frozen entrees, condiments, and beverages. Industry executives believe this is a fast-growing market segment, and though labels are not mandatory, some consumer segments are attracted to this product feature.

Opponents of mandatory labeling for GMFs argue that there is no evidence that the products have any health hazards and that being required to carry a

“genetically engineered” label would stigmatize the food products and raise issues of safety where none exist. They support their argument by pointing to the fact that the FDA has concluded that GMFs are “substantially similar” to conventional foods and thus do not need to be labeled or tested for safety.

The issues of safety and labeling of GMFs are not likely to go away. Special-interest groups on both sides of the debate continue to be active in advocating their points of view. The agribusiness industry continues to argue that the foods are safe and that mandatory testing and labeling are not necessary. Consumer activists, however, have brought together environmentalists, organic farmers, chefs, and religious leaders, and they continue to make the case for rigorous safety testing and labeling.¹⁵⁰ To be sure, all consumer stakeholders are potentially affected by the outcome of these debates, so it is likely that they will continue into the near future.

Summary

Business use of technology today is so dramatic that the topic merits a separate chapter. In this chapter, basic concepts such as technology and the technological environment were introduced and defined. The benefits and side effects or hazards of technology were discussed. The symptoms of society’s intoxication with technology were outlined. Questions regarding the ethics of technology were raised in two broad domains: information technology and biotechnology.

In the realm of information technology, the category with the most widespread current impact in business, topics included electronic commerce, invasion of privacy via e-commerce, government’s involvement in Internet privacy invasion, and business initiatives. Questionable practices and uses of technology were raised, including particular industries such as the porn industry, Internet gambling, and Web-based music services. Computer technology in the workplace, one of the most

significant areas of application, has been used for monitoring e-mail and employee movement, as well as Internet usage and other forms of surveillance. Questions regarding the ethics of new technologies such as cell phones were also raised. The field of biometrics merits close watch in the future.

The field of biotechnology was discussed with respect to social and ethical implications. A key topic in this sphere included the new field of bioethics. Two arenas of biotechnology were identified and discussed—that of genetic engineering, to include a discussion of stem cell research, cloning, and genetic testing and profiling; and the general domain of genetically modified foods. It is anticipated that the debate over food safety and labeling will continue for years as different interest groups raise questions about the appropriateness and safety of genetically modified foods.

Key Terms

bioethics (page 375)

biotechnology (page 355)

chief privacy officer (CPO) (page 362)

cloning (page 379)

electronic commerce (page 356)
embryonic stem cells (page 376)
ethical lag (page 353)
genetically modified foods (GMFs) (page 376)
genetic engineering (page 376)
genetic profiling (page 381)
genetic testing (page 380)

information technology (page 355)
surveillance (page 366)
technological determinism (page 353)
technological environment (page 350)
technology (page 349)
therapeutic cloning (page 379)

Discussion Questions

- Are there any benefits or negative side effects of technology in business that have not been mentioned in this chapter? Discuss.
- Do you agree that society is intoxicated with technology? Does this pose special problems for business with respect to the ethics of technology? Will such intoxication blind people to ethical considerations?
- Do you think business is abusing its power with respect to invasion of privacy of both consumers and employees? What about surveillance? Which particular practice do you think is the most questionable?
- Is it an exaggeration to question the ethical implications for business of cell-phone and text-messaging use? Discuss both sides of this issue.
- Do you think genetically modified foods raise a legitimate safety hazard? Should government agencies such as the FDA take more action to require safety testing? What about warning labels? Do you think warning labels would unfairly stigmatize GMFs and make consumers question their safety? Is this fair to the GMF industry?

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Ethical Issues in the Global Arena

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Identify and describe the concepts of internationalization and globalization of business.
- 2 Summarize the arguments for and against globalization.
- 3 Explain the evolving role of and problems with multinational corporations in the global environment.
- 4 Recognize the major ethical challenges of operating in the multinational environment.
- 5 Describe ISCT and the concepts of hypernorms and moral free space.
- 6 Discuss strategies for improving global ethics.
- 7 Enumerate international rights and moral guidelines for improving business operations in the global sphere.

The rise of global business as a critical element in the world economy is one of the most significant developments of the past 50 years. This period has been characterized by the rapid growth of direct investment in foreign lands by the United States, by countries in Western Europe, by Japan, and by other industrialized countries as well. In the United States, domestic issues have been made immensely more complex by the escalating international trend. At the same time, the internationalization of business has created unique problems of its own. It no longer appears that international markets can be seen as opportunities that may or may not be pursued. Rather, international markets now are seen as natural extensions of an ever-expanding global marketplace that must be pursued if firms are to remain competitive. Only recently has there been evidence of a backlash against global business. The attacks on the World Trade Center on September 11, 2001, the most shocking development to date, were seen by many as an attack on global capitalism, especially that practiced by the United States.

This event likely will modify the practice of global business and its ramifications for business ethics in ways yet unseen.

Peter Drucker has termed the expanded marketplace the **transnational economy**. He goes on to say that, if business expects to establish and maintain leadership in one country, it must also strive to hold a leadership position in all developed markets worldwide. This apparent need helps explain the worldwide boom in transnational investments.¹ One early definition of this transnational or global economy was as follows: trade in goods, a much smaller trade in services, the international movement of labor, and international flows of capital and information.² In recent years, we have seen the globalization trend explode, and its critics continue to oppose many of these efforts. In the United States, for example, arguments over the outsourcing of jobs to less developed countries continue to be a subject of national debate.

The complexity introduced by the transnational economy and the globalization of business is seen clearly when ethical issues arise. At best, business ethics is difficult when we are dealing with one culture. Once we bring two or more cultures into consideration, it gets extremely complex. Managers have to deal not only with differing customs, protocol, and ways of operating but also with differing concepts of law and standards of acceptable practices. All of this is then exacerbated by the fact that world political issues become intertwined. For example, what might be intended as an isolated corporate attempt to bribe an official of a foreign government, in keeping with local custom, could explode into major international political tensions between two or more countries.

The New, New World of International Business

We have traversed through several different eras in the internationalization of business since the post-World War II decade (1945–1955). There have been the Growth Years (1955–1970), the Troubled Years (1970–1980), and the New International Order (1980–present), according to one international business expert.³ The New, New World of international business and business ethics can be said to have begun in the fall of 1999.

Thomas Friedman, in his seminal book *The World Is Flat: A Brief History of the Twenty-First Century* (2006), argued that there have been three great eras of globalization. Using the numbering system of the software industry, Friedman argues that Globalization 1.0 was during the period 1492–1800 and Globalization 2.0 covered 1800–2000. Globalization 3.0 began in 2000, according to Friedman, and continues today. Friedman argues that when the Internet and e-commerce became robust in the late 1990s, the world shrunk from a size small to a size tiny.⁴ He argues that the availability of cheap labor and telecommunications the world over has had the effect of creating a “flat” world. Thus, no matter where a company is physically

located, it can now compete for customers who may be located anywhere in the world. Friedman argues that the driving force of this flattening process is globalization and that it is gaining momentum.⁵

The first strong evidence of a backlash movement against globalization occurred in the fall of 1999. At that time, the World Trade Organization (WTO) was meeting in Seattle, and there were massive demonstrations and protests in the streets. The WTO talks collapsed as fifty thousand protestors rioted, expressing extreme hostility and violence toward the idea of global business.⁶ This backlash against globalism continued with massive demonstrations in Washington, DC, in April 2000, Prague in the fall of 2000, Quebec in April 2001, Genoa during the summer of 2001, and Cancun during 2003. On a lesser scale, it continued through the G8 meeting of world leaders in Sea Island, Georgia, in the summer of 2004, though the protests were moderated. Even in 2006, a Time.com article was still discussing the backlash against globalization.⁷

Another defining moment in the backlash against globalization had to be the terrifying attacks on the World Trade Center in New York City and the Pentagon in Washington on September 11, 2001, resulting in massive death and destruction. A number of observers have claimed that the hostile attacks against the twin towers of the World Trade Center represented an attack on America's leading role in global business and all it stands for. Though it is hard to know whether this is a valid interpretation, many feel that it is and, in any event, this horrific incident marks a moment in time when world trade and commerce will never be the same or be seen in the same light. This significant act of mass murder and destruction has changed global business and will continue to impact the related concerns of global business ethics and global corporate citizenship.

Perhaps the most recent series of events that might increase the backlash against globalization occurred during 2007 in the United States. The events had to do with the importation from China of dangerous products into the United States. Beginning early in the year, tainted pet food was traced to China; since then, other unsafe products have been traced to Chinese origins. The incidents involved potentially deadly, defective, or contaminated products, including toys, tires, toothpaste, cough syrup, and seafood.⁸ The dangerous products awakened both the United States and China to a latent crisis. For China, if it does not correct these problems, it will have a significant dampening effect on its exports. For the United States and other affected countries, it raises the questions of product safety and regulation over imports and the issue of who is legally responsible when foreign products hurt people in the importing country.⁹ Both countries are taking initiatives to resolve these problems, but one can't help but wonder whether this might generate another dimension of backlash against global trade.

To explore the topic of globalization further, it is first helpful to consider what global business really means. Second, it is useful to consider briefly some of the sentiments behind the continuing protests against globalism, because this new reality of world attitudes and questions being raised about global capitalism cannot be ignored.

CONCEPTS OF GLOBAL BUSINESS

A number of different terms are used to describe the trends in global business over the past several decades. Some of the more prominent ones include internationalization, globalization, globalism, and global capitalism. Countless businesses today have become internationalized but not necessarily globalized. **Internationalization** may be thought of as a “process by which firms increase their awareness of the influence of international activities on their future and establish and conduct transactions with firms from other countries.”¹⁰ Some of the characteristics of internationalization include exporting, acting as licensor to a foreign company, establishing joint ventures outside the home country with foreign companies, and establishing or acquiring wholly owned businesses outside the home country.¹¹

By contrast, the terms **globalism or globalization** suggest the economic integration of the globe. Globalization refers to “global economic integration of many formerly national economies into one global economy.”¹² This is made possible by free trade, especially by free capital mobility, and by easy or uncontrolled migration. Whereas internationalization simply recognizes that nations increasingly rely on understandings among one another, globalization is the “effective erasure of national boundaries for economic purposes.”¹³ Though these are technical distinctions that are helpful to be aware of, it is not always clear when people talk about globalization whether they are just using it as another term for internationalization of business or seeing it as global economic integration. Sometimes observers are just referring to global capitalism, which is the system of free movement of resources around the world. Obviously, true globalization is an extreme status that has not yet been achieved, but one that many hold as an ultimate aspiration.

According to *BusinessWeek*, globalization today is a term that has come to encompass everything from “expanded trade” and “factories shifting around the world” to the “international bodies that set the rules for the global economy” (i.e., the World Trade Organization, the International Monetary Fund, and the World Bank).¹⁴ For our purposes, *BusinessWeek*’s broad concept of globalism or globalization probably fits best. It encompasses both internationalization and trends toward globalization, and invokes the roles of the major international organizations. We should remember, however, that we often need to probe deeply to figure out how someone is using these terms, for they may mean different things to different people.

CONTINUING BACKLASH AGAINST GLOBALIZATION

We stated earlier that there has been an evident backlash against globalization that has been most apparent since the protests in Seattle in the fall of 1999 against the activities of the World Trade Organization (WTO). The protestors at the Seattle meeting have been described in various ways. They have been identified as a peculiar meld of extreme leftists and rightists, trade unionists, radical

environmentalists, and self-appointed representatives of civil society insisting on saving the poor people of developing countries from economic development.¹⁵ They have also been described as a visible coalition between labor and environmentalists—“teamsters and turtles”—as one sign said, as well as other key constituencies, such as human rights activists.¹⁶ In short, they are special-interest groups committed to halting the expansion of global capitalism and trade.

The backlash against globalization that began in Seattle continued at a number of important global meetings since then. The height of the protests and destruction came in Genoa, Italy, in the summer of 2001 at the G8 Summit meeting of the eight wealthiest countries in the world. There were at least two days of violent riots that resulted in death and destruction. The violence at the G8 Summit shocked the world. One positive outcome of the Genoa meetings was an exposure of and split within the antiglobalization ranks between those who want to reform global capitalism peacefully and the anarchists who want to destroy it.

Protestors promised to continue their opposition at future meetings, saying that some of the attacks have been a direct result of U.S. foreign policy and that only an end to global capitalism would ensure safety for all.¹⁷ Surely, there was more behind the terrorism than opposition to global business, but this is how many saw it. The controversy surrounding globalization has continued in other meetings of international bodies. In recent years, the breakdown of trade talks in Cancun in 2003 is one of the most significant examples. Many poor countries were counting on the WTO's Fifth Ministerial Conference in Cancun, Mexico, to improve the status of poor countries relative to developed countries, but the talks failed and were closed when it became apparent progress was not being made.¹⁸ One analyst held that the trade talks failed “because of intransigence and brinkmanship by both rich and poor countries; because of irresponsible and inflammatory behavior by NGOs; and because of the deeply flawed decision-making system of the WTO itself.”¹⁹

Two recent issues have heightened sensitivities, especially in the United States, toward globalization: the trend toward the outsourcing of jobs to less-developed nations and the tenth anniversary of NAFTA.

In the past few years, no other single issue has heightened debate over globalization in the United States more than the trend toward companies moving jobs offshore. First, it was manufacturing jobs. Recently, it has been technical jobs, including higher paying white-collar jobs in the information technology industry. Economists and social scientists on both sides of this issue are debating it continuously, but public opinion polls show that **outsourcing** (also called **offshoring**) jobs abroad is unpopular. Polls have shown that most Americans believe the outsourcing of jobs abroad is bad for the economy.²⁰ This opinion has been registered in spite of the jobs data, which has shown little impact on aggregate job losses being attributed to the offshoring trend.²¹ In addition to the outsourcing of jobs has been the insourcing of cheap labor as manifested in the illegal alien controversy.

The second major issue to bring the subject of globalization into renewed debate was the tenth anniversary of the passage of the **North American Free**

Trade Agreement (NAFTA). NAFTA, passed in 1994, brought under one canopy three significantly different economies—the wealthy United States, the middle-class Canada, and striving Mexico. According to one observer, the pain of NAFTA has been felt most in the Midwest, where manufacturing jobs have been lost to Mexico and Canada, and are now being lost to China and other developing countries. It is believed that NAFTA-related job losses have been amplified by other jobs lost to globalization and that NAFTA has become the “symbol of all of that pain.”²² It is apparent that the concern over moving jobs offshore and the anniversary of NAFTA have fueled antagonism toward globalization in recent years.

The New, New World of globalization (Friedman’s Globalization 3.0) is one in which the pros and cons of globalization are now back on the table for consideration and discussion. Many observers think globalization is inevitable; an opposing group thinks a form of “globophobia” has set in. The debate on globalization is likely to continue for some time.

Globalists and Antiglobalists

The Center for the Study of American Business recently published a major report on the pros and cons of globalization. They argued that on one side we see the **globalists**, who strongly advocate open markets with private firms moving freely across the globe. They believe that investors, consumers, employees, and environmentalists are better off due to globalization. On the other side are the **antiglobalists**, who have taken to the streets to protest the expansion and greed of corporate global enterprises. They believe that globalization is responsible for the destruction of local environments and emerging economies, abuses of human rights, the undermining of local cultures, and the sovereignty of nation-states.

The antiglobalists also decry the power of international bodies, notably the World Trade Organization, the International Monetary Fund, and the World Bank.²³ Figure 10-1 summarizes some of these two groups’ views on globalization as it affects consumers, workers, the environment, developing nations, and human rights. It should be clear from these pros and cons that globalization has significant ethical issues embedded in it for stakeholders.

While having to accept globalization as a reality that seems to be taking over the world, the backlash against globalization continues today among most of the rich nations of the world. Large majorities of people in the United States and Europe are viewing globalization today as an overwhelmingly negative force, and citizens are looking to their governments to cushion the blows they believe have come from their countries’ trading with emerging nations.²⁴ *Financial Times*/Harris polls (2007) in Britain, France, the United States, and Spain revealed people were three times more likely to say that globalization was having a negative effect than a positive effect on their countries. The opinion of executives that opening economies to freer trade is beneficial to poor and rich nations alike is apparently not shared by the citizens of the rich countries.²⁵

Figure 10-1 *The Pros and Cons of Globalization*

		Globalists	Antiglobalists
Impact On:	Consumers	Open markets allow for free trade of goods and services, lower costs, greater efficiency. Lower prices, greater variety of goods and services, rising living standards.	Benefits the wealthy and further impoverishes the poor. Widening wealth gap worldwide. Harmful to low-income consumers.
	Employees	Faster economic growth; higher wages; more employment; improved working conditions.	Globalism places profits above people—depressing wages, displacing workers, undermining workers' rights.
	Environment	Global capitalism means rapid economic growth, resources necessary to clean up environments, development of more efficient CO ₂ -reducing technologies, protection of ecosystems; pollution reduction.	Results in exploitation and destruction of ecosystems in name of corporate greed. Ignores adverse impacts on environments. More pollution, especially carbon dioxide. Exacerbated global warming.
	Developing Nations	Open markets, cross-border investments are keys to national economic development. Higher standards of living, better working conditions, cleaner environments.	Global capitalism, world trade bodies, world financial institutions conspire to keep developing nations in debt, destroys local economies, further impoverishes peoples.
	Human Rights	Free and open markets create cultures/institutions supporting rule of law and free expression. Spreads economic/political freedom to far corners of world (e.g., Taiwan and South Korea).	In blind pursuit of profits, global corporations ignore abuses of human rights, including political and religious oppression, false imprisonment, torture, free speech, abuses of workers, especially women and children.

Source: Summarized from Robert Batterson and Murray Weidenbaum, *The Pros and Cons of Globalization* (St. Louis: Center for the Study of American Business, January 2001), 3–12.

Against this backdrop of the New, New World of business that we now find ourselves in, we can consider some of the ongoing ethical challenges faced by **multinational corporations (MNCs)** as they do business in the global sphere.

MNCs and the Global Environment

Not all problems of operating in a global business environment are attributable to MNCs. However, MNCs have become the symbolic heart of the problem because they represent the prototypical international business form. Whereas in 1962

almost 60 percent of the largest corporations in the world were U.S.-based, it has been assumed for years that they were the major targets of the antiglobalization movement. In modern times, American MNCs are no longer dominant. Today, only about 185 of 500 of the largest MNCs in the world are U.S.-based. The European Union has 126 and Japan has 108. Further, MNCs of developing countries, such as Mexico's Cemex, are sprouting up.²⁶ The size of the MNCs is another reason they are highlighted. According to *Global, Inc.*, only 47 of the 100 largest "economies" of the world are now nation-states. The other 53 are MNCs. For example, ExxonMobil Corporation, the world's largest company in terms of sales, has annual revenues that exceed the gross domestic product (GDP) of all but 20 of the world's 220 nations.²⁷

CHANGED SCOPE AND NATURE OF MNCs

Over the years, both the scope and the nature of MNCs have changed. In the early 1900s, the United Fruit Company was growing bananas in Central America and achieving a degree of notoriety for its "invasion" of Honduras. Another wave of MNCs was in the extractive industries (oil, gas, gems). Today, financial institutions, chemical companies, pharmaceutical companies, manufacturers, and service firms represent the kinds of enterprises that may be found operating in the global business environment.

The investment of U.S.-based MNCs has been phenomenal over the past three decades or more, growing to well into the hundreds of billions of dollars. Likewise, European and Asian MNCs have grown significantly during this same time period. We should also note that the most challenging situation for MNCs is when they are operating in so-called emerging nations, developing countries, or **less-developed countries (LDCs)**, where charges of exploitation and abuse of power seem more plausible. These situations are ripe for charges of capitalist imperialism in struggling economies, and they are often cited by the antiglobalists.

UNDERLYING CHALLENGES IN A MULTINATIONAL ENVIRONMENT

There are at least two underlying and related challenges or problems as firms attempt to operate in a multinational environment. One problem is *corporate legitimacy* as the MNC seeks a role in a foreign society. The other problem is the fundamentally *differing philosophies* that may exist between the firm's home country and the host country in which it seeks to operate.²⁸ These two challenges set the stage for examining how ethical problems arise in the global environment.

Corporate Legitimacy

For an MNC to be perceived as legitimate in the eyes of a host country, it must fulfill its social responsibilities.²⁹ As we discussed in Chapter 2, these include economic, legal, ethical, and philanthropic responsibilities. Larger firms, in particular, are seen as outsiders, and the expectations on them are greater than

on smaller, less visible firms. Further, the similarities and differences between the cultures of the two countries affect the perceived legitimacy. For example, an American firm operating in Canada is not likely to experience major problems. An American or a Western firm operating in Saudi Arabia, however, could be perceived as quite alien.³⁰ Differences between the values and lifestyles of managers who live in the two countries could pose serious legitimacy problems. If a host country finds the lifestyles or values repugnant—as many LDCs may well find the materialistic lifestyles and values of managers from advanced economies—legitimacy may be difficult to achieve.

Another, perhaps more basic, barrier to achieving legitimacy is the inherent conflict that may exist between the interests of the MNC and those of the host country. The MNC is seeking to *optimize globally*, while host governments are seeking to *optimize locally*. This may pose little difficulty for an MNC operating in a developed country, where macroeconomic or regulatory policies are sophisticated and appropriate. But it may pose serious problems in the LDCs, where there is often the perception that MNCs are beyond the control of local governments. In these latter situations, especially, it is not uncommon to see the local government impose various control devices, such as indigenization laws requiring majority ownership by locals, exclusion of foreign firms from certain industries, restrictions on foreign personnel, or even expropriation.³¹

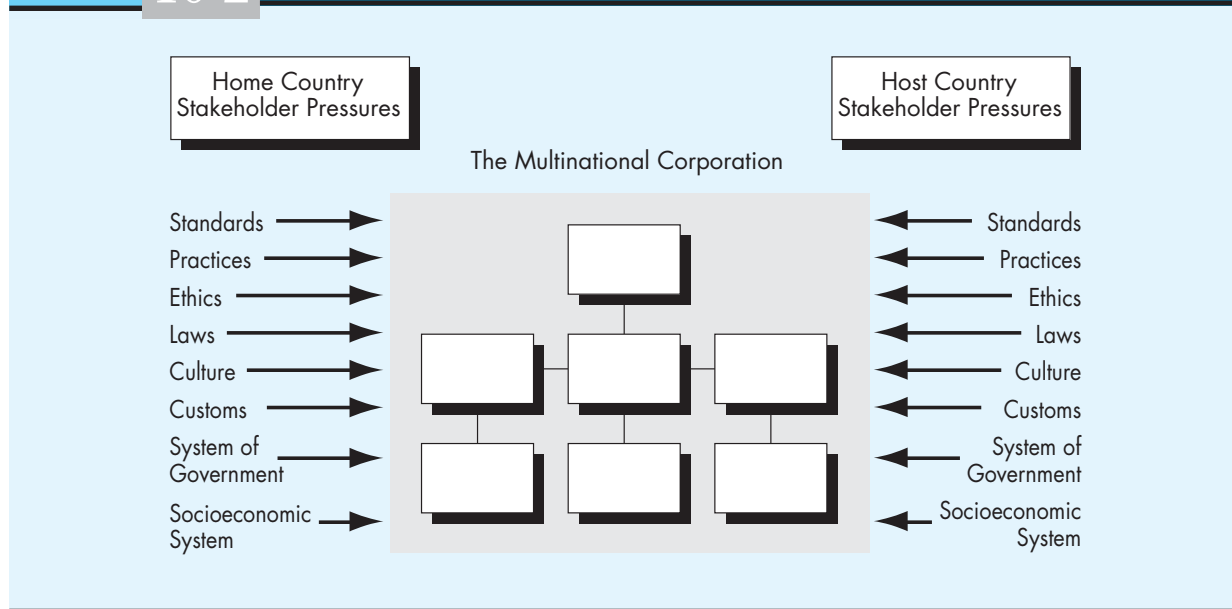
Differing Philosophies between MNCs and Host Countries

Closely related to the legitimacy issue is the dilemma of MNCs that have quite different philosophical perspectives from those of their host countries. The philosophy of Western industrialized nations, and thus their MNCs, focuses on economic growth, efficiency, specialization, free trade, and comparative advantage. By contrast, LDCs, for example, have quite different priorities. Other important objectives for them might include a more equitable income distribution or increased economic self-determination. In this context, the industrialized nations may appear to be inherently exploitative in that their presence may perpetuate the dependency of the poorer nation.³²

These philosophical differences build in an environment of tension that sometimes results in stringent actions being taken unilaterally by the host country. During the 1970s, for example, the environment for MNCs investing in LDCs became much more harsh. Some of these harsh actions initiated by the host countries included outright expropriation (as occurred in the oil industry) and creeping expropriation (as occurred in the manufacturing industries when foreign subsidiaries were required to take on some local partners). Other restrictions included limits on profits repatriation.³³ As a result of the dilemmas that the MNCs face, it is easy to understand why Richard DeGeorge has argued that “First World MNCs are both the hope of the Third World and the scourge of the Third World.”³⁴

Thus, MNCs increasingly find themselves in situations where their very legitimacy is in question and their philosophical perspective is radically different from that of their host countries. Added to this are the normal problems of

Figure 10-2 *The Dilemma of the Multinational Corporation*



operating in a foreign culture with different types of governments, different languages, different legal systems, diverse stakeholders, and different social values. One could well argue that ethical challenges are built into this environment. MNCs are attempting to bridge the cultural gaps between two peoples; yet, as they attempt to adapt to local customs and business practices, they are assailed at home for not adhering to the standards, practices, laws, or ethics of their home country. Indeed, these pose ethical dilemmas for MNCs.

Figure 10-2 graphically depicts the dilemma of MNCs caught between the characteristics and expectations of their home country and those of one or more host countries.

OTHER MNC-HOST COUNTRY CHALLENGES

Globalization is “one of the most powerful and pervasive influences on nations, businesses, workplaces, communities, and lives . . .” according to Rosabeth Moss Kanter, in *World Class: Thriving Locally in a Global Economy*.³⁵ Global issues are always at the forefront of CEOs’ agendas. According to Richard Cavanagh, president and CEO of The Conference Board, a continuing hot topic has been “navigating the management maze of globalization.”³⁶ As part of this, challenges facing business have been significant in the social values and ethics arenas.

There are so many issues framing the challenges between MNCs and host countries that it is almost impossible to draw limits on them. However, we must limit our focus in this chapter. Before discussing a few select ethical issues in the

next section, we will first identify what a few of these broader challenges are. The fundamental issues we will touch on include the cultural aspects of global business, business/government interactions in global operations, management and control of resources in global operations, and, finally, exploration of global markets.³⁷

Facing Cultural Differences

It has been argued that the most significant reason why MNC managers fail is their inability to cope with the foreign cultural environment. Managers and companies experience culture shock when they are faced with cultures and languages that are significantly different from their own. Culture becomes one of the most critical make-or-break factors in successful multinational corporate operations. Culture, customs, language, attitudes, and institutions vary from country to country, and these differences often pose insurmountable obstacles to success for MNCs. Frequently, it is difficult to differentiate a cultural issue from an ethical issue in this environment.

Business and Government Differences

Beyond the differences that stem from cultural variables, the interaction of the business and government sectors poses challenges for MNC executives. Depending on the region of the world and industry under consideration, the extent of the business/government interactions may vary widely. In worldwide financial services, for example, heavy regulation was typical until the 1980s, when deregulation began in the United States and spread to other countries as well. Deregulation came fast to world banking, yet now some re-regulation is occurring.

Government continues to be very important in some countries. “Japan, Inc.,” for example, has referred to the close-knit relationship between the Japanese government and the private sector. By contrast, government and business are more at arm’s length in the United States. In Korea, government has always been influential, and only in recent years has the banking sector been privatized. In Europe, government has been intimately involved in business and banking from time to time. The European Union thinks differently about the government’s role in antitrust regulation than does the United States. Many key industries have been nationalized in Great Britain, depending on which political party is in power.³⁸ In the Globalization 3.0 era, multinationals are being forced to learn about a whole host of new, business/government relationships in competing countries, especially in China, India, and Russia.

Management and Control of Global Operations

Two issues are important here. One issue is *organizational structure and design*, and the other issue is *human resource management*. MNCs must employ a multiplicity of organizational approaches in their markets. This is in significant part due to host government regulations. MNC management becomes complex when the firm licenses in Country A, has joint ventures in Country B, and countertrades in

Country C. In each environment, the firm faces different organizational challenges. A second major topic is the proper use of human resources. In the arena of staffing, a question arises concerning the tactical use of home versus host country nationals. Use of each implies different costs and benefits for the firm. Other critical human resource issues include selection and training.³⁹ As firms globalize, another challenge is creating and enforcing codes of conduct across global operations.

Exploration of Global Markets

A final topic in this section is the exploration of global markets as a vital MNC–host country challenge. Although U.S. MNCs dominated world markets for a long period of time, this is no longer the case. Today, we have a world of intense competition among firms all over the globe. In the past 20 years, there has been a remarkable resurgence, not only from Japan and the European economies but from some other countries as well (e.g., China, India, South Korea, Latin America). One major issue in this general topic is the question of strategic alternatives that may be used by MNCs considering expansion into new foreign markets. Various strategies involving products and promotions are possible. Relevant factors in such strategic planning include the product function or need satisfied, conditions of product use, consumers' ability to buy, and communications strategy.⁴⁰

Another major issue surrounds the pursuit of developing third world markets, or emerging economies. Marketing concepts for Asia, Africa, and some countries in Latin America may differ markedly from those we have in the United States. This category of issue is quite important in connection with our discussion of global ethics, because less-developed countries pose significant temptations to MNCs to exploit and cut corners. Richard D. Robinson suggests that we need to be sensitive to the long-run national interests of such countries. He advocates three levels of sensitivity. First, management of MNCs should be sensitive to the need to *modify or redesign products* so that they will be appropriate for their intended markets. An example of this was a truck manufacturer that modified its truck design to accommodate the rough roads, extreme heat, and high elevations found in Turkey.

Second, management must be sensitive to the *impacts of products*, especially in terms of their impacts on the long-term interests of non-Western markets. For example, luxury products and those of a fundamentally labor-saving nature would not necessarily be appealing under all circumstances to a development-conscious foreign government. Third, MNC managers should be sensitive to the extent to which their *products are politically vulnerable*. Products that are politically vulnerable may lead to labor agitation, public regulation (for example, price fixing and allocation quotas), nationalization, or political debates. Examples of products that in the past have led to political debates and action include sugar, salt, kerosene, gasoline, tires, and medicines.⁴¹ A recent example of this point has been the attitude toward the major gasoline producers by the government of Venezuela.

The need to be sensitive to marketing in other countries provides an appropriate transition to our discussion of ethical issues in the global business environment. It should be clear from this discussion that ethical issues or conflicts might easily arise from cultural conditions that are not anticipated by the MNCs. Further, even though we will examine in more detail such visible issues as marketing practices, plant safety, questionable payments, and sweatshops in cheap-labor factories in developing countries, we should be ever vigilant of the fact that ethical dilemmas can also arise in such realms as operations management, financial management, risk management, labor relations, and global strategic management.

Ethical Issues in the Global Business Environment

For many companies, most of the ethical problems that arise in the international environment are in the same categories as those that arise in their domestic environments. These ethical issues reside in all of the functional areas of business: production/operations, marketing, finance, accounting, and management. These issues concern the fair treatment of stakeholders—employees, customers, the community, and competitors. These issues involve product safety, plant safety, advertising practices, human resource management, environmental problems, business practices, and so on.

These ethical problems seem to be somewhat fewer in developed countries, but they exist there as well. The ethical challenges seem to be worse in underdeveloped countries, LDCs, or developing countries because these countries are at earlier stages of economic development and typically do not have a legal or ethical infrastructure in place to help protect their citizenry. This situation creates an environment in which there is a temptation to go with lower standards, or perhaps no standards, because few government regulations or activist groups exist to protect the stakeholders' interests. In the LDCs, the opportunities for business exploitation and the engagement in questionable (by developed countries' standards) practices are abundant.

We will discuss some prominent examples of ethical issues in the global sphere to provide some appreciation of the development of these kinds of issues for business. We will discuss two classic ethical issues that have arisen with regard to questionable marketing and manufacturing safety practices. Then, we will discuss the issue of labor or human rights abuses often found in "sweatshops" (the use of cheap labor in developing countries)—a topic that has dominated international business discussions for the past decade. Next, we will consider the special problems of corruption, bribery, and questionable payments, which have been ethical issues in the United States for more than 30 years. From these examples, we should be able to develop an appreciation of the kinds of ethical challenges that confront MNCs and others doing business globally.

Ethics in Practice Case

AN INNOCENT REVELATION?

For a couple of years, I worked as an assistant manager at a gas station in my hometown of Randers, Denmark. The location of the station was perfect, and this was proven every day by long lines and big sales. The way the job was scheduled was that the person on duty would always manage the station single-handedly, standing behind the desk, running the cash register. Every day, several thousand dollars was secured in the gas station's safe. Six people worked the gas station—all around the age of 18.

The key to the station's safe was hidden in the back, and only the employees and the manager knew the hiding place. The manager would take the money stored in the safe and deposit it at the local bank every third day, but one week this action was postponed a couple of days because of a holiday. Therefore, a large sum of money was accumulating at the station. One employee was aware of this fact and revealed it to her friends. At the same time, she agreed to tell about the hiding place for the key, and within a few days her friends broke into the station, found the key, and stole close to \$19,000.

The employee and her friends had figured that the insurance company would pay for my manager's loss and therefore all parties would be satisfied, except for the insurance company, who, they thought, would not really be affected by the loss. They claimed, "Everybody knows how rich these insurance companies are."

The bottom line of this story was that the insurance company did not pay, because the key was hidden in the same room where the safe was kept and this apparently voided the insurance.

The ethical question in this story is this: If you knew that no one would discover the employee's irresponsible decision to tell about the hidden key, and that the insurance company would reimburse the manager, would you also have done the same thing if you had received a fairly big portion of the money? In this case, I assume that the insurance company could easily afford the reimbursement, which means that all parties should be satisfied (and you would get a little richer).

1. What are the ethical problems in this case? Is it a situation unique to business in Denmark?
2. If the employee's decision to tell about the hidden key was never discovered, could her action somehow be justified as just an innocent revelation? Why or why not? Identify the ethical principles involved here.
3. Imagine that the employee's revelation was never discovered. Would you have chosen to do as she did if we assume that the manager got reimbursed? Many of us pay a lot of money in insurance premiums, so why not get a little back?

Contributed by Anders Braad

QUESTIONABLE MARKETING AND PLANT SAFETY PRACTICES

A classic example of a questionable marketing practice is the now-infamous infant formula controversy that spanned most of the 1970s, continued into the 1980s and 1990s, and even remains an issue today. The plant safety issue is best illustrated by

examining the Union Carbide Bhopal crisis that began in late 1984 and continued into the 1990s and is not completely resolved today. These issues are important because they illustrate the endless problems companies can face as a result of mistakes made in global business ethics and how their effects can be felt for decades.

Questionable Marketing: The Infant Formula Controversy.

The **infant formula controversy** is a classic in illustrating the ethical questions that can arise while doing business abroad. We will briefly reveal some basic facts about this now-classic case.⁴² For decades, physicians working in tropical lands (many of which were LDCs) realized that there were severe health risks posed to infants from bottle-feeding as opposed to breast-feeding. Such countries typically had neither refrigeration nor sanitary conditions. Water supplies were not pure, and, therefore, powdered infant formula mixed with this water contained bacteria that would likely lead to disease and diarrhea in the bottle-fed infant. Because these LDCs are typically poor, mothers tend to overdilute the powdered formula, trying to make it last longer, thus diminishing significantly the amount of nutrition the infant receives. Once a mother begins bottle-feeding, her capacity for breast-feeding quickly diminishes. Poverty also leads the mother to put in the bottle less-expensive substitute products. These products, such as powdered whole milk and cornstarch, are not acceptable substitutes. They are nutritionally inadequate and unsatisfactory for the baby's digestive system.

By the late 1960s, it was apparent that in the LDCs there was increased bottle-feeding, decreased breast-feeding, and a dramatic increase in the numbers of malnourished and sick babies. Bottle-feeding was cited as one of the major reasons. The ethical debate began when it was noted that several of the infant formula companies, aware of the conditions just described, were promoting their products and, therefore, promoting bottle-feeding in an intense way. Such marketing practices as mass advertising, billboards, radio jingles, and free samples became commonplace. These promotional devices typically portrayed the infants who used their products as healthy and robust, in sharp contrast with the reality that was brought about by the conditions mentioned.

One of the worst marketing practices entailed the use of "milk nurses"—women dressed in nurses' uniforms who walked the halls of maternity wards urging mothers to get their babies started on formula. In reality, these women were sales representatives employed by the companies on a commission basis. Once the infants began bottle-feeding, the mothers' capacity to breast-feed diminished, and they became hooked on the formula.⁴³

Although several companies were engaging in these questionable marketing practices, the Swiss conglomerate Nestlé was singled out by a Swiss social activist group in an article published in 1974 titled "Nestlé Kills Babies." At about the same time, an article appeared in Great Britain titled "The Baby Killers."⁴⁴ From this point on, a protracted controversy developed with Nestlé and other infant formula manufacturers on one side and a host of organizations on the other side filing shareholder resolutions and lawsuits against the company. Among the

groups that were actively involved in the controversy were church groups such as the National Council of Churches and its Interfaith Center on Corporate Responsibility (ICCR), UNICEF, the World Health Organization (WHO), and the Infant Formula Action Coalition (INFACT). Nestlé was singled out because it had the largest share of the world market and because it aggressively pushed sales of its infant formula in developing countries, even after the World Health Organization developed a sales code to the contrary.⁴⁵

In 1977, INFACT and ICCR organized and led a national boycott against Nestlé that continued for almost seven years. More than 70 American organizations representing doctors, nurses, teachers, churches, and other professionals participated in the boycott. These groups mounted an international campaign aimed at changing these objectionable marketing practices in the LDCs.⁴⁶ In 1984, after spending tens of millions of dollars resisting the boycott, Nestlé finally reached an accord with the protesters. The company agreed to four changes in its business practices:

1. It would restrict the distribution of free samples.
2. It would use Nestlé labels to identify the benefits of breast-feeding and the hazards of bottle-feeding.
3. It promised to help ensure that hospitals would use its products in accordance with the WHO code.
4. It agreed to drop its policy of giving gifts to health professionals to encourage them to promote infant formula.

The protesters, in return, agreed to end their boycott but to continue monitoring Nestlé's performance.⁴⁷

The infant formula controversy continued through the 1980s and well into the 1990s. In 1991, Nestlé (which controlled more than 40 percent of the worldwide market) and American Home Products (which controlled about 15 percent of the worldwide market) announced that after decades of boycotts and controversy, they planned to discontinue the practice of providing free and low-cost formula to developing countries.

With this action—its most aggressive ever—Nestlé attempted to quell the protracted criticism that it had defied WHO's marketing restrictions by dumping huge quantities of baby formula on third world hospitals. The distribution of supply had been a lingering concern in the infant formula controversy. Until this announcement, Nestlé had supplied formula on a request basis but over the next several years planned to distribute formula only on a request basis to children "in need," as outlined in the WHO guidelines. The pledges by Nestlé and American Home Products, the world's two biggest infant formula makers, were regarded as a watershed in the bitter infant formula controversy.⁴⁸

The infant formula controversy has been rich with examples of the actions and power of social activist groups and governments and the various strategies that might be employed by MNCs. For our purposes, however, it illustrates the character of questionable business practices by firms pursuing what might be called normal practices were it not for the fact that they were being pursued in

foreign countries where local circumstances made them questionable.⁴⁹ The infant formula controversy also illustrates the endurance of certain ethical issues, particularly in the global arena.

The AIDS crisis, especially in Africa, has put an unusual twist on the infant formula debate. Some now say that UNICEF, the UN agency charged with protecting children, today may be indirectly responsible for thousands of African babies being infected with the deadly AIDS virus. AIDS has entered the picture since the early boycotts of Nestlé and others, and it was discovered that HIV-infected mothers could transfer the disease through breast-feeding to their own children. In response to this problem, Nestlé and formula maker Wyeth-Ayerst Labs said they stood ready to donate tons of free formula to the infected women. However, UNICEF refused to give the green light to these gifts. Nestlé claims it has gotten desperate requests from African hospitals for free formula, but the company will not act without UNICEF's approval because it does not want to renew the boycott against the company. The executive director of UNICEF, meanwhile, has said that she doesn't believe Nestlé and the other infant formula providers have a particular role to play in the AIDS crisis. She thinks they should just comply with the WHO code.⁵⁰

Critics of Nestlé continue beyond the AIDS issue. Since 2004, the allegation has been that Nestlé is now trying to market infant formula to Hispanic mothers in the United States to boost their share of this \$3 billion market. The major question seems to be whether companies such as Nestlé should market baby formula to low-income immigrant mothers, many in California, when health experts and government officials maintain that breast-feeding is healthier and saves in terms of long-term health care costs. A spokeswoman for Nestlé said that the product is being marketed with a fully bilingual label so that Hispanic mothers can make an informed choice.⁵¹

Even today, the International Baby Food Action Network (IBFAN) continues to advocate safety in feeding babies and lobbies against companies that continue engaging in questionable practices.⁵² With the AIDS crisis and marketing in the United States to low-income mothers complicating the controversy, it is apparent that no easy solutions are available.

Plant Safety and the Bhopal Tragedy

The Union Carbide **Bhopal tragedy** in late 1984 brings into sharp focus the challenges of multinationals operating in a foreign, particularly less-developed, business environment. The legal issues surrounding this event have not yet been totally resolved and may not be for years to come in spite of earlier agreements reached. On December 3, 1984, a leak of methyl isocyanate gas caused what many have termed the "worst industrial accident in history." The gas leak killed more than two thousand people and injured two hundred thousand others. The tragedy has raised numerous legal, ethical, social, and technical questions for MNCs.⁵³ Observers who have studied this tragedy say the death toll and destruction are many times greater than the "official" numbers indicate. One report is that more than thirty-five hundred were killed in the accident.⁵⁴

Interviews with experts just after the accident revealed a belief that the responsibility for the accident had to be shared by the company and the Indian government. According to Union Carbide's own inspector, the Bhopal plant did not meet U.S. standards and had not been inspected in more than two years. The Indian government allowed thousands of people to live very near the plant, and there were no evacuation procedures.⁵⁵

Many different questions have been raised by the Bhopal disaster. Among the more important of these issues are the following:⁵⁶

1. To what extent should MNCs maintain identical standards at home and abroad regardless of how lax laws are in the host country?
2. How advisable is it to locate a complex and dangerous plant in an area where the entire workforce is basically unskilled and where the populace is ignorant of the inherent risks posed by such plants?
3. How wise are laws that require plants to be staffed entirely by local employees?
4. What are the responsibilities of corporations and governments in allowing the use of otherwise safe products that become dangerous because of local conditions? (This question applies to the infant formula controversy also.)
5. After reviewing all the problems, should certain kinds of plants be located in developing nations?

At the heart of these issues is the question of differing safety standards in various parts of the world. This dilemma arose in the 1970s, when American firms continued to export drugs and pesticides that had been restricted in the United States. Pesticides, such as DDT and others that had been associated with cancer, were shipped to and used in LDCs by farmers who did not understand the dangers or the cautions that were needed in the use of these products. Not surprisingly, poisonings occurred. In 1972, hundreds to thousands of Iraqis died from mercury-treated grain from the United States. In 1975, Egyptian farmers were killed and many made ill by a U.S.-made pesticide. Asbestos and pesticide manufacturing plants that violated American standards were built in several countries. These companies typically broke no laws in the host countries, but many experts are now saying that the Bhopal tragedy has taught us that companies have a moral responsibility to enforce high standards, especially in developing countries not yet ready or able to regulate these firms.⁵⁷

One major problem that some observers say contributed to the Bhopal explosion and, indeed, applies to MNCs generally is the requirement that firms be significantly owned by investors in the host country. Union Carbide owned only 50.9 percent of the Bhopal, India, subsidiary. It has been observed that this situation may have reduced Union Carbide's motivation and/or capacity to ensure adequate industrial and environmental safety at its Bhopal plant, mainly by diluting the degree of parent control and reducing the flow of technical expertise into that plant. If developing countries continue to insist on a dilution of MNC control over manufacturing plants, this may also diminish the MNC's

motivation and incentive to transfer environmental management and safety competence.

Another major problem highlighted by the Bhopal explosion was the fact that the people of developing countries are often unaware of the dangers of new technology. As one expert observed, countries such as India (at the time) had not “internalized the technological culture.”⁵⁸ On the one hand, the LDCs want technology because they see it as critical to their economic development, but often their ability to understand and manage the new technology is in serious doubt.

The complexity and tragedy of the Bhopal explosion case for its victims, the Indian government, and Union Carbide are attested to by the fact that this issue is still unresolved even today. In 1989, Union Carbide extricated itself from relief efforts by agreeing to pay the Indian government \$470 million to be divided among victims and their families. By 1993, courts had only distributed \$3.1 million of this sum. The overburdened government relief programs in India have been mired in mismanagement and corruption. It has been observed that virtually every level of the relief bureaucracy in India is rife with corruption. Government officials demanded bribes from illiterate victims trying to obtain documents required for the relief money. Doctors have taken bribes from victims to testify in their court cases, and unscrupulous agents have fished for bribes by claiming they could get victims’ cases expedited on the crowded docket. Claims courts that would determine final compensation for victims were not set up until 1992—eight years after the gas leak. Lawyers and officials say it could be another 20 years before this case is settled.⁵⁹

According to more recent information put out by Dow Chemical, which bought Union Carbide in 2001, the gas that leaked from the plant was formed when a disgruntled employee, apparently bent on spoiling a batch of the gas, added water to a storage tank. The company said it took moral responsibility for the incident despite its being an act of sabotage. Union Carbide subsequently sold its 50.9 percent interest in Union Carbide India Limited and donated the proceeds from the sale to a trust to build a hospital in Bhopal.⁶⁰

Even today, the Union Carbide tragedy continues to haunt Dow Chemical more than two decades after the accident. Survivors of the accident and their supporters continue to push Dow to pay as much as \$1 billion in additional damages for what they claim are unmet medical bills and toxic cleanup.⁶¹ In 2004, led by a small group of socially responsible investment funds, activists continued to push Dow Chemical to provide further disclosure on potential legal and financial risks associated with the Union Carbide explosion. Dow continues to argue that the \$470 million settlement it paid in 1989 resolves its outstanding liabilities.⁶²

In July 2006, 34-year-old Sunil Verma hung himself in his room. He was wearing a T-shirt that read “No More Bhopals.” Verma’s parents and five of his siblings perished in the Bhopal explosion in 1984. It is reported that today, one hundred and fifty thousand people continue to live with mental and physiological damage from the incident.⁶³ Dow Chemical Company continues to argue that it never owned or operated the Bhopal plant, which is now under the control of the state government

of Madhya Pradesh, India. It says that the plant site is now owned by the state and that it is up to them to decide what to do with the property.⁶⁴

Current webpages (www.bhopal.org, www.bhopal.net, www.bhopal.com) document that the Bhopal tragedy continues to be of deep concern even at the end of the first decade of the twenty-first century.

The lessons from the Bhopal disaster are many and will continue to be debated. In companies around the globe, the Bhopal disaster has sparked continued controversy in the debate about operating abroad. To be sure, ethical and legal issues are central to the discussions. What is at stake, however, is not just the practices of businesses abroad but also the very question of the presence of businesses abroad. Depending on the final outcome of the Union Carbide case, MNCs may decide that the risks of doing certain types of business abroad are too great.

SWEATSHOPS, HUMAN RIGHTS, AND LABOR ABUSES

No issue has been more consistently evident in the global business ethics debate than the MNCs' use and abuse of women and children in cheap-labor factories in developing countries. The major players in this controversy, large corporations, have highly recognizable names—Nike, Wal-Mart, Gap, Kmart, Reebok, J.C. Penney, and Disney, to name a few. The countries and regions of the world that have been involved are also recognizable—Southeast Asia, Pakistan, Indonesia, Honduras, Dominican Republic, Thailand, China, the Philippines, and Vietnam. Sweatshops have not been eliminated in the United States either, but the most serious problems seem to be in the developing countries.⁶⁵

[http://SEARCH THE WEB WEB](http://SEARCHTHEWEBWEB)

UNITED STUDENTS AGAINST SWEATSHOPS

United Students Against Sweatshops (USAS) is an international student movement of campuses and individual students fighting for sweatshop-free labor conditions and workers' rights. USAS believes that university standards should be brought into line with those of its students, who demand that their school's logo be emblazoned on clothing made in decent working conditions.

On its website, United Students Against Sweatshops says it is a grassroots, youth-run, student labor

organization, with approximately 200 affiliated high schools, colleges, and universities, and contacts on more than 400 campuses. Its governing board is a coordinating committee of 13 students who are elected at its national summer conferences by the entire membership.

For more information about USAS's goals and activities and about sweatshops, generally, visit the website at <http://www.studentsagainstsweatshops.org>.

Though **sweatshops**, characterized by child labor, low pay, poor working conditions, worker exploitation, and health and safety violations, have existed for decades, they have grown in number in the past few years as global competition has heated up and corporations have gone to the far reaches of the world to lower their costs and increase their productivity. A landmark event that brought the sweatshop issue into sharp focus was the 1996 revelation by labor rights activists that part of Wal-Mart's Kathie Lee Collection, a line of clothes endorsed by then-prominent U.S. talk-show host Kathie Lee Gifford, was made in Honduras by seamstresses slaving 20 hours a day for 31 cents an hour.

The revelation helped turn Gifford, who was unaware of where the clothes were being made or under what conditions, into an anti-sweatshop activist.⁶⁶ The Nike Corporation has also become a lightning rod for social activists concerned about overseas manufacturing conditions, standards, and ethics. A major reason for this has been the company's high profile and visibility, extensive advertising using athletic superstars, as well as the stark contrast between the tens of millions of dollars Nike icons Michael Jordan and Tiger Woods earn and the daily wage rate of several dollars the company's subcontractors once paid their Indonesian workers.⁶⁷

Critics of MNC labor practices, including social activist groups, labor unions, student groups, and grassroots organizations, have been speaking out, criticizing business abusers and raising public awareness. These critics claim many businesses are exploiting children and women by paying them poverty wages, working them to exhaustion, punishing them for minor violations, violating health and safety standards, and tearing apart their families. Many of these companies counter that they offer the children and women workers a superior alternative. They say that, although their wage rates are embarrassing by developed-world standards, those rates frequently equal or exceed local legal minimum wages, or average wages.

Defenders of sweatshops further say that, because so many workers in LDCs work in agriculture and farming, where they make less than the average wage, the low but legal minimums in many countries put sweatshop workers among the higher-paid workers in their areas.⁶⁸ According to a recent study conducted by economists, it was found that MNCs generally paid more, often a lot more, than the wages offered by locally owned companies. In one study, it was found that affiliates of U.S. MNCs pay a wage premium that ranges from 40 percent to 100 percent higher than the local average pay in low-income countries.⁶⁹

Fair Labor Association (FLA)

The sweatshop issue has been so prominent in the past few years that, to improve their situations or images, many criticized companies have begun working diligently to improve working conditions, further joint initiatives, establish codes of conduct or standards for themselves and their subcontractors, conduct social or ethical audits, or take other steps. In 1996, President Bill Clinton, with Kathie Lee Gifford, was instrumental in helping to establish the Fair Labor Association (FLA), (www.fairlabor.org), an organization of clothing firms, unions, and human rights

groups focused on the worldwide elimination of sweatshops. Its members, which include Eddie Bauer, L.L. Bean, Nike, Patagonia, Liz Claiborne, and Reebok, were encouraged by a survey showing that three-quarters of America's shoppers would pay higher prices for clothes and shoes bearing "No Sweat" labels.

The FLA is still very active, but there have been a number of other proposals aimed at eliminating or improving sweatshops. Some proposals call for clothing firms and their contractors to impose a code of conduct that would prohibit child labor, forced labor, and worker abuse; establish health and safety regulations; recognize workers' right to join a union; limit the workweek to 60 hours (except in exceptional business circumstances); and insist that workers be paid at least the legal minimum wage (or the "prevailing industry wage") in every country in which garments are made. Under such proposals, the garment industry would also create an association to police the agreement.

These proposals have some drawbacks, however. For example, the legal minimum wage in many developing countries is below the poverty line. In addition, the "prevailing industry wage" could prove to be a convenient escape clause. Some groups are also concerned that the task force has, in effect, sanctioned 60-hour working weeks and that it will still allow 14-year-olds to work if local laws do. Another big issue will be monitoring the agreements abroad. For example, Liz Claiborne alone has 200 contractors in more than 25 countries. Furthermore, in some countries, like the Philippines, Malaysia, Thailand, and Vietnam, sweatshops go to great lengths to hide their business dealings by "fronting" businesses using false documents to "prove" they pay minimum wages and by intimidating workers to keep quiet.⁷⁰

Social Accountability 8000 (SA8000)

Another initiative to improve sweatshop conditions was created by Social Accountability International (SAI). The scheme, called Social Accountability 8000 or SA8000, was designed to piggyback on the ISO8000 quality-auditing system of the International Standards Organization (ISO), now used in more than 57 countries and 71 industries.⁷¹

http://SEARCH THE WEB WEB

SWEATSHOPS AROUND THE WORLD

According to its website, Sweatshop Watch serves low-wage workers nationally and globally, with a focus on eliminating sweatshop exploitation in California's garment industry and around the world. The organization believes that workers should earn a living wage in

a safe, decent work environment, and that those responsible for the exploitation of sweatshop workers must be held accountable.

To review current activities in this arena, visit the Sweatshop Watch website at <http://www.sweatshopwatch.org>.

The SA8000 initiative, launched in the fall of 1997, involved a broad spectrum of U.S. and foreign companies, such as Avon, Sainsbury, and Toys “R” Us. The current standards for SA8000 may be found at <http://www.sa-intl.org>, but a summary follows:

1. *Child Labor*: No workers under the age of 15; minimum lowered to 14 for countries operating under the ILO Convention 138 developing-country exception; remediation of any child found to be working.
2. *Forced Labor*: No forced labor, including prison or debt bondage labor; no lodging of deposits or identity papers by employers or outside recruiters.
3. *Health and Safety*: Provide a safe and healthy work environment; take steps to prevent injuries; regular health and safety worker training; system to detect threats to health and safety; access to bathrooms and potable water.
4. *Freedom of Association and Right to Collective Bargaining*: Respect the right to form and join trade unions and bargain collectively; where law prohibits these freedoms, facilitate parallel means of association and bargaining.
5. *Discrimination*: No discrimination based on race, caste, origin, religion, disability, gender, sexual orientation, union or political affiliation, or age; no sexual harassment.
6. *Discipline*: No corporal punishment, mental or physical coercion, or verbal abuse.
7. *Working Hours*: Comply with the applicable law but, in any event, no more than 48 hours per week with at least one day off for every seven-day period; voluntary overtime paid at a premium rate and not to exceed 12 hours per week on a regular basis; overtime may be mandatory if part of a collective bargaining agreement.
8. *Compensation*: Wages paid for a standard workweek must meet the legal and industry standards and be sufficient to meet the basic need of workers and their families; no disciplinary deductions.
9. *Management Systems*: Facilities seeking to gain and maintain certification must go beyond simple compliance to integrate the standard into their management systems and practices.⁷²

There are two options for companies interested in using the SA8000 standard: (1) certification to SA8000, and (2) involvement in the Corporate Involvement Program (CIP).

1. *Certification to SA8000*: Companies that operate production facilities can seek to have individual facilities certified to SA8000 through audits by one of a number of accredited certification bodies. SA8000 certification is conducted by organizations accredited and overseen by SAI’s own auditors. Both certified and accredited organizations undergo semi-annual review and revisits.
2. *SA8000 Corporate Involvement Program*: Companies that focus on selling goods or that combine production and selling can join the SA8000 Corporate Involvement Program (CIP). The CIP is a two-level program that helps

companies evaluate SA8000, implement the standard, and report publicly on implementation progress.

- *SA8000 Explorer (CIP Level One)*: Evaluate SA8000 as an *ethical sourcing tool* via pilot audits.
- *SA8000 Signatory (CIP Level Two)*:
 - Implement SA8000 over time in some or all of the supply chain through certification.
 - Communicate implementation progress to stakeholders via SAI-verified public reporting.⁷³

As of March 2007, the total number of facilities certified worldwide was 1,315, which encompassed 63 countries and 70 industries.⁷⁴

Individual Company Initiatives

In addition to the initiatives by such industry organizations as the Fair Labor Association and Social Accountability International (SA8000), it is important to highlight some of the efforts by individual companies to address the issues surrounding sweatshops. A number of companies have developed *global outsourcing guidelines* and codes and have made important strides in attempts at self-monitoring of their production facilities in less-developed countries. Companies such as Nike, adidas-Salomon (formerly adidas), Levi Strauss & Co., and the Gap are notable examples.⁷⁵

In the spirit of transparency, Gap, Inc., released a 40-page report in 2004 that offered an unusual look at its factory conditions abroad. It has updated this report in its 2005–2006 Social Responsibility Report. Gap's report revealed that the working conditions at many of its three thousand factories worldwide are far from perfect. The Gap report documented a wide variety of workforce violations at plants making its clothing but revealed even worse conditions at plants vying to win Gap contracts. Some of the details revealed in the report were quite specific. The company found that 10 percent to 25 percent of its factories in China, Taiwan, and Saipan were using psychological coercion or verbal abuse. More than 50 percent of the factories visited in sub-Saharan Africa ran machinery without proper safety devices. As a result, the company revoked contracts with 136 factories in 2003 because of severe or persistent violations. Critics of sweatshops said they were pleased with the move toward greater openness. A representative from the Interfaith Center on Corporate Responsibility in New York described the report as a "major step forward."⁷⁶ Beginning with its 2005–2006 Social Responsibility Report, Gap has pledged to issue a report every two years. Its next report is scheduled to be released in 2009 and will cover updates from 2007–2008.⁷⁷ Gap's strategy may motivate a number of other companies to be more forthright about their factories overseas.

Despite the best of efforts by some companies to improve factory conditions in emerging countries, there is growing evidence that some suppliers have

learned how to conceal abuses and continue to get away with unacceptable practices. In a major recent report, *BusinessWeek* disclosed that many factories, especially in China, have learned how to “game the system” through questionable practices. Some of these practices include keeping double sets of books; scripted responses wherein managers and employees are tutored how to answer auditors’ questions about hours, pay, and safety practices; and hidden production, whereby plants meet U.S. demands by secretly shifting work to subcontractors that violate pay and safety standards, but these subcontractors are hidden from the auditors.⁷⁸

Sweatshops and labor abuses sharply contrast the “haves” and the “have-nots” of the world’s nations. Consumers in developed countries have benefited greatly by the lower prices made possible by cheap labor. It remains to be seen how supportive those consumers will be if prices rise because MNCs improve wage rates and conditions in LDCs. The MNCs face a continuing and volatile ethical issue that is not likely to go away. Their profits, public image, and reputations may hinge on how well they respond. The MNCs must handle a new dimension in their age-old quest to balance shareholder profits with the desires of expanded, global stakeholders who want better corporate social performance.

Alien Tort Claims Act and Human Rights Violations

Looking beyond possible human rights violations in sweatshops, claims that companies may have violated the human rights of foreign nationals may come back to haunt firms that have been accused of more serious human-rights abuses. What is at stake is the U.S. courts’ interpretation of an obscure piece of legislation known as the **Alien Tort Claims Act (ATCA)**. Though researchers cannot determine why Congress passed this little-known act of 1789, today it is the centerpiece of a controversy that may have widespread implications for American firms operating abroad. An interesting development has been recent efforts to use ATCA to sue transnational companies for violations of international law in countries outside the United States. The ATCA allows foreign individuals to sue U.S. firms in U.S. courts for companies’ actions abroad. If these suits are allowed to proceed, the ATCA could become a powerful tool to increase corporate accountability around the globe.⁷⁹

Current cases under adjudication in the United States are of interest to U.S.-based MNCs because they are increasingly being named as defendants in alien tort cases for doing business in countries with repressive governments. Some of the lawsuits allege that the companies are aiding and abetting human-rights abuses of various host governments.⁸⁰ As of 2007, there were at least a dozen ongoing cases in the United States. Among them were the following:⁸¹

Occidental Petroleum of Los Angeles. *Relatives of people who were killed in an airstrike by the Columbian military say that the company, Occidental Petroleum, should pay them damages because its security contractor worked with the military to*

take out leftist terrorists accused of sabotaging Occidental's pipeline operation. In this case, the plaintiffs say the attack killed 17 unarmed civilians.

Del Monte. The company is being sued by five union officials in Guatemala who say they were kidnapped by armed men who were hired by Del Monte's subsidiary and forced to quit their jobs at a banana farm.

Chevron. The company is fighting a lawsuit filed by Nigerians who claim Chevron should be liable for the killing of protestors by Nigerian security forces outside a refinery owned by its subsidiary.

Geo W. Drummond, Ltd., of Alabama. The plaintiffs in this case accuse Drummond's subsidiary in Colombia of paying death squads to kill labor leaders.

A lawyer for Drummond, Ltd., said the following about its lawsuit: "I realize that there are problems in lots of different countries, but to have the U.S. courts attempt to provide remedies for all the injustices that occur in countries around the world is not a rational system."⁸²

Many of the companies say that they are being unfairly targeted by liberal activists who are using the law to try to remedy the injustices of foreign governments. Many of the lawyers for these companies also say the companies are being blamed for crimes they deplore and knew nothing about. The president of the National Foreign Trade Council observed that the ATCA statute is being misused and that it is being exploited by trial lawyers who have seized the law as their new "asbestos" litigation and are hoping to get rich by hitting the jackpot.⁸³

If upheld in these applications, the ATCA could represent a devastating level of legal and financial liability for U.S.-based MNCs engaged in global business. Suddenly, what were once human-rights ethical issues could become significant and costly legal issues. We know from the Nestlé and Bhopal cases that these crises are not quickly resolved. These are definitely cases to be carefully watched.

CORRUPTION, BRIBERY, AND QUESTIONABLE PAYMENTS

Corruption, bribes, and questionable payments occurred for decades prior to the 1970s. It was in the mid-1970s, however, that evidence of widespread questionable corporate payments to foreign government officials, political parties, and other influential persons became widely known. Such major corporations as Lockheed, Gulf Oil, Northrop, Carnation, and Goodyear were among those firms admitting to such payments. Huge sums of money were involved. Gulf, for example, admitted paying \$4.2 million to the political party of then-President Park of Korea. Gulf also created a subsidiary in the Bahamas that was then used as a conduit for unlawful political contributions. Lockheed acknowledged payments of \$22 million, mostly to officials in the Middle East.⁸⁴

One of the most notorious cases was that of Lockheed giving \$12.5 million in bribes and commissions in connection with the sale of \$430 million worth of Tri-Star airplanes to All Nippon Airways. The president of Lockheed defended the payments, claiming that it was common practice and that it was expected to give

bribes in Japan. The news of the payments rocked Japan more than it did the United States, because then-Prime Minister Kakuei Tanaka and four others were forced to resign and stand trial. Prince Bernhard of the Netherlands was also disgraced because of his involvement with Lockheed.⁸⁵ Another important point made about this case was that Lockheed did not offer a bribe, but rather the Japanese negotiator demanded it. This point raises the continuing question in matters of this kind: “Are those who accede to bribery equal in guilt to those who demand bribes?”⁸⁶

Cases of bribery and corruption continue to the current day. In 2007, a huge bribery scandal continued to unfold at Siemens, the German electronics firm. Investigators examining the Siemens books said they had found questionable payments going back to the early 1990s totaling more than a billion euros (\$1.4 billion), with most of the bribes going to business consultants.⁸⁷

Corruption in global business continues to be a major problem. It starts with outright bribery of government officials and the giving of questionable political contributions. Beyond these, there are many other activities that are corrupt: the misuse of company assets for political favors, kickbacks and protection money for police, free junkets for government officials, secret price-fixing agreements, and insider dealing, just to mention a few. All of these activities have one thing in common. They are attempts to influence the outcomes of decisions wherein the nature and extent of the influence are not made public. In essence, these activities are abuses of power.⁸⁸

Though one seldom hears an official definition of corruption, such synonyms as dishonesty, sleaze, fraud, deceit, and cheating are typically assumed. Some of the definitions of corruption that have been set forth include the following:⁸⁹

Behavior on the part of officials in the public sector, whether politicians or civil servants, in which they improperly and unlawfully enrich themselves, or those close to them, by the misuse of the public power entrusted to them. This would include embezzlement of funds, theft of corporate or public property as well as corrupt practices such as bribery, extortion or influence peddling. Transparency International (TI)

Corruption involves behavior on the part of officials in the public and private sectors, in which they improperly and unlawfully enrich themselves and/or those close to them, or induce others to do so, by misusing the position in which they are placed. World Bank

Corruption comes in many forms, some petty and some grand. Though incalculably lucrative to a few, corruption is hugely damaging in terms of its effects on stakeholders. It corrodes the rule of law, the legitimacy of government, the sanctity of property rights, and incentives to invest and accumulate. Corruption also is a drag on a country’s growth. One study said that the country of Colombia’s GDP would rise by about 20 percent if corruption there fell.⁹⁰ A major problem, of course, is that those who benefit from corruption most will resist attempts to curb it, and often these are politicians in the decision-making roles.

Bribery, more than any other form of corruption, has been the subject of continuing debate, and the practice merits closer examination. Simply speaking, bribery is the practice of offering something (usually money) in order to gain an illicit advantage. Bribes, of course, are illegal in most places and generally held to be unethical, but it is informative to consider the arguments that have been set forth for and against them. Some businesspeople continue to argue that bribery is necessary, and some countries of the world continue to assert that they are culturally necessary or defensible.

Arguments for and against Bribery

Arguments typically given in favor of permitting bribery include the following: (1) they are necessary for profits in order to do business; (2) everybody does it—it will happen anyway; (3) it is accepted practice in many countries—it is normal and expected; and (4) bribes are forms of commissions, taxes, or compensation for conducting business between cultures.

Arguments frequently cited against giving bribes include (1) bribes are inherently wrong and cannot be accepted under any circumstances; (2) bribes are illegal in the United States and most developed nations, and, therefore, unfair elsewhere; (3) one should not compromise her or his own beliefs; (4) managers should not deal with corrupt governments; (5) such demands, once started, never stop; (6) one should take a stand for honesty, morality, and ethics; (7) those receiving bribes are the only ones who benefit; (8) bribes create dependence on corrupt individuals and countries; and (9) bribes deceive stockholders and pass on costs to customers.⁹¹

The costs of bribes and other forms of corruption are seldom fully understood or described. Several studies suggest the economic costs of such corrupt activities. When government officials accept “speed” money or “grease payments” to issue licenses, the economic cost is 3 to 10 percent above the licensing fee. When tax collectors permit underreporting of income in exchange for a bribe, income tax revenues may be reduced by up to 50 percent. When government officials take kickbacks, goods and services may be priced 20 to 100 percent higher to them. In addition to these direct economic costs, there are many indirect costs—demoralization and cynicism and moral revulsion against politicians and the political system. Due to bribery and corruption, politicians have been swept from office in countries such as Brazil, Italy, Japan, and Korea.⁹²

A new, major study on bribery has found that increases in bribery payments were associated with lower annual growth rates for companies surveyed. It was found that a 1 percent rise in the rate of bribery payments translated into a 3.3 percent drop in firms’ annual rate of growth. This study investigated businesses in Uganda and was commissioned by the World Bank. The study’s purpose was to assess barriers that companies must deal with in Uganda. The final conclusion of the study was that bribes are costly and that the greater the frequency or size of the bribe, the greater the loss of a firm’s growth potential. This study adds to the economic argument against bribes.⁹³

Ethics in Practice Case

I LOVE MY JOB—JUST DON'T ASK HOW I GOT IT!

Last spring, one of my very close friends graduated with an MBA. She interviewed with many companies during her last semester at school. However, there was no job. After graduating, she decided to apply to other companies. At one of the companies, she got preselected and then selected for the final round of interviews. After the final interview was conducted, she was informed that a decision would be mailed to her within the next six weeks.

My friend's father happened to know the general manager of this company. When there was no reply for almost five weeks, my friend's father decided to speak with the general manager. The general manager checked with the human resources department and informed my friend's father that his daughter had not been short-listed and, therefore, was not being considered in the final list of applicants for a position.

About five days later, my friend's father called the general manager again, but this time for something else. He had decided to offer a bribe to this friend, the general manager, in order to get his daughter the job. Bribing high-ranking managers to secure employment is an accepted practice in my country. A

sum of money was mutually agreed upon, and my friend's father personally delivered the cash to the general manager. Within the next four weeks, she was offered the management trainee position.

After working there for a month, my friend told me this whole story and how glad she was that her father had done all this for her. She loved her job and said that she couldn't have been happier anywhere else. She also told me not to mention this to anyone, because it would harm her family's reputation. Bribing is an accepted practice in my country, but not out in the open.

1. Is it ethical to give or take bribes just because everybody does it and it is an accepted practice in one's country?
2. If bribery is an accepted practice, why did the friend want to keep this quiet?
3. Should employees be hired on the basis of merit or according to how much they can bribe to secure a job?
4. If you had been in my friend's place, would you have accepted the job?

Contributed by Radhika Sadanah

The Foreign Corrupt Practices Act (FCPA)

One of the first initiatives by a major government to address the problem of corruption and bribery in international business was the passage of the U.S. Foreign Corrupt Practices Act in 1977. Many of the payments and bribes made by U.S.-based MNCs were not illegal prior to the passage of the FCPA. Even so, firms could have been engaging in illegal activities depending on whether and how the payments were reported to the Internal Revenue Service (IRS). With the passage of the FCPA, however, it became a criminal offense for a representative of an American corporation to offer or give payments to the officials of other governments for the purpose of getting or maintaining business. The FCPA specifies a series of fines and prison terms

that can result if a company or management is found guilty of a violation.⁹⁴ The legislation was passed not only for legal and ethical reasons but also out of a concern for the image of the United States abroad.

According to the Justice Department, SEC investigations in the mid-1970s led to more than 400 U.S. companies admitting they had made questionable payments in excess of \$300 million to foreign government officials, politicians, and political parties. The questionable payments ran the gamut from bribery of high foreign officials to secure some type of favorable action by a foreign government to so-called facilitating payments that allegedly were made to ensure that government functionaries discharged certain ministerial or clerical duties. In response, Congress enacted the FCPA to bring a halt to the bribery of foreign officials and to restore public confidence in the integrity of the American business system.⁹⁵

The FCPA was intended to have and has had a significant impact on the way American firms do business globally. A number of firms that paid bribes to foreign officials have been the subject of criminal and civil enforcement actions, resulting in large fines and, sometimes, suspension and debarment from federal procurement contracting. Sometimes their employees and officers have gone to jail.⁹⁶ In recent years, the Department of Justice has been cracking down on bribery abroad at an accelerating pace. One anticorruption practice lawyer observed in 2007 that there have been more cases prosecuted under the FCPA in the last four and a half years than in the previous twenty-six years combined.⁹⁷ The consensus seems to be that the increased prosecutions have been driven by the Justice Department's post-Enron enthusiasm and companies' increased reporting of violations under the Sarbanes-Oxley Act.⁹⁸

The Justice Department's crackdown on corrupt practices has taken a new turn in that it is now attempting to catch both U.S. and foreign companies. Unbeknownst to many companies, foreign companies whose securities are publicly traded in the United States are also subject to the FCPA.⁹⁹ One telecommunications firm based in France, accused of bribing Costa Rican officials, was prosecuted because it had a government contract in Costa Rica, but the money flowed through an American bank. This gave the Justice Department a rationale for intervening. The Justice Department has prosecuted four times the number of foreign bribery cases in the past five years as in the preceding five years. Another justification for the prosecutions has been the 1998 revisions to the FCPA that extended jurisdiction to any foreign company or individual doing business in the United States.¹⁰⁰ The Justice Department has also set its sights on Siemens, the German company, for its recent bribes and illicit payments to union officials. CEOs and CFOs in Europe are now concerned not only about their own reputational damage, but also that their own countries' regulators will follow the United States' lead and turn up the heat.¹⁰¹

The FCPA differentiates between bribes and facilitating payments. The law does not prohibit so-called **grease payments**, or minor, facilitating payments to officials, for the primary purpose of getting them to do whatever they are supposed to do anyway. Such payments are commonplace in many countries. The real problem is that some forms of payments are prohibited (for example, bribes),

but other payments (for example, grease payments) are not prohibited. The law is sometimes ambiguous on the distinctions between the two.¹⁰²

To violate the FCPA, payments (other than grease payments) must be made corruptly to obtain business. This suggests some kind of *quid pro quo*. The idea of a corrupt *quid pro quo* payment to a foreign official may seem clear in the abstract, but the circumstances of the payment may easily blur the distinction between what is acceptable “grease” (e.g., payments to expedite mail pickup or delivery, to obtain a work permit, to process paperwork) and what is illegal bribery. The safest strategy for managers to take is to be careful and to seek a legal opinion when questions arise.

Figure 10-3 summarizes some of the key features of the antibribery provisions of the FCPA.

Figure 10-3 *Antibribery Provisions of the Foreign Corrupt Practices Act—Key Features*

- In general, the FCPA prohibits American companies from making corrupt payments to foreign officials for the purpose of obtaining or keeping business.
- The Department of Justice is the chief enforcement agency, with a coordinate role played by the Securities and Exchange Commission (SEC).
- The FCPA’s antibribery provisions extend to two types of behavior: (1) making bribes directly and (2) making bribes through intermediaries.
- Applies to any individual firm, officer, director, employee, or agent of the firm and any stockholder acting on behalf of the firm.
- The person making or authorizing the payment must have a corrupt intent, and the payment must be intended to induce the recipient to misuse his official position to direct business wrongfully to the payer or to any other person.
- Prohibits paying, offering, promising to pay, or authorizing to pay or offer, money or anything of value.
- The prohibition extends only to corrupt payments to a foreign official, a foreign political party or party official, or any candidate for foreign political office, or anyone acting in an official capacity.
- Prohibits corrupt payments through intermediaries.
- An explicit exception is made to the bribery provisions for “facilitating payments” for “routine governmental action.”
- The following criminal penalties may be imposed: firms are subject to a fine of up to \$2 million; officers, directors, stockholders, employees, and agents are subject to a fine of up to \$100,000 and imprisonment for up to five years. Fines imposed on individuals may not be paid by the firm.

Source: “Foreign Corrupt Practices Act Antibribery Provisions,” U.S. Department of Justice, <http://www.osec.doc.gov/ogc/occic/fcparev.html>, retrieved August 18, 2007.

Figure 10-4 *Bribes Compared to Grease Payments*

Definitions	Examples
<i>Grease Payments</i>	
<p>Relatively small sums of money given for the purpose of getting minor officials to:</p> <ul style="list-style-type: none"> • Do what they are supposed to be doing • Do what they are supposed to be doing faster or sooner • Do what they are supposed to be doing better than they would otherwise 	<p>Money given to minor officials (clerks, attendants, customs inspectors) for the purpose of expediting. This form of payment helps get goods or services through red tape or administrative bureaucracies.</p>
<i>Bribes</i>	
<p>Relatively large amounts of money given for the purpose of influencing officials to make decisions or take actions that they otherwise might not take. If the officials considered the merits of the situation only, they might take some other action.</p>	<p>Money given, often to high-ranking officials. Purpose is often to get these people to purchase goods or services from the bribing firm. May also be used to avoid taxes, forestall unfavorable government intervention, secure favorable treatment, and so on.</p>

Figure 10-4 presents a basic distinction, with examples, between bribes (which are prohibited) and grease (or facilitating) payments (which are not prohibited) based on the FCPA.

The Growing Anticorruption Movement

As we move toward the end of the first decade of the new millennium, corruption and bribery in global business continue to be vital topics. With significant increases in global trade and competition, free markets, and democracy over the past decade, this comes as no surprise. Several powerful developments are worthy of mention. Each has contributed to what some have called a growing **anticorruption movement**.

Transparency International. An innovative special-interest group was founded in 1993—**Transparency International (TI)**—modeled after the human-rights group Amnesty International. TI has established itself as the world's foremost anticorruption organization. According to its own website, TI is a "global civil society organization" leading the fight against corruption, bringing people together in a powerful worldwide coalition to end the devastating impact of corruption on men, women, and children around the world. TI's mission is to create change toward a world free of corruption.¹⁰³

TI has defined five priorities in its fight against worldwide corruption. These include fighting corruption in (1) the private sector, (2) politics, (3) public contracting, (4) international anticorruption conventions, and (5) poverty and development. It maintains more than 90 national chapters run by local activists.¹⁰⁴ One of the primary tools TI uses to combat corruption is its now-famous annual **Corruption Perception Index (CPI)**. The annual CPI has been widely credited with putting TI and the issue of corruption on the international policy agenda. The CPI ranks more than 150 countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. The result of the ranking is a list of countries in the world ranging from “highly clean” (least corrupt) to “highly corrupt.”¹⁰⁵ In TI’s 2006 rankings, the most recent available when this is being written, the most “highly clean” countries included Finland, Iceland, New Zealand, Denmark, Singapore, Sweden, Switzerland, Norway, Australia, and the Netherlands. The most “highly corrupt” countries included Haiti, Myanmar, Iraq, Guinea, Sudan, Democratic Republic of the Congo, Chad, Bangladesh, and Uzbekistan.¹⁰⁶

In addition to the CPI, Transparency International also publishes what it calls the **Bribe Payers’ Index (BPI)**. The Bribe Payers’ Index ranks leading exporting countries in terms of the degree to which international companies with their headquarters in those countries are likely to pay bribes to senior public officials in key emerging market economies. In that sense, the BPI measures the supply side of bribery in the countries where the bribes are paid. Countries are ranked on a mean score from the answers given by respondents to the statement, “In the business sectors with which you are most familiar, please indicate how likely companies from the following countries are to pay or offer bribes to win or retain business in this country.”¹⁰⁷ Among the major exporting countries of the world, the countries that are perceived to pay more bribes include China, India, Russia, Turkey, and Taiwan, according to 2006 data available at this writing.¹⁰⁸

A new and related index to that of Transparency International is the **Public Integrity Index**, the centerpiece of the Global Integrity report, issued by The Center for Public Integrity. The Global Integrity Index assesses the existence and effectiveness of anticorruption mechanisms that promote public integrity. The Public Integrity Index is a quantitative scorecard of governance practices in each country, which assesses the institutions and practices that citizens can use to hold their governments accountable to the public interest. This index does not measure corruption itself, but rather the opposite of corruption: the extent of citizens’ ability to ensure their government is open and accountable. The Public Integrity Index ranks countries as strong, moderate, weak, or very weak on holding government accountable to its citizens.¹⁰⁹

Undoubtedly, TI and the Center for Public Integrity hope and expect that public exposure to its corruption ratings will bring pressure to bear on countries and companies to become less corrupt.

OECD Antibribery Initiatives. Another major development in the growing anticorruption movement is an antibribery treaty and initiative that the 29 industrialized nations of the Organization for Economic Cooperation and Development (OECD) and five other countries agreed to in late 1997.¹¹⁰ In 2007,

the OECD, now 30 members strong, celebrated the tenth anniversary of its antibribery convention.¹¹¹ The OECD member nations agreed to ban international bribery and to ask each member nation to introduce laws patterned after the U.S. FCPA in its country. The main thrust of the treaty was to criminalize bribes to foreign officials who have sway over everything from government procurement contracts and infrastructure projects to privatization tenders.

The OECD Convention to combat bribery made it a crime to offer, promise, or give a bribe to a foreign public official in order to obtain or retain international business deals. A related text effectively puts an end to the practice of according tax deductibility for bribe payments made to foreign officials. The convention commits its signatory countries, including all the world's biggest economies, to adopt common rules to punish companies and individuals who engage in bribery transactions. Today, bribing a foreign public official is a crime in the 37 countries that have ratified the Convention.¹¹²

In spite of good intentions, the OECD has been criticized for not doing enough quickly enough. It has also been criticized for dramatically failing to live up to its own governance and antisleaze standards. Even the antibribery watchdog's boss, in 2007, was accused of promoting cronies and accepting lavish pay and freebies. He defended himself by saying that attacks on him were motivated partially by his attempts to stamp out bribery in member countries.¹¹³ The broader criticism is that the OECD antibribery signatories have failed to follow through on their plans. In 2007, more than half of the 34 countries surveyed had failed to act on their international commitments.¹¹⁴ Implementation and execution, often problems in effective management, have been serious issues for the OECD's initiatives.

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BRIBERY HOTLINE AVAILABLE FOR REPORTING CORRUPTION

TRACE, Inc. is a nonprofit membership association that specializes in antibribery services. TRACE members are "pre-vetted" partners for multinational companies seeking to do business with entities that share their commitment to transparent business practices.

One of Trace's resources is BRIBELine, a bribery hotline intended to help companies fight corruption by giving individuals an opportunity to register complaints. BRIBELine is a secure, multilingual Web-based mechanism through which companies and individuals can anonymously report bribes. It is quick and easy to use. No names are requested or collected,

and reports made to BRIBELine are not used for investigations or prosecutions. Instead, the information gathered through BRIBELine is aggregated and publicly reported by country and by sector, shining a spotlight on the worst offenders, providing companies with an additional risk mitigation tool, encouraging governments to reduce corruption in their ranks, and helping those working to increase transparency and reduce bribery to target their efforts more effectively.

Learn more about BRIBELine at TRACE'S website: <http://www.traceinternational.org/> Also see Michael Peel, "Bribery hotline receives hits from dozens of nations," *Financial Times*, July 30, 2007, p. 8.

It may be some years to come before the OECD Antibribery Convention is fully implemented. However, the OECD represents a significant initiative by a number of major countries in the global battle to eliminate corruption from commercial transactions.

UN Convention Against Corruption (UNCAC). Another major initiative to combat corruption around the world was passed in 2003. The UN Convention Against Corruption was implemented in December 2005.¹¹⁵ UNCAC created the opportunity to develop a global language about corruption and a coherent implementation strategy. A multitude of international anticorruption agreements already exist; however, their implementation has been uneven and only moderately successful. The UNCAC gives the global community the opportunity to address both of these weaknesses and begin establishing an effective set of benchmarks for effective anticorruption strategies.¹¹⁶

From a business perspective, UNCAC claims to hold the potential to become the global framework for combating corruption, which will pave the way for the establishment of a level playing field for all market participants. A central objective of UNCAC is to bring a higher degree of uniformity in the formulation and application of anticorruption rules across the world. For companies doing business in multiple jurisdictions, this agreement aspires to improve legal certainty and facilitate their global compliance efforts, thereby allowing them to fully compete in open markets without being exposed to extortion or unfair practices by their competitors.¹¹⁷ UNCAC builds on the UN Global Compact, which presents nine principles of conduct in the areas of human rights, labor standards, and environment. In 2004, a new principle of the Global Compact was adopted, the “10th Principle,” which states “Businesses should work against corruption in all its forms, including extortion and bribery.”¹¹⁸ To date, more than 133 countries have endorsed UNCAC and 30 UN member countries have ratified it.¹¹⁹

Individual Country Initiatives. In addition to OECD and UNCAC antibribery initiatives, some individual countries have begun antibribery campaigns on their own. Interestingly, many of the countries that have begun such campaigns are countries that typically do not score very highly on business ethics surveys. A case in point is the efforts initiated in Mexico under the leadership of President Vicente Fox. In 2001, Fox appointed a new anticorruption czar. The first such czar, Francisco Barrio, a former governor of Chihuahua state in northern Mexico, was responsible for unearthing corruption and federal spending irregularities in a country with a long history of both. In a pilot undercover program, Barrio’s office discovered that public servants in seven Mexican cities were charging and pocketing the equivalent of \$100 apiece, in addition to regular fees, to issue driver’s licenses. Barrio stated that corruption could not be eradicated in Fox’s six-year term, but the government could lay the foundation for reducing it on all levels.¹²⁰ Barrio resigned in 2003 to run for congress, and it seems that Mexico never again got back on track with its ethics improvements. Mexico received an overall “Weak” rating in the 2006 Global Integrity Index.¹²¹ The experience of Mexico tells us how hard it is to eliminate corruption. Corruption is widespread

and deeply rooted in countries like Mexico. According to Transparency International, the average Mexican household pays an estimated 7 percent of its annual income on bribes for public service.¹²² Though the country has not been very successful in stopping corruption, some give the president and the country credit for addressing the issue.¹²³

Several other countries have reported attempts to clean up corruption. In Russia, President Vladimir Putin created an anticorruption coalition to start cleaning up his country. Putin admitted that Western investment would not pour into Russia without major improvements in governance and in the fight against corruption.¹²⁴ Russia received an overall “Weak” rating in the 2006 Global Integrity Index.¹²⁵ A surprising development has been the efforts to fight corruption in Malaysia. There, the government created an Anticorruption Agency to investigate and combat corruption. They arrested two prominent businessmen and a sitting cabinet member on charges of corruption. Prime Minister Abdullah Ahmad Badawi believes the initiative has encouraged foreign investors, though he has received many criticisms for the programs his government has begun.¹²⁶

According to Oliver August, former Beijing bureau chief for the *Times* of London, the country of China is among the most corrupt of the newly emerging super-economies. He argues that corruption is the Achilles’ heel of China’s economic boom.¹²⁷ He has observed that almost no major business transaction gets done in China without cash payments under the table. He points to an enormous amount of corruption and bribery that has undergirded China’s preparation for the 2008 Olympic Games in Beijing. In an effort to avert a public relations disaster, top officials in China have begun what appears to be a crackdown on corruption. Scheduled to begin in late 2007 is China’s first purportedly independent anticorruption agency. An anticorruption commissioner has also been recently appointed.¹²⁸ Time will tell whether these initiatives will bear fruit. In the 2006 Transparency International Corruption Perception Index, China ranked 70th from the top, tied with India, another emerging superstar economy. In TI’s Bribe Payers’ Index for the same year, China and India ranked 29th and 30th out of just 30 countries ranked.¹²⁹

The best way to deal with bribes seems to be to stem the practice before it starts. A major paradox is that the very people who often benefit from illicit payments—the politicians—are the ones who must pass the laws and set the standards against bribes and corruption in the first place. Another factor is that bribes and corruption, whenever possible, need to be exposed. Public exposure, more than anything else, has the potential to bring questionable payments under control. This means that practices and channels of accountability need to be made public.¹³⁰

The Corruption Perception Index and Bribe Payers’ Index should help in this regard. So should the country rankings by Global Integrity with its Public Integrity Index. Beyond these steps, managers need to see that such corruption and bribery are no longer in their best interests. Not only do bribes corrupt the economic system, but they corrupt business relationships as well and cause business decisions to be made on the basis of factors that ultimately destroy all the institutions involved. The OECD treaty and individual country efforts indicate

that many countries now understand this important point. Their efforts will not totally eliminate bribery, but they do represent a significant step toward reducing bribery and bringing it under control.

We have by no means covered all the areas in which ethical problems reside in the global business environment. The topics treated have been major ones subjected to extensive public discussion. Examples of other issues that have become important recently and will probably increase in importance include the issues of international competitiveness, protectionism, industrial policy, political risk analysis, outsourcing, and antiterrorism. Also vital will be the dangers of developed countries importing dangerous products from some of the less-developed ones. These issues are of paramount significance in discussions of business's relations with international stakeholders. Other issues that include an ethical dimension are national security versus profit interests, the use of internal transfer prices to evade high taxes in a country, mining of the ocean floor, and harboring of terrorists. Space does not permit us to discuss these issues in detail.

OTHER GLOBAL ETHICS ISSUES

Many other ethical issues that MNCs face could be discussed, but space does not permit an exhaustive discussion of these issues. A couple of additional topics should be mentioned, however, because they help to characterize the difficulties associated with global business in the 2000s. As a result of the acts of terrorism evident in recent years, doing business abroad in certain countries has become more difficult and, indeed, dangerous. Kidnappings, murder, and violence against businesspeople abroad, particularly in troubled nations, are making it harder to find workers willing to subject themselves to these threats. The kidnapping and killing of Paul Johnson, Jr., in Saudi Arabia during the summer of 2004 will deter some from taking these kinds of jobs. In spite of these threats, many do accept the risks of working abroad in unsettled countries.

Peter Singer, in an insightful book titled *Corporate Warriors*,¹³¹ said, "Whether it's Columbia or Saudi Arabia or Iraq, there are always some people willing to bear those risks."¹³² Even though this may be true, it will still be incumbent upon MNCs to take actions to secure the safety of those working abroad. The recent instability and violence are expected to have at least three effects on the operations of companies in some of the dangerous countries. Workers will expect higher pay to adjust for the risk-reward trade-off. Companies will face higher insurance premiums to cover workers and their assets. Higher security costs will doubtless follow.¹³³ MNCs will perceive an added ethical responsibility toward their employees and stakeholders while doing business in dangerous countries.

A related issue is the problem of companies deciding to continue doing business in rogue nations even though the government has prohibited it. The term *rogue nations* was first used in the 1990s to describe nations that were considered to pose a threat to the United States. In the 2000s, the term was broadened to include countries that share a number of attributes, among them countries that brutalize their own people and squander their natural resources, display no regard for international law, threaten their neighbors and callously violate international

treaties, reject basic human values, and sponsor terrorism around the globe.¹³⁴ According to a *CBS News* special report titled “Doing Business with the Enemy,” there are U.S. companies that are helping to drive the economies of rogue countries like Iran, Syria, and Libya, which have sponsored terrorists.¹³⁵ Though U.S. law bans American companies from doing business with rogue nations, several companies such as Halliburton, ConocoPhillips, and General Electric have found ways to continue doing business in these countries. Apparently, the law does not apply to foreign or offshore subsidiaries as long as they are run by non-Americans.¹³⁶

A major concern with respect to these companies is that large institutional investors, such as pension funds, own stock in many of the companies and, therefore, are indirectly supporting their business ventures. According to the CBS report, just about anyone with a 401(k) pension plan or mutual fund has money invested in companies that are doing business in these rogue nations.¹³⁷ This is an issue to watch closely in the days ahead.

These issues will continue to be ethical issues for global business in the years to come. As the public becomes more aware of companies doing business in rogue nations, it is expected that heightened pressures will be placed on these companies to discontinue such ventures. Meanwhile, this is just one of among many other ethical issues that are shaping global business today.

Improving Global Business Ethics

The most obvious conclusion to extract from the discussion up to this point is that business ethics is much more complex at the global level than at the domestic level. The complexity arises from the fact that a wide variety of value systems, stakeholders, cultures, forms of government, socioeconomic conditions, and standards of ethical behavior exist throughout the world. Recognition of diverse standards of ethical behavior is important, but if we assume that firms from developed countries should operate in closer accordance with developed countries’ standards than with those of LDCs, the strategy of ethical leadership in the world will indeed be a challenging one.

Because U.S. and European MNCs have played such a leadership role in world affairs—usually espousing fairness and human rights—these firms have a heavy responsibility, particularly in underdeveloped countries and developing nations. The power–responsibility equation also suggests that these firms have a serious ethical responsibility in global markets. That is, our larger sense of ethical behavior and social responsiveness derives from the enormous amount of power we have.

In this section, we will first discuss the challenge of honoring and balancing the ethical traditions of a business’s home country with those of its host country. We will do this primarily through a discussion of Enderle’s four global types and an application of Donaldson and Dunfee’s Integrative Social Contracts Theory (ISCT). Next, we will discuss four recommended courses of action for conducting business in foreign environments: (1) develop worldwide codes of conduct, (2) factor ethics

into global strategy, (3) suspend activities when faced with unbridgeable ethical gaps, and (4) develop periodic “ethical impact statements.”¹³⁸ We will close out by taking a look at some other steps companies are taking to improve their global ethics.

BALANCING AND RECONCILING THE ETHICS TRADITIONS OF HOME AND HOST COUNTRIES

One of the greatest challenges that businesses face operating in foreign countries is achieving some kind of reconciliation and balance in honoring both the cultural and moral standards of their home and host countries. Should a business adhere to its home country’s ethical standards for business practices or to the host country’s ethical standards? There is no simple answer to this question. The diagram presented in Figure 10-5 frames the extreme decision choices businesses face when they consider operating globally.

Ethical Imperialism

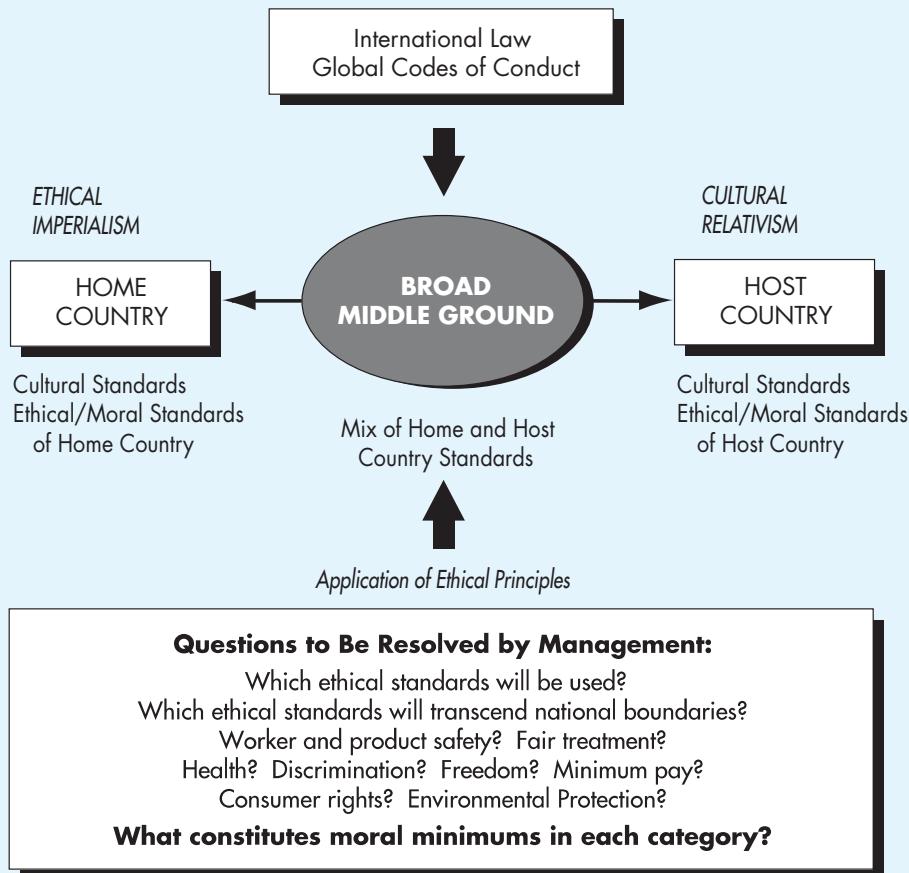
At one extreme is a position some have called “ethical imperialism.” This position holds that the MNC should continue to follow its home country’s ethical standards even while operating in another country. Because U.S. standards for treating employees, consumers, and the natural environment are quite high relative to the standards in many less-developed countries, it is easy to see how managers might find this posture appealing.

As reliance on foreign factories has soared in recent years and harsh conditions have been documented by the media, an increasing number of companies, such as Levi Strauss, Nordstrom, Wal-Mart, and Reebok, have espoused higher standards for foreign factories that cover such issues as wages, safety, and workers’ rights to organize.¹³⁹ These standards more nearly approximate U.S. views on how such stakeholders ought to be treated than some host countries’ views. Such higher standards could be seen by foreign countries, however, as the United States attempting to impose its standards on the host country—thus the name “ethical imperialism” for one end of the continuum.

Cultural Relativism

At the other extreme in Figure 10-5 is a position often called “cultural relativism.” This position is characterized by foreign direct investors such as MNCs following the host country’s ethical standards. This is the posture reflected in the well-known saying, “When in Rome, do as the Romans do.” This position would argue that the investing MNC should set aside its home country’s ethical standards and adopt the ethical standards of the host country. For example, if Saudi Arabia holds that it is illegal to hire women for most managerial positions, the investing MNC would accept and adopt this standard, even if it counters its home country’s standards. Or, if the host country has no environmental protection laws, this position would argue that the MNC need not be sensitive to environmental standards.

Figure 10-5 *Ethical Choices in Home versus Host Country Situations*



It has been argued that cultural relativism holds that no culture's ethics are better than any other's and that there are, therefore, no international rights or wrongs. If Thailand tolerates the bribery of government officials, then Thai tolerance is no worse than Japanese or German intolerance. If Switzerland does not find insider trading morally repugnant, then Swiss liberality is no worse than American restrictiveness.¹⁴⁰ Most ethicists find cultural relativism to be a case of moral or ethical relativism and, therefore, an unacceptable posture for MNCs to take.

Figure 10-5 presents a series of questions management needs to ask to help it determine its stance on home versus host country ethics. Depending on the issue (e.g., health versus minimum pay), companies may be more or less compelled to follow their home country's ethics. Key questions that must be posed and

answered include: Which ethical standards will be used? Which ethical standards will transcend national boundaries? What constitutes moral minimums with respect to each category of ethical issue?

A Typology of Global Types

George Enderle, an international business expert, has observed and categorized at least four different types of global firms with respect to their use of home versus host country ethical standards:¹⁴¹

- Foreign country type
- Empire type
- Interconnection type
- Global type

Foreign Country Type. This type of firm conforms to local customs and ethics, assuming that the ethical standards of the host country are adequate and appropriate. This approach represents moral or cultural relativism.

Empire Type. This type of company applies its domestic or home country standards without making any serious adaptations to the host country. These companies export their values in a wholesale fashion, often disregarding the consequences. An example would be Great Britain in India and elsewhere prior to 1947. This approach represents ethical imperialism.

Interconnection Type. These companies regard the international sphere as differing significantly from the domestic sphere in that their interconnectedness transcends national identities. An example of this would be states engaging in commercial business in the European Union or NAFTA. In this type, the entire concept of national interests is blurred. Companies don't try to project a national identity.

Global Type. This type of business firm abstracts from all regional differences. These firms view the domestic or home standards as not relevant or applicable. With this type, the nation-state may be seen as vanishing as only global citizenry applies.

The purpose of identifying each of these types is to illustrate the various mixtures or combinations of home and host country standards that a business operating in the global sphere might adopt.

Integrative Social Contract Theory (ISCT)

Integrative Social Contract Theory (ISCT), according to Donaldson and Dunfee, is an approach to navigating cross-national cultural differences.¹⁴² Two key concepts in this theory are the notions of *hypernorms* and *moral free space*. They explain these two concepts by depicting a series of concentric circles representing the core norms held by corporations, industries, or economic cultures. At the center are **hypernorms**,

which are transcultural values. These include, for example, fundamental human rights or basic prescriptions common to most major religions. The values they represent are by definition acceptable to all cultures and all organizations.

Moving out from the center of the concentric circles, next would be **consistent norms**. These values are more culturally specific than those in the center but are consistent with hypernorms and other legitimate norms. The next circle is **moral free space**. Here, one finds norms that are inconsistent with at least some other legitimate norms existing in other economic cultures. These norms could be in mild tension with hypernorms, though they may be compatible with them. These are strongly held cultural beliefs in particular countries. Finally, in the outer circle are **illegitimate norms**. These are norms that are incompatible with hypernorms. An example of this might be the practice of exposing workers to unacceptable levels of carcinogens.

These different levels of norms are then used to comment on Enderle's four types of corporations, discussed in the previous section. Regarding the foreign country type, the researchers say that nothing limits the free moral space of the host country. Thus, if a host country accepts government corruption and environmental degradation, then so much the worse for honest people and environmental integrity. Both the global and empire types succeed in avoiding the

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PRINCIPLES AND CODES FOR SOCIALLY RESPONSIBLE BUSINESS PRACTICES

Over the years, various groups interested in international business ethics have developed a number of different guidelines or codes of conduct for conducting business in the global arena. "Principles & Codes for Socially Responsible Business Practices" at http://www.goodmoney.com/directry_codes.htm, the website developed by Good Money, a company focused on socially responsible investing, has an excellent listing of select global guidelines. A few of these important and interesting guidelines include:

- *Caux Round Table: Principles for Business*—designed to set a world standard against which business behavior can be measured.
- *CERES Principles*—formerly the Valdez Principles, the CERES Principles are for environmentally sound global business practices.
- *Universal Declaration of a Global Ethic*—a code to address the crises in the global economy, ecology, and politics.
- *The MacBride Principles*—a corporate code of conduct for U.S. companies doing business in Northern Ireland.
- *The Maquiladoras Standards of Conduct*—drafted for companies doing business in the Maquiladores of Mexico.
- *Principles for Global Corporate Responsibility*—drafted by three interfaith organizations from Canada, the United States, and the United Kingdom for transnational corporations.

fierce relativism of the foreign country type but may fall prey to the opposite problem. Because each of these has its own set blueprint of right and wrong, each may suffocate the host country's moral free space and leave no room for legitimate local norms. The empire type exhibits a version of moral imperialism; the global type may impose its home country morality on a host culture, thus imposing its version of a global morality on the host country.¹⁴³

According to Donaldson and Dunfee, only the interconnection type satisfies ISCT by acknowledging both universal moral limits (hypernorms) and the ability of communities to set moral standards of their own (moral free space). This type balances better than the others a need to retain local identity with the acknowledgment of values that transcend individual communities; thus, it manages to balance moral principles with moral free space in a more convincing way than in the other three models.¹⁴⁴

In summary, ISCT uses the principles of moral free space and adherence to hypernorms as a balanced approach to navigating global international waters. While honoring hypernorms, companies do not have to simply adopt a "do in Rome as the Romans do" philosophy. But, they do need to be sensitive to the transcultural value implications of their actions. In turn, the concept of moral free space makes them ever vigilant of the need to precede judgment with an attempt to understand the local host country culture. The result, of course, is the very real probability that moral tension will be an everyday part of doing business in the global sphere.¹⁴⁵

It may sound like a simplistic solution to say that the MNC needs to operate in some broad middle ground where a mix of home and host country ethical standards may be used. The challenge for managers will be to determine what mix of ethical standards should be used and how this decision should be made. As mentioned earlier, managers will need to ask themselves which moral standards are applicable in the situations they face. Use of ethical principles such as those articulated in the previous chapters—rights, justice, utilitarianism, and the Golden Rule—still apply. Managers will need to decide which ethical standards should transcend national boundaries and thus represent hypernorms: Safety? Health? Discrimination? Freedom?

Managers will need to decide what will represent their moral minimums with respect to these and other issues. It would be nice to think that international laws and global codes of conduct will make these decisions easier. Though some are available, it is doubtful that such guidelines will be easily applicable. In the interim, managers will need to be guided by the ethical concepts at their disposal, possibly with help from some of the approaches to which we now turn.

STRATEGIES FOR IMPROVING GLOBAL BUSINESS ETHICS

There are four major strategies or categories of action that would help MNCs conduct global business while maintaining an ethical sensitivity in their practices and decision making. We will now discuss these and use them to help organize suggested strategies and actions that have been made by a number of experts.

Global Codes of Conduct

There are two ways of thinking about global codes of conduct. First, there are specific corporate global codes that individual companies have developed. Second, there are global codes or guidelines that have been developed by various international organizations. Each of these deserves some consideration.

Corporate Global Codes. In Chapter 8, we discussed codes of conduct, and that discussion applies in the global sphere as well. While operating in the global sphere, MNCs have been severely criticized for operating with divergent ethical standards in different countries, thus giving the impression that they are attempting to exploit local circumstances. A growing number of MNCs, such as Chiquita Brands International, Caterpillar Tractor, Allis Chalmers, S.C. Johnson, and Medtronic, have developed and used codes geared to worldwide operations.¹⁴⁶

One of the first and most well known of the corporate global codes was that of Caterpillar Tractor Company, issued by the chairman of the board, titled “A Code of Worldwide Business Conduct.” It was first published in 1974 and last amended in 2005, and the company asserts that it sets a high standard for honesty and ethical behavior by every employee.¹⁴⁷ The code went into considerable detail and had major sections that covered the following vital areas: ownership and investment, corporate facilities, relationships with employees, product quality, sharing of technology, accounting and financial records, different business practices, competitive conduct, observance of local laws, business ethics, relationships with public officials, and international business.

Other companies do not have comprehensive codes addressing their international operations but rather codes containing sections that address foreign practices. For example, in its *Standards of Business Conduct*, Northrop Grumman Corporation dedicates a whole section to the subject of “International.”¹⁴⁸ In its “International” section, the code begins as follows:

*Employees and consultants or agents representing the company abroad or working on international business in the United States should be aware that the company’s Values and Standards of Conduct apply to them anywhere in the world. Less than strict adherence to laws and regulations that apply to the company’s conduct of international business would be considered a compromise of our Values and Standards of Conduct.*¹⁴⁹

The code then goes on to specifically address topics such as export controls, the Foreign Corrupt Practices Act, and laws of other countries.

Other companies have specific categories of ethical issues in which they address global considerations. For example, Chiquita Bananas says the following regarding improper payments —“We do not pay bribes. This includes not giving anything of value directly or indirectly to any government official for purposes of influencing any official act or decision, inducing any official to violate his or her official duty, or securing any improper advantage for Chiquita or anyone else.”¹⁵⁰

The GBS Codex. Toward the end of 2005, four researchers published what they termed a Global Business Standards (GBS) Codex.¹⁵¹ The GBS Codex was not intended to be a model code of conduct for global business but a benchmark for companies wanting to develop their own world-class code. The researchers studied five well-known global codes put together by international organizations and fourteen codes of the world's largest companies, and extracted the underlying ethical principles they felt the different codes had in common. The researchers found eight principles, representing worldwide ethical standards, that they thought were basic to the codes studied. The eight principles identified and described standards of conduct in the following category areas: fiduciary, property, reliability, transparency, dignity, fairness, citizenship, and responsiveness.¹⁵² The researchers argued that companies that wanted to assess their current codes of conduct or to create new codes of conduct would find their eight principles useful as a standard by which comparisons could be made. As of this writing, it was too early to assess the extent to which the GBS Codex has been used in practice.

Corporate codes of conduct are usually just the starting point for companies in dealing with global business ethics. The acid test is whether these codes become living documents that the companies actually use on a daily basis.

Global Codes/Standards Set by International Organizations. In addition to individual corporate codes, a number of international organizations have developed global codes or standards that they hope companies will adopt and follow. Some of these codes focus on one specific issue; many provide standards across a number of issue areas. Figure 10-6 summarizes brief information about some of the more prominent of these external standards.

Ethics and Global Strategy

The major recommendation here is that the ethical dimensions of multinational corporate activity should be considered as significant inputs into top-level strategy formulation and implementation.¹⁵³ Even more broadly, corporate social policy should be integrated into strategic management.¹⁵⁴ At the top level of decision making in the firm, corporate strategy is established. At this level, commitments are made that will define the underlying character and identity that the organization will have. The overall moral tone of the organization and all decision making and behaviors are set at the strategic level, and management needs to ensure that social and ethical factors do not get lost in the preoccupation with market opportunities and competitive factors.

If ethics does not get factored in at the strategic formulation level, it is doubtful that ethics will be considered at the level of operations where strategy is being implemented. Unfortunately, much current practice has tended to treat ethics and social responsibility as residual factors. A more proactive stance is needed for dealing with ethical issues at the global level. Strategic decisions that may be influenced by ethical considerations in the global sphere include, but are not limited to, product/service decisions, plant location, operations policy, marketing policy and practices, and human resource management policies. More and more

Figure

10-6

Global Standards or Codes of Conduct Developed by International Organizations

Codes, Standards, or Guidelines	Brief Description and Website
UN Global Compact	<p>The Global Compact's operational phase was launched at UN Headquarters in New York on July 26, 2000. Today, thousands of companies from all regions of the world, international labor, and civil society organizations are engaged in the Global Compact, working to advance 10 universal principles in the areas of human rights, labor, the environment, and anticorruption. www.unglobalcompact.org/</p>
Caux Roundtable Principles	<p>The CRT Principles for Business are a worldwide vision for ethical and responsible corporate behavior and serve as a foundation for action for business leaders worldwide. As a statement of aspirations, the CRT Principles aim to express a world standard against which business behavior can be measured. www.cauxroundtable.org/</p>
Ceres Principles	<p>The Ceres Principles are a 10-point code of corporate environmental conduct to be publicly endorsed by companies as an environmental mission statement or ethic. Embedded in that code of conduct is the mandate to report periodically on environmental management structures and results. More than 50 companies have endorsed the Ceres Principles, including 13 Fortune 500 firms. www.ceres.org/</p>
Global Sullivan Principles	<p>The objectives of the Global Sullivan Principles are to support economic, social and political justice by companies where they do business; to support human rights and to encourage equal opportunity at all levels of employment, including racial and gender diversity on decision-making committees and boards; to train and advance disadvantaged workers for technical, supervisory, and management opportunities. www.thesullivanfoundation.org/</p>
OECD Guidelines for Multinational Enterprises	<p>The Guidelines are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in a variety of areas, including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. www.oecd.org/daf/investment/guidelines</p>
Principles for Global Corporate Responsibility: Bench Marks	<p>The Principles promote positive corporate social responsibility consistent with the responsibility to sustain the human community and all creation. The <i>Bench Marks</i> state comprehensive standards and expectations fundamental to a responsible company's action. www.bench-marks.org/</p>

companies are employing departments and strategies with respect to global corporate social responsibility and global business citizenship.¹⁵⁵

Levi Strauss & Co. A useful illustration of ethics being factored into strategic decision making is provided by Levi Strauss & Co. Because Levi Strauss operates

in many countries and diverse cultures, it reasoned that it must take special care in selecting its contractors and the countries where its goods are produced in order to ensure that its products are being made in a manner consistent with its values and reputation. In the early 1990s, therefore, the company developed a set of *global sourcing guidelines* that established standards its contractors must meet. As examples, their guidelines banned the use of child and prison labor. They stipulated certain environmental standards. Wages must, at minimum, comply with the law and match prevailing local practice. By factoring these ethical considerations into its strategic decisions, Levi argued that it receives important short- and long-term commercial benefits.¹⁵⁶ In 2005, Levi Strauss took the unprecedented action of publishing on its website a list of all active owned-and-operated and contract factories producing the company's branded products. The company's senior vice president for global sourcing said: "We believe that greater transparency within the supply chain will provide additional momentum for our efforts to improve working conditions in apparel factories worldwide. Our hope is that this level of transparency will become standard across the apparel sector, fostering greater collaboration among brands in shared factories."¹⁵⁷

Starbucks. Another example of a company integrating ethical concerns into its corporate strategies is that of Starbucks Coffee Co., the Seattle-based firm. In an innovative pilot program initiated in 1998, Starbucks began paying a premium above-market price for coffee, with the bonus going to improve the lives of coffee workers. The initial payments would be made to farms and mills in Guatemala and Costa Rica, which would co-fund health care centers, farm schools, and scholarships for farmworkers' children. Starbucks's incentive program was part of a larger "Framework for Action," its plan for implementing its code of conduct, created in 1995.¹⁵⁸ By 2004, Starbucks had implemented a full-fledged fair-trade coffee program. Starbucks' Fair Trade certification program increases farmers' incomes through forming cooperatives and linking them directly to coffee importers—coffee prices are guaranteed a minimum price, allowing farmers a more sustainable way of life.¹⁵⁹ Starbucks continues this program and pays a premium to the farmers for its coffee beans.¹⁶⁰

Another way Starbucks integrates ethics into its corporate strategy is through its Supplier Code of Conduct. The Code was introduced in September 2003. Suppliers are required to have an officer or owner of the company sign an acknowledgment that they agree to comply with Starbucks' code and standards. New suppliers are required to comply as a condition of doing business with Starbucks. Already in place were specific standards for Starbucks coffee suppliers as part of Starbucks' Coffee Sourcing Guidelines. Coffee suppliers are required to adopt these standards to become a Starbucks preferred supplier.¹⁶¹

Suspension of Activities

An MNC may sometimes encounter unbridgeable gaps between the ethical values of its home country and those of its host country. When this occurs, and reconciliation does not appear to be in sight, the MNC should consider suspending activities in the

host country. For example, years ago IBM and Coca-Cola established a precedent for this activity by suspending their activities in India because of that country's position on the extent of national ownership and control.¹⁶² These companies no longer have this policy.

Also, Levi Strauss undertook a phased withdrawal from China, largely in response to human-rights concerns, and suspended sourcing in Peru because of concerns about employee safety. It later lifted the suspension because conditions had improved.¹⁶³ Companies also have pulled out of Burma (now also called Myanmar) due to human-rights violations. In a fight against corruption, Procter & Gamble even closed a Pampers diaper plant in Nigeria rather than pay bribes to customs inspectors.¹⁶⁴

In 2006, the Ecuadorian government seized control of the operations of Occidental Petroleum, prompting the U.S. government to discontinue free trade talks with the country. Officials in the United States claim that the Ecuadorian government's confiscation of Occidental's operations breaks foreign investment laws.¹⁶⁵ Occidental doesn't have too much choice but to suspend operations because of the treatment it has received.

In 2007, a number of companies were having difficulties operating in Venezuela. As President Hugo Chávez has been leading his country toward "twenty-first century socialism," new rules restricting companies doing business there have been forthcoming. According to *BusinessWeek*, President Chávez has already forced global oil companies, phone carriers, and power companies to hand over control of key assets. He states he has plans to nationalize the banks, hospitals, and steel companies. Foreign direct investment has plunged in Venezuela over the past couple of years.¹⁶⁶ Chávez's strong-arm tactics have already caused two major oil companies—ExxonMobil and ConocoPhillips—to announce they are leaving the country.¹⁶⁷

The changing business and society relationships in countries such as Ecuador and Venezuela will force companies that believe in free trade and normal legal and human rights to discontinue doing business there.

Suspension of business in a foreign country is not a decision that can or should be taken too hastily, but it must be regarded as a viable option for those firms that desire to travel on the higher moral road of free trade. Each country is at liberty to have its own standards, but this does not mean that other country's firms must do business in that country. What does ethical leadership mean if it is not backed up by a willingness and an ability to take a moral stand when the occasion merits?

Ethical Impact Statements and Audits

MNCs need to be constantly aware of the impacts they are having on society, particularly foreign societies. One way to do this is to periodically assess the company's impacts. Companies have a variety of impacts on foreign cultures, and ethical impacts represent only a few of these. The impact statement idea probably derived, in part, from the practice of environmental impact statements pioneered years ago. Ethical impact statements are similar to the corporate social audit, a concept discussed in Chapter 2. Social auditing is "a systematic attempt to identify, analyze, measure (if possible), evaluate, and monitor the effect of an

organization's operations on society (that is, specific social groups) and on the public well-being."¹⁶⁸ **Ethical impact statements** would be an attempt to assess the underlying moral justifications for corporate actions and the consequent results of those actions. The information derived from these actions would permit the MNCs to modify or change their business practices if the impact statement suggested that such changes would be necessary or desirable.

One form of ethical impact assessment is some firms' attempts to monitor their compliance with their companies' global ethics codes. For example, Mattel, Inc., the toy company, developed an independent audit and monitoring system for its code. Mattel's monitoring program was headed by an independent panel of commissioners who selected a percentage of the company's manufacturing facilities for annual audits. In one audit, for example, Mattel terminated its relationship with three contractor facilities for refusing to meet company-mandated safety procedures.¹⁶⁹ Mattel continues its auditing of compliance to its code of conduct through its Global Manufacturing Principles.¹⁷⁰

In spite of the care that Mattel has used over the years, during the summer of 2007, it was forced into a massive voluntary recall of 9 million toys manufactured in China. The toys apparently had been farmed out to some subcontractors who engaged in the unacceptable practices of using lead paint, which is dangerous for children, and making other toys that had hazardous magnets.¹⁷¹ This contrast of high standards with poor performance demonstrates how difficult global business can sometimes be.

COMPANIES ACT AGAINST CORRUPTION

A major study conducted by The Conference Board and the Ethics and Compliance Officers Association (ECO) has revealed some details on companies' recent anticorruption campaigns within their organizations. When asked what was the single most important factor in their company's decision to develop an anticorruption program, the most frequent responses were "senior management leadership and personal convictions," "bribe payments being illegal under their home country laws," the belief that "bribe payments are wrong," and the impact of "Sarbanes-Oxley Section 404."¹⁷²

The report revealed that there were five vital steps among anticorruption programs that seemed to work best for companies:¹⁷³

1. High-level Commitment by Top Management
2. Detailed Statements of Policies and Operating Procedures
3. Training and Discussion of Policies and Procedures
4. Hotlines and Helplines for All Organizational Members
5. Investigative Follow-Up, Reporting, and Disclosure

These vital steps, when combined with the strategies for improving global business ethics discussed earlier, go a long way toward establishing a solid foundation for fighting bribery and corruption, the most insidious issues in global business ethics. The good news is that companies are now very much aware of these issues and are moving quickly to address them.

Summary

Ethical dilemmas pose difficulties, in general, for businesses, and those arising in connection with doing business in foreign lands are among the most complex. The current period is characterized by an increasing antiglobalization sentiment, and the attacks on the World Trade Center and subsequent acts of terrorism have created an unstable global environment. A cursory examination of major issues that have arisen in global business ethics over the past several decades shows that they rank right up there with the most well-known news stories. The infant formula controversy, the Bhopal tragedy, corruption and bribery, concern about human rights and sweatshops, and the exploits of MNCs in third world countries have all provided an opportunity for business critics to assail corporate ethics in the international sphere. These problems arise for a multiplicity of reasons, but differing cultures, value systems, forms of government, socioeconomic systems, and underhanded and ill-motivated business exploits have all been contributing factors. The possible applications of the Alien Tort Claims Act (ATCA) to U.S.-based MNCs raises to a new level

of urgency the actions, decisions, and policies of these firms in foreign lands.

Steps taken by the United States and other major countries to address the issues of corruption and bribery include the Foreign Corrupt Practices Act, OECD antibribery initiatives, and the UN Convention Against Corruption. Individual country initiatives are also vital, as are the efforts of nonprofit organizations such as Transparency International.

The balancing of home and host country standards using Integrative Social Contracts Theory, global codes of conduct, the integration of ethical considerations into corporate strategy, the option of suspending activities, and the use of ethical impact statements, offer some hope that global business can be better managed. Current trends point to a growth in business activity in the transnational economy, and though there is some evidence of a backlash against globalization, these issues will become more rather than less important in the future. Indeed, it could easily be argued that business's greatest ethical challenges in the future will be at the global level.

Key Terms

Alien Tort Claims Act (ATCA) (page 415)

anticorruption movement (page 422)

antiglobalists (page 396)

Bhopal tragedy (page 407)

Bribe Payers' Index (BPI) (page 423)

bribery (page 418)

consistent norms (page 432)

corruption (page 417)

Corruption Perception Index (CPI) (page 423)

ethical impact statements (page 439)

globalism or globalization (page 394)

globalists (page 396)

grease payments (page 420)

hypernorms (page 431)

illegitimate norms (page 432)

infant formula controversy (page 405)

internationalization (page 394)

less-developed countries (LDCs) (page 398)

moral free space (page 432)

multinational corporations (MNCs) (page 397)

North American Free Trade Agreement (NAFTA)
(page 395)

offshoring (page 395)

outsourcing (page 395)

Public Integrity Index (page 423)
sweatshops (page 411)

transnational economy (page 392)
Transparency International (TI) (page 422)

Discussion Questions

1. Drawing on the notions of moral, amoral, and immoral management introduced in Chapter 7 categorize your impressions of (a) Nestlé, in the infant formula controversy and (b) Union Carbide, in the Bhopal tragedy.
2. As an MNC seeks to balance and honor the ethical standards of both the home and host countries, conflicts inevitably will arise. What criteria do you think managers should consider as they try to decide whether to use home or host country ethical standards?
3. Explain ISCT and the concepts of hypernorms and moral free space. Provide an example of each. What difficulties would a manager encounter in applying these concepts?
4. Differentiate between a bribe and a grease payment. Give an example of each.
5. Conduct research, for purposes of updating, the latest rankings of Transparency International and the activities of the OECD, UNCAC, and individual country initiatives. How could countries such as China and India most effectively improve their TI rankings?
6. What are the major strategies companies might employ in improving global business ethics? What are the key steps research has shown are important to successful company anticorruption efforts?

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External Stakeholder Issues

- CHAPTER 11** | *Business, Government, and Regulation*
- CHAPTER 12** | *Business Influence on Government and Public Policy*
- CHAPTER 13** | *Consumer Stakeholders: Information Issues and Responses*
- CHAPTER 14** | *Consumer Stakeholders: Product and Service Issues*
- CHAPTER 15** | *The Natural Environment as Stakeholder*
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Business, Government, and Regulation

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Articulate a brief history of government's role in its relationship with business.
- 2 Appreciate the complex interactions among business, government, and the public.
- 3 Identify and describe government's nonregulatory influences, especially the concepts of industrial policy and privatization.
- 4 Explain government regulation and identify the major reasons for regulation, the types of regulation, and issues arising out of deregulation.
- 5 Provide a perspective on privatization versus federalization, along with accompanying trends.

The depth, scope, and direction of government's involvement in business have made the business/government relationship one of the most hotly debated issues of modern times. Government's role, particularly in the regulation of business, has ensured its place among the major stakeholders with which business must establish an effective working relationship if it is to survive and prosper.

Business has never been fond of government playing an activist role in establishing the ground rules under which business operates. In contrast, public interest has been cyclical, going through periods when it has thought that the federal government had too much power and other periods when it has thought that government should be more activist. Ronald Reagan came into office in 1980, when the public was growing somewhat weary of an active federal role. Throughout the 1980s, the federal government played less and less of a role, especially in terms of

monitoring and regulating business. It was not without reason, therefore, that in late 1989 *Time* magazine ran a cover story titled “Is Government Dead?”¹ The “Reagan Revolution” of an inactive federal government had left the public with a desire for government to become active again. It was against this backdrop that George Herbert Walker Bush was elected president in 1988.

During the first Bush administration (1988–1992), the country witnessed a growth in the rate of federal government spending that exceeded that of the Reagan years. The Clinton administration (1992–2000) then sought a middle ground, advocating a more activist role for the government in international politics and social concerns, while launching other initiatives to control federal spending. As the economy rebounded in the early 1990s, the peace dividend brought new prosperity, and cost-cutting initiatives took hold, the rate of government spending slowed dramatically. Total government spending went from 20.4 percent of GDP in 1990 to 17.6 percent in 2000, its lowest level since 1948.²

The George W. Bush administration came into office in 2001 on a platform of a reduced role for federal government; however, the terrorist attacks of September 11, 2001, changed everything.³ Repercussions of the attacks, such as the bailout of the troubled airline industry, potential relief for other distressed industries, the increase in military spending, and the federalization of airport security expanded dramatically both government spending and governmental intervention in business activities.⁴ Other increases in federal spending were unrelated to 9/11. By the end of fiscal year 2006, the federal deficit stood at \$248 billion (despite a record \$237 billion surplus in fiscal year 2000): The Congressional Budget Office predicted the possibility of returning to a surplus, but only if personal and corporate taxes rise.⁵

In this chapter, we will examine the relationship between business and government, although the general public will assume an important role in the discussion as well. A central concern in this chapter is the government’s role in influencing business. Exploring this relationship carefully will provide an appreciation of the complexity of the issues surrounding business/government interactions. From the prospective manager’s standpoint, one needs a rudimentary understanding of the forces and factors that are involved in these issues before one can begin to talk intelligently about strategies for dealing with them. Unfortunately, more is known about the nature of the problem than about the nature of solutions, as is common when dealing with complex social issues. In the next chapter, we will discuss how business attempts to influence government and public policy.

A Brief History of Government’s Role

In the early days of the United States, the government supported business by imposing tariffs to protect our fledgling industries. In the second half of the 1800s, government gave large land grants as incentives for private business to build

railroads. Several railroads had grown large and strong through mergers, and people began to use them because their service was faster, cheaper, and more efficient. This resulted in a decline in the use of alternative forms of transportation, such as highways, rivers, and canals. Many railroads began to abuse their favored positions. For example, a railroad that had a monopoly on service to a particular town might charge unfairly high rates for the service. Competitive railroads sometimes agreed among themselves to charge high but comparable rates. Higher rates were charged for shorter hauls, and preference was shown to large shippers over smaller shippers.

Public criticism of what were perceived as abusive practices led to the passage of the Interstate Commerce Act of 1887, which was intended to prevent discrimination and abuses by the railroads. This act marked the beginning of extensive federal government regulation of interstate commerce. The act created the Interstate Commerce Commission, which became the first federal regulatory agency and a model for future agencies.⁶

Many large manufacturing firms and mining firms also began to abuse consumers during the late 1800s. Typical actions included the elimination of competition and the charging of excessively high prices. During this period, several large firms formed organizations known as *trusts*. A trust was an organization that brought all or most competitors under a common control that then permitted them to eliminate most of the remaining competitors by price-cutting, an act that forced the remaining competitors out of business. Then, the trusts would restrict production and raise prices. As a response, Congress passed the Sherman Antitrust Act in 1890, which became the first in a series of actions intended to control monopolies in various industries. The Sherman Act outlawed any contract, combination, or conspiracy in restraint of trade, and it also prohibited the monopolization of any market. In the early 1900s, the federal government used the Sherman Act to break up the Standard Oil Company, the American Tobacco Company, and several other large firms that had abused their economic power.⁷

The Clayton Antitrust Act was passed in 1914 to augment the Sherman Act. It addressed other abusive practices that had arisen. It outlawed price discrimination that gave favored buyers preference over others and forbade anticompetitive contracts whereby a company would agree to sell only to suppliers who agreed not to sell the products of a rival competitor. The act prohibited an assortment of other anticompetitive practices. Also in 1914, Congress formed the Federal Trade Commission, which was intended to maintain free and fair competition and to protect consumers from unfair or misleading practices.⁸

Another great wave of regulation occurred during the Great Depression and the subsequent New Deal of the 1930s. Significant legislation included the Securities Act of 1933 and the Securities and Exchange Act of 1934. These laws were aimed at curbing abuses in the stock market, stabilizing markets, and restoring investor confidence. Significant labor legislation during this same period signaled government involvement in a new area. Several examples were the 1926 Railway Labor Act, the 1932 Norris-LaGuardia Act, and the 1935 Wagner Act.

During the New Deal period in the 1930s, government also took on a new dimension in its relationship with business, actively assuming responsibility for restoring prosperity and promoting economic growth through public works

programs. In 1946, this new role of government was formalized with the passage of the Full Employment Act.

Prior to the mid-1950s, most congressional legislation affecting business was economic in nature. After that time, legislation was concerned largely with the quality of life.⁹ Several illustrations of this include the Civil Rights Act of 1964, the Water Quality Act of 1965, the Occupational Safety and Health Act of 1970, the Consumer Product Safety Act of 1972, the Warranty Act of 1975, and the Americans with Disabilities Act of 1990. Recently, issues of national security have taken the forefront: Key examples of this are the USA Patriot Act of 2001 and the Homeland Security Act.

Just as the areas in which government has chosen to initiate legislation have changed, the multiplicity of roles that government has assumed has increased the complexity of its relationship with business. Several of the varied roles that government has assumed in its relationship with business are worth exploring because they suggest the influence, interrelationships, and complexities that are present.¹⁰ These roles indicate that government:

1. Prescribes the rules of the game for business
2. Is a major purchaser of business's products and services
3. Uses its contracting power to get business to do things it wants
4. Is a major promoter and subsidizer of business
5. Is the owner of vast quantities of productive equipment and wealth
6. Is an architect of economic growth
7. Is a financier
8. Is the protector of various interests in society against business exploitation
9. Directly manages large areas of private business
10. Is the repository of the social conscience and redistributes resources to meet social objectives

After examining and assessing these various roles, one can perhaps begin to appreciate the crucial interconnectedness between business and government and the difficulty both business and the public have in fully understanding (much less prescribing) what government's role ought to be in relation to business.

The Roles of Government and Business

We do not intend to philosophize in this chapter on the ideal role of government in relation to business, because this is outside our stakeholder frame of reference. However, we will strive for an understanding of current major issues as they pertain to this vital relationship. For effective management, government's role as a stakeholder must be understood.

The fundamental question underlying our entire discussion of business/government relationships is, "What should be the respective roles of business and

government in our socioeconomic system?" This question is far easier to ask than to answer, but as we explore it, some important basic understandings begin to emerge.

The issue could be stated in a different fashion: Given all the tasks that must be accomplished to make our society work, which of these tasks should be handled by government and which should be handled by business? This poses the issue clearly, but there are other questions that remain to be answered. If we decide, for example, that it is best to let business handle the production and distribution roles in our society, the next question becomes, "How much autonomy are we willing to allow business?" If our goals were simply the production and distribution of goods and services, we would not have to constrain business severely. In modern times, however, other goals have been added to the production and distribution functions: for example, a safe working environment for those engaging in production, equal employment opportunities, fair pay, clean air, safe products, employee rights, and so on. When we superimpose these goals on basic economic goals, the task of business becomes much more complex and challenging.

Because we do not automatically factor these more socially oriented goals into business decision making and processes, it often falls on government to ensure that those goals that reflect social concerns be achieved. Thus, whereas the marketplace dictates economic production decisions, government becomes one of the citizenry's designated representatives charged with articulating and protecting the public interest.

A CLASH OF ETHICAL BELIEF SYSTEMS

A clash of emphases partially forms the crux of the antagonistic relationship that has evolved between business and government over the years. This problem has been termed "a clash of ethical systems." The two ethical systems (systems of belief) are the **individualistic ethic of business** and the **collectivistic ethic of government**. Figure 11-1 summarizes the characteristics of these two philosophies.¹¹

Figure 11-1 *The Clash of Ethical Systems Between Business and Government*

Business Beliefs

- Individualistic ethic
- Maximum concession to self-interest
- Minimizing the load of obligations society imposes on the individual (personal freedom)
- Emphasizes inequalities of individuals

Government Beliefs

- Collectivistic ethic
- Subordination of individual goals and self-interest to group and group interests
- Maximizing the obligations assumed by the individual and discouraging self-interest
- Emphasizes equality of individuals

The clash of these two ethical systems partially explains why the current business/government relationship is adversarial in nature. In elaborating on the adversarial nature of the business/government relationship, Neil Jacoby offered the following comments:

Officials of government characteristically look upon themselves as probers, inspectors, taxers, regulators, and punishers of business transgressions. Business-people typically view government agencies as obstacles, constraints, delayers, and impediments to economic progress, having much power to stop and little to start.¹²

The business/government relationship not only has become adversarial but also has been deteriorating. The goals and values of our pluralistic society have become more complex, more numerous, more interrelated, and, consequently, more difficult to reconcile. The result has been increasing conflicts among diverse interest groups, with trade-off decisions becoming harder to make. In this process, it has become more difficult to establish social priorities, and consensus has in many cases become impossible to achieve.¹³

SOCIAL, TECHNOLOGICAL, AND VALUE CHANGES

As we attempt to understand why all this has happened, it is only natural to look to changes in the social and technological environments for some explanations. Since World War II, four major changes impacted the business/government relationship. First, a national society has arisen out of local and regional societies.¹⁴ Second, the rise of a “communal society” has led to a great emphasis on public goods and the internalization of external costs. Third, the revolution of rising expectations has increased the demand for “entitlements”—good jobs, excellent housing, and other amenities. Fourth, a rising concern has emerged for an improved “quality of life.”¹⁵

In addition to these, six other societal value changes have shaped the course of business/government relations. These are the youth movement, the consumer protection movement, the ecology movement, the civil rights movement, the women’s movement, and the egalitarian movement.¹⁶

In a sense, this last movement—the egalitarian movement—embraces all of the others, because it represents an effort to create an equitable balance of all that is good in life. Thus, the value changes that have taken place “have multiplied the number of political decisions that have to be made relative to the number of decisions made in markets.”¹⁷ To the extent that these political decisions affect business—and they do to a great extent—we can understand the basic conflict arising once again in a clash between individualist and collectivist belief systems. Government’s responses to changes taking place in society have put it in direct opposition to business in terms of both philosophy and mode of operation. Although one might argue that this clash of belief systems is not as severe today as it once was, the basic differences still serve to frame the positions of the two groups.

Interaction of Business, Government, and the Public

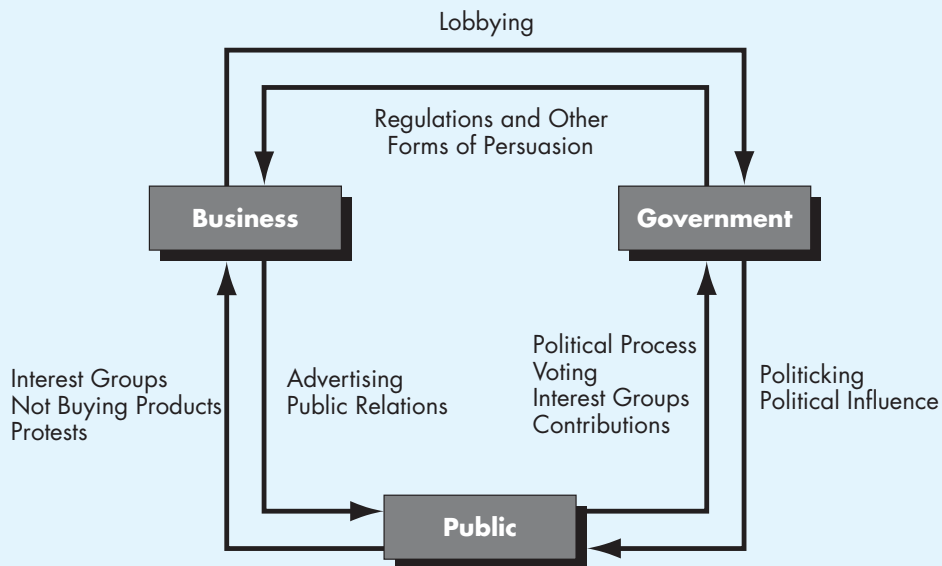
This section offers a brief overview of the influence relationships among business, government, and the public. This should be helpful in understanding both the nature of the public policy decision-making process and the current problems that characterize the business/government relationship. Figure 11-2 illustrates the pattern of these influence relationships.

One might rightly ask at this point, “Why include the public? Isn’t the public represented by government?” In an ideal world, perhaps this would be true. To help us appreciate that government functions somewhat apart from the public, we depict it separately in the diagram. In addition, the public has its own unique methods of influence that we also depict separately.

GOVERNMENT/BUSINESS RELATIONSHIP

Government influences business through regulation, taxation, and other forms of persuasion that we will consider in more detail in the next section. Business, likewise, has its approaches to influencing government, which we will deal with in

Figure 11-2 *Interaction Among Business, Government, and the Public*



Chapter 12. Lobbying, in one form or another, is business's primary means of influencing government.

PUBLIC/GOVERNMENT RELATIONSHIP

The public uses the political processes of voting and electing officials (or removing them from office) to influence government. It also exerts its influence by forming special-interest groups (farmers, small-business owners, educators, senior citizens, truckers, manufacturers, and so forth) to wield more targeted influence. Government, in turn, uses politicking, public policy formation, and other political influences to have an impact on the public.

BUSINESS/PUBLIC RELATIONSHIP

Business influences the public through advertising, public relations, and other forms of communication. The public influences business through the marketplace or by forming special-interest groups (for example, American Association of Retired Persons, Friends of the Earth, American Civil Liberties Union) and protest groups.

Earlier, we raised the question of whether government really represents the public. This question may be stated another way: "Who determines what is in the public interest?" In our society, determining the public interest is not a simple matter. Whereas government may be the official representative of the public, we should not assume that representation occurs in a straightforward fashion. As we saw in Figure 11-2, the public takes its own initiatives both with business and with government. The three major groups, therefore, are involved in a dynamic interplay of influence processes that strive to define the current public interest.

Our central concern in this chapter is with government's role in influencing business, and we now turn our attention to that topic. Here, we will begin to see more clearly how government is a major stakeholder of business. Government's official priority is in representing the public interest as it sees and interprets the public's wishes. But, like all large bureaucratic organizations, government also takes on a life of its own with its own goals and agenda.

Government's Nonregulatory Influence on Business

Recognizing that in 2007 the federal government's budget was nearly \$2.8 trillion, we can begin to appreciate the magnitude of the effect government has on all institutions in society. We will limit our treatment to the federal government's influence on business, but we must remain mindful of the presence and influence of state and local governments as well.

Broadly speaking, we may categorize the kinds of influence government has on business as *nonregulatory* and *regulatory*. In the next major section, we will focus on

government regulation, but in this section, let us consider the wide range of nonregulatory influences that government has on business.

Two major issues merit consideration before we examine some of the specific policy tools or mechanisms government uses to influence business. These two major issues are (1) industrial policy and (2) privatization. Industrial policy is concerned with the role that our government plays in the world of international trade, and privatization zeroes in on the question of whether current public functions (for example, public education, public transit, social security, fire service) should be turned over to the private (business) sector. Both of these issues have important implications for the business/government relationship. They are both important, because they seem to come into and out of popularity on a fairly regular basis.

INDUSTRIAL POLICY

Important initial questions include “What does industrial policy mean, and why has it become such a hotly debated issue?” An **industrial policy** may be defined as follows: “Any selective government measure that prevents or promotes changes in the structure of an economy.”¹⁸

This very broad definition by itself does not give us enough focus to understand the concept. Let us elaborate. One school of thought thinks of industrial policy as some variation of the British model, wherein government provides help for older, declining industries. Therefore, when steel company executives in the United States argue for tax breaks and tariffs that would enable them to survive and compete with foreign competition, they are asking for an industrial policy.¹⁹

Another school of thought is exemplified by Robert Reich in his book *The Next American Frontier*, wherein he argues for a national industrial policy that attempts to identify winning (or sunrise) industries and foster their growth. As for losing (or sunset) industries, industrial policy would have as its goal redirecting resources into growth fields.²⁰

Variations on these themes could yield a variety of industrial policy schools of thought. Five schools of thought that give us insights into industrial policy include the following: the accelerationists, the adjusters, the targeters, the central planners, and the bankers.²¹ The **accelerationists** would try to pinpoint industries that promise to become strong international competitors and position them to move

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ONE-STOP SHOPPING

To keep abreast of the changes in industrial policy in the United States, go to <http://www.USA.gov>. USA.gov is an easy-to-search, free-access website designed to provide a centralized place to find informa-

tion from U.S. local, state, and federal government agency websites. From this site, one can search every word of every U.S. government document in a very short time.

rapidly into world markets. Their goal would be to accelerate changes already signaled by the marketplace. The **adjusters** would offer adjustment assistance to declining industries in return for commitments that they would slim down, modernize, and help their employees relocate and train for new skills and jobs.

The **targeters** would target a select group of sectors or industries (for example, high-tech, agriculture, energy, finance, health care equipment) to be turned into engines for growth. The **central planners** would advocate growth-oriented macroeconomic policies that would come close to comprehensive planning. Finally, the **bankers** would advocate a federally backed industrial development bank that would provide “patient capital”—money that could be sunk into a high-risk venture for five to ten years or longer.

The debate over industrial policy became more active upon publication of Reich’s *The Next American Frontier*, which was published when the United States lost significant ground to Japan as the world leader in industrial expansion. Many experts saw the very survival of the U.S. economy at stake in the face of subsidized foreign competition from Japan and other industrialized countries. Indeed, a trade confrontation arose between the United States and Japan over the significant trade imbalances arising out of these issues.

During the Reagan (1980–1988) and first Bush (1988–1992) administrations, the notion of industrial policy was not looked upon with great favor. Both of these administrations advocated a free-market posture rather than government activism via industrial policy. President Clinton, however, supported several actions that typify an active industrial policy. For example, the Clinton administration took an activist stance in promoting the Internet by creating a Framework for Global Electronic Commerce. This framework outlined key principles for supporting the evolution of electronic commerce, identified where international efforts were needed, and designated the U.S. governmental agencies responsible for leading the effort. They did this because businesses were wary of becoming involved in the then-new Internet and because they were unsure of the legal environment and feared government regulation and taxation would stifle Internet commerce.²²

The George W. Bush administration entered office intending to follow in the early Reagan and George H. W. Bush administrations’ footsteps by adopting a free-market posture and minimizing government intervention. However, the events of September 11, 2001, prompted extensive new regulations in the areas of homeland security; the Enron meltdown, as well as the other financial scandals that followed, prompted new regulations in corporate governance. As has been the case with previous administrations, the upward trend in regulatory intensity continues. The annual page count in the *Federal Register* is an imperfect measure of regulatory intensity, but the overall upward trend tells us something about the nature of government and business. The *Federal Register* averaged 74,610 pages for the first three years of the second (George W.) Bush administration, compared to 71,578 pages for the eight years of the Clinton administration, 59,519 for the first (George H. W.) Bush administration, and 54,335 for the Reagan administration.²³ The *Federal Register* celebrated its eightieth birthday in 2006. In 1936, it contained 2,355 pages; by 2005, the page count had grown more than thirtyfold to a staggering 77,752 pages.²⁴

ARGUMENTS FOR INDUSTRIAL POLICY

Proponents of an industrial policy (more active role of government in the business sector) cite a variety of reasons for supporting it. First, of course, is the declining or threatened competitiveness of the United States in world markets. A second argument is the use of industrial policy by other world governments, including Germany, Britain, France, and Italy. A third major argument is that the United States already has an industrial policy, but it is the haphazard result of unplanned taxes, tariffs, regulatory policies, and research and development policies. Our current system has been called an ad hoc industrial policy because the United States has, in fact, intervened in many specific industries as emergencies have arisen.

After the terrorist attacks on 9/11, the crippled airline industry requested bailouts of about \$24 billion. Congress passed a bailout program of \$15 billion—\$5 billion in immediate cash assistance and \$10 billion in loan guarantees.²⁵ Other affected industries soon made requests as well. There is a long history of government stepping in to rescue industries in distress. In 1971, the Lockheed Corporation received \$250 million in loan guarantees from Congress. In 1976, the federal government merged seven failing Northeast railroads and then spent about \$7 billion to keep the combined entity afloat. In 1979, the Chrysler Corporation received up to \$1.5 billion in loan guarantees. And in 1989, Congress addressed the savings-and-loan crisis by closing more than one thousand S&Ls at a cost of \$124 billion.²⁶

Some government interventions have been unqualified successes. Chrysler paid off its loan seven years early, and the government received a profit of \$350 million. Others, however, have been fraught with problems. The Lockheed bailout was rocky from the start. When it was revealed that Lockheed had paid foreign bribes, the government ousted two top executives and proceeded to give Lockheed activities very close scrutiny.²⁷ In the case of airlines, the U.S. government has made \$119 million from its equity ownership in the shares of airlines like Frontier.²⁸ One key to success is for the government to require equity in return for aid: The U.S. government made their profit from the Chrysler bailout due to such an arrangement.²⁹ It would seem logical, then, that all government bailouts would include an equity arrangement; however, corporate lobbyists typically block the way, according to former senator Peter Fitzgerald (R-Illinois), one of the authors of the airline bailout agreement. He said a divided airline industry made it possible for them to integrate an equity arrangement into their bailout bill.³⁰

ARGUMENTS AGAINST INDUSTRIAL POLICY

Critics of industrial policy also have significant reasons for their views. Critics say that government interference reduces the market's efficiency. How do you keep politics out of what ought to be economic decisions? Some politicians, as well as experts, think the United States should focus on rescuing steel and other "sunset" industries. Others argue we ought to promote emerging "sunrise" industries, such as breakthrough products in high technology.

Those who oppose industrial policy say that foreign success with it has been highly variable. As a country with a strong industrial policy, Japan provides a case

in point. Japan has had as many failures as successes with its government's development agency, the Ministry of International Trade and Industry (MITI). MITI helped to build Japan's computer, semiconductor, and steel industries; however, its efforts to promote the aluminum-refining, petrochemical, shipping, and commercial aircraft industries were not successful.³¹ Further, Japan's favorable industrial policies (*keiretsu*), combined with lifetime employment, are ill-suited to surviving economic recessions, and the Japanese business system has produced relatively few entrepreneurial risk-takers.³²

Few observers today would argue that a strong industrial policy helps firms to compete in a fast-moving global economy; in fact, one rarely hears the term today outside of economics. Most developed countries are not seeking to institute a strong industrial policy.³³ Nevertheless, government intervention in business continues, sometimes in ways that are appropriate and sometimes not. Critics charge that various interventions such as "voluntary" restrictions on imports, occasional bail-outs for nearly bankrupt companies, and a wide array of subsidies, loan guarantees, and special tax benefits for particular firms and industries constitute an industrial policy by default.³⁴

Interest in the concept of industrial policy ebbs and flows, depending on which administration is in office and what is happening in the external environment. Many of the problems that started the current debate are still with us, while new problems have arisen to add further complexity to the issue. Industrial policy (whether coordinated or by default) is a powerful nonregulating approach by government to influence business that is certain to be a topic of debate for years to come.

PRIVATIZATION

Privatization, generally speaking, refers to the process of "turning over to" the private sector (business) some function or service that was previously handled by some government body.³⁵ More than \$700 billion in assets have been privatized worldwide, with emerging economies accounting for almost 40 percent of that.³⁶ Privatization is an integral part of the twenty-first-century strategies of both developed and developing countries, with the intent being to capture both the discipline of the free market and a spirit of entrepreneurial risk-taking.³⁷

Recent privatization efforts are breaking new ground by privatizing valuable assets instead of the privatization of surplus and underutilized assets as has been the focus in the past; to that end, some states have now begun to privatize toll roads and bridges.³⁸ These privatization arrangements involve long-term concessions that specify clear relationships, roles, and responsibilities for the business and the government: The state continues to own the asset but gives private companies the opportunity to manage them in a way that extracts the most value.³⁹ Investors have paid billions for the cash flows from tolls and other user fees on such properties as the Chicago Skyway and the Indiana toll road; however, some legislators are expressing concern about possible price gouging, future infrastructure support, and the length of the leases.⁴⁰

To understand privatization, we need to differentiate two functions government might perform: (1) producing a service and (2) providing a service.⁴¹

Ethics in Practice Case

INCOMPATIBLE GOALS FOR THE FDA

When it comes to lifesaving drugs, we want both safety and speed. We want safety because a drug that cures one disease should not cause another. We want speed because the longer it takes for a lifesaving drug to hit the market, the more people will die because it was not available in time to save their lives.

In the 1980s, there was a public outcry because the FDA took nearly three years to approve most drugs; with the AIDS epidemic in full swing, that meant that many people died before the drugs that would save them became available. With the help of Congress, the FDA and the drug industry eventually worked out an arrangement in which companies would pay millions of dollars in fees in return for an FDA guarantee that drug reviews would be completed within a year or within six months for a medicine that would save lives.

The arrangement effectively addressed the problem of the time required for FDA approval; however, a new problem arose. Drug companies would not let their money pay for drug safety monitoring after the drug was on the market. As federal funding slowed, and the FDA became increasingly dependent on industry funds, the safety program diminished and speed became the watchword. The deal required that the FDA submit annual reports on review time but not on the safety of drugs that were already on the

market. Managers are judged by the speed with which decisions are made; questions about safety are seen as simply slowing down the decision process. FDA employees who speak out about safety concerns report that they are often ostracized and penalized for expressing their concerns.

1. What are the ethical issues in this case? Who are the stakeholders and what are their stakes?
2. When dealing with drugs that treat critical illnesses, how do you decide between speed and safety when enhancing one diminishes the other? On what basis are you making your decision?
3. Was it wrong for companies to help fund drug testing when it meant that lifesaving drugs could be available to patients more quickly? Were the problems that arose inevitable?
4. If you were responsible for regulating pharmaceutical drugs, what changes would you make to alleviate this situation? What trade-offs would you make? What type of industrial policy would your decision be advocating? Be specific.

Source: Gardiner Harris, "Potentially Incompatible Goals at F.D.A.," *New York Times* (June 11, 2007), Section A, p. 14.

Producing versus Providing a Service

A city government would be providing a service if it employed a private security firm to work at the coliseum during the state basketball play-offs. This same city government would be producing a service if its own police force provided security at the same basketball tournament. The federal government would be providing medical care to the aged with a national Medicare program. The "production" of medical care would be coming from private physicians. The government would be providing and producing medical care if it employed its own staff of doctors as,

for example, the military does. The terminology can be very confusing, but the distinction must be made, because sometimes government provides a service (has a program for and actually pays for a service) and sometimes it produces a service (has its own employees who do it).⁴²

The Privatization Debate

Proponents of privatization in both the United States and Europe suggest that the functions of entire bureaucracies need to be contracted out to the private sector. They maintain that government at all levels is involved in thousands of businesses in which it has no real comparative advantage and no basic reason for being involved. They also argue that publicly owned enterprises are less efficient and less flexible than competitive private firms.⁴³ Opponents of privatization contend that there are certain activities that cannot be safely or effectively handled by the private sector. They point to the **federalization** of airport security (the return of airport security to the government sector) following the 9/11 terrorist attacks.

Privatization efforts are always undertaken with the hope that they will lead to improvements in efficiency and overall performance. In some cases, these hopes are realized, but in others they are not. On average, a privatized firm's performance improves, but there is considerable variance in post-privatization performance among individual firms.⁴⁴ Differences in post-privatization performance can result from differences in the ways that firms implement privatization programs, as well as the nature of the program being privatized. The nature of top management, the functioning of the board, and the strategic actions the firms undertake will all contribute to the likelihood of a privatization strategy's success.⁴⁵

These two issues—industrial policy and privatization—are largely unresolved. As a result, they continue to be discussed and debated. As we have seen, the success of these efforts is largely dependent on their context—both the environments in which they are adopted and the ways in which they are implemented. It is clear that both industrial policy and privatization will have significant implications for the business/government relationship for years to come.

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TO PRIVATIZE OR NOT TO PRIVATIZE

The Reason Public Policy Institute (RPPI) sponsors a website devoted to the issue of privatization (<http://www.privatization.org>). In it, they provide research and analysis, reports, and recommendations on how to streamline government through privatization. The non-

partisan group has worked closely with Democratic and Republican officials as well as a range of federal agencies. Their monthly newsletter, *Privatization Watch*, and their *Annual Privatization Report* provide information on the latest in privatization efforts around the globe.

We now return to our discussion of the ways in which government uses various policies and mechanisms for influencing business.

OTHER NONREGULATORY GOVERNMENTAL INFLUENCES ON BUSINESS

Government has a significant impact on business by virtue of the fact that it has a large payroll and is a *major employer* itself. At all levels, government employs millions of people who, as a consequence of being government employees, see things from the government's perspective. Government is also in the position of being a standard-setter: For example, the eight-hour workday began in the federal government. After a decade of emphasis on the private sector, the role of government has begun to expand since the 9/11 terrorist attacks; bailouts of troubled industries, increased defense spending, a shift of R&D money toward defense purchases, and higher spending on the social safety net all give government a larger role in the U.S. economy.⁴⁶

Government is one of the largest *purchasers* of goods and services produced in the private sector. Some key industries, such as aerospace, electronics, and shipbuilding, are very dependent on government purchasing. Government can exert significant influence over the private sector by its insistence that minorities be hired, depressed areas be favored, small businesses be favored, and so on. Changes in government policy can dramatically change a firm's business environment.⁴⁷ For some firms in narrow markets, such as defense, the government dominates and controls whether or not those firms have a good year—indeed, whether or not they survive at all.⁴⁸

Government influences the behavior of business through the use of *subsidies* in a variety of ways. Generous subsidies are made available to industries such as agriculture, fishing, transportation, nuclear energy, and housing and to groups in special categories, such as minority-owned enterprises and businesses in depressed areas. Quite often, these subsidies have special qualifications attached.

Government also influences business, albeit indirectly, by virtue of its *transfer payments*. Government provides money for social security, welfare, and other entitlement programs that totals hundreds of billions of dollars every year. These impacts are indirect, but they do significantly affect the market for business's goods and services.⁴⁹

Government is a major *competitor* of business. Organizations such as the TVA compete with private suppliers of electricity; the Government Printing Office competes with private commercial publishers and printing firms; and the United States Postal Service competes with private delivery services. In areas such as health, education, recreation, and security, the competition between government and private firms runs the gamut of levels—federal, state, and local.

Government loans and *loan guarantees* are sources of influence as well. Government lends money directly to small businesses, housing providers, farmers, and energy companies. Often, such loans are made at lower interest rates than those of private competitors. Loan guarantee programs, such as the one provided to Chrysler, is another way in which government's influence is felt.⁵⁰

Taxation, through the Internal Revenue Service, is another example of a government influence. Tax deductibility, tax incentives, depreciation policies, and tax credits are tools that are all at the disposal of the government. A critical example of the government's taxing power occurred when a "luxury tax" was added as a minor part of the government's deficit-reduction package. This new luxury tax ended up virtually crippling the boat-building industry. It led to massive layoffs and adversely affected dozens of related industries. Ironically, the luxury tax resulted in lower tax revenues than those industries had produced.⁵¹

Monetary policy, although it is administered through the Federal Reserve System, can have a profound effect on business. Although the Federal Reserve System is technically independent of the executive branch, it often responds to presidential leadership or initiatives.

Finally, *moral suasion* is a tool of government.⁵² This refers to the government's attempts, usually through the president, to "persuade" business to act in the public interest by taking or not taking a particular course of action. These public-interest appeals might include a request to roll back a price hike, show restraint on wage and salary increases, or exercise "voluntary" restraints of one kind or another. When New York mayor Rudy Giuliani exhorted businesses to reopen, customers to return to buying, and tourists to return to New York City after the attacks on the World Trade Center, he was exerting moral suasion.

Persuasion has its benefits, because regulation carries with it so many costs, so some administrations have tried to work with business to develop standards rather than set regulations with which business must comply. The George W. Bush administration falls under this category: Under this administration, OSHA issued the fewest significant standards in its history, only one major safety rule, plus a health standard that was mandated by a federal court.⁵³ The assessment of whether this strategy has been successful depends on the party one asks. Administration officials say that they have relieved industry of burdensome rules, while causing workplace injuries and deaths to decline during their tenure. Critics counter that voluntary programs do not force the less-conscientious businesses to improve their practices and that they fail to focus on specific hazards.⁵⁴

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THE "LESS GOVERNMENT IS MORE" PHILOSOPHY

The Cato Institute (<http://www.cato.org>) is a nonprofit public policy research foundation that monitors governmental regulations from a Libertarian perspective; it advocates minimal government intervention. The institute publishes *Regulation*, a maga-

zine devoted to monitoring the administration's regulatory activity, analyzing the implications of governmental regulations, and reporting on its effect on businesses and communities.

Government's Regulatory Influences on Business

In many ways, government regulation has been the most controversial issue in the business/government relationship. Government regulation has affected virtually every aspect of how business functions. It has affected the terms and conditions under which firms have competed in their respective industries. It has touched almost every business decision ranging from the production of goods and services to packaging, distribution, marketing, and service. Most people agree that some degree of regulation has been necessary to ensure that consumers and employees are treated fairly and are not exposed to unreasonable hazards and that the environment is protected. However, they also think that government regulation has often been too extensive in scope, too costly, and inevitably burdensome in terms of paperwork requirements and red tape. One thing is clear: the level of regulation continues to rise.

Some analysts feel the problem is worse today than it has ever been. In a recent article titled "America's Regulatory Mess," the *Economist* suggested that an increase in political funding from business has led to increased political interference in regulatory policy. Corporate donors want results from the politicians they support.⁵⁵ Another problem is the change in the nature of the regulatory issues. According to Robert Litan of the Brookings Institution, deregulation of the trucking and airline industries involved government stepping out of the way and so industry incumbents welcomed it; however, industry incumbents did not welcome deregulation of the telecom and electrical utility industries because regulators had to devise a form of managed competition that involved the setting of pricing, the creating of access, and so forth, which brought about elaborate rule books.⁵⁶

REGULATION: WHAT DOES IT MEAN?

Generally, **regulation** refers to the act of governing, directing according to rule, or bringing under the control of law or constituted authority. Although there is no universally agreed-upon definition of federal regulation, we can look to the definition of a federal regulatory agency proposed years ago by the Senate Governmental Affairs Committee.⁵⁷ It described a federal regulatory agency as one that:

1. Has decision-making authority
2. Establishes standards or guidelines conferring benefits and imposing restrictions on business conduct
3. Operates principally in the sphere of domestic business activity
4. Has its head and/or members appointed by the president (generally subject to Senate confirmation)
5. Has its legal procedures generally governed by the Administrative Procedures Act

The commerce clause of the U.S. Constitution grants to the government the legal authority to regulate. Within the confines of a regulatory agency as outlined here, the composition and functioning of regulatory agencies differ. Some are headed by an administrator and are located within an executive department—for example, the Federal Aviation Administration (FAA). Others are independent commissions composed of a chairperson and several members located outside the executive and legislative branches—such as the Interstate Commerce Commission (ICC), the Federal Communications Commission (FCC), and the Securities and Exchange Commission (SEC).⁵⁸

REASONS FOR REGULATION

Regulations have come about over the years for a variety of reasons. Some managers probably think that government is just sitting on the sidelines looking for reasons to butt into their business. There are several legitimate reasons why government regulation has evolved, although these same businesspeople may not entirely agree with them. For the most part, however, government regulation has arisen because some kind of **market failure** (failure of the free-enterprise system) has occurred and government, intending to represent the public interest, has chosen to take corrective action. We should make it clear that many regulations have been created primarily because of the efforts of special-interest groups that have lobbied successfully for them. The governmental decision-making process in the United States is characterized by congressional regulatory response to the pressures of special-interest groups as well as to perceived market failures.

Four major reasons or justifications for regulation are typically offered: (1) controlling natural monopolies, (2) controlling negative externalities, (3) achieving social goals, and (4) other reasons.

Controlling Natural Monopolies

One of the earliest circumstances in which government felt a need to regulate occurred when a natural monopoly existed. A **natural monopoly** exists in a market where the economics of scale are so great that the largest firm has the lowest costs and thus is able to drive out its competitors. Such a firm can supply the entire market more efficiently and cheaply than several smaller firms. Local telephone service is a good example, because parallel sets of telephone wires would involve waste and duplication that would be much more costly.

Monopolies such as this may seem “natural,” but when left to their own devices could restrict output and raise prices. This potential abuse justifies the regulation of monopolies. As a consequence, we see public utilities, for example, regulated by a public utility commission. This commission determines the rates that the monopolist may charge its customers.⁵⁹

Related to the control of natural monopolies is the government’s desire to intervene when it thinks companies have engaged in anticompetitive practices. A recent example of this was the Justice Department’s investigation of the Microsoft Corporation case in which the company was accused of anticompetitive trade

practices. The U.S. Court of Appeals in a mixed ruling overturned an initial court ruling, recommending that Microsoft be split in two. The appeals court reprimanded the judge for publicly criticizing Microsoft but upheld the finding of fact that the Windows operating system constitutes a monopoly in the PC market and that Microsoft violated the Sherman Antitrust Act with its marketing tactics. Microsoft would bundle new features into their Windows operating system as a way of breaking into new markets. They then designed their operating system so that it worked more smoothly with Microsoft products than with others—giving it a clear and, according to the courts, unfair marketing advantage.⁶⁰

Nearly ten years after the effort to break up Microsoft began, the saga continues. In that time, the Clinton administration gave way to the second Bush administration and the attitude toward antitrust issues changed markedly. This became evident when a top antitrust official urged state prosecutors to reject a confidential antitrust complaint that Google filed alleging that Microsoft's new operating system, Vista, is designed to discourage use of Google's desktop search program.⁶¹ Several state prosecutors have indicated they believe Google's charge has merit and will pursue the allegations, whether or not the federal government joins them.⁶²

Controlling Negative Externalities

Another important rationale for government regulation is that of controlling the **negative externalities** (or spillover effects) that result when the manufacture or use of a product gives rise to unplanned or unintended side effects on others (other than the producer or the consumer). Examples of these negative externalities are air pollution, water pollution, and improper disposal of toxic wastes. The consequence of such negative externalities is that neither the producer nor the consumer of the product directly "pays" for all the "costs" that are created by the manufacture of the product. The "costs" that must be borne by the public include an unpleasant or a foul atmosphere, illness, and the resulting health care costs. Some have called these **social costs**, because they are absorbed by society rather than incorporated into the cost of making the product.

Preventing negative externalities is enormously expensive, and few firms are willing to pay for these added costs voluntarily. This is especially true in an industry that produces an essentially undifferentiated product, such as steel, where the millions of dollars needed to protect the environment would only add to the cost of the product and provide no benefit to the purchaser. In such situations, therefore, industry incumbents may even welcome government regulation because it requires all firms competing in a given industry to operate according to the same rules. By forcing all firms to incur the costs, regulation can level the competitive playing field.

Just as companies do not voluntarily take on extra expenditures for environmental protection, individuals often behave in the same fashion. For example, automobile emissions are one of the principal forms of air pollution. But how many private individuals would voluntarily request an emissions control system if it were offered as optional equipment? In situations such as this, a government standard that requires everyone to adhere to the regulation is much more likely to address the public's concern for air pollution.⁶³

Recently, a new partner has joined the fray regarding regulation. The Bush administration, as an ardent advocate of deregulation, has rolled back the laws concerning environmental protection; however, the judicial branch has responded in an unprecedented manner. In just a few weeks in spring of 2007, federal judges have rejected attempts to weaken protections for national forests, upended a plan that would further the decline of endangered salmon, rejected challenges to clean air laws, and used the Clean Water Act to curb pollution from mining companies.⁶⁴ Most dramatically, the Supreme Court ruled that the Clean Air Act all but requires the EPA to regulate the emission of greenhouse gasses.⁶⁵

Achieving Social Goals

Government not only employs regulations to address market failures and negative externalities but also seeks to use regulations to help achieve certain **social goals** it deems to be in the public interest. Some of these social goals are related to negative externalities in the sense that government is attempting to correct problems that might also be viewed as negative externalities by particular groups. An example of this might be the harmful effects of a dangerous product or the unfair treatment of minorities resulting from employment discrimination. These externalities are not as obvious as air pollution, but they are just as real.

Another important social goal of government is to keep people informed. One could argue that inadequate information is a serious problem and that government should use its regulatory powers to require firms to reveal certain kinds of information to consumers. Thus, the Consumer Product Safety Commission requires firms to warn consumers of potential product hazards through labeling requirements. Other regulatory mandates that address the issue of inadequate information include grading standards, weight and size information, truth-in-advertising requirements, product safety standards, and so on.

Other important social goals that have been addressed include preservation of national security (deregulation of oil prices to lessen dependence on imports), considerations of fairness or equity (employment discrimination laws), protection of those who provide essential services (farmers), allocation of scarce resources (gasoline rationing), and protection of consumers from excessively high price increases (natural gas regulation).⁶⁶

Other Reasons

There are several other reasons for government regulation. One is to control **excess profits** by transferring income for the purposes of economic fairness. For example, as a result of the Arab oil embargo, oil stocks went up suddenly by a factor of 10. One argument was that the extra profits collected by these producers were somehow undeserved and the result of plain luck, not wise investment decisions. So, in situations such as this in which profits are drastically, suddenly, and perhaps undeservedly increased, some have argued for government regulation.⁶⁷

Another commonly advanced rationale for regulation is to deal with **excessive competition**. The basic idea behind this rationale is that excessive competition will lead to prices being set at unprofitably low levels. This action will force firms out of

business and ultimately will result in products that are too costly because the remaining firm will raise its prices to excessive levels, leaving the public worse off than before.⁶⁸

TYPES OF REGULATION

Broadly speaking, government regulations address two basic types of goals, economic and social. Therefore, it has become customary to identify two different types of regulation: economic regulation and social regulation.

Economic Regulation

The classical or traditional form of regulation that dates back to the 1800s in the United States is **economic regulation**. This type of regulation is best exemplified by old-line regulatory bodies such as the Interstate Commerce Commission (ICC), which was created in 1887 by Congress to regulate the railroad industry; the Civil Aeronautics Board (CAB), which was created in 1940; and the Federal Communications Commission (FCC), which was established in 1934 to consolidate federal regulation of interstate communications and, later, radio, telephone, and telegraph. These regulatory bodies divide along industry lines; they regulate business behavior through controlling and influencing economic or market variables such as prices (maximum and minimum), entry to and exit from markets, and types of services offered.⁶⁹

In the federal regulatory budget today, the major costs of economic regulation are for (1) finance and banking (e.g., Federal Deposit Insurance Corporation and Comptroller of the Currency), (2) industry-specific regulation (e.g., Federal Communications Commission and Federal Energy Regulatory Commission), and (3) general business (e.g., Department of Commerce, Department of Justice, Securities and Exchange Commission, and Federal Trade Commission).⁷⁰

Later, we will discuss deregulation, a trend that has significantly affected the old-line form of economic regulation that has dominated business/government relations for the past 100 years.

Social Regulation

The 1960s ushered in a new form of regulation that has come to be known as **social regulation**, because its major thrust is the furtherance of societal objectives quite different from the earlier focus on markets and economic variables. While economic regulation focuses on markets, social regulation focuses on business's impacts on people. This emphasis on people addresses the needs of people in their roles as employees, consumers, and citizens.

Two major examples of social regulations having specific impacts on people as employees were (1) the Civil Rights Act of 1964, which created the Equal Employment Opportunity Commission (EEOC) and (2) the creation of the Occupational Safety and Health Administration (OSHA) in 1970. The goal of the EEOC is to provide protection against discrimination in all employment practices. The goal of OSHA is to ensure that the nation's workplaces are safe and healthy.

Figure 11-3 *Comparison of Economic and Social Regulations*

	Economic Regulations	Social Regulations
Focus	Market conditions, economic variables (entry, exit, prices, services)	People in their roles as employees, consumers, and citizens
Industries Affected	Selected (railroads, aeronautics, communications)	Virtually all industries
Examples	Civil Aeronautics Board (CAB) Federal Communications Commission (FCC)	Equal Employment Opportunity Commission (EEOC) Occupational Safety and Health Administration (OSHA) Consumer Product Safety Commission (CPSC) Environmental Protection Agency (EPA)
Current Trend	From regulation to deregulation; however, problems with deregulation could reverse that trend	Stable—No significant increase or decrease in agencies

An example of major social regulation protecting people as consumers was the creation of the Consumer Product Safety Commission (CPSC) in 1972. This body's goal is to protect the public against unreasonable risks of injury associated with consumer products. An example of a major social regulation to protect people as citizens and residents of communities was the creation of the Environmental Protection Agency (EPA) in 1970. The goal of EPA is to coordinate a variety of environmental protection efforts and to develop a unified policy at the national level.

Figure 11-3 summarizes the nature of economic versus social regulations along with pertinent examples.

Whereas economic regulation was aimed primarily at companies competing in specific industries, the newer form of social regulation addresses business practices affecting all industries. In addition, there are social regulations that are industry specific, such as the National Highway Traffic Safety Administration (automobiles) and the Food and Drug Administration (food, drugs, medical devices, and cosmetics). Figure 11-4 summarizes the major U.S. independent regulatory agencies along with their dates of establishment. In addition to these, we should remember that there are several regulatory agencies that exist within executive departments of the government. Examples of this latter category include the following:

Agency	Department
Food and Health Administration	Health and Human Services
Antitrust Division	Justice
Drug Enforcement Administration	Justice

Occupational Safety and Health Administration	Labor
Federal Highway Administration	Transportation

Government regulation represents a response to a felt need in the environment, so it is not surprising that the most recent regulations are responses to two major environmental events, the 9/11 terrorist attacks on the World Trade Center and the Pentagon, and the financial scandals of Enron, WorldCom, and the like. For the former, national security has been the primary concern. In particular, the collection, protection, and dissemination of information have been impacted. In response to

Figure 11-4 Major U.S. Regulatory Agencies

Agency	Year Established
Interstate Commerce Commission*	1887
Federal Reserve System (Board of Governors)	1913
Federal Trade Commission	1914
International Trade Commission	1916
Federal Home Loan Bank Board**	1932
Federal Deposit Insurance Corporation	1933
Farm Credit Administration	1933
Federal Communications Commission	1934
Securities and Exchange Commission	1934
National Labor Relations Board	1935
Small Business Administration	1953
Federal Maritime Commission	1961
Council on Environmental Quality	1969
Cost Accounting Standards Board	1970
Environmental Protection Agency	1970
Equal Employment Opportunity Commission	1970
National Credit Union Administration	1970
Occupational Safety and Health Review Commission	1971
Consumer Product Safety Commission	1972
Commodity Futures Trading Commission	1974
Council on Wage and Price Stability	1974
Nuclear Regulatory Commission	1974
Federal Election Commission	1975
National Transportation Safety Board	1975
Federal Energy Regulatory Commission	1977
Office of the Federal Inspector for the Alaska Natural Gas Transportation System***	1979
Transportation Security Administration	2001

*Terminated in 1995. Replaced by the Surface Transportation Board.

**Terminated in 1939. Functions were reassigned to various housing agencies until 1955, when it was redesignated as an independent agency. In 1989, it was abolished and responsibility for oversight of Federal Home Loan Banks was transferred to the Federal Housing Finance Board.

***Abolished by Congress in 1992 and all powers were transferred to the Secretary of Energy.

Ethics in Practice Case

TO COMPLY OR NOT TO COMPLY WITH THE GOVERNMENT REGULATION

Every summer and Christmas vacation for the past four years, I have worked in the maintenance department of Gilman Paper Company. Working there to help finance my college education, I have been exposed to many questionable practices. One of the most prominent problems is the adherence to safety regulations.

OSHA (Occupational Safety and Health Administration) requires that a vessel-confined-space entry permit be filled out before a person enters the confined area and that a “sniffer” (a device used to detect oxygen deficiencies and other harmful or combustible gases) be present and operational whenever a person is inside. A confined space is defined as any area without proper air ventilation and/or an area more than five feet deep. For example, tanks and pits are confined spaces.

Anytime a person enters or leaves a confined space, the person is required to place her or his initials on the entry permit. This is for the physical protection of the worker and the liability protection of the company. If workers are seen violating this policy, they can be reprimanded or fired on the spot.

In my many experiences with these confined spaces, I have observed on numerous occasions that these policies are not broken by the workers, but by the supervisors. It is their responsibility to obtain these permits and sign them, as well as obtain the

use of a sniffer. Sometimes the supervisors and the workers will forget that we are working in a confined space and thus forget the permit and sniffer. When someone has realized that we are in a confined space, however, the supervisors have often asked us to initial the permit at various places as if the permit had been there all along.

When we work for extended periods of time in these areas, the sniffer’s batteries often go dead as well. Instead of following regulations and leaving the area until a new sniffer can be obtained, the supervisors often tell employees to stay, declaring, “The air is fine. You don’t need a sniffer!”

My problem is this: should I sign these permits when I know it is dishonest, or should I do the “right” thing and let OSHA know that this regulation is being broken time and time again? After all, I’m not even a full-time employee, so who am I to cause trouble?

1. Who are the stakeholders in this case, and what are their stakes?
2. What should I have done in this situation? Is this regulation important, or is this just more government “red tape”? Should I have just “gone along to get along” with the supervisors?

Contributed by Dale Dyals

the latter, new economic regulations address issues of corporate accountability. Most notably, the Sarbanes-Oxley Act (SOX) set extensive new reporting procedures and requirements for firms listed on U.S. stock exchanges and instituted severe penalties for firms that fail to comply. SOX is discussed in more detail in Chapter 4.

SOX is emblematic of the dilemma of regulation. On one hand, it is an effective response to a serious problem, the lack of investor confidence in the wake of the

Enron and WorldCom scandals. As with all regulation, however, it presents additional burdens for firms. Auditing and reporting compliance costs for firms with revenues of less than \$1 billion increased 130 percent following the Act's introduction.⁷¹ New listings of foreign firms on U.S. exchanges dropped precipitously, while a significant portion of U.S. public companies considered going private because of the cost of regulatory compliance.⁷²

ISSUES RELATED TO REGULATION

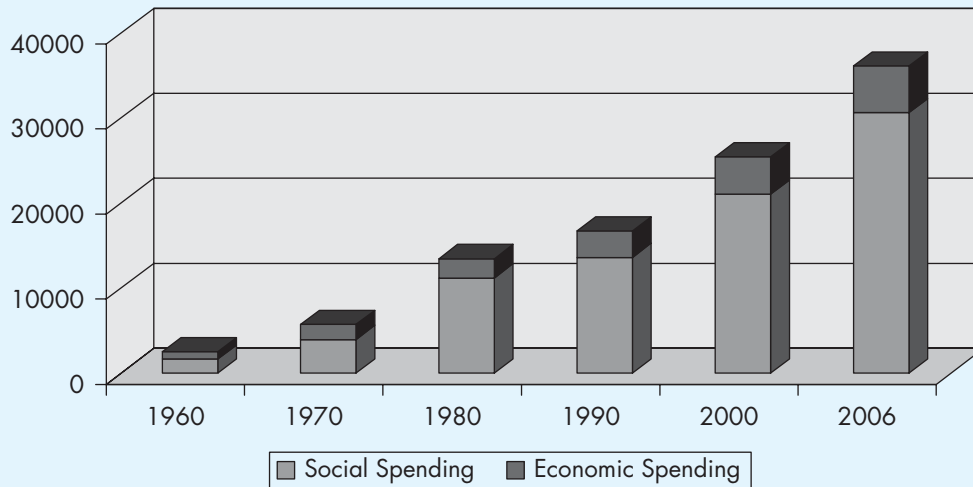
It is important to consider some of the issues that have arisen out of the increased governmental role in regulating business. In general, managers have been concerned with what might be called "regulatory unreasonableness."⁷³ We could expect that business would just as soon not have to deal with these regulatory bodies; therefore, some of business's reactions are simply related to the nuisance factor of having to deal with a complex array of restrictions. However, other legitimate issues that have arisen over the past few years also need to be addressed.

To be certain, there are benefits of government regulation. Businesses treat employees more fairly and provide them with safer work environments. Consumers are able to purchase safer products and receive more information about them. Citizens in all walks of life have cleaner air to breathe and cleaner water in lakes and rivers. These benefits are real, but their exact magnitudes are difficult to measure. Costs resulting from regulation also are difficult to measure. The **direct costs** of regulation are most visible when we look at the number of new agencies created, aggregate expenditures, and growth patterns of the budgets of federal agencies responsible for regulation. There were 14 major regulatory agencies prior to 1930, over two dozen in 1950, and 57 by the early 1980s. The most rapid expansion came in the 1970s.⁷⁴ Figure 11-5 shows the rise in spending for both economic and social regulation in millions of constant 2000 dollars.

In addition to the direct costs of administering the regulatory agencies, there are **indirect costs** such as forms, reports, and questionnaires that business must complete to satisfy the requirements of the regulatory agencies. These costs of government regulation get passed on to the consumer in the form of higher prices. There are also **induced costs**. The induced effects of regulation are diffuse and elusive, but they constitute some of the most powerful consequences of the regulatory process. In a real sense, then, these induced effects are also costs. Three effects are worthy of elaboration.⁷⁵

1. *Innovation may be affected.* When corporate budgets must focus on "defensive research," certain types of innovation are less likely to take place. To the extent that firms must devote more of their scientific resources to meeting government requirements, fewer resources are available to dedicate to new product and process research and development and innovation. However, the relationship is anything but clear. A recent study showed that deregulation actually had a dramatic negative impact on public-interest environmental research by public utilities, whereas regulation can have a positive impact on pollution abatement research by profit-maximizing firms.⁷⁶ The moral of these findings

Figure 11-5 *Regulatory Spending in the United States*



Sources: Jerry Brito and Melinda Warren, "Growth in Regulation Slows: An Analysis of the U.S. Budget for Fiscal Years 2007 and 2008," *Mercatus Center* (June 19, 2007); http://www.mercatus.org/Publications/pubID.4071.cfilter.0/pub_detail.asp.

seems to be that organizations will pursue their own interests. Regulation can require firms to lower their pollution so they can maximize their profits with greater expenditures on research to lower emissions. In contrast, utilities that once received reinforcement for doing research in the public interest may find they no longer have an incentive for that research once they begin to compete on profits.

2. *New investments in plant and equipment may be affected.* To the extent that corporate funds must be used for regulatory compliance purposes, these funds are diverted from more productive uses. Environmental and job safety requirements lessen productivity, and uncertainty about future regulations diminishes motivation for introducing new products and processes.⁷⁷ Once again, the incentives will play a major part. Investments that aid the firms in complying with regulations are likely to be continued or increased, whereas those that are beyond the scope of the regulation are likely to diminish.
3. *Small business may be adversely affected.* Although it is not intentional, federal regulations can have a disproportionately adverse effect on small firms due to economies of scale. Large firms have more money, personnel, and resources with which to get the work of government done than do small firms.

A day in the life of Frank Cremeans conveys the frustrations of many small business owners and managers about government regulation. As owner of

Cremeans Concrete & Supply Co. in Ohio, he received unannounced visits by officials from four separate federal and state regulatory agencies in one day. The four agencies were the EPA, OSHA, the local health department, and the mine-inspection agency. Mr. Cremeans said he could not believe it. He had to drop everything and spend the entire day dealing with the officials' demands.⁷⁸

Deregulation

Quite frequently, trends and countertrends overlap with one another. Such is the case with regulation and its counterpart, **deregulation**. There are many reasons for this overlapping, but typically they include both the economic and the political. From an economic perspective, there is a continual striving for the balance of freedom and control for business that will be best for society. From a political perspective, there is an ongoing interplay of different societal goals and means for achieving those goals. The outcome is a mix of economic and political decisions that seem to be in a constant state of flux. Thus, in the economy at any point in time, trends that appear counter to one another can coexist simultaneously. These trends are the natural result of competing forces seeking some sort of balance or equilibrium.

This is how we can explain the trend toward deregulation that evolved in a highly regulated environment. Deregulation represents a counterforce aimed at keeping the economy in balance. It also represents a political philosophy that prevailed during the period of its origin and growth.

Deregulation is one kind of regulatory reform. But, because it is unique and quite unlike the regulatory reform measures discussed earlier, we will treat it separately. Deregulation has taken place primarily with respect to economic regulations, and this, too, helps to explain its separate treatment.

PURPOSE OF DEREGULATION

The basic idea behind deregulation has been to remove certain industries from the old-line economic regulations of the past. The purpose of this deregulation, or at least a reduced level of regulation, has been to increase competition with the expected benefits of greater efficiency, lower prices, and enhanced innovation. These goals have not been uniformly received, and it is still undecided whether deregulation works as a method of maximizing society's best interests. Figure 11-6 outlines the airline industry's experience with 25 years of deregulation.

TREND TOWARD DEREGULATION

When the trend toward deregulation began in the 1980s, most notably exemplified in the financial industry, the telecommunications industry, and the transportation (trucking, airline, railroad) industry, it represented business's first major redirection in 50 years.⁷⁹ The result seemed to be a mixed bag of benefits and problems. On the benefits side, prices fell in many industries, and better service appeared in some industries along with increased numbers of competitors and innovative products and services.

Figure 11-6 *The U.S. Airline Industry: First to Deregulate*

October 24, 1978, was a watershed in aviation history. On that date, President Jimmy Carter signed the Airline Deregulation Act, and the world of aviation changed forever. The Civil Aeronautics Board no longer had the power to determine pricing and set the routes. The industry quickly filled with new carriers and new routes, and the country club atmosphere soon shifted to cutthroat competition. Many airlines went bankrupt or were absorbed by others. Even heavyweights like Eastern and PanAm tottered until they both went bankrupt in 1991.

The average U.S. airfare dropped from about \$140 in 1977 to \$60 in 2000 (in constant 1983 dollars). As a result, the number of U.S. airline passengers nearly tripled from 220 million in 1977 to 650 million in 2000. Between 2000 and 2005, airlines lost a cumulative \$35 billion. The older “legacy” carriers have slashed costs and staff to try to compete with the newer airlines such as Southwestern and JetBlue. More Americans are flying, but they are spending far less to do so. Airplanes fly at or near capacity, airports are congested, and security considerations require a much longer waiting time for passengers. All of this contributes to a diminished flying experience for the customer: lost luggage is now one of the least of passenger concerns.

According to Bob Crandall, former CEO of American Airlines, the American airline industry is in a total state of disrepair. He blames “deplorably bad government policy” that has created three big problems. First, he says that American bankruptcy laws prevent airlines from folding when they should have their assets sold and be broken up. Second, stringent labor laws permit unions to make demands that are not consistent with the economic reality. Third, he asserts that foreign competitors have benefited from the U.S. government’s inability to recognize the importance of having a strong airline industry in the United States.

The situation is likely to come to a head soon as an overtaxed air traffic control system stretches to its limit. The U.S. Air Transport Association expects the number of flights to increase from forty-five thousand in 2007 to sixty-one thousand in 2016. In the past, expansion required simply adding more equipment or hiring more controllers, but the scope of the system is near maximum capacity. Now, the entire system requires replacement. The Next Generation Air Transportation System uses a satellite-based navigation and surveillance system. It would make it possible to accommodate more flights and do so more safely, it would permit pilots to communicate with each other, and it would allow planes to save fuel in the process. The technology is available, but the funding is not. In a deregulated industry, the challenges are great as interest groups line up to oppose major change. Private and executive aircraft do not currently contribute to the system in a way that reflects their actual usage: They do not want their user fees to rise. The closing of older air traffic control centers will mean loss of jobs for some. Regulated airfares corresponded to the distance traveled, but now deregulated fares bear little resemblance to the cost of a flight for the control system. The *Economist* opined, “America was the first to deregulate, but now it’s snowed under.” The U.S. Congress will have some difficult decisions to make to enable the U.S. airline industry to continue to compete in an increasingly challenging environment.

Sources: Richard Newman, “Deregulation Was Good for Travelers, Hard on Airlines,” *The Record*, Hackensack, NJ (December 7, 2003); “In the Land of Free Flight.” *The Economist* (June 16, 2007), 5–8.

Several problems arose also. Although prices fell and many competitors entered some of those industries, more and more of those competitors were unable to compete with the dominant firms. They were failing, going bankrupt, or being absorbed by the larger firms. Entry barriers into some industries were enormous and had been greatly underestimated. This has been shown to be the case in airline, trucking, railroad, and long-distance telephone service.⁸⁰ Most dramatically, deregulation is generally blamed for the savings-and-loan industry crisis, which resulted in an unprecedented \$124 billion bailout by the U.S. government.

Another problem that developed was that a few firms began to dominate key industries. This trend was obvious in transportation, where the major railroad, airline, and trucking companies boosted their market shares considerably during the 1980s. The top six railroads went from about 56 percent of market share to about 90 percent during this time. The top six airlines went from about 75 percent of market share to about 85 percent. The top 10 trucking firms went from about 38 percent of market share to about 58 percent. Prior to its breakup, AT&T enjoyed about an 80 percent share of the domestic market and a virtual monopoly in the huge toll-free, big-business, and overseas markets.⁸¹

DILEMMA WITH DEREGULATION

The dilemma with deregulation is how to enhance the competitive nature of the affected industries without sacrificing the applicable social regulations, i.e., to allow for freer competition, not to lower health and safety requirements. This is the second major problem with deregulation that we need to discuss. Unfortunately, the dog-eat-dog competition unleashed by economic deregulation can force many companies to cut corners in ways that endanger the health and/or safety of their customers. The following are a few industries at the forefront of the deregulation issue.

Trucking Industry

Trucking deregulation received a big boost when George W. Bush was elected president. Duane W. Ackle and Walter P. McCormick, chairman and president, respectively, of the American Trucking Association, became advisors to the Bush–Cheney transition team on transportation issues. These were just the first two of many trucking industry executives and lobbyists who have received influential posts in the federal government since 2000. From 2000 to 2005, the trucking industry spent about \$37 million on lobbying for rules that industry officials say have saved the industry billions.⁸² In April 2003, the Transportation Department issued rules that increased the maximum allowable hours of driving from 60 to 77 over seven consecutive days and from 70 to 88 hours over eight consecutive days. Maximum daily work hours (which includes loading) were set at 14.⁸³

Congress provided very little scrutiny of trucking standards, but the courts have been less reticent. Concerned about the relaxed standards, several safety organizations brought a lawsuit to a federal appeals court. A three-judge panel ruled that the Federal Motor Carrier Safety Administration was guilty of “ignoring its own evidence that fatigue causes many truck accidents.”⁸⁴ They went on to say

that “the agency admits that studies show that crash risk increases, in the agency’s words, ‘geometrically’ after the eighth hour on duty” and questioned the legality of the “agency’s passive regulatory approach.”⁸⁵ One year later, in 2005, the agency issued rules that were almost the same; at this writing, those rules are being challenged again in court.⁸⁶

Telecommunications Industry

Since the breakup of AT&T in 1984, telephone rates have been cut in half, and aggressive competitors, such as MCI and Sprint, have moved quickly to adopt fiber-optic cable and other service improvements.⁸⁷ The Telecommunications Act of 1996 did not always achieve its promise of lower rates and better service. In fact, after the act’s inception, thousands of rural phone subscribers were without phone service. Before the act, cross-subsidization (urban subscribers and major long-distance carriers paid extra) ensured universal service. Although the new law proposed a new subsidy system, legal battles slowed its implementation.⁸⁸ In contrast, business and urban customers were the first beneficiaries of the new broadband services.⁸⁹

Ten years after the Telecommunications Act, the landscape has changed. Telecommunication deregulation is proceeding at a fast pace with countries around the world and states across the United States developing their own deregulation plans. Changes in market power and available technology are driving the deregulation trend. Local carriers tend not to have the market power needed to keep prices artificially high, and viable competitive alternatives now exist from wireless and voice-over-Internet-protocol (VOIP) providers.⁹⁰

Financial Services

Financial services in the United States were one of the most heavily regulated industries until the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980. It removed caps on deposit interest rates. Congress then began gradually to take apart the regulatory barriers that had been in place for decades. The Federal Deposit Insurance Improvement Act of 1991 loosened restrictions on deposit insurance premiums, the Neal-Riegle Interstate Banking Act of 1994 removed geographic restrictions on branches, and the Gramm-Leach-Bliley Act of 1999 created financial holding companies and removed enforced separation of insurance companies and commercial and investment banks.⁹¹ It appeared that the deregulation of financial services would continue until two events—9/11 and the Enron financial scandals—changed the tide.

In response, a variety of agencies within the U.S. government began to issue new financial rules and regulations; the Internal Revenue Service, the FBI, the Justice Department, the Financial Crimes Enforcement Network, and the Federal Reserve each contributed to financial service reregulation.⁹² The Committee on Capital Market Regulation issued a report in November 2006 that claimed the U.S. share of initial public offerings (IPOs) fell from 50 percent in 2000 to 5 percent in 2005 due to “regulatory intensity.”⁹³ While not all observers agree with the committee’s conclusion, most concur that the decision regarding the level at which

financial services should be regulated holds serious implications for the competitiveness of U.S. business in the global economy.

Electric Utilities

Beginning in 1996, various states passed electric restructuring initiatives, and Congress considered a range of bills all geared to bring competition to the electric utilities. As had been true with telephone deregulation, consumers were expected to save money, but those savings were considered to have inherent trade-offs.⁹⁴ Power companies had traditionally provided special programs to aid the community and people in need. As was true of telephone companies, these programs were financed by spreading the cost over the customer base. The main concern with deregulation was that only those programs that could be used to enhance image or advertising were expected to remain.⁹⁵

Eventually it became apparent that the problem was not going to be fair distribution of the money that would be saved. Instead, in the state of California, the problem became how to distribute the losses—\$35 billion in excess costs that occurred over an 18-month period. In the words of the *Wall Street Journal*, “Given that mistakes can prove so costly, is electricity-market restructuring worth the risk?”⁹⁶ Enron and other energy-trading companies manipulated the market to inflate prices artificially, and their machinations continue to haunt any efforts to bring efficiencies to the industry.⁹⁷ Unfortunately, California is not an exception. Deregulation has led to sharply increased prices in other states—75 percent in Maryland and up to 50 percent in Illinois.⁹⁸ Any new attempts to change the system must now devote significant efforts to reassuring consumers that the plan will not open the door to more market manipulation.⁹⁹

Summary

Any discussion of business and society must consider the paramount role played by government. Although the two institutions have opposing systems of belief, they interconnect in their functioning in our socioeconomic system. In addition, the public assumes a major role in a complex pattern of interactions among business, government, and the public. Government exerts a host of nonregulatory influences on business. Two influences with a macro orientation include industrial policy and privatization. A more specific influence is the fact that government is a major employer, purchaser, subsidizer, competitor, financier, and persuader. These roles permit government to affect business significantly.

One of government’s most controversial interventions in business is direct regulation. Government regulates business for several legitimate reasons, and in the past two decades social regulation has been more dominant than economic regulation. There are many benefits and various costs of government regulation. A response to the problems with regulation has been deregulation. However, bad experiences in key industries such as trucking, airlines, telecommunication, financial services, and utilities have caused many to wonder what the optimal mix of regulation and deregulation should be.

Key Terms

- accelerationists (page 457)
- adjusters (page 458)
- bankers (page 458)
- central planners (page 458)
- collectivistic ethic of government (page 453)
- deregulation (page 475)
- direct costs (page 473)
- economic regulation (page 469)
- excess profits (page 468)
- excessive competition (page 468)
- federalization (page 462)
- indirect costs (page 473)
- individualistic ethic of business (page 453)
- induced costs (page 473)
- industrial policy (page 457)
- market failure (page 466)
- natural monopoly (page 466)
- negative externalities (page 467)
- privatization (page 460)
- regulation (page 465)
- social costs (page 467)
- social goals (page 468)
- social regulation (page 469)
- targeters (page 458)

Discussion Questions

1. Briefly explain how business and government represent a clash of ethical systems (belief systems). With which do you find yourself identifying most? Explain. With which would most business students identify? Explain.
2. Explain why the public is treated as a separate group in the interactions among business, government, and the public. Doesn't government represent the public's interests? How should the public's interests be manifested?
3. What is regulation? Why does government see a need to regulate? Differentiate between economic and social regulation. What social regulations do you think are most important, and why? What social regulations ought to be eliminated? Explain.
4. Outline the major benefits and costs of government regulation. In general, do you think the benefits of government regulation exceed the costs? In what areas, if any, do you think the costs exceed the benefits?
5. What are the trade-offs between privatization and federalization? When would one or the other be more appropriate? What problems might you foresee?

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Business Influence on Government and Public Policy

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Describe the evolution of corporate political participation.
- 2 Differentiate among the different levels at which business lobbying occurs.
- 3 Explain the phenomenon of political action committees (PACs) in terms of their historical growth, the magnitude of their activity, and the arguments for and against them.
- 4 Define coalitions and describe the critical role they now assume in corporate political involvement.
- 5 Discuss the Bipartisan Campaign Reform Act and other issues surrounding campaign financing.
- 6 Outline the principal strategic approaches to political activism that firms are employing.

As our previous discussion of industrial policy showed, government is a central stakeholder of business. Government's interest, or stake, in business is broad and multifaceted, and its power is derived from its legal and moral right to represent the public in its dealings with business.

Today, because of the multiple roles it plays in influencing business activity, government poses significant challenges for business owners and managers. Government not only establishes the rules of the game for business functions but also influences business in its roles as competitor, financier, purchaser, supplier, watchdog, and so on. Opportunities for business and government to cooperate in a mutual pursuit of common goals are present to some extent, but the major opportunity for business is in developing strategies for effectively working with government in such a way that businesses achieve their own objectives. In doing

this, business has the responsibility of obeying the laws of the land and of being ethical in its responses to government expectations and mandates. To do otherwise raises the specter of abuse of political power. As the regulatory environment has become more intense and complex and as other changes have taken place in society, businesses have had little choice but to become more politically active.

Attempts by business to influence government are a major and accepted part of the public policy process in the United States. The active participation of interest groups striving to achieve their own objectives drives the U.S. political system. The business sector is, therefore, behaving in a normal and expected fashion when it assumes an advocacy role for its interests. Other groups, whether they be labor organizations, consumer groups, farmers' groups, doctors' organizations, real estate broker organizations, military groups, women's rights organizations, environmental groups, church groups, and so on, all strive to pursue their special interests with government. Today's pluralism necessitates that all of these groups seek to influence government. The public interest in this special-interest-driven process is that the system maintains some semblance of a balance of power and that the activities and practices of these organizations remain legal and ethical.

Corporate Political Participation

Political involvement is broadly defined as participation in the formulation and execution of public policy at various levels of government. As decisions about the current and future shape of society and the role of the private sector shift from the marketplace to the political arena, corporations, like all interest groups, find it imperative to increase their political involvement and activity.¹

Historically, companies entered into debates in Washington only on an issue-by-issue basis and with no overall sense of a purpose, goal, or strategy. Companies also tended to be reactive; that is, they dealt with issues only after the issues had become threats. This approach became obsolete as the kinds of changes we have described began to occur. Today, success in Washington is just as important as success in the marketplace. Just as business has learned that it must develop competitive strategies if it is to succeed, it has learned that political strategies are essential as well.² Even a corporate giant like Microsoft had to learn to be an active and effective player.

A LESSON LEARNED

Microsoft opened its first lobbying office in 1995, 20 years after the founding of the company. The office had only one staff person, Jack Krumholtz, a 33-year-old lawyer with no real Washington experience and no secretary. He wasn't given a cushy office with a view of the Potomac. Instead, he had an office in the Microsoft federal sales office, across from a suburban shopping mall and seven miles from downtown D.C.³ Another lobbyist described the Microsoft command post as "Jack

and his Jeep,” because the Jeep was the only downtown location Krumholtz had available.⁴

After the U.S. Justice Department brought an antitrust case against Microsoft, the company began to realize its isolationist policy wasn't working. In addition to increasing its political giving, the company retained a cadre of well-connected lobbyists and public relations officials to present its case to legislators and the public.⁵ A *BusinessWeek* article showed Microsoft pulling out all the stops. Krumholtz and his colleagues moved to a modern building on DuPont Circle. The in-house staff had grown to 14, and they had scores of high-powered help on retainer. They gave millions to both parties in the 2000 presidential election, hired both Bush and Gore advisers as lobbyists, and became the ninth-largest “soft money” corporate donor in the United States. They ran national ad campaigns featuring a “warm and fuzzy” Bill Gates and touting their multimillion-dollar charity campaign. Think tanks that supported their interests received major donations; those that espoused views counter to theirs received nothing. They even farmed out legal work to most of the law firms in D.C. so that most of the lawyers in town would be constrained from working for their competitors.⁶

After years of struggling with antitrust cases both domestic and abroad, their work began to pay off. Microsoft succeeded in positioning one of its top lawyers to chair the American Bar Association's antitrust section, a group that has significant influence over the development of antitrust policy and law.⁷ In addition, one of the top antitrust lawyers at a firm that represented Microsoft on several antitrust disputes became the top antitrust official at the Justice Department. In 2007, he raised eyebrows by sending a memo to state attorneys general around the United States, urging them to reject a confidential Google antitrust complaint. The Justice Department under the George W. Bush administration sent a delegation to the European Union, headed by a former Microsoft lawyer and lobbyist, which argued Microsoft's case with the European Union. The Department has also criticized the European Commission and the Korean Fair Trade Commission for their stances on Microsoft.⁸

An appeals court overturned the court-ordered breakup of Microsoft, and an agreement with the Justice Department settled the antitrust charges while still calling for more stringent oversight of the company's practices. Although Microsoft's political involvement has yielded success, the company cannot afford to relax its efforts. Anticompetitive behavior charges from the European Union and competitors such as Google continue to preoccupy the company.

Had Microsoft taken its governmental relations more seriously more quickly, the company might have avoided much of this trouble. Marshall Phelps, corporate vice president and deputy general counsel for Microsoft, said that Microsoft should have negotiated sooner with the U.S. Department of Justice. According to Phelps, the company has now learned to deal with antitrust issues, but they could have saved themselves considerable difficulty. “Had Microsoft been a little quicker to give in on this, that and the other, (it) wouldn't be in the same pickle . . . one of the problems companies get into (is) when they don't realize how powerful they are and how powerful they are perceived as being.”⁹

Phelps offers advice for other companies facing antitrust inquiries: “Discretion is the better part of valor, and it’s better to be a bit more humble in the face of regulators because they are never going to go away. I don’t care how many good lawyers you have or how much money. The regulators still win. That’s just the rule. All the more reason you want to be cooperative and make the government think they won. You want to say, ‘Yep, you won. We’ll change our practices.’” According to Phelps, Microsoft is now following that advice, changing its own practices and “desperately trying” to make regulatory peace with the European Union.¹⁰

Microsoft learned the hard way that political involvement is not optional. In response, they continue to employ a range of activities to promote their interests. To appreciate more fully the participation of business in the process of public policy formation in the United States, it is necessary to understand the approaches that business uses to influence government stakeholders.

In this chapter, we will focus only on the following major approaches: (1) lobbying, (2) PACs, (3) coalition building, and (4) political strategy. At this point, our perspective will be largely descriptive as we seek to understand these approaches, their strengths and weaknesses, and business’s successes and failures with them. At the same time, however, we must be constantly vigilant of possible abuses of power or violations of sound ethics.

BUSINESS LOBBYING

Lobbying is the process of influencing public officials to promote or secure the passage or defeat of legislation. Lobbying is also used to promote the election or defeat of candidates for public office. Lobbyists are intensely self-interested. Their goals are to promote legislation that is in their organizations’ interests and to defeat legislation that runs counter to their organizations’ interests. Business interests, labor interests, ethnic and racial groups, professional organizations, and those simply pursuing ideological goals they believe to be in the public interest are lobbying at the federal, state, and local levels. Our focus is on business lobbying at the federal level, although we must remember that this process is also occurring daily at the state and local levels.

Lobbying has been defined as the professionalization of the art of persuasion.¹¹ Lobbying serves several purposes. It is not just a technique for gaining legislative support or institutional approval for some objective such as a policy shift, a judicial ruling, or the modification or passage of a law. Lobbying may also be directed toward the reinforcement of established policy or the defeat of proposed policy shifts. Lobbying also targets the election or defeat of national, state, and local legislators. A lobbyist may be a lawyer, a public relations specialist, a former head of a public agency, a former corporate executive, or a former elected official. In this sense, there is no typical lobbyist.¹² It is clear, however, that more and more businesses, as well as other special-interest groups, are turning to lobbyists to facilitate their involvement in the public policy process. A cartoon depicts the increasing stature of lobbyists. The teacher asks the class, “Who runs America?” She then gives her students the following choices: “the President, the Supreme Court, or Congress?” An astute class member responds, “Lobbies.”¹³

ORGANIZATIONAL LEVELS OF LOBBYING

The business community engages in lobbying at several organizational levels. At the broadest level are **umbrella organizations**, which represent the collective business interests of the United States. The best examples of umbrella organizations are the Chamber of Commerce of the United States and the National Association of Manufacturers (NAM). Out of these have grown organizations that represent some subset of business in general, such as the Business Roundtable, which was organized to represent the largest firms in America, and the National Federation of Independent Businesses (NFIB), which represents smaller firms.

At the next level are **trade associations**, which are composed of many firms in a given industry or line of business. Examples include the National Automobile Dealers Association, the National Association of Home Builders, the National Association of Realtors, and the Tobacco Institute. Finally, there are individual **company lobbying** efforts. Here, firms such as IBM, AT&T, Ford, and Delta Airlines lobby on their own behalf. Typically, companies use their own personnel, establish Washington offices for the sole purpose of lobbying, or hire professional lobbying firms or consultants located in Washington or a state capital. An example of company lobbying was given previously in Microsoft's lesson learned. Figure 12-1 depicts examples of the broad range of lobbying and political-interest organizations used by businesses.

We will now discuss lobbying in greater detail, beginning with the use of professional lobbyists.

Professional Lobbyists

Lobbyists, sometimes derisively referred to as "influence peddlers," operate under a variety of formal titles and come from a variety of backgrounds. Officially, they are lawyers, government affairs specialists, public relations consultants, or public affairs consultants. Some are on the staffs of large trade associations based in Washington. Others represent specific companies that have Washington offices dedicated to the sole purpose of representing those companies in the capitol city. Still others are professional lobbyists who work for large law firms or consulting firms in Washington that specialize in representing clients to the lawmakers. Figure 12-2 shows the level of expenditures professional lobbyists make each year.

The Washington lobbyist is frequently a former government official. Some are ex-congressional staff members or ex-members of Congress. Others are former presidential staff assistants or other highly placed government officials. The law prohibits many of these individuals from lobbying for one year after leaving office; however, one year is a relatively short apprenticeship for people who are likely to increase their former salaries many times over. For example, after serving as chief architect of the Medicare prescription drug law, former representative Billy Tauzin (R-Louisiana) received a lucrative job offer to lobby for the pharmaceutical industry. Pundits suggested that he had already earned his salary when he walked in the door because the Medicare bill provided huge profits for drug makers.¹⁴ Tauzin began his job as chairman and CEO of the drug industry trade group Pharmaceutical Research and Manufacturers of America (PhRMA) in January

Figure 12-1 *Examples of the Range of Lobbying Organizations Used by Businesses*

Broad Representation: Umbrella Organizations

- Chamber of Commerce of the United States
- National Association of Manufacturers (NAM)
- Business Roundtable
- National Federation of Independent Businesses (NFIB)
- State Chambers of Commerce
- City Chambers of Commerce

Midrange Representation: Trade and Professional Associations and Coalitions

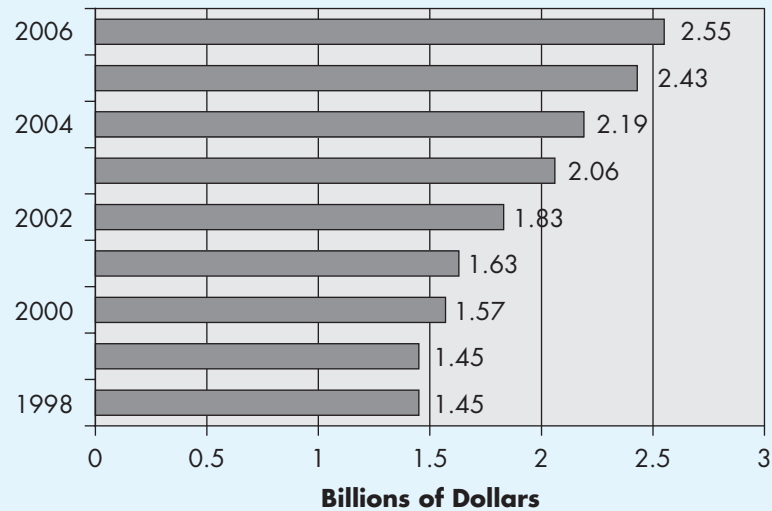
- National Automobile Dealers Association
- National Association of Realtors
- American Petroleum Institute
- American Trucking Association
- National Association of Medical Equipment Suppliers
- Tobacco Institute
- Health Benefits Coalition
- United States Telecom Association

Narrow/Specific Representation: Company-Level Lobbying

- Washington and State Capital Offices
- Law Firms Specializing in Lobbying
- Public Affairs Specialists
- Political Action Committees (PACs)
- Grassroots Lobbying
- Company-Based Coalitions
- Former Government Officials

2005.¹⁵ He did not register to lobby until 2006 due to a one-year waiting period mandated by the Ethics Reform Act of 1989. In the meantime, however, he was able to advise other lobbyists on how to proceed and was able to call on his former chief of staff, who joined PhRMA with him.

What do business lobbyists accomplish? Lobbyists offer a wide range of services that include drafting legislation, creating slick advertisements and direct-mail

Figure 12-2 *U.S. Lobbying Expenditures*

Source: www.opensecrets.org

campaigns, consulting, and, most importantly, getting access to lawmakers. Access, or connections, seems to be the central product that the new breed of lobbyist is selling—the returned phone call, the tennis game with a key legislator, or the golf outing with the Speaker of the House. With so many competing interests in Washington today, the opportunity to get your point across in any format is a significant advantage. Lobbyists also play the important role of showing busy legislators the virtues and pitfalls of complex legislation.¹⁶ Figure 12-3 summarizes some of the various activities that business lobbyists accomplish for their clients.

Grassroots Lobbying

In addition to lobbying directly through the use of professional lobbyists, firms use what is called **grassroots lobbying**, which refers to the process of mobilizing the “grassroots”—individual citizens who might be most directly affected by legislative activity—to political action. Trade associations and the umbrella organizations also use grassroots lobbying actively. The better corporate grassroots lobbying programs usually arise in companies whose leaders recognize that people are a firm’s most potent political resource. Although firms cannot direct or require people to become politically involved, they persuade and encourage them.

Trade associations often use grassroots support by asking their members to contact their representatives. They also organize rallies, target mail campaigns, develop instant advertisements, and use computerized phone banks.¹⁷ However,

Figure 12-3 What Business Lobbyists Do for Their Clients

- Get access to key legislators (connections)
- Monitor legislation
- Establish communication channels with regulatory bodies
- Protect firms against surprise legislation
- Draft legislation, slick ad campaigns, direct-mail campaigns
- Provide issue papers on anticipated effects of legislative activity
- Communicate sentiments of association or company on key issues
- Influence outcome of legislation (promote helpful legislation, defeat harmful legislation)
- Assist companies in coalition building around issues that various groups may have in common
- Help members of Congress get reelected
- Organize grassroots efforts

the grassroots response must be genuine, or at least appear to be genuine. The old techniques of phony “**astroturf lobbying**” no longer hold much sway; hundreds of phone calls or thousands of identical postcards, letters, or e-mails that arrive on the same day are rarely effective.¹⁸

Some organizations and trade associations have created fake groups that appear to be grassroots but are largely created and funded by an organization or trade association. For example, a group called “Americans for Technology Leadership (ATL)” funded polls that concluded the American public was not very interested in the Microsoft antitrust case. Then, when 19 state attorneys general were considering what remedy to seek, ATL funded another poll that found that the public wanted their state’s attorneys general to devote their attention to other issues, not the Microsoft case.¹⁹ ATL also hired telemarketers to make unsolicited calls to people, asking them if they would send a letter to Congress to demand that the Department of Justice drop the antitrust case. The telemarketer would offer to draft and mail the letter to the person’s congressperson for them—they simply needed to give permission to use their names. What was ATL? It was a group designed to develop grassroots support for Microsoft: Fully funded by Microsoft, it had few dues-paying members.²⁰ The Internet has now made it possible not only to create fake groups but also manufacture fake consumers. With the heavy use of listserv electronic mailing lists in a variety of arenas, corporations can now invent people to log on and record messages that show no indication of the company for which they are working.²¹

Grassroots lobbying has become one of the most frequently used and most effective techniques both for individual firms and for associations and coalitions. A few examples of successful grassroots lobbying efforts at the company level are helpful in understanding its power. During the debate over the North American Free Trade Agreement (NAFTA), Ford Motor Co. as well as other automakers tapped into a network of 32 top automobile suppliers and their employees to

drum up letters and telephone calls to Capitol Hill in support of the trade pact. The company also called on its five thousand dealers for grassroots lobbying support.²² NAFTA was subsequently passed. More recently, credit unions across the nation employed grassroots lobbying to urge congressional support of H.R. 1151—the Credit Union Membership Access Act, which relaxes credit union membership requirements. In addition to eliciting the traditional onslaught of petitions and personal letters, thousands of credit union members lobbied their lawmakers directly on Capitol Hill.²³ These efforts undoubtedly led to the landslide vote in which the House passed the bill.

The technology revolution has ushered in **cyberadvocacy** as a new form of grassroots campaigning. Computers and the Internet have made communication infinitely easier. Books and consulting services have sprung up to assist organizations in using the Internet to both amass grassroots support and enable grassroots supporters to contact their legislators. There is a danger with the use of e-mail. According to Stella Anne Harrison of the Juno Advocacy Network, “Blanket e-mail messages can be equated with spam—unwarranted and irrelevant overload of e-mail messages that can be ignored. However, targeted and specific e-mails are another matter.” She recommends that advocates include their name and home address so that legislators will know they are hearing from their constituents.²⁴

Trade Association Lobbying

In their May 2006 report *Hidden Rivers*, the Center for Political Accountability dubbed trade associations “the Swiss bank accounts of American politics.” This in-depth examination of how the nation’s trade associations have become conduits for unlimited corporate political spending produced a surprising conclusion: Trade associations helped companies conceal and spend over \$100 million in just one year. Of major concern is the fact that trade associations “are subject to even less disclosure than the much criticized spending of independent political committees (“527s’).”²⁵

Lobbying at the association level is frequent today. One recent successful experience worth noting was the pharmaceutical industry’s success at blocking Congress’s efforts to impose price controls and allow the importation of less expensive drugs. The Pharmaceutical Research and Manufacturers of America (PhMRA) spent \$8.5 million to defeat the importation component of the Medicare prescription drug benefit bill. Individual companies also spent millions, including Eli Lilly & Co. (\$2.2 million), Bristol-Meyers Squibb Co. (\$2.6 million), and Johnson & Johnson (\$2.2 million). The pharmaceutical industry as a whole spent \$29 million in lobbying to scuttle importation, which was more than any other sector.²⁶ In a true show of the trade association’s strength, the pharmaceutical industry was able to have a law passed that barred the federal government from negotiating the prices of prescription drugs supplied through Medicare. A subsequent House effort to reintroduce a bill that would have allowed for negotiation of lower prices never made it out of committee.²⁷ At this writing, the new Democratic House passed the Medicare Price Negotiation Act, which requires price negotiation for lower prices

for Medicare prescription drugs, but the White House has issued a statement that President Bush would veto any push to require price negotiation in the Medicare program.²⁸ Given the pharmaceutical industry's army of lobbyists and millions in lobbying expenditures, it can be difficult for other voices to make themselves heard in the process. In the words of Amy Allina, program director at the National Women's Health Network, "We are up against an army."²⁹

Industries do not always speak with one voice, as has been true with the pharmaceutical industry. Trade associations sometimes find themselves in the undesirable role of battling with each other in their attempts to lobby Congress. An example of these types of battles occurred between the credit union and the banking industries regarding the scope of services supplied by credit unions. Credit unions argued that they provide services to individuals and small businesses that traditional banks shun. They contended that they should be able to expand the services they provide to this generally underserved population. Banks countered that credit unions enjoy an unfair competitive advantage by virtue of their exemptions from both taxes and the Community Reinvestment Act (CRA) obligations required of banks and thrifts. They maintained that large, multiple-employer credit unions should be subject to the same taxes, CRA rules, and safety requirements as banks. Ultimately, the House passed H.R. 1151, the Credit Union Membership Access Act, which relaxed restrictions on credit union membership.³⁰

Umbrella Organizations

The umbrella organizations are associations, too. But unlike a trade association, an umbrella organization has a broad base of membership that represents businesses in several different industries of various sizes. Historically, the two major umbrella organizations in the United States have been the Chamber of Commerce of the United States and the National Association of Manufacturers. Two other prominent organizations include the Business Roundtable and the National Federation of Independent Businesses. Each of these groups has political action as one of its central objectives.

Chamber of Commerce of the United States. The national Chamber of Commerce was founded in 1912 as a federation of businesses and business organizations. In addition to firms, corporations, and professional members, the Chamber has thousands of local, state, and regional chambers of commerce; American Chambers of Commerce abroad; and several thousand trade and professional associations. Its diversity of membership shows why it is referred to as an umbrella organization.

Historically, the U.S. Chamber of Commerce had been a legislative powerhouse in its ability to influence public policy. Its power gradually waned over the years.³¹ When Thomas Donohue became the Chamber president, he promised to awaken the "sleeping giant, missing in action from many important battles." As president and CEO, Donohue is credited with revitalizing the Chamber in "money, members and influence."³² One tactic he has used with great success is to dispense favors to individual businesses that might not want their company name

associated with lobbying efforts. Wal-Mart and the American Council of Life Insurers, among others, each contributed \$1 million to a campaign to help elect judges known for being friendly to business.³³ Donohue is not afraid to take controversial stances. He railed at the post-Enron regulations, charging that “Government agencies have gone overboard” and “Accounting error should not be seen as a crime,” causing the Business Roundtable to distance itself from his actions.³⁴ At \$72,740,000, its 2006 lobbying expenditures dwarfed those of other business associations.³⁵

National Association of Manufacturers (NAM). NAM describes itself as “America’s oldest and largest national broad-based industrial trade association.”³⁶ Although the membership of NAM has historically been tilted toward the larger smokestack industry firms, it now includes small and medium-sized firms as well as member associations. The membership of NAM encompasses every industrial sector and all 50 U.S. states.³⁷ This diversity provides a challenge for NAM, because their small and midsized member firms believe NAM is more concerned with the needs of the global companies than their own, and the concerns of small firms often differ from those of the larger, global players.³⁸

One particular point of contention is the issue of free trade. The large firms tend to be free-trade advocates, a stance with which NAM agrees; however, the small firms are increasingly desirous of protection.³⁹ The issue came to a head during a 2007 meeting of the board. The membership of NAM had voted to fight Chinese currency manipulation, because it creates an unfair situation for small U.S. firms that try to compete with Chinese firms or multinational firms operating in China.⁴⁰ The NAM board voted to go against the vote of the membership. This led to the creation of a new organization, the American Alliance for Manufacturing, based in Washington. In addition, the Michigan Tooling Association expanded and renamed itself the Tooling, Manufacturing, and Technologies Association.⁴¹

Business Roundtable. Formed in 1972, the Business Roundtable is often regarded as an umbrella organization, although it has a restricted membership. It is an association of chief executive officers of leading corporations with a combined workforce of more than 10 million employees in the United States and \$3.7 trillion in revenues.⁴² Former chairman John T. Dillon and current president John Castellani turned the organization—long regarded as a sleeping giant—into a “lobbying juggernaut.”⁴³ The renewed vigor has led to increased membership with Hewlett-Packard, Ford Motor, and IBM returning as members.⁴⁴

The Business Roundtable is different from most groups, such as the Chamber of Commerce and NAM, in the extent of participation by the chief executive officers. Rather than pushing narrow issues that benefit narrow interests, the Roundtable selects concerns based on “the impact the problem will have on the economic well-being of the nation.” Working in task forces on specific issues, the Business Roundtable is committed to “advocating public policies that ensure vigorous economic growth, a dynamic global economy, and the well-trained and productive U.S. workforce essential for future competitiveness.”⁴⁵

National Federation of Independent Businesses (NFIB). During the end of the twentieth century, the growth of small businesses came to dominate the business news. It should not be surprising, therefore, that the NFIB, as a small business association, also came into a position of power. We might think of the NFIB as an umbrella organization for smaller businesses. When *Fortune* magazine last conducted its ranking of the Power 25 Lobbying, the NFIB ranked third overall and tops in business organizations for clout.⁴⁶

One of the best ways to appreciate the NFIB's political power is to describe its success at grassroots lobbying.⁴⁷ The NFIB made its mark by strong and successful lobbying against former President Clinton's health care plan. They also were integral in obtaining congressional action on the inheritance tax, successful in challenging the OSHA ergonomics rule, and at the forefront of the fight to provide small business with equal access to government contracting.⁴⁸ Part of their power stems from their ability to speak with one voice due to the homogeneity of their membership and the many issues that small businesses share because of their size. For this reason, it avoids the problems faced by the NAM.

Coalition Building

A noteworthy and growing mechanism of political involvement in the public policy process is the creation and use of **coalitions** to influence government processes. A coalition forms when distinct groups or parties realize they have something in common that might warrant joining their forces, at least temporarily, for joint action. More often than not, an issue that various groups feel similarly about creates the opportunity for a coalition.

Coalition formation has become a standard practice for firms interested in accomplishing political goals or influencing public policy. If a company or an association wants to pass or defeat particular legislation, it needs to seek the support of any individual or organization that has a similar position on the issue.⁴⁹ Coalitions enable members to share their resources and pool their energies when they confront difficult issues. Coalitions also enable a company to push for its own agenda without necessarily having its name attached to the campaign.⁵⁰

Because coalitions tend to form around issues, an astute political strategist could analyze past, present, and likely future coalitions so that coalition behavior could be anticipated and managed. To do this, MacMillan and Jones⁵¹ recommend the following steps:

1. *Manage the sequence in which issues are addressed.* This kind of control can dictate priorities and emphasis and result in the proper channeling of effort to suit the organization's interests.
2. *Increase the visibility of certain issues.* By doing this, the strategist can focus attention in such a way that her or his goals are met.
3. *Unbundle issues into smaller subissues.* The strategist may be able to reach her or his goals by slowly but surely accomplishing one small step at a time. The net result may be more success for the entirety.

One high-profile example of coalition building around a specific issue is the Coalition for Security and Competitiveness. In 2007, eight leading trade associations (the Aerospace Industries Association, Association for Manufacturing Technology, Coalition for Employment through Exports, Electronic Industries Alliance, Information Technology Industry Council, National Association of Manufacturers, National Foreign Trade Council, and U.S. Chamber of Commerce) joined to lobby the Bush administration for modernization of the U.S. export control system in order to make it more efficient, predictable, and transparent.⁵² These associations represent firms that must export goods in a time when terror concerns and global competitiveness make it increasingly difficult to use outdated methods and modalities. The goal of the proposed modernization is to protect the security of sensitive military technologies, while also maintaining technological leadership and industrial competitiveness.⁵³

Political Action Committees

To this point, our discussion of lobbying has focused primarily on interpersonal contact and powers of persuasion. We now turn our attention to **political action committees (PACs)**, the principal instruments through which business uses

<http://SEARCHTHEWEB.WEB>

TRACKING THE MONEY: WHO GIVES, WHO GETS, AND HOW IS IT SPENT?

The Center for Responsive Politics is a nonpartisan, nonprofit research group based in Washington, DC, that tracks the flow of money in politics and assesses its impact. The Center's goal is to create "a more educated voter, an involved citizenry, and a more responsive government." Support for the Center comes from a combination of foundation grants and individual contributions. They will accept no contributions from businesses or labor unions. Their website (<http://www.opensecrets.org>) contains a variety of information regarding the role of money in the political process. By law, candidates must disclose contributions from any individuals who give them more than \$200 and any PACs or political committees. Visitors to the website can find out who made political contributions from their own or any zip code (and to whom they made them). They can also search various issues and find out who is giving money, and to

whom, to ensure that their interests prevail. The website also offers information regarding federal election law and other related issues. Visitors to the site can sign up for their "Money in Politics Alerts"—weekly e-mail messages that highlight special-interest legislation on Capitol Hill. The focus is on "who is giving the money and who is getting it." For additional information on donations as well as details on how political contributions are spent, log on to <http://www.politicalmoneyline.com/>. In 2006, Congressional Quarterly Inc. (CQ) acquired Political Money Line, an independent source of campaign finance information. These two sites, along with the federal site on elections (<http://fec.gov.>), combine to provide the interested voter with a wealth of background information on politics and the role of money in it.

financial resources to influence government. PACs should be thought of as one facet of lobbying. However, because they have become such an influential phenomenon, they deserve separate treatment in this text.

EVOLUTION OF PACs

PACs have been around for years, but their influence has been most profoundly felt in the past two decades. This is perhaps because the bottom line in politics, as well as in business, is most often measured in terms of money—who has it, how much they have, and how much power they are able to bring to bear as a result. This is the **Golden Rule of Politics**: “He who has the gold, rules.”⁵⁴

Business PACs appeared on the scene in the early 1970s as a direct result of the 1974 amendments to the Federal Election Campaign Act (FECA). Under this law, organizations of like-minded individuals (such as business, labor, and other special-interest groups) may form together and create a PAC for the purpose of raising money and donating it to candidates for public office.⁵⁵ In 2006, there were 4,217 PACs officially registered with the Federal Election Commission: Corporate PACs were the largest subgroup with 1,621 committees.⁵⁶ They raised \$773.5 million, spent \$656.3 million, and contributed \$248.2 million to federal candidates from January 1, 2005, through June 30, 2006. Receipts increased by 23 percent and disbursements increased by 27 percent: Contributions to candidates were 21 percent higher than at this point in the 2004 campaign.⁵⁷ Figure 12-4 shows the top 10 PAC contributors to federal candidates.

Figure 12-4 *Top 10 PAC Contributors to Federal Candidates (2005–2006)*

PAC	Total Amount	Percentage	
		Democratic	Republican
National Association of Realtors	\$3,752,005	49%	51%
National Beer Wholesalers Assoc.	\$2,946,500	31%	69%
National Association of Home Builders	\$2,900,000	26%	73%
National Automobile Dealers Association	\$2,821,600	30%	70%
International Brotherhood of Electrical Workers	\$2,796,875	97%	3%
Operating Engineers Union	\$2,784,435	78%	21%
American Bankers Association	\$2,748,299	36%	64%
Laborers Union	\$2,687,150	85%	15%
American Association for Justice	\$2,558,000	96%	3%
Credit Union National Association	\$2,412,853	45%	54%

Source: The Center for Responsive Politics (<http://www.opensecrets.org>). Based on data released by the FEC on Monday, June 04, 2007.

Ethics in Practice Case

INFLUENCING LOCAL GOVERNMENT

My friend runs a small Atlanta chemical company that produces alum. Alum is used for many purposes, including water purification, and the company had a contract with Fulton County for this use for many years. In all the years they had this contract, they received it through open bidding. This was the case every renewal year until this year, when they were again the low bidder. A larger company based in the North with a division in Georgia was awarded the contract, even though its bid was about 3 percent higher. This would have been acceptable if there had been a quality or delivery problem in the past, but this had never been the case.

My friend met with a former county commissioner to seek advice about, and reasons for, this situation. The commissioner believed that there was an under-

the-table agreement and advised my friend to sue the county and its purchasing manager. The problem is that the contract is relatively small and the lawsuit would almost certainly cost more than the contract.

1. Is filing a lawsuit the best way for this chemical company to influence the county commission? What options does the company have?
2. Do companies now have to lobby local or other governments to get business? Do they need to make PAC contributions? Bribes or kickbacks?
3. What action should this small chemical company take?

Contributed by Jack Rood

ARGUMENTS FOR PACs

Not surprisingly, those who support PACs are primarily those who collect and donate the money (for example, the business community) and those who receive the money (many members of Congress and candidates for office). Businesses see PACs as a positive and constructive way to participate in the political process. They see PACs as a reasonable means by which business, labor, and other interest groups may organize their giving. They argue that business giving is offset by labor giving and by the multitude of other special-interest groups that also have formed PACs.

Many of the congressional recipients of PAC contributions also advocate PACs. There is less uniformity of support among Congress than among the business community, however. One reaction from our elected officials is resentment at the suggestion that they can be bought. The larger problem seems to be the growing dependency of politicians on PAC money. In general, members of Congress seem to support the idea of PAC contributions, because their campaign financing has become increasingly dependent on it. With each passing year, however, the need for reform of PAC laws has become more apparent to many politicians.

ARGUMENTS AGAINST PACs

Some of the most vocal opposition to PACs and the role they are playing comes from current and past members of Congress themselves. Veteran lawmakers like

Paul Simon (D–Illinois) and Bill Bradley (D–New Jersey) cited the perpetual need to chase money as a major factor in why they left office.⁵⁸ The frustrations of many members of Congress are summed up in the comments of former senator Robert Dole (R–Kansas): “When these political action committees give money, they expect something in return other than good government. It is making it much more difficult to legislate. We may reach a point where if everybody is buying something with PAC money, we can’t get anything done.” He worries about differing treatment of the rich and the poor: “Poor people don’t make campaign contributions. You might get a different result if there were a Poor-PAC up here.”⁵⁹

Dole’s point is borne out by a *Money* article. In it, Ann Reilly Dowd estimated the price that special-interest contributions exact on the average household. According to a recent Progressive Policy Institute study, U.S. taxpayers paid \$47.7 billion for corporate tax breaks and subsidies, costing the average household about \$483. Import quotas for sugar, textiles, and other goods totaled another \$110 billion, with a total cost per household of \$1,114. The average U.S. household was expected to pay \$1,600 for legislation that protects corporations and the wealthy.⁶⁰ Although some of these tax breaks and subsidies are certain to be sound policy and would be implemented with or without financial motivation, Dowd raises an interesting point. Certainly many of those tax breaks, subsidies, and quotas can be traced back to the coffers of PACs.

PACs and the Vote-Buying Controversy

Many studies have been done to calculate correlations between PAC giving and congressional voting. The major problem is that correlations do not necessarily prove causation. But correlations do appear convincing and are used by PAC critics to fullest advantage. Several political analysts have been able to conduct studies using more sophisticated statistical techniques than simple correlation. These studies have been able to control for variables, such as party ideology and past voting records, in an effort to determine what independent effects the contributions have.

These studies have mixed results. Some find strong support, others find no support, and a third group has mixed or marginal findings.⁶¹ One factor may be the context of the situation, and so researchers have subsequently looked for contingencies that might explain the differences. In a recent study, Jeffrey Cohen and John Hamman explored the affect of PAC contributions on the regulation of cable television. In support of their hypotheses, they found that PAC contributions were more influential when given to House candidates than to Senate candidates. They explain it in two ways: The more frequent elections of House members make them more susceptible to campaign financing concerns, and the smaller size of the House constituencies (as opposed to the Senate constituencies) means House members have fewer interest groups with which they must contend. Similarly, they found that PAC money was more influential when issues were at the smaller interest-group level, and its importance became diluted when issues moved to the broader arena of the entire House or Senate.⁶²

While it is difficult to isolate specific PACs and specific votes, the benefits of corporate political activity are more easily determined. A 2007 study shows that corporate donations to political campaigns are associated with an increase in firm value of 3.5 percent.⁶³ The authors speculate that the increase in firm value stems from the economic benefits accruing to the companies from legislation they supported; the return is greatest for firms in the candidate's home state.⁶⁴

Center for Public Integrity Study

A recent study released by the Washington-based Center for Public Integrity reported a connection between political contributions and \$8 billion in contracts awarded to more than 70 U.S. companies for work in Afghanistan and postwar Iraq. Most of these companies were established political players in Washington, with employees or board members who had close ties to both parties through the executive branch, members of Congress, or the highest levels of the military. These companies had contributed nearly \$49 million to national political campaigns and parties: 13 of the 14 largest contractors receiving the largest awards employed former government officials or persons with close ties to the government. These top 14 had given nearly \$23 million in political contributions.⁶⁵

PAC contributions appear to be most effective when certain conditions prevail.⁶⁶ These conditions include the following:

1. *When the issue is less visible.* PAC funds are more likely to be effective while the issue being debated is less visible—that is, not yet in the full glare of public and media scrutiny.
2. *During the early stages of the legislative process.* When agenda setting and subcommittee work are being done, the public, the press, and “watchdog” groups are not as attentive.
3. *When the issue is narrow, specialized, or unopposed.* PAC contributions are more effective on specialized or unopposed issues than on broad national issues.
4. *When PACs are allied.* When “PACs travel in packs” and work together, they can wield considerable power.
5. *When PACs adapt lobbying techniques to their contribution strategies.* Successful PACs also employ grassroots lobbying with contributions.

PACs AND CAMPAIGN FINANCING

Because PAC money is easy to come by, it is clear why PACs have so much influence with their contributions. When this fact is combined with the ever-escalating sums of money that legislators need to get and stay elected, the result is quite powerful. The increasing dependency on PAC contributions is driven partly by the rising costs of getting elected and partly by the ease of getting PAC money. According to Common Cause president and CEO Scott Harshberger, “This system is a gravy train for members of Congress—and a meal ticket for special interests, many of whom want something in return.”⁶⁷

Not only has the dependency on PAC money become a serious problem, but it is also growing increasingly evident that most of the money is going to

incumbents. In the 2004 election cycle, PACs contributed nearly 80 cents of every dollar to incumbents.⁶⁸ This makes it difficult to effect political change in elections. If, however, challengers are able to surmount this challenge and take seats away from incumbents, as they did in the 2006 election, they will begin to enjoy the incumbent advantage. At this writing, the 2008 election is well over a year away, but PACs are already beginning to shift some of their dollars to the Democratic side of the aisle.⁶⁹

Recent attention has focused on the way in which PAC funds are spent. Leadership PACs are a specific form of PAC with far fewer limitations on how the money may be spent. They have been around for a long time but did not come into general use until the mid-1990s when former Congressman Tom Delay (R-Texas) began to urge Republican lawmakers to make use of them. Now they are common on both sides of the aisle.⁷⁰ Leadership PACs allow those lawmakers holding safe seats to funnel money to colleagues at risk of not being reelected. Instead, they seem to be evolving into slush funds, covering such purchases as hotels, meals, flowers, jewelry, limousines, art, and even funerals.⁷¹

The Hard Facts About Soft Money

The **Bipartisan Campaign Reform Act (BCRA)** is also known as McCain-Feingold for its chief sponsors, Senators John McCain (R-Arizona) and Russell Feingold (D-Wisconsin). The legislation, which went into effect on November 6, 2002, represented “the most sweeping change of the U.S. campaign finance system in a quarter century.”⁷² Its purpose was to remove the influence of **soft money** on candidates running for national office. Soft money is a contribution made to political parties instead of to political candidates. Soft money contributions were unregulated prior to the law and often used to run “issue ads” just prior to an election. In contrast, law already regulated **hard money**, donations made directly to the candidates.

The BCRA banned soft money and prevented special-interest groups from airing “issue ads” in the period prior to an election, while raising the limits for hard money donations. This act created a series of odd bedfellows who joined together to file lawsuits to fight it; groups as disparate as the National Rifle Association, the American Civil Liberties Union, the Chamber of Commerce, and the AFL-CIO challenged its constitutionality in court. In 2003, the Supreme Court issued a split 5-to-4 decision that upheld McCain-Feingold’s soft money and issue ad restrictions but declared the act’s prohibition on minors making contributions to candidates and political parties to be unconstitutional. However, the restriction on “issue ads” went again to the Supreme Court in 2007, after the membership of the Court had shifted; another 5-to-4 ruling reversed the earlier decision and declared the act’s issue ad restrictions to be unconstitutional as a limitation on free speech.⁷³ Challenges to the law continue to arise and so future changes in the landscape of campaign financing are likely.

Although McCain-Feingold represented a significant step forward in campaign financing, problems remain. As Republican lobbyist Ron Kaufman said, “Campaign cash is like the Pillsbury Doughboys. You push it in one place and it pops out in another.”⁷⁴ Soft money is still pouring in as Democrat and

Ethics in Practice Case

PATRIOTISM VS. PROFITS: WHAT SHOULD A FIRM DO?

One way that business can influence government is to circumvent governmental mandates through creative use of loopholes. This can improve corporate profits, meeting one of business's responsibilities, but does business have any responsibility to the governments whose resources enable them to grow and prosper?

According to a report filed by Citizens for Tax Justice and Change to Win, Wal-Mart avoided \$2.3 billion in state taxes from 1999 to 2005. Wal-Mart is not alone in this strategy; big box retailers and other companies across the country have used a variety of tactics to avoid paying taxes whenever possible. Wal-Mart is simply the biggest of the lot and, by all accounts, the most adept at keeping costs down.

One of the techniques Wal-Mart has used is basically to rent its stores but then pay itself the store rent. One Wal-Mart subsidiary pays rent to a real estate investment trust (REIT), which can receive a break on taxes if it pays out dividends. Another Wal-Mart subsidiary owns 99 percent of the REIT and thus receives the dividends tax-free. This corporate tax loophole is illegal at the federal level, but states have been slower to plug it. Many are scrambling to do so now. Still, as one loophole is plugged, another one opens. These various tax-saving strategies that firms are employing have helped to lower the share of income tax that companies pay while individual income tax payments continue to rise.

1. Who are the stakeholders and how are they affected by Wal-Mart's cost-saving strategy? Are Wal-Mart's actions in trying to minimize income tax payments in any possible way socially responsible?
2. Do companies have a responsibility to pay a fair share of income tax to state and federal governments? Who determines what that fair share should be?
3. Where do you draw the line on tax savings by corporations? Are the above REIT strategies acceptable?
4. After receiving the bulk of U.S. government contracts to fight the wars in Afghanistan and Iraq, Halliburton relocated its operations to Dubai, a haven from U.S. taxes. Senator Leahy described this move as "the wickedest of entrepreneurial greed." Do you agree or do you find the move acceptable?
5. Although Enron paid no taxes in 2002, they received a \$278 million tax rebate on a tax break from stock options cashed in by employees. The study also found that Enron paid no taxes in four of the five years from 1996 to 2000, during which time the company collected \$381 million in tax refunds. Is this socially responsible behavior?
6. U.S. law bans virtually all commerce with countries like Iran, Syria, and Libya that have sponsored terrorists. However, three *Fortune* 500 firms—Halliburton, Conoco-Phillips, and General Electric—were identified in the report as doing business in Iran and Syria. The law contains a loophole that these firms utilized: it does not apply to any foreign or offshore subsidiary run by non-Americans.
7. What implications do these situations hold for industrial policy? What would you do if you were a CEO of one of these corporations? What changes would you make, if any, if you were a government official? Are there lines that corporations should not cross? If so, what are they?

Source: Jesse Drucker, "Wal-Mart Cuts Taxes by Paying Rent to Itself." *Wall Street Journal - Eastern Edition*, A1-A12.; <http://www.ctj.org>; David Ivanovich, "Investigators: Enron Taxes 'Eye-Popping,'" *Houston Chronicle* (February 13, 2004); *60 Minutes* (January 25, 2004).

Republican strategists set up new groups to take the place of the political parties. Some worry that these groups will be less accountable than the political parties were prior to the law's inception.⁷⁵ These nonprofit organizations, known as **527s** for the section of the tax code that governs their activities, are allowed to raise and spend soft money on campaigns. The Federal Election Commission (FEC) imposed limits on their use of soft money but opted not to shut them down.⁷⁶ Efforts to develop new formal regulations for these groups have not succeeded as of this writing.⁷⁷ However, the FEC monitors the organizations to make sure they stay within existing law by looking at how the groups word their appeals, describe themselves, and spend their money.⁷⁸

Another means by which firms are able to get around campaign financing reform is the act of **bundling**, the collection of individual donations that are then delivered to the candidate in a lump sum. Typically, a senior executive will host a fund-raising event and invite high-level employees to attend and donate up to the \$2,000 limit. Executives may be given lucrative bonuses with the implicit understanding that they will make the maximum contribution. Bundling is not new, but it has reached new heights since McCain-Feingold. Clearly, one unintended consequence of campaign financing reform has been to shift the burden for political contributions from corporations to their employees.⁷⁹

Strategies for Political Activism

We have discussed some of the principal approaches by which business has become politically active—lobbying, PACs, and coalitions. To be sure, there are other approaches, but these are the major ones. In our discussion, we have unavoidably made reference to the use of these approaches as part of a strategy. To develop the idea of strategy for political activism, it is important to understand that managers must not only identify useful approaches but also address when and under what conditions these various approaches should be used or would be most effective. We do not want to carry this idea too far, because it is beyond the scope of this book. On the other hand, some discussion of strategies for political activism is necessary to help us fulfill our stakeholder frame of reference. As managers devise and execute political strategies, it is useful to see their initiatives as factors in their development of stakeholder management capabilities.

Having experienced failures and surprises in the political and social arenas, organizations are expanding their strategic vision and action by developing strategies for coping with a rapidly changing social and political environment. The purpose of political strategy is “to secure a position of advantage regarding a given regulation or piece of legislation, to gain control of an idea or a movement and deflect it from the firm, or to deal with a local community group on an issue of importance.”⁸⁰ Often, such strategies are exercised in arenas beyond the regulatory/legislative scene. In pursuing political strategy, two major approaches or strategies are desirable: (1) keeping an issue off the public agenda and out of the limelight and (2) helping to define the public issue. If the company cannot do the first, which is a strategy of containment, it should strive for the second, which

allows the firm to exercise some control in shaping the issue. If both of these approaches fail, the company will need to pursue a coping strategy.⁸¹

At this point, it is useful to consider several other ideas about political strategy: the regulatory life cycle approach, contingency approaches, and corporate political entrepreneurship.

REGULATORY LIFE CYCLE APPROACH

Several fairly sophisticated attempts to link corporate political strategies with key issues or variables have been set forth. One links the **regulatory life cycle** to the use of political strategies. There are various stages in the regulatory life cycle—formation, formulation, implementation, administration, and modification—that require or demand that the firm adjust its political strategy contingent on the stage that an issue has reached. For example, capturing key bureaucrats is meaningful only in the later stages, whereas corporate grassroots campaigns are advantageous only during the early stages.⁸²

CONTINGENCY APPROACHES

One example of a **contingency approach** to corporate political strategy and legislative decision making considers two major variables: (1) the number of salient issues in a legislative district and (2) the amount of information a legislator possesses concerning voter preferences on these issues. Knowledge of these two contingencies is useful in the selection of effective corporate political strategies for specific issues. If the corporation can identify the set of legislators who will be the key to important decisions, then the task is (1) to determine the salience of the issue under consideration to each legislator's constituency and (2) to identify the expected position(s) of voters on the issue. This will permit a prediction of the probable position of each legislator and facilitate the company's selection of an appropriate political strategy (for example, lobbying, constituency building, or making campaign contributions through a PAC).⁸³

Another approach proposes that the political activities (campaign financing, direct lobbying, coalition building) of a company are contingent on (1) the various modes of corporate responses the firm determines are appropriate for the environment in which it finds itself, (2) its internal corporate conditions, and (3) its anticipated political risks. The three modes a firm may find itself in are (1) the defensive mode, (2) the accommodative mode, and (3) positive activism.⁸⁴

The **defensive mode** is characterized by a situation in which a company sees its objectives as completely legitimate, thinks that anyone opposing these objectives is an adversary, and generally operates by itself in the political arena. The major company goal in this situation is to maintain the status quo in terms of political climate, legislative makeup, and regulatory environment. The strategies suggested are typically ad hoc and reactive. In this mode, of course, the firm would see the external environment and internal corporate conditions as conducive to such a defensive posture.⁸⁵

The **accommodative mode** is one in which the firm thinks its political objectives are contingent on its ability to co-opt other groups to its viewpoint. Here, the firm is willing to form coalitions that are likely to become the norm. This mode does not require a radical departure from traditional goals and strategies but is more responsive and adaptive to a changing political environment and structure. The accommodative mode would appear to be minimally required in today's environment.

Positive activism is a mode in which the focus moves from responding to external pressures to the initiation and development of a national agenda and a more progressive role in the public policy process. Firms become active leaders for social and political change rather than just responding to external factors. This mode is proactive in nature, and its goal is to anticipate and shape future events.⁸⁶

In today's environment, it could be argued that the politically successful firm needs at least to operate in an accommodative mode and ideally to adopt a positive activism strategy. There may be situations in which the defensive mode would still be appropriate, but these situations are rapidly fading from the scene. For the firm or industry that finds itself in an increasingly competitive environment, positive activism should be the strategy of choice. Furthermore, it is the strategy that is most compatible with innovative, aggressive, and professional management that understands the broader role of business in society and what it takes to be successful today.

Summary

A new political landscape emerged on September 11, 2001. An administration that entered office with a platform of reduced government intervention began to take part in corporate bailouts and federalization of services that were once in the private sector. A weak economy entered a recession, and items that were once at the forefront of the legislative agenda were shelved to deal with issues that arose with the 9/11 tragedy. Record surpluses have been replaced by record deficits, and a nation once at peace is now a nation at war. In this environment, corporate political participation has taken on renewed importance.

The arrival of the Bipartisan Campaign Reform Act (BCRA) has created a dramatic change in the ways that companies will be able to influence candidates and political parties. Nevertheless, lobbying and corporate political contributions

remain a permanent part of the political landscape. Business advocating for its interests is an important part of maintaining the balance of power needed in a pluralistic society. To maintain a true balance of power, however, businesses must advocate in a way that is both ethical and legal.

We have described a variety of ways that companies seek to influence government in order to gain access to political decision-makers and influence government action, as well as ways the companies can undertake them. While we describe these strategies individually, we should remember that politically active firms are inclined to combine various strategies.⁸⁷ They make PAC contributions, set up their own lobbyists in Washington offices, contract with outside lobbyists to represent their interests, and join together with like-minded organizations to push for change through trade

associations and coalitions. PACs and lobbying are not separate strategies; they are part of an overall approach.⁸⁸

Business's political activity continues to be controversial with the public. As we discussed in Chapter 1, business often receives criticism for using and abusing its power. Nowhere is this more evident than in corporate lobbying and

its outcomes. The BCRA (McCain-Feingold) was a response to valid concerns that the use of soft money gave business and other advocates disproportionate power in the political process. As new excesses develop, new regulations will come to address the problems they present. That is the ongoing "back-and-forth" that characterizes the political process.

Key Terms

527s (page 502)

accommodative mode (page 504)

astroturf lobbying (page 490)

Bipartisan Campaign Reform Act (BCRA)
(page 500)

bundling (page 502)

coalitions (page 494)

company lobbying (page 487)

contingency approach (page 503)

cyberadvocacy (page 491)

defensive mode (page 503)

Golden Rule of Politics (page 496)

grassroots lobbying (page 489)

hard money (page 500)

lobbying (page 486)

political action committees (PACs) (page 495)

political involvement (page 484)

positive activism (page 504)

regulatory life cycle (page 503)

soft money (page 500)

trade associations (page 487)

umbrella organizations (page 487)

Discussion Questions

1. Explain lobbying in your own words. Describe the different levels at which lobbying takes place. Why is there a lack of unity among the umbrella organizations?
2. What is a PAC? What are the major arguments in favor of PACs? What are the major criticisms of PACs? In your opinion, are PACs a good way for business to influence the public policy process? What changes would you recommend for PACs?
3. Explain the regulatory life cycle approach to political activism. Differentiate it from contingency approaches.
4. Discuss the Bipartisan Campaign Reform Act and its likely effect on future elections. What further types of campaign financing reform would you recommend?
5. Discuss efforts by companies to circumvent governmental regulations. Is the use of legal loopholes ethical?

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Consumer Stakeholders: Information Issues and Responses

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Recite the consumer's Magna Carta and explain its meaning.
- 2 Chronicle the evolution of the consumer movement, highlighting Ralph Nader's role.
- 3 Identify the major abuses of advertising and discuss specific controversial advertising issues.
- 4 Enumerate and discuss other product information issues that present problems for consumer stakeholders.
- 5 Describe the role and functions of the FTC.
- 6 Discuss the strengths and weaknesses of regulation and self-regulation of advertising.

How important are consumers as stakeholders? According to management expert Peter Drucker, there is only one valid definition of business purpose: to create a customer.¹ Of course, retaining that customer is essential, too. In *The Loyalty Effect*, Frederick Reichheld showed that small increases in customer retention rates can lead to dramatic increases in profits.² Clearly, businesses must create and retain customers if they are to succeed in today's competitive marketplace. It is not surprising, therefore, that **customer relationship management (CRM)** has become the mantra of marketing.³ Customer relationship management is "the ability of an organization to effectively identify, acquire, foster, and retain loyal profitable customers."⁴ With CRM guiding businesses in their customer relations, one would expect consumers to be pleased, or at least satisfied, with the way they have been treated. Unfortunately, that hasn't been the case. The consumer is still "often ignored"⁵ and, in practice,

CRM has been said to be “an awful lot of bland talk and not a lot of action.”⁶ In practice, the customer care revolution is largely considered a failure.⁷

A recent survey by Customer Care Measurement and Consulting (CCMC) found that 45 percent of the individuals surveyed had a serious consumer problem or complaint in the past year and that 60–70 percent of those having complaints became enraged at the way the company handled the problem.⁸ It is not surprising, therefore, that 45 percent of CEOs conceded that their corporations did not deserve the loyalty of their customers.⁹ It is true that the American Customer Satisfaction Index is on the rise, up 1.4 percent in 2006; however, it measures the quality of goods and services rather than the way the customer is treated.¹⁰ Taken together, these statistics seem to indicate that although product and service quality has improved, the treatment of customers has deteriorated. This can have serious consequences for competitiveness. Reichheld’s study of customer loyalty tested a variety of survey items and found that one simple question was the best measure of customer loyalty: “Would you recommend this product/service to a friend?”¹¹ In most industries, the answer to that question correlated with the growth rates among competitors.¹²

The issue of business and the consumer stakeholder is at the forefront of discussions about business and its relationships with and responsibility to the society in which it exists. Products and services are the most visible manifestations of business in society. For this reason, the whole issue of business and its consumer stakeholders deserves a careful examination. We devote two chapters to it. In this chapter, we focus on the evolution and maturity of the consumer movement and product information issues—most notably, advertising. In Chapter 14, we consider product issues, especially product safety and liability, and business’s response to its consumer stakeholders.

The Consumer Movement

The basic expectations of the consumer movement can be found in the “**consumer’s Magna Carta**,” or the four basic consumer rights spelled out by President John F. Kennedy in his “Special Message on Protecting the Consumer Interest.”¹³ Those rights included the right to safety, the right to be informed, the right to choose, and the right to be heard.

The **right to safety** is concerned with the fact that many products (insecticides, foods, drugs, automobiles, appliances) are dangerous. The **right to be informed** is intimately related to the marketing and advertising function. Here, the consumer’s right is to know what a product really is, how it is to be used, and what cautions must be exercised in using it. This right includes the whole array of marketing: advertising, warranties, labeling, and packaging. The **right to choose**, although perhaps not as great a concern today as the first two rights, refers to the assurance that competition is working effectively. The fourth right, the **right to be heard**, was

Figure 13-1 *Lessons from the Consumers Movement*

One year after taking office as the president of Consumers Union, Jim Guest gave a speech to the Consumer Federation of America's Consumer Assembly. In it, he listed five "overarching lessons" he derived from the abuses of consumer trust that had occurred in the marketplace. The following are those lessons:

1. Although the consumer movement has had a strong impact, it is still absolutely essential for achieving a fair and just marketplace for all consumers.
2. Effective public oversight is needed where
 - a. Corporations lack the incentives to regulate their own behavior responsibly.
 - b. Health, safety and other special concerns are an issue.
3. Our product safety net and consumer protection infrastructure have serious holes. For public watchdogs to be effective, they must receive necessary resources, authority, and public support.
4. The consumer movement must intensify the fight for affordable goods and services, fair financial practices, and a fair chance at a decent standard of living. Government must provide for those who do not have a fair chance at a decent standard of living. Too many consumers still cannot afford the basic necessities.
5. In the United States, consumers must curb the wasteful overconsumption that threatens the environment.

In the closing of this talk "from one consumer organization to another," Guest described the movement as being in a time of both crisis and opportunity. Much has been achieved, but there is still a very long way to go, with very serious and real problems remaining to be resolved.

Source: Remarks by Jim Guest, President, Consumers Union of U.S., Inc., "Consumers and Consumerism in America Today," *Consumer Assembly of the Consumer's Federation of America* (March 15, 2002).

proposed because of the belief of many consumers that they could not effectively communicate to business their desires and, especially, their grievances.¹⁴

Although these four basic rights do not embody all the responsibilities that business owes to consumer stakeholders, they do capture the fundamentals of business's social responsibilities to consumers. Consumers today want "fair value" for money spent, a product that will meet "reasonable" expectations, full disclosure of the product's (or service's) specifications, a product/service that has been truthfully advertised, and a product that is safe and has been subjected to appropriate product safety testing. Consumers also expect that if a product is too dangerous, it will be removed from the market or some other appropriate action will be taken.

For decades, there have been outcries that business has failed in these responsibilities to consumers, leaving them often neglected or mistreated.¹⁵ The roots of consumer activism date back to 1906, when Upton Sinclair published *The Jungle*, his famous exposé of unsanitary conditions in the meat-packing industry.¹⁶ The contemporary wave of consumer activism, however, started to build in the late 1950s, took form in the 1960s, matured in the 1970s, and continues today,

although in a different form. The following definition of **consumerism** captures the essential nature of the consumer movement:

*Consumerism is a social movement seeking to augment the rights and powers of buyers in relation to sellers.*¹⁷

Although the consumer movement is often said to have begun with the publication of Ralph Nader's criticism of General Motors in *Unsafe at Any Speed*,¹⁸ the impetus for the movement was actually a complex combination of circumstances. The conditions necessary for bringing about a social movement of any kind were present for consumerism. These conditions are "structural conduciveness, structural strains, growth of a generalized belief, precipitating factors, mobilization for action, and social control."¹⁹

Figure 13-1 presents the five overarching lessons Consumers Union president Jim Guest has taken from the consumer's movement.

RALPH NADER'S CONSUMERISM

We cannot overstate the contribution that Ralph Nader made to the birth, growth, and nurturance of the consumer movement. Nader arrived on the scene 40 years ago, but he is still the acknowledged father of the consumer movement. The impact of Nader's auto safety exposé, *Unsafe at Any Speed*, cannot be overstated. His book not only gave rise to auto safety regulations and devices (safety belts, padded dashboards, stronger door latches, head restraints, air bags, and so on) but it also created a new era—that of the consumer. Nader, personally, was thrust into national prominence.

Unsafe at Any Speed criticized the auto industry generally and General Motors specifically. Nader objected to the safety of the GM Corvair in particular. GM could not figure out what motivated Nader, so in 1966, it hired a couple of

<http://SEARCHTHEWEBWEB>

THE BETTER BUSINESS BUREAU

The Better Business Bureau (BBB) maintains a website that provides useful information for both business and individual consumers (<http://www.bbb.org>). Funded by member businesses, the purpose of the BBB is to "promote and foster the highest ethical relationship between businesses and the public." To further that goal, the BBB's website provides a variety of helpful resources, such as business and consumer alerts, consumer buying guidelines, and business publications.

Website visitors can file complaints online, obtain reports on businesses or charities, or locate the BBB serving their local communities. Although the BBB is best known for its work as a watchdog organization, it also acknowledges organizations that exemplify the best in marketplace ethics. Information about past and present BBB Torch Award winners is available on the BBB website.

detectives to trail and discredit him. GM denied that it had used women as “sex lures” as part of its investigation. However, the company did apologize to Nader at a congressional hearing and paid him \$480,000 for invasion of his privacy.

Nader put his money to work and built an enormous and far-reaching consumer protection empire. His legions of zealous activists became known as “Nader’s Raiders.”

Nader and the consumer movement were the impetus for consumer legislation being passed in the 1970s. The 1980s, however, did not turn out to be a consumer decade. One observer noted how uncontroversial Nader had become and posited that it was not only because of the climate of the times but also because most of the significant gains that were to be made had been made.²⁰ In the late 1980s, however, Nader began what *BusinessWeek* dubbed his “second coming.” Nader successfully campaigned to roll back car insurance rates in California and to squelch a congressional pay raise. These victories vaulted him to a prominence he had not enjoyed in years.²¹ In 2000, Nader ran as the Green Party candidate for U.S. president with a campaign that focused on establishing a viable third party, attacking corporate wealth, and protecting the environment. He was unsuccessful in his goal of getting 5 percent of the total popular vote so that the Green Party would be eligible to receive federal matching funds in the 2004 presidential election. In the process, however, he raised the ire of Democrats, labor leaders, feminists, and environmentalists who characterized him as a “spoiler” who tipped the election to George W. Bush.²² When he announced a second run for the presidency in February 2004, the Green Party disavowed him, and a poll found that two-thirds of Americans did not want him to run again.²³ He ran as a reform/populist/independent candidate and received 465,650 votes (0.38%).²⁴ This count was far fewer than the votes he had received in 2000.²⁵

Ralph Nader continues to be a controversial man. A 2007 documentary about Nader is titled *An Unreasonable Man*.²⁶ The title is from “Maxims for Revolutionists” in George Bernard Shaw’s 1903 play, *Man and Superman*.²⁷

The reasonable man adapts himself to the world; the unreasonable one persists in trying to adapt the world to himself. Therefore all progress depends on the unreasonable man.

Shaw was right: Nader may be an unreasonable man, but he has also been the source of considerable progress for consumers. Consumer complaints did not disappear with the advent of Ralph Nader’s activism; instead, they intensified. One of Nader’s greatest contributions is that he made consumer complaints respectable.

CONSUMERISM IN THE TWENTY-FIRST CENTURY

Many groups make up the loose confederation known as the consumer movement. The power held by consumers is not the result of organized group lobbying—instead, their efforts today are at the grassroots level. Grassroots activism of consumers has never been stronger. In England, a relatively small group of

Figure 13-2 Examples of Consumer Problems with Business

- The high prices of many products
- The poor quality of many products
- The failure of many companies to live up to claims made in their advertising
- Hidden fees
- The poor quality of after-sales service
- Too many products breaking or going wrong after you bring them home
- Misleading packaging or labeling
- The feeling that it is a waste of time to complain about consumer problems because nothing substantial will be achieved
- Inadequate guarantees and warranties
- Failure of companies to handle complaints properly
- Too many products that are dangerous
- The absence of reliable information about various products and services
- Not knowing what to do if something is wrong with a product you have bought

disgruntled consumers brought the country to a halt by protesting the price of gas. They set up blockades that emptied roads, closed schools, and caused panic buying in supermarkets. The Internet has made it easier for consumer groups to respond to issues more quickly and more forcefully. It makes it possible to not only inform consumers of concerns that have arisen but also to rally the troops to take action. This is of special concern for global companies whose interests are far-flung. According to Cordelia Brabbs of *Marketing*, “Global companies find themselves under the watchful eye of their customers. If they fail to behave impeccably at all times, they risk finding their misdemeanors broadcast on a high-speed information network.”²⁸ It is impossible to catalog them all, but Figure 13-2 lists examples of the major problems consumers have with business’s products and services.

Before we consider more closely the corporate response to the consumer movement and the consumer stakeholder, it is fruitful to look in more detail at some of the issues that have become prominent in the business/consumer relationship and the role that the major federal regulatory bodies have assumed in addressing these issues. Broadly, we may classify the major kinds of issues into two groups: **product information** and the product itself. As stated earlier, in this chapter we focus on product information issues such as advertising, warranties, packaging, and labeling. The next chapter will focus on the product itself. Throughout our discussion of products, the reader should keep in mind that we are referring to services also.

Product Information Issues

Why have questions been raised about business’s social and ethical responsibilities in the area of product information? Most consumers know the answer. Companies understandably want to portray their products in the most flattering light.

However, efforts to paint a positive portrait of a product can easily cross the line into misinformation regarding the product's attributes. Consumers Union (CU), an independent, nonprofit testing and information organization, exists to protect consumers' interests. They conduct independent tests of products and report their findings in their print and online editions of *Consumer Reports* (CR).²⁹ "Selling It" is a segment in the print edition of *Consumer Reports*; it is designed to "memorialize the excesses in the world of marketing." The following items are examples of the absurdities they chronicle:

- Croyden House Instant Soup's label says it "tastes like homemade chicken soup," but then goes on to say that there is no chicken in it. Thus, as CR notes, it's only likely to taste homemade to you if the main ingredient in your homemade soup is pregelatinized tapioca starch.³⁰
- Those blue bits you might see in Hungry Jack Blueberry Pancake and Waffle Mix are not blueberries. They are "bits of dextrose, partially hydrogenated soybean and cottonseed oil, bleached wheat flour, cellulose gum, blue and red coloring and other stuff that doesn't grow on a berry bush."³¹
- Blast O Butter popcorn promises to "blast your taste buds into oblivion," but there is no butter anywhere to be found. Instead, it contains partially hydrogenated vegetable oil and natural and artificial flavors.³²

These cases are actual examples of the questionable use of product information. It is not clear whether the firms that created the aforementioned communications were intending to deceive, but the information they provided did not match the reality of the product. Business has a legal responsibility, and an ethical responsibility, to provide fair and accurate information on its products or services.

The primary issue with product or service information falls in the realm of advertising. Other information-related areas include warranties or guarantees, packaging, labeling, instructions for use, and the sales techniques used by direct sellers.

ADVERTISING ISSUES

The debate over the role of advertising in society has been going on for decades. Most observers have concentrated on the economic function of advertising in our market system, but opinions vary as to whether advertising is beneficial or detrimental as a business function. Critics charge that it is a wasteful and inefficient tool of business and that our current standard of living would be even higher if we could be freed from the negative influence of advertising. These critics argue that advertising raises the prices of products and services because it is an unnecessary business cost, the main effect of which is to circulate superfluous information that could better and more cheaply be provided on product information labels or by salespeople in stores. The result is that significant amounts of money are spent that produce no net consumer benefit.³³

In response, others have claimed that advertising is a beneficial component of the market system and that the increases in the standard of living and consumer satisfaction may be attributed to it. They argue that, in general, advertising is an

efficient means of distributing information because there is such an enormous and ever-changing array of products about which consumers need to know. From this perspective, advertising is an effective and relatively inexpensive way to inform consumers of new and improved products.³⁴

Proponents of advertising argue that even uninformative advertising still tells consumers a lot. Advertising heavily, even if vaguely, helps attract shoppers to retail stores through a kind of they-must-be-doing-something-right logic. The increased traffic then cost-reduction technologies such as computerized inventory, modern warehouses, and quantity discounts, thus further lowering marginal costs. The advertising can promote efficiency, even if it provides no hard information, by signaling to consumers where the big-company, low-price, high-variety stores are. Economists have argued that retail juggernauts such as Wal-Mart, Home Depot, and Circuit City have taken advantage of this phenomenon. Viewed in this way, advertising is seen as a net plus for society because it tends to lower prices and increase variety.³⁵

The debate over whether advertising is a productive or wasteful business practice will undoubtedly continue. As a practical matter, however, advertising has become the lifeblood of the free enterprise system. It stimulates competition and makes available information that consumers can use in comparison buying. It also provides competitors with information with which to respond in a competitive way and contains a mechanism for immediate feedback in the form of sales response. So, despite its criticisms, advertising does provide social and economic benefits to the American people.

With the thousands of products and their increasing complexity, the consumer today has a real need for information that is clear, accurate, and adequate. **Clear information** is that which is direct and straightforward and which relies on neither deception nor manipulation. **Accurate information** communicates truths, not half-truths. It avoids gross exaggeration and innuendo. **Adequate information** provides potential purchasers with enough information to make the best choice among the options available.³⁶

Whereas providing information is one legitimate purpose of advertising in our society, another legitimate purpose is persuasion. Most consumers today expect that business advertises for the purpose of persuading them to buy their products or services, and they accept this as a part of the commercial system. Indeed, many people enjoy companies' attempts to come up with yet another interesting way to sell their products. It is commonplace for people to talk with one another about the latest interesting or entertaining advertisement they have seen. Awards are given for outstanding advertisements, as well as for those that are particularly bad. Nevertheless, there is evidence that the public may be losing its patience. A recent survey by Yankelovich Partners, a market research company, found that 60 percent of the survey respondents have a more negative opinion of advertising than they did previously, 61 percent believe the practice has spun out of control, and 69 percent are attracted to products that help them avoid commercials altogether.³⁷

Ethical issues in advertising arise as companies step over the line in their attempts to inform and persuade consumer stakeholders. The frequently heard

Ethics in Practice Case

WHERE ARE MY SLIPPERS?

For the past six months, I have been working as a telesales accounts manager for a manufacturer of bedroom slippers. The firm had recently opened the telesales department on a trial basis to reach smaller retailers whose sales volumes were not large enough to attract the attention of the regional field representatives. Traditionally, the busiest time for the firm is the period from September to December, when retailers are ordering the inventories they want to have on hand for the Christmas shopping season. Last year, the number of orders coming in was unexpectedly heavy and the lead time needed to ship the orders was nearly a month. Unless the order was placed by the end of November, it was unlikely that the retailer would have the merchandise on its shelves by Christmas. However, the department manager encouraged us to take the late orders and promise delivery by Christmas, even though we knew that the merchandise wouldn't be delivered until early January. Most likely, the retailers wouldn't have wanted the merchandise if

they had known the actual delivery date. Our manager's reasoning for this practice was that we needed to boost our department's sales revenue to ensure that upper management saw our department as a success at the end of the trial period. In other words, our jobs could be on the line. Also, each order that we may have lost meant a smaller commission check.

1. How would you characterize the practice in which our firm engaged?
2. Were the jobs of all the people associated with the telesales department more important than ethical principles?
3. Should I have followed my manager's orders and gone along with what I thought was a deceptive marketing practice? Is the practice all that bad if there is some chance we could deliver on time?

Contributed by David Alan Ostendorff

phrase "the seamy side of advertising" alludes to the economic and social costs that derive from advertising abuses, such as those mentioned earlier in the chapter, and of which the reader is probably able to supply ample personal examples.

Advertising Abuses

We will cover four types of advertising abuses in which ethical issues reside. These include situations in which advertisers are ambiguous, conceal facts, exaggerate, or employ psychological appeals.³⁸ These four types cover most of the general criticisms leveled at advertising.

Ambiguous Advertising. One of the more gentle ways that companies deceive is through **ambiguous advertising**, in which something about the product or service is not made clear because it is stated in a way that may mean several different things.

There are several ways in which an ad can be made ambiguous. One way is to make a statement that leaves to the viewer the opportunity to infer the message by using **weasel words**. These are words that are inherently vague and for which the company could always claim it was not misleading the consumer. An example of a weasel word is “help.” Once an advertiser uses the qualifier “help,” almost anything could follow, and the company could claim that it was not intending to deceive. We see ads that claim to “help us keep young,” “help prevent cavities,” or “help keep our houses germ free.” Think how many times you have seen expressions in advertising such as “helps stop,” “helps prevent,” “helps fight,” “helps you feel,” “helps you look,” or “helps you become.”³⁹ Other weasel words include “like,” “virtually,” and “up to” (for example, stops pain “up to” eight hours—which simply means it won’t stop pain for more than eight hours). The use of such words makes ads ambiguous.

Another way to make an ad ambiguous is through use of legalese or other excessively complex and ambiguous terminology. In “Selling It,” *Consumer Reports* provided the following paragraph that was included in a department store’s advertising:

*Items indicated on sale or referencing a comparative former or future price represent reductions from former or future offering prices (with or without actual sales) at Kohl’s or at a competitor of the item or of comparable merchandise. Intermediate markdowns may have been taken. Clearance merchandise is excluded from entire stock categories herein.*⁴⁰

Concealed Facts. A type of advertising abuse called **concealed facts** refers to the practice of not telling the whole truth or deliberately not communicating information the consumer ought to have access to in making an informed choice. Another way of stating this is to say “a fact is concealed when its availability would probably make the desire, purchase, or use of the product less likely than its absence.”⁴¹ This is a difficult area because few would argue that an advertiser is obligated to tell “everything,” even if that were humanly possible. For example, a pain reliever company might claim the effectiveness of its product in superlative terms without stating that there are dozens of other products on the market that are just as effective. Or, an insurance company might promote all the forms of protection that a given policy would provide without enumerating all the situations for which the policy does not provide coverage.

Ethical issues arise when a firm, through its advertisements, presents facts in such a selective way that a false belief is created. As consumers, it is up to us to be informed about factors such as competitors’ products, prices, and so on. Of course, judgment is required in determining which ads have and have not created false beliefs. This makes the entire realm of deceptive advertising a challenge. At times it can be considered harmless. For example, a burrito restaurant in a college town ran a humorous newspaper ad with “FREE BEER” in large block letters; underneath in small letters were the words “will not be served.” No one accused this company of unlawful deception; however, not all instances of concealed facts are considered benign.

Another concealed fact, or false belief, often created by marketers is in the realm of **fees**, a financial annoyance with many consumers today. Fees are extra surcharges, often hidden, that the consumer later finds out about after purchasing the product or service. For example, telephone companies add to your bill something called “federal subscriber line charges,” or something similar, when in fact the government doesn’t require it and the company itself is taking the money. A related example is what consumer advocates call un-fees. These are fees the government once did require the companies to pay but no longer do. Companies find ways to rename these fees and continue charging the consumer anyway. Other “hidden” fees include booking fees when purchasing airline tickets through a human rather than on the website, shocking credit card fees if your payment is one hour late, and banking fees for all sorts of misdemeanors. At one time, banks used to charge fees to discourage bad behavior, but now, fees have become a profit center for the banking industry, which earns billions of dollars annually on them.⁴² Today, you have to be a sophisticated consumer willing to do timely detective work to root out the rules and policies governing fees companies charge.

An increasingly popular form of concealed advertising is **product placement**, the practice of embedding products in movies and TV shows. Product placements are everywhere. For example, the judges on *American Idol* drink from Coke cups, and the “green room” in which contestants wait is now the “Coke Red Room.”⁴³ Ryan Seacrest tells viewers to text message their votes over AT&T Wireless and, in each episode, they somehow manage to find a new reason for the remaining contestants to sing and dance around a Ford vehicle.⁴⁴ In another variation, termed **plot placement**, sponsors have paid to make their products part of the plotline of a TV show. Revlon played an important part in the plotline of ABC’s *All My Children*; Avon was integrated into the plotline of NBC’s *Passions*.⁴⁵ These forms of advertising are a response to the “TiVo effect.” The popularity of digital video recorders (DVRs) such as TiVo has lessened the time that consumers spend watching commercials. The fact that DVRs make it easy and convenient for TV watchers to zap through commercials has advertisers looking for new ways to make customers take notice.⁴⁶ Even advertising stalwarts like Coca-Cola, with its advertising budget of more than \$300 million per year, are relying less on traditional ads and more on product placement in DVDs and video games.⁴⁷

Commercial Alert filed a petition with the FTC and the FCC to require concurrent, conspicuous, and clear disclosure of product placement ads. However, the Freedom to Advertise Coalition, a coalition of advertising and media organizations, attacked the proposal as an unconstitutional violation of artistic freedom. They said that the suggestion of “pop-up” disclosures, as the product placement occurs, would make television virtually unwatchable, and added that the current rules, which permit product placement as long as the commercial relationship is disclosed, are time tested and adequate.⁴⁸ The FTC responded that they understood Commercial Alert’s concern, but they would not take formal action. As of this writing, the FCC has not responded.⁴⁹

Exaggerated Claims. Companies can also mislead consumers by exaggerating the benefits of their products and services. **Exaggerated claims** are claims that simply cannot be substantiated by any kind of evidence. An example of this would be a claim that a pain reliever is “50 percent stronger than aspirin” or “superior to any other on the market.”

One kind of exaggeration is known as **puffery**, a euphemism for hyperbole or exaggeration that usually refers to the use of general superlatives. Is Budweiser really the “King of Beers”? Are Wheaties the “Breakfast of Champions”? Normally, a claim of general superiority fits squarely into puffery and is allowable. However, companies walk a fine line when engaging in puffery. They need to be certain that no direct comparison is being made. According to attorney D. Reed Freedman, “It is no longer enough to take comfort in making the same kinds of claims that have been made in an industry for some time. Those (marketers) making aggressive claims need to consider ways a reasonable consumer will interpret those claims, and marketers need to be able to prove every interpretation that is reasonable.”⁵⁰

Most people are not too put off by puffery, because the claims are so general and so frequent that any consumer would know that the firm is exaggerating and simply doing what many do by claiming their product is the best. It has been argued, however, that such exaggerated product claims (1) induce people to buy things that do them no good, (2) result in loss of advertising efficiency as companies are forced to match puffery with puffery, (3) drive out good advertising, and (4) generally result in consumers losing faith in the system because they get so used to companies making claims that exceed their products’ capabilities.⁵¹

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COMMERCIAL ALERT

Commercial Alert (<http://www.commercialalert.org>) is a national nonprofit organization dedicated to protecting children and communities from commercialism. Their website provides details about the myriad

- The proposal to name Boston subway stops was rescinded.
- The FTC began to require companies to disclose when they paid people to promote products to their peers.

ways in which commercialism is infusing daily life in the United States and offers recommendations for citizen action. Their efforts have led to numerous successes, for example:

- Alcohol ads planned for NBC were stopped.
- N2H2, a web filter that tracked the movement of schoolchildren on the Internet and sold the information to private companies and the Pentagon, was dropped out of schools.

Psychological Appeals. In advertising, **psychological appeals** are those designed to persuade on the basis of human emotions and emotional needs rather than reason. There is perhaps as much reason to be concerned about ethics in this category as in any other category. One reason is that the products can seldom deliver what the ads promise (i.e., power, prestige, sex, masculinity, femininity, approval, acceptance, and other such psychological satisfactions).⁵² Another reason is that psychological appeals can stir emotions in a way that is manipulative and appears designed to take advantage of the consumer's vulnerability. For example, many home security salespeople will watch the newspapers for reports of home break-ins and then call the home owner with a sales pitch for a new home security system.

After the September 11 terrorist attacks, many advertising campaigns were reworked with psychological appeals that sounded a patriotic theme. General Motors adopted "Keep America Rolling" as its new slogan for selling cars. The New York Sports Club gym offered discount rates and appealed to consumers to take on memberships to "Keep America Strong." In the backdrop of Tommy Hilfiger ads, the stars and stripes were waving. Flags were also emblazoned across the chests of Ralph Lauren models and in department store displays. Many questioned the appropriateness of using patriotism to sell products. "It's just gross to sell your products on the graves of these victims and their families," said Bob Garfield of *Advertising Age*. "[These are] heinous marketing programs built around the nation's emotions in this tragedy."⁵³ The issue arose again in the 2004 presidential election when George W. Bush used images of September 11 in political ads. Some of the relatives of victims of the tragedy expressed outrage, while others found it appropriate. Opinions about the appropriateness of these ads will vary, but one thing is clear: advertisers walk a fine line when using psychological appeals, particularly at a time of tragedy. The images used in a 2006 ad for a Chevy truck drew on a variety of themes, including bus boycotts, Vietnam, Nixon resigning, Hurricane Katrina, fires, floods, and the attacks of September 11. This led the *New York Times* to opine, "When it comes to selling cars, trucks or even politicians, you can wave the flag or you can drape one over a coffin. You can't do both."⁵⁴

Specific Controversial Advertising Issues

We have considered four major kinds of deceptive advertising—ambiguous advertising, concealed facts, exaggerated claims, and psychological appeals. There are many other variations on these themes, but these are sufficient to make our point. Later in this chapter, we will discuss the FTC's attempts to keep advertising honest. But even there we will see that the whole issue of what constitutes deceptive advertising is an evolving and amorphous concept, particularly when it comes to the task of proving deception and recommending appropriate remedial action. This is why the role of business responsibility is so crucial as business sincerely attempts to deal with its consumer stakeholders in a fair and honest manner.

Let us now consider seven specific advertising issues that have become particularly controversial in recent years: comparative advertising, use of sex in

advertising, advertising to children, marketing to the poor, advertising of alcoholic beverages, cigarette advertising, health and environmental claims, and ad creep.

Comparative Advertising. One advertising technique that has become controversial and threatens to affect advertising negatively, in general, is **comparative advertising**. This refers to the practice of directly comparing a firm's product with the product of a competitor. Some examples of past comparative campaigns are Coke versus Pepsi, Whopper versus Big Mac, Subway versus Quiznos, Avis versus Hertz, and Papa John's versus Pizza Hut. A recent example is the "Get a Mac" campaign. The ads feature two men, Mac and PC, standing in front of a white background. PC is in an ill-fitting jacket and tie, while Mac is in comfortable jeans. The banter between the two characters is a running comparison of the two machines. The campaign seems to have struck a nerve with the public: the Wikipedia "Get a Mac" site has a long list of spoofs that the campaign has inspired.⁵⁵ In some circles, however, the campaign seems to have backfired. Writing for *Slate*, Seth Stevenson gives the ad campaign a grade of C+. In his words, "They are conceptually brilliant, beautifully executed and highly entertaining. But they don't make me want to buy a Mac . . . Isn't smug superiority (no matter how affable and casually dressed) a bit off-putting as a brand strategy?"⁵⁶

At one time, the idea of naming your competitor or competitor's product in an ad was taboo in the United States. For years, the television networks did not allow it, so companies had to be content with referring to their competition as "the other leading brand" or "Brand X." In the early 1970s, the FTC began to accept the direct comparison approach, because it thought this approach would provide more and better information to the consumer. The networks cooperated by lifting their ban. Thus, the United States entered the new era of comparative advertising. Due to the supportive attitude of the European Union, companies in Western Europe have also been warming to the practice.⁵⁷

Whether out of pride or general business interest, more and more companies are fighting back when they think the competition has gone too far. Companies may take their adversaries to court, before the FTC, or before voluntary associations, such as the National Advertising Division of the Council of Better Business Bureaus, which attempt to resolve these kinds of disputes. A recent example is Procter & Gamble (P&G): they faced five lawsuits in 13 months when they began mounting aggressive comparison campaigns. Kimberly-Clark sued P&G over an ad that made fun of Huggies, its diaper product.⁵⁸ Colgate-Palmolive sued the company over a commercial that showed a woman having difficulty with a product resembling its White Strips brand of tooth whitener. Other lawsuits came from Georgia-Pacific, Playtex Products, and Johnson & Johnson.⁵⁹

Comparative advertising is an issue that will not be going away. Internationally, the move has been toward freeing up restrictions on the practice. It is now commonplace in the United Kingdom, where complaints about competitors using comparative advertising have mushroomed.⁶⁰ Countries like New Zealand, where trademark legislation once made it illegal to use a competitor's trademark in an ad, have eased restrictions to follow the global trend.⁶¹

There can be good reasons to launch comparative ads, but they do come at a cost. Even A. G. Lafley, chief executive of P&G, has expressed concern: "Frankly, from a consumer's standpoint, I think it begins to undermine industry credibility." So when does it make sense? Robert Howell, European president of McCann-Erickson, says that market leaders should not engage in it. It can make the company look like a bully.⁶² There are several questions that should be asked by both those who are victims of comparative ads and those who are contemplating using them. For example, were consumers actually asked to compare one brand with another? Was the sample of consumers representative of product users? Could the consumers in the study really discriminate between the products being compared?⁶³ Questions such as these are essential if companies are to develop sound research methods on which to base comparative ads. To do otherwise is to invite criticism from the public and competitors alike.

Use of Sex in Advertising. The use of sex in U.S. advertising was one of the burning ethical issues in the past. It took front stage in the early 1970s when several women's groups were offended by a series of television commercials sponsored by National Airlines. In 1971, National introduced its provocative "I'm Cheryl, Fly Me" advertising campaign. The airline followed that campaign with a commercial that showed female flight attendants looking seductively at the viewers, saying, "I'm going to fly you like you've never been flown before."⁶⁴ Today, sexual references and innuendos in advertising have become commonplace and so the issue sparks less controversy. Says consumer behavior professor Bruce Stern, "We're moving into an arena that we are becoming numb to things that would have offended us a few years ago."⁶⁵

A recent survey conducted by Market Facts for *American Demographics* found that 31 percent of the population is offended by the use of sex in advertising. Moreover, 61 percent said they are less likely to buy a product that is sold through the use of sex in advertising, while only 26 percent are more likely.⁶⁶ Even where offense is not taken, sex does not necessarily sell. The irrelevant use of sex can take attention away from the product or service being sold.⁶⁷ Some major fashion designers have moved away from sex in their campaigns; most notably, Abercrombie & Fitch terminated their sexually explicit catalogue not because of any offense taken but because they failed to lure customers.⁶⁸ Advertisers have responded to this change in attitudes by targeting their sexually oriented advertisements to more specific markets, "Playboy Lites" such as *Maxim*, *FHM*, and *Stuff* that cater primarily to teen/young adult males.⁶⁹ A 2006 study of the sexual content of advertising found substantial growth in the way that men's magazine ads sexualize and objectify women: 78 percent of women in men's magazine ads were sexualized from 1993 to 2003, compared to 40 percent a decade earlier.⁷⁰

Ads that portray young women as sex objects can have a serious impact on the physical and mental health of girls. A 2007 task force report from the American Psychological Association studied this issue and found that the media's sexualization of young women can lead to a lack of confidence with their bodies, as well as depression, eating disorders, and low self-esteem.⁷¹

Advertising to Children. A hotly debated issue over the past several decades has been advertising to children, specifically on television. A typical weekday afternoon or Saturday morning in America finds millions of kids sprawled on the floor, glued to the TV, or staring at the computer. American children watch an average of 28 hours of television per week, seeing an average of 20,000 30-second commercials in the process.⁷² Given the amount of time children spend in front of the TV, it is not surprising that the content of what they see is a serious concern. The 65,000-member American Academy of Pediatrics issued a policy statement in their journal, *Pediatrics*.⁷³ The group wants the number of ads during kids' shows cut in half, with no ads for junk food in shows watched primarily by those who are eight years old and younger. They also recommended that ads for alcohol be limited to text and product pictures and that erectile dysfunction ads be run only after 10:00 p.m.⁷⁴

Children are the consumers of the future, and so companies are eager to get their foot in the door of their spending habits. Merchandisers are trying to instill brand loyalty in the adults that children will eventually become. This was taken to a new level when "Cool Shopping Barbie" had her own personal toy MasterCard, with a cash register that had the MasterCard logo and a terminal through which Barbie could swipe her card to make a purchase. According to William F. Keenan of Creative Solutions, an advertising and marketing agency, "[If you] set the brand by age seven, they will favor the brand into adulthood. One of the smartest places to plant marketing seeds in the consumer consciousness is with kids."⁷⁵ This is particularly troubling given an American Psychological Association (APA) finding that children under the age of eight do not have the cognitive development to understand persuasive intent, making them easy targets.⁷⁶ Children have proved to be receptive targets as well. A phenomenon called **age compression** or "kids getting older younger" (KGOY) has marketers targeting eight- and nine-year-olds with products once meant for teenagers; with the overabundance of ads to which they are exposed, children are tiring of toys much earlier and looking for products that they see teenagers using.⁷⁷

In 1990, the Children's Television Act was passed. This act prohibited the airing of commercials about products or characters during a show about those products or characters and limited the number of commercial minutes in children's shows. Critics say the FCC created weak rules to enforce the act, thereby sending the message that it was not taking the legislation seriously. Part of the act required stations and networks to schedule educational programs for children.⁷⁸ Of course, much has changed since that act was passed. With the rise of the Internet has come a new way for firms to advertise to children. More than two-thirds of the children and teen Internet sites rely on advertising for their revenue. Banner ads were not successful in reaching children, and so these Internet sites have employed games, e-mail, and wireless technology in creative ways. For example, Candystand.com boasts a very popular golf game with Lifesaver holes.⁷⁹

In 1974, a Children's Advertising Review Unit (CARU) of the National Advertising Division of the Council of Better Business Bureaus was established to respond to public concerns. CARU developed "Self-Regulatory Guidelines for

Children’s Advertising.” Figure 13-3 summarizes seven basic principles from those guidelines.

The function of the CARU guidelines is to delineate those areas that need particular attention to help avoid deceptive advertising messages to children. The basic activity of CARU is the review and evaluation of child-directed advertising in all media. When advertising to children is found to be misleading, inaccurate, or inconsistent with the guidelines, CARU seeks changes through the voluntary cooperation of advertisers. For example, in 2007, CARU asked Sony Pictures Entertainment, Inc., to refrain from advertising “Stomp the Yard,” on Nickelodeon during children’s programming, because the movie is rated PG-13 due to a scene of violence, some sexual material, and language.⁸⁰

Although CARU is self-regulatory, they are able to use some teeth when necessary. When CARU evaluated the lilromeo.com website of UMG records, they found substantial violations of both CARU’s guidelines and the Federal Children’s Online Privacy Protection Act (COPPA). When UMG Recordings refused to cooperate, CARU referred the case to the Federal Trade Commission (FTC). The FTC entered a consent decree and imposed \$400,000 in fines.⁸¹ In 2006, CARU

Figure 13-3 *Principles of Advertising to Children*

The following core principles underlie CARU’s guidelines for advertising directed to children under the Age of 12:

1. Advertisers have special responsibilities when advertising to children or collecting data from children online. They should take into account the limited knowledge, experience, sophistication and maturity of the audience to which the message is directed. They should recognize that younger children have a limited capacity to evaluate the credibility of information, may not understand the persuasive intent of advertising, and may not even understand that they are being subject to advertising.
2. Advertising should be neither deceptive nor unfair, as these terms are applied under the Federal Trade Commission Act, to the children to whom it is directed.
3. Advertisers should have adequate substantiation for objective advertising claims, as those claims are reasonably interpreted by the children to whom they are directed.
4. Advertising should not stimulate children’s unreasonable expectations about product quality or performance.
5. Products and content inappropriate for children should not be advertised directly to them.
6. Advertisers should avoid social stereotyping and appeals to prejudice, and are encouraged to incorporate minority and other groups in advertisements and to present positive role models whenever possible.
7. Advertisers are encouraged to capitalize on the potential of advertising to serve an educational role and influence positive personal qualities and behaviors in children, *e.g.*, being honest, and respectful of others, taking safety precautions, engaging in physical activity.
8. Although there are many influences that affect a child’s personal and social development, it remains the prime responsibility of the parents to provide guidance for children. Advertisers should contribute to this parent-child relationship in a constructive manner.

Source: <http://www.caru.org/guidelines/guidelines.pdf>

expressed concern over advertising from Manley, maker of the Blue Man Group Music Station Percussion Tubes and Keyboard Experience. The commercial showed a young boy becoming frustrated with traditional musical instruments because he was unable to make music. Then three Blue Men replace the traditional instruments with an electronic keyboard and the “percussion tubes.” The commercial showed how an MP3 player could be used in conjunction with the products and indicated in very small type at the bottom of the screen “Each Sold Separately” and “MP3 Player Not Included.” CARU had two concerns. One was whether children would be able to duplicate the performance shown in the commercial and the other was whether children would realize that the MP3 player would not be included in the purchase. When Manley failed to provide what CARU would consider a substantive response, CARU referred the matter to the FTC. At this writing, the FTC has not responded.⁸²

Efforts to curb children’s advertising span the globe. The European Union’s directive on television regulation bans “programs that might seriously impair the development of minors” but allows unencrypted programming “that might be harmful to minors providing they are preceded by an acoustic warning or made clearly identifiable throughout their duration by means of a visual symbol.”⁸³ The EU prohibits product placement in programming aimed at children and also does not allow words like “only” to be used to describe prices. They also forbid advertisers from persuading children to ask their parents to buy the product for them.⁸⁴ In Australia, children’s advertising may not imply that the people who buy an advertised product are more generous than people who do not buy it. Mexico does not restrict the amount of children’s advertising, but tobacco and alcohol advertising are prohibited. In contrast, Denmark permits the advertising of alcoholic beverages to children as long as the beverage’s strength is no greater than 2.8 percent, it is not placed in a program directly aimed at children, and no children are shown drinking it.⁸⁵

In a promising development, Kellogg Co., the world’s largest cereal maker, announced in 2007 that it would take actions to raise the nutritional value of cereals and snacks it markets to children and would not promote foods in TV, radio, print, or on websites that reach audiences of which half are children under the age of 12 unless the product meets its new standards. Kellogg stated its plan was to reformulate products to meet its new, more nutritious standards, and to stop marketing them to children under 12 by the end of 2008.⁸⁶ Other new policies announced by Kellogg included the discontinuance of sponsor placements of its products aimed at children under 12 and that it will not use branded toys or licensed characters (e.g., Shrek) on food packages unless the products meet their new standards. Kellogg’s actions were partially in response to threatened lawsuits by parents and nutritional advocacy groups concerned about childhood obesity.⁸⁷

Marketing to the Poor. A variety of businesses have found that significant profits can be obtained from marketing to poor people. In the subprime credit industry, businesses provide financing to high-risk borrowers at higher-than-average prices. While this gives poor people greater access to cars, credit cards,

computers, and homes, it often ends with the borrower buried under a mountain of debt. This questionable practice is growing. The Federal Reserve reports that households earning \$30,000 or less paid auto loan interest rates that were 16.8 percent higher than the rates paid by households earning more than \$90,000; by 2004, the difference had risen to 56.1 percent.⁸⁸ Mortgage loans showed the same increase with a 6.4 percent gap in 1989 to a 25.5 percent gap in 2004.⁸⁹ The past several years have been the worst ever in home mortgage foreclosures and loan defaults. Many of these have come from the subprime mortgage market, where relatively poor people are lured into loans they have little hope of repaying. This has especially occurred with adjustable rate mortgages in an era of rising interest rates. Several of the deceptive marketing practices mentioned earlier have been involved in these loans: concealed facts, ambiguous advertising, and psychological appeals.

Another technique through which business profits from the poor is in the form of payday loans—loans that provide the borrower with an advance on his or her paycheck. As the FTC warns, these loans equal costly cash. For example, a borrower might write a personal check for \$115 to borrow \$100 for up to two weeks. The payday lender agrees to hold the check until the person's next payday. Then, depending on the plan, the lender deposits the check, which the borrower can redeem by paying the \$115 in cash. Alternatively, the borrower can roll over the check by paying a fee to extend the loan for another two weeks. In this example, the cost of the initial loan is a \$15 finance charge and 391 percent APR. If they roll over the loan three times, the finance charge would climb to \$60 to borrow \$100.⁹⁰ Similar tactics are used by many credit card companies, rent-to-own outfits, and used car dealers.

Tax preparation services provide another way of making money from the poor. Jackson-Hewitt is one of many firms providing quick tax refund services for a fee. Advertising "Money Now," they will prepare your tax return and provide you with an advance on your refund. Low income tax payers have access to a variety of free tax preparation services, but many still use this expensive service because they do not understand the price they will pay for receiving an early refund.

BusinessWeek tells the story of a single mother with five children who was making ends meet on \$8500 a year until she was laid off. She borrowed \$400 for rent and food from Advance America, a payday loan service; then she renewed the loan every two weeks, eventually paying more than \$2500 in fees before she paid it off. Two months after paying it off, she was anxious for her \$4500 tax refund and so she took out a refund-anticipation loan from Jackson-Hewitt. It cost her \$453 (10.4 percent) to get that short-term loan.⁹¹ When asked about the price she paid for these loans, the young mother sounded confused, replying, "What do you call it—interest?"⁹²

The issue with marketing to the poor is the vulnerability of the consumer. All consumers are vulnerable to a certain extent because business has more information about its product or service than the consumer. However, poor people are especially vulnerable because they are likely to be less educated and thus less aware of the true price of the products or services being advertised to them.

Nevertheless, businesses continue to push these products. The Federal Reserve reports that the total amount owed by households earning less than \$30,000 has grown 247 percent from 1989 through 2004.⁹³

Advertising of Alcoholic Beverages. Special issues about advertising to adults also exist. One that became quite controversial in recent years is advertising of alcoholic beverages on television. In 1996, Seagram & Sons broke a 48-year voluntary ban on advertising hard liquor on television. The company argued that a standard serving of hard liquor contained the same amount of alcohol as beer or wine, and advertising is allowed for those products.⁹⁴ DISCUS (the Distilled Spirits Council of the United States) then rewrote its “Code of Good Practice” to allow member distillers to advertise on radio and television. The Seagram decision created a groundswell for change in all possible directions. Today, TV is a major and growing component of hard liquor advertising. During 2005, spirits advertisers increased TV spending nearly 48 percent, despite a 2 percent cut in overall spending.⁹⁵

Of course, hard liquor is not the only concern. Ralph Nader’s Commercial Alert organization targeted Anheuser-Busch for its use of a variety of cartoon characters in its campaigns. They cited a KidCom market study that shows that the Budweiser frogs were American children’s “favorite ads,” just as the tobacco-smoking “Joe Camel” had been their favorite ad some years ago.⁹⁶ More recently, Anheuser-Busch has faced criticism over a new product, Spykes. The brightly colored, fruit-flavored malt beverage was sold in attractive two-ounce bottles that resembled beauty products. Critics charged that the beverage was designed to appeal to kids.⁹⁷ Anheuser-Busch withdrew the drink from the market due to a combination of pressure from critics and low sales.⁹⁸

Although efforts to curb advertising abuses continue, consumer advocates may find they face an uphill battle. In an online survey, advertisers were asked what they would recommend in the following scenario: “The owner of a small ad agency has an opportunity to pitch a national beer distributor on a \$150 million account. He is conflicted because he believes that most alcohol advertising is irresponsible and targets young adults. Still, he realizes this could be big business. He confides in friends and colleagues, and receives mixed advice. Should he pitch the account?”⁹⁹ In response, 70.8 percent said that he should pitch the account while 21 percent said he should not pitch the account.¹⁰⁰

Cigarette Advertising. No industry has been under greater attack than the cigarette industry for its products and its marketing and advertising practices. Cigarette makers are under fire from all sides. Two particularly important issues dominate the debate about cigarette advertising. First, there is the general opposition to promotion of a dangerous product. As the World Health Organization (WHO) puts it, “Cigarettes remain the only legal product that kills half of its regular users when consumed as intended by the manufacturer.”¹⁰¹ The second issue concerns the ethics of the tobacco industry’s advertising to young people and to less-educated consumer markets.

An example of the latter concern was when R.J. Reynolds (RJR) was publicly taken to task by several consumer groups for its Joe Camel campaign. One frequently cited study appeared in the *Journal of the American Medical Association*. In this study, it was found that more than half the children from the ages of three to six were able to match the Joe Camel logo with a photograph of a cigarette. Six-year-olds were almost as familiar with Joe Camel as they were with a Mickey Mouse logo.¹⁰² Perhaps one of the strongest indicators of the success of the Joe Camel ad campaign was the statistic of smoking among the youth market. From the time the Joe Camel mascot was introduced in 1987 to its discontinuation in 1997, Camel's share of the under-18 market soared from 0.5 to 33 percent, according to data supplied by a coalition of health groups. The market share among smokers ages 18 to 24 increased from 4.4 to 7.9 percent. In 1997, the FTC ruled 3-to-2 that the Joe Camel ads violated the law by targeting children under 18 and asked RJR to remove the cartoon from any venue where a child might see it. RJR canceled the ad campaign.¹⁰³ Shortly after that, the government asked Philip Morris to retire the Marlboro Man.¹⁰⁴

Although Joe Camel and the Marlboro Man are gone, the issue of advertising to young people remains. As an *Advertising Age* editorial opined, "Nobody said doing the right thing was always easy, but the folks at Philip Morris Co. could help write the book on how to do the right thing the wrong way when it comes to youth smoking." The company distributed 125 million free book covers with the theme "Reflect Confidence—Think Don't Smoke" to students from kindergarten through high school age. The covers featured colorful graphics and include both the surgeon general's warning and the name of Philip Morris. With the colorful graphics, the surgeon general's warning, and the copyright credit, the covers looked "alarmingly like a colorful pack of cigarettes."¹⁰⁵

There was some hope the issue of tobacco advertising to children would be less of a problem as time went by. After the tobacco settlement, the companies assumed voluntary restrictions on their advertising, promising that they would not advertise in magazines that were read by children. R.J. Reynolds was fined for violating that settlement by advertising in magazines such as *InStyle*, *Spin*, and *Hot Rod*.¹⁰⁶ Philip Morris came under scrutiny recently for an advertising campaign that urged parents to warn their children about the dangers of smoking. A 2006 study in the *American Journal of Public Health* assessed the impact of both the ads that urged young people not to smoke and the ads that urged parents to warn their children about smoking.¹⁰⁷ The researchers found no discernible impact of the ads aimed directly at youth, and they found that the ads aimed directly at parents had the opposite impact. The more teenagers were exposed to the ads aimed at parents, the greater their intention to smoke and the more likely they were to have smoked in the last 30 days.¹⁰⁸

The problem shows no signs of abating. In 2006, the attorneys general of 38 states announced a settlement with R.J. Reynolds—the charge was that the company violated a prohibition on youth marketing with its Camel Exotic Blends, which included flavors like Dark Mint and Blackjack Gin.¹⁰⁹ By the time of the settlement, R.J. Reynolds had already discontinued making and advertising the

products in question. However, the case raises questions for other tobacco products in which flavors play a big part. Smokeless tobacco, with an annual growth rate of 3–6 percent, and cigars, with a market growth of nearly 4 percent, come in flavors like grape, peach, and apple. Rolling papers come in a wide variety of flavors, including marshmallow, candy cane, and sizzling bacon. The relationship of such flavors to youth marketing prohibitions is certain to be the topic of future discussions.¹¹⁰

Health and Environmental Claims. Advertising and labeling practices that make claims about health and environmental safety have taken on increasing importance. One reason that these issues have come to the forefront is the renewed enforcement activities of the Food and Drug Administration (FDA), the Federal Trade Commission (FTC), and state attorneys general in cracking down on misleading claims. Since the health- and environmentally conscious 1990s, consumers' interest in products that are healthful and protect the environment has grown, so it is not too surprising that these issues have gained so much attention.

Because health and environmental claims attract customers, marketers are tempted to tout claims that aren't really valid. Nutrition bars make up a \$1 billion yearly market that has attracted a variety of companies. The FDA contacted 18 nutrition bar makers about their nutritional claims. The *Los Angeles Times* reported that a test of nutrition bars found that 60 percent of the bars tested failed to live up to their claims. Consumerlab.com tested 30 nutrition bars for levels of fat, sodium, and carbohydrates, among other ingredients. According to the lab, the claims for 18 of the bars were found to underreport those things that dieters try to avoid; only the claims for 12 bars were reported to be accurate. Seven bars contained two to three times the amount of sodium they reported; four bars contained more saturated fat. Half of the products tested contained more carbohydrates than their labels indicated.¹¹¹

The FTC investigated KFC's claims that their original recipe fried chicken has less fat than a Burger King Whopper and can work well in a low-carbohydrate diet.¹¹² This is but one in an array of efforts by companies to portray their foods as being healthier than they are. One way of concealing a food's fat, carbohydrate, and calorie content is to be creative with the definition of a single serving. Many products that appear to be packaged as single servings are actually labeled as if they contain multiple servings. For example, an individual Stouffer's Chicken Pot Pie is labeled as being two servings; a package of Maruchan's Oriental Ramen Noodles is two servings as well. Many consumers do not realize that they must double the calorie content listed for these products if they eat the entire package.¹¹³

Diet products are often offenders in this category. Marketers of the Enforma System settled FTC charges of deceptive advertising by agreeing to pay \$10 million in consumer redress. They were accused of making false claims about their products "Fat Trapper" and "Exercise in a Bottle." The product had been promoted through infomercials that featured former baseball player Steve Garvey. The claims made included "Lose weight without dieting," "Eat anything that you want," and "Permanently blocks fat so it can't be absorbed by your body." In

addition to the payout, the final order set stipulations about the company's future activities.¹¹⁴ A recent FTC study of 300 weight-loss ads concluded that 40 percent of the ads made at least one false statement.¹¹⁵ The commission warned media companies that their newspapers, magazines, and television stations that ran the ads were part of the problem and that they might take legal action against the media outlets along with providers of the products or services. However, in less than a year, the FTC issued a statement that media outlets were running fewer "clearly false" ads and that they would continue with the voluntary restrictions. They issued new guidelines for judging the veracity of weight-loss ads.¹¹⁶

Another major controversial advertising practice is companies claiming that their products and/or their product packages are environmentally friendly or safe. DuraLube agreed to pay \$2 million in consumer redress for what the FTC found were, among other things, unsubstantiated claims of being environmentally friendly. The FTC had previously charged a half-dozen other motor oil additive manufacturers, including STP and Valvoline. Along with the performance claims, the FTC found DuraLube's environmental claims regarding emission reduction and lack of chlorinated compounds to be unsubstantiated. In addition, DuraLube had claimed inaccurately that the product was tested by the EPA. In addition to the \$2 million settlement, DuraLube was required to visit their distributors to notify them of the FTC order and replace all labels and packaging.¹¹⁷

Ad Creep. *Ad creep* refers to the way that advertising can increasingly be found everywhere one looks. It is generally estimated that people see about three thousand ads each day. According to Jim Twitchell, author of *Twenty Ads That Shook the World*, the problem of ad creep is only going to get worse. He believes that the average person is exposed to about five thousand ads each day, and the last time one could go an entire day without seeing an ad was probably about 1915. "We're already putting them on the floor tiles in grocery stores, on worksheets in home economics classes, on video screens in shopping carts. Eventually, we could see ads on stoplights or in drinks with bubbles that will bring you a message from their sponsor."¹¹⁸ Ads have also gone to places that once were not considered acceptable for advertisements. School buses, textbooks, doctors' offices, and historical monuments have all been festooned with advertisements. The traditional term for advertising that is located in nontraditional places is **ambient**, but *ad creep* reflects both the way the ads have grown and the way people often feel about its creators.¹¹⁹

A variety of factors contribute to ad creep. A declining network TV audience and increased dispersion from cable and Internet outlets combine with soaring network television rates to make it difficult to blanket the population with an advertising message. The arrival of digital video recorders such as TiVo has made it easier for viewers to speed through ads without watching them. One response to ad-skipping technologies such as TiVo has been companies inserting ads into video games. Given that most PCs and an increasing number of video games are connected to the Internet, it will be possible to update advertisements when required.¹²⁰

Furthermore, ad creep just generates more ad creep, because people become numb to messages in traditional places and so unique new venues are sought—just to get the consumer’s attention.¹²¹ An example of the lengths advertisers go to get a person’s attention can be found in Britain. A London ad agency recruited university students to wear brand logos on their foreheads for about GBP 4.20 (\$6.83) an hour. The logos are temporary tattoos—wearers are allowed to shower but not rub their foreheads. John Carver, cofounder of Cunning Stunts Limited, thought up the idea as a way of getting around the many restrictions on cigarette advertising. Of course, only “suitably hip” foreheads need apply.¹²²

These seven controversial advertising methods are simply the tip of the iceberg. Issues have been raised about the marketing of pharmaceutical drugs directly to patients through magazine and television ads. These ads encourage patients to ask their doctor for the prescription drug, to the frustration of doctors everywhere. Concerns have also been raised about the marketing of guns and ammunition, particularly in family stores like Wal-Mart and Kmart. Channel One, a television station that beams educational programming to schools across the country, has been sharply criticized for its commercials, which students end up watching along with the educational programming. Audiences in movies everywhere have bemoaned the inclusion of commercials in the preview clips because they are captive audiences, unable to change the channel. There is no end to the list of concerns about the advertising practices undertaken today. Businesspeople must tread carefully to make certain they don’t cross the line where their customers become more annoyed with their practices than attracted to their products.

WARRANTIES

From the glamorous realm of advertising, we now proceed to the less glamorous issues of warranties. **Warranties** were initially used by manufacturers to limit the length of time they were expressly responsible for products. Over time, they came to be viewed by consumers as devices to protect the buyer against faulty or defective products. Most consumers have had the experience of buying a hair dryer, stereo, computer, refrigerator, automobile, washing machine, chain saw, or any of thousands of other products only to find that it did not work properly or did not work at all. That’s when warranties and guarantees take center stage.

The law recognizes two types of warranties—implied and express. An **implied warranty** is an unspoken promise that there is nothing significantly wrong with the product and that the product can be used for the purpose intended. An **express warranty** is explicitly offered at the time of the sale. The nature of express warranties can range from advertising claims to formal certificates; they can be oral or written.

The passage of the Magnuson-Moss Warranty Act of 1975 helped to clarify the nature of warranties for consumers. This act was aimed at clearing up a variety of misunderstandings about manufacturers’ warranties—especially whether a **full warranty** was in effect or whether certain parts of the product or certain types of defects were excluded from coverage, resulting in a **limited warranty**. Also at issue was whether or not the buyer had to pay shipping charges when a product

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THE “LIFETIME” OF A BACKPACK

For the past few years, I have been working at a sporting goods store that sells high-quality backpacks. One day I was working at the customer counter, ringing up sales and responding to queries. A man came in with a backpack that had obviously seen a great deal of life. It was torn and worn from years of heavy use. He gave it to me and said that he was returning it so that we could make good on the backpack’s “Lifetime Guarantee.” The backpack is of high quality and the well-known manufacturer prominently displays the guarantee in its advertising materials.

I explained to the customer that the “lifetime guarantee” does not mean that he can return the backpack after any amount of use. The guarantee is not for *his* lifetime but, instead, it is for the *lifetime of the backpack*. I then explained that, according to the manufacturer, the lifetime of a backpack is considered to be about four years.

The customer became irate. He said that the wording of the guarantee was purposely deceptive and that one shouldn’t have to read the fine print or visit the company’s website to determine what the guarantee really means. Then he threw the backpack in my face and stormed out, leaving his backpack behind. I thought he was being incredibly rude,

so I followed him out to the parking lot to tell him so. We talked about the situation, and I explained that the information has always been available on the website. He questioned why he should be expected to double-check a company’s website before buying a product. We parted cordially.

After he left, I thought about his upset and his argument. Was the customer right? Did the wording of the guarantee deceive him? If it is a four-year warranty, why not say that? If it is deception, to what extent am I complicit? Should I warn customers about the meaning of the guarantee even if that information is likely to steer them to other products, and perhaps other stores? To whom am I most responsible?

1. Is the “lifetime guarantee” deceptive advertising?
2. Does an employee of the store have a responsibility to warn customers?
3. Does the store have a responsibility to clarify the guarantee?
4. If you were in this position, what would you do?

Contributed Anonymously

was sent to and from the factory for servicing of a defect.¹²³ It set standards for what must be contained in a warranty and the ease with which consumers must be able to understand it. If a company, for example, claims that its product has a full warranty, it must contain certain features, including repair “within a reasonable time and without charge.”¹²⁴ The law holds that anything less than this unconditional assurance must be promoted as a limited warranty.

With the rise of e-commerce, warranties have become an important issue. Companies find that warranties or guarantees are essential when marketing by mail. The internationalization of commerce that has resulted from the Internet has presented new challenges. International e-commerce has been largely unregulated.

Scott Nathan, an attorney who specializes in e-commerce law, explains that the “speed ‘n’ ease” factor heightens the warranty problems. “Because of the lack of international law governing warranties,” says Nathan, “be prepared to defend the performance of your polka dot widgets in a foreign court.”¹²⁵

An ethical issue of increasing concern is **extended warranties** or service plans that lengthen the warranty period and are offered at an additional cost. Consumer advocates advise against most extended warranties, because they often cost as much as the original item purchased would eventually cost to replace. Eric Antum, editor of *Warranty Week*, explains that retailers might make only \$10 on a \$400 television but will then make \$50 on a \$100 extended warranty.¹²⁶ Not surprisingly, the lure of big profits has led to some hardball sales tactics; consumers spent \$16 billion on extended warranties in 2006.¹²⁷

Of course, if companies simply offer complete satisfaction, with no fine print, the warranty problem is not such a problem. Few companies accomplish this, but one that does is L.L. Bean, whose guarantee says, “Our products are guaranteed to give 100 percent satisfaction in every way. Return anything purchased from us at any time if it proves otherwise. We will replace it, refund your purchase price or credit your credit card, as you wish. We do not want you to have anything from L.L. Bean that is not completely satisfactory.”¹²⁸

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SUPER BOWL FEVER

During my senior year, I was working for a major retail store. What struck me the most about this experience was how easily customers could bring back used merchandise and get refunds. A good example might be “Super Bowl Fever.” People came to the store and bought the largest TV sets just to watch the Super Bowl on the weekend. Then, they returned and requested full refunds for the TV sets on the following Monday morning. Furthermore, I was amazed by the fact that some customers asked the store for full refunds without receipts, and the merchandise not only was used but, in some cases, had been used for several months. However, on many occasions, the customers got their money back right

away or checks would be sent to them if they didn’t have their receipts with them.

1. What exactly do businesses owe consumers? Is this not an example of taking consumer satisfaction to ridiculous lengths?
2. Is this an ethical practice on the part of consumers? Does a company “owe” customers this degree of satisfaction?
3. What actions, if any, should such a retail store take to control this practice?

Contributed Anonymously

PACKAGING AND LABELING

Abuses in the packaging and labeling areas were fairly frequent until the passage of the Federal Packaging and Labeling Act of 1967. The purpose of this act was to prohibit deceptive labeling of certain consumer products and to require disclosure of certain important information. This act, which is administered by the Federal Trade Commission, requires the FTC to issue regulations regarding net contents disclosures, identity of commodity, and name and place of manufacturer, packer, or distributor. The act authorizes additional regulations when necessary to prevent consumer deception or to facilitate value comparisons with respect to declaration of ingredients, slack filling of packages, “downsizing” of packaging, and use of “cents off” designations. The act gives the FTC responsibility for consumer commodities and cosmetics, which are regulated by the Food and Drug Administration.¹²⁹ As we mentioned in an earlier section, the packaging and labeling issue is drawing renewed interest because of health and environmental claims.

OTHER PRODUCT INFORMATION ISSUES

It is difficult to catalog all the consumer issues in which product information is a key factor. Certainly, advertising, warranties, packaging, and labeling constitute the bulk of the issues. In addition to these, however, we must briefly mention several others. Sales techniques in which direct sellers use deceptive information must be mentioned. Other laws that address information disclosure issues include the following:

1. *Equal Credit Opportunity Act*, which prohibits discrimination in the extension of consumer credit
2. *Truth-in-Lending Act*, which requires all suppliers of consumer credit to fully disclose all credit terms and to permit a three-day right of rescission in any transaction involving a security interest in the consumer’s residence (for example, in the case of home equity loans)
3. *Fair Credit Reporting Act*, which ensures that consumer-reporting agencies provide information in a manner that is fair and equitable to the consumer
4. *Fair Debt Collection Practices Act*, which regulates the practices of third-party debt-collection agencies

The Federal Trade Commission

We have discussed three main areas of product information—advertising, warranties, and packaging/labeling. Both the FTC and the FDA are actively involved in these issues. It is important now to look more closely at the FTC, the federal government’s major instrument for ensuring that business lives up to its

responsibilities in these areas. Actually, the FTC has broad and sweeping powers, and it delves into several other areas that we will refer to throughout the book. The Consumer Product Safety Commission and the Food and Drug Administration are major regulatory agencies, too, but we will consider them more carefully in the next chapter, where we discuss products and services more specifically.

Some history and evolution of the FTC will be helpful in gaining a better appreciation of government activism and its relationship to the political parties in power in Washington at various points in time. The FTC is one of the oldest of the federal agencies, charged with the responsibility for overseeing commercial acts and practices. It was created in 1914, originally as an antitrust weapon, and was broadened in 1938 to permit the agency to pursue “unfair or deceptive acts or practices in commerce.”¹³⁰ In 2004, the Commission celebrated its ninetieth anniversary with a public symposium on its past, present, and future.¹³¹

Two major activities of the FTC are (1) to maintain free and fair competition in the economy and (2) to protect consumers from unfair or misleading practices. The FTC may issue cease and desist orders against companies it believes to be engaging in unlawful practices. The firms must then stop such practices unless a court decision sets aside the order. The FTC also issues trade regulation guides for business and conducts a wide variety of consumer-protection activities.¹³² In the arena of possible deceptive advertising practices, the FTC monitors advertising and may ask advertisers for proof of their claims. If the FTC decides an ad is false or misleading, it may order the advertiser to withdraw the ad or run “corrective” advertising to inform the public that the former ads were deceptive. Advertisers also may be fined for violating an FTC order.¹³³

Over the years, Congress has given the FTC enforcement responsibility in a variety of consumer-related fields, including the important Truth-in-Lending, Fair Packaging and Labeling, Fair Credit Reporting, and Equal Credit Opportunity Acts. Congress gave the FTC broad powers out of fear that any specification of a list of prohibitions might lead business to reason that it could do anything not on the list. Figure 13-4 presents an overview statement of the vision, mission, and goals of the FTC. The FTC’s Bureau of Consumer Protection has the following major divisions: advertising practices, credit practices, enforcement, marketing practices, and service industry practices.

EARLY ACTIVISM OF THE FTC

The FTC actually did relatively little from 1941 to 1969, a period Thomas G. Krattenmaker called the “decades of neglect.” But 1970 to 1973 were the “years of promise” for the FTC.¹³⁴ The agency became “activist” when President Richard Nixon appointed Miles Kirkpatrick as chairman. Kirkpatrick and his staff of eager young lawyers put the FTC on the map, so to speak, and the agency became so aggressive that it created “an escalating struggle” between itself and business.¹³⁵ The source of the struggle was the FTC’s zealotry, its fuzzy and broad powers, its lack of consistency in its own administration, and its concept of what constitutes proper business conduct.

Figure 13-4 *Role of the FTC***Vision, Mission, and Goals**

The Federal Trade Commission enforces a variety of federal antitrust and consumer-protection laws. The commission seeks to ensure that the nation's markets function competitively and are vigorous, efficient, and free of undue restrictions. The commission also works to enhance the smooth operation of the marketplace by eliminating acts or practices that are unfair or deceptive. In general, the commission's efforts are directed toward stopping actions that threaten consumers' opportunities to exercise informed choice. Finally, the commission undertakes economic analysis to support its law enforcement efforts and to contribute to the policy deliberations of the Congress, the executive branch, other independent agencies, and state and local governments, when requested.

In addition to carrying out its statutory enforcement responsibilities, the commission advances the policies underlying the congressional mandates through cost-effective, non-enforcement activities, such as consumer education.

Source: Federal Trade Commission, <http://www.ftc.gov/ftc/mission.htm>

The FTC's activism continued when Michael Pertschuk became chairman in 1977. His directorship spanned the late 1970s and early 1980s and encompassed many of the children's advertising developments we discussed earlier in this chapter. Although many of the controversial initiatives preceded his appointment, he became identified with all of them. Yet Pertschuk was accurately identified with the initiatives because, for 12 years prior to his chairmanship, he was staff director and chief counsel for the Senate Commerce Committee. He had nurtured and drafted practically all the major consumer legislation that was passed, including the Magnuson-Moss Warranty Act. Unfortunately, Pertschuk developed a reputation for being antibusiness. This hurt his relationship with the business community so much that he never overcame it.¹³⁶

LESS ACTIVE YEARS OF THE FTC

Succeeding Pertschuk as chairman was James C. Miller III, appointed by President Reagan. As do so many agencies upon the election of a new administration, the FTC shifted its focus to the Reagan approach to regulation. Miller was dubbed by some in the press as Reagan's "deregulation czar," and he took the FTC off into another, less active direction. Miller characterized the FTC's activism on behalf of consumers during the 1970s as "excesses" and embarked on a course that was much more in keeping with the Reagan doctrine.¹³⁷ The same general approach to regulation continued under Miller's successor, Daniel Oliver. Miller and Oliver gained reputations as deregulators who willingly slashed the FTC's budget and staff.

THE FTC REASSERTS ITSELF IN THE 1990S

After almost a decade of Reagan-era deregulation that saw the FTC's workforce cut in half and its enforcement efforts greatly reduced or redirected, the FTC began reasserting itself in the early 1990s. Janet D. Steiger became its chairperson, and under Steiger the FTC came back to life. It did not return to its heyday of the 1970s, but through a series of highly visible cases it reasserted itself. According to one observer, the FTC started looking more like the FTC of the pre-Reagan administration rather than the seemingly toothless agency it became in the 1980s.¹³⁸

Among the high-profile cases the FTC pursued in the 1990s, it won headlines by cracking down on Nintendo, the video-game maker, for price fixing; moving in on "900" telephone numbers for advertisements aimed at children; and accusing major colleges and Capital Cities/ABC for conspiring to limit the market for televised college football games.¹³⁹

In another initiative, the FTC took action against shoemakers who claimed their shoes are "Made in USA" when, in fact, some are "assembled" in the United States but include some imported components and materials. This was a significant action against New Balance and Hyde Athletic Industries, who had touted the "Made in USA" claim. Although most would agree that the integrity of a "Made in USA" label is important, many agree that the increasingly global economy makes 100 percent U.S. content unreachable. A spokesman for Toyota Motor Sales USA, Inc., has said, "If you applied the FTC standard to our industry, there's no such thing as an American car."¹⁴⁰

In April 1995, Robert Pitofsky, a specialist on trade regulation and antitrust law, became the chairman of the FTC. Pitofsky's appointment signaled a shift in focus for the agency. Although advertising and other marketing issues were still pursued, antitrust battles moved to the front burner. In June 1998, the FTC issued an antitrust complaint against Intel Corporation, alleging that the company withheld important technology information from competing vendors.¹⁴¹ Pitofsky's reign as chairman was characterized as one of the most activist eras of the FTC.

THE FTC IN THE TWENTY-FIRST CENTURY

Timothy Muris became the new FTC chairman in 2001. He brought with him experience in three areas of the agency, having previously served as assistant director of the Planning Office (1974–1976), director of the Bureau of Consumer Protection (1981–1983), and director of the Bureau of Competition (1983–1985). The FTC's transition from the Pitofsky to the Muris administration was characterized by continuity rather than conflict. In an address to the American Antitrust Institute, Muris said that the areas in which he agreed with Pitofsky far outnumbered the areas in which they differed.¹⁴²

A major accomplishment of the Muris administration is the National Do-Not-Call Registry. The registry, which opened to consumers in June 2003, forbids telemarketers from calling consumers who sign up with the registry. The FTC also instituted a requirement that all companies placing marketing calls have their

information available for consumers' caller ID systems. Consumers can then report companies that make calls in violation.¹⁴³

On August 16, 2004, Deborah Platt Majoras was sworn in as the new chairman of the Federal Trade Commission; the agency she oversees now has a budget of \$211 million and more than one thousand staffers.¹⁴⁴ In characterizing the difference between her style and that of her predecessor, Majoras says, "Tim is an academic and I bring a practical business background to the position, but many of our underlying principles remain the same."¹⁴⁵ She has extracted millions of dollars in settlements from firms that made misleading claims for weight-loss products but has opted not to require disclosure of the existence of product placement or the sources of word-of-mouth advertising.¹⁴⁶ Her preference is that business self-regulate where possible and that the police action of the FTC be a court of last resort.¹⁴⁷

Self-Regulation in Advertising

Cases of deceptive or unfair advertising in the United States are handled primarily by the FTC. In addition to this regulatory approach, self-regulation of advertising has become an important business response. Under the regulatory approach, advertising behavior is controlled through various governmental rules that are backed by the use of penalties. **Self-regulation**, on the other hand, refers to the control of business conduct and performance by business itself rather than by government or by market forces.¹⁴⁸

TYPES OF SELF-REGULATION

Business self-regulation of advertising may take on various forms. One is **self-discipline**, where the firm itself controls its own advertising. Another is **pure self-regulation**, where the industry (one's peers) controls advertising. A third type is **co-opted self-regulation**, where the industry, of its own volition, involves nonindustry people (for example, consumer or public representatives) in the development, application, and enforcement of norms. A fourth type is **negotiated self-regulation**, where the industry voluntarily negotiates the development, use, and enforcement of norms with some outside body (for example, a government department or a consumer association). Finally, a fifth type is **mandated self-regulation** (which may sound like an oxymoron), where the industry is ordered or designated by the government to develop, use, and enforce norms, whether alone or in concert with other bodies.¹⁴⁹

THE NATIONAL ADVERTISING DIVISION'S PROGRAM

The most prominent instance of self-regulation in the advertising industry is the program sponsored by the National Advertising Division (NAD) of the Council of Better Business Bureaus, Inc. The NAD and the National Advertising Review

Board (NARB) were created in 1971 by the American Advertising Federation, the American Association of Advertising Agencies, the Association of National Advertisers, and the Council of Better Business Bureaus to help sustain high standards of truth and accuracy in national advertising.

The NAD initiates investigations, determines issues, collects and evaluates data, and makes the initial decision as to whether it can agree that an advertiser's claims are substantiated. When the NAD is unable to agree that substantiation is satisfactory, the advertiser is asked to undertake modification or permanent discontinuance of the advertising. If the NAD fails to resolve a controversy, appeal can be made to the NARB, which has a reservoir of more than 50 men and women representing national advertisers, advertising agencies, and the public sector. The chairman of the NARB selects an impartial panel of five members for each appeal. The parties involved submit briefs expressing their views for discussion at an oral hearing, after which the panel issues a public report.¹⁵⁰ If the NAD is unable to resolve the case successfully, they refer it to the FTC. Commissioner Majoras describes the NAD as an important partner in the FTC's work against deceptive advertising. In her words, "Any self-regulatory system, to be effective, has to have an 'or else' attached to it and the 'or else' is, 'We'll refer you to the FTC.'"¹⁵¹

It is useful to conclude this chapter by providing insights into how the three types of moral manager models, introduced in Chapter 7, would view consumer stakeholders. Therefore, Figure 13-5 presents a brief statement as to the likely orientations of immoral, amoral, and moral managers to this vital stakeholder group.

Figure 13-5 *Three Moral Management Models and Their Orientations Toward Consumer Stakeholders*

Model of Management Morality Orientation to Consumer Stakeholders

Immoral Management Customers are viewed as opportunities to be exploited for personal or organizational gain. Ethical standards in dealings do not prevail; indeed, an active intent to cheat, deceive, and/or mislead is present. In all marketing decisions—advertising, pricing, packaging, distribution—the customer is taken advantage of to the fullest extent.

Amoral Management Management does not think through the ethical consequences of its decisions and actions. It simply makes decisions with profitability within the letter of the law as a guide. Management is not focused on what is fair from the perspective of the customer. The focus is on management's rights. No consideration is given to ethical implications of interactions with customers.

Moral Management Customers are viewed as equal partners in transactions. The customer brings needs/expectations to the exchange transaction and is treated fairly. Managerial focus is on giving the customer fair value, full information, fair guarantee, and satisfaction. Consumer rights are liberally interpreted and honored.

Summary

Among stakeholder groups, consumers rank at the top. In a consumption-driven society, business must be especially attentive to the issues that arise in its relationships with consumers. It is a paradox that consumerism arose during the very period that the business community discovered the centrality of the marketing concept to business success. The consumer's Magna Carta includes the rights to safety, to be informed, to choose, and to be heard. Consumers expect more than this, however, and thus the consumer movement, or consumerism, was born. Ralph Nader was the father of this movement and made consumer complaints respectable.

Product information issues compose a major area in the business/consumer stakeholder relationship. Foremost among these is advertising.

Many issues have arisen because of perceived advertising abuses, such as ambiguity, concealed facts, exaggerations, and psychological appeals. Specific controversial spheres have included, but are not limited to, comparative advertising, use of sex in advertising, advertising to children, marketing to the poor, advertising of alcoholic beverages, advertising of cigarettes, health and environmental claims, and ad creep. Other product information issues include warranties, packaging, and labeling. The major body for regulating product information issues has been the FTC. The FDA and the state attorneys general have become active as well. On its own behalf, however, business has initiated a variety of forms of self-regulation.

Key Terms

accurate information (page 516)
ad creep (page 531)
adequate information (page 516)
age compression (page 524)
ambient (page 531)
ambiguous advertising (page 517)
clear information (page 516)
comparative advertising (page 522)
concealed facts (page 518)
consumerism (page 512)
consumer's Magna Carta (page 510)
co-opted self-regulation (page 539)
Customer Relationship Management (CRM)
 (page 509)
exaggerated claims (page 520)
express warranty (page 532)
extended warranties (page 534)
fees (page 519)
full warranty (page 532)

implied warranty (page 532)
limited warranty (page 532)
mandated self-regulation (page 539)
negotiated self-regulation (page 539)
plot placement (page 519)
product information (page 514)
product placement (page 519)
psychological appeals (page 521)
puffery (page 520)
pure self-regulation (page 539)
right to be heard (page 510)
right to be informed (page 510)
right to choose (page 510)
right to safety (page 510)
self-discipline (page 539)
self-regulation (page 539)
warranties (page 532)
weasel words (page 518)

Discussion Questions

1. In addition to the basic consumer rights expressed in the consumer's Magna Carta, what other expectations do you think consumer stakeholders have of business?
2. What is your opinion of the consumerism movement? Is it "alive and well" or is it dead? Provide evidence for your observations.
3. Give an example of a major abuse of advertising from your own observations and experiences. How do you feel about this as a consumer?
4. With which of the kinds of controversial advertising issues are you most concerned? Explain.

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Consumer Stakeholders: Product and Service Issues

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Describe and discuss the two major product issues: quality and safety.
- 2 Explain the role and functions of the Consumer Product Safety Commission and the Food and Drug Administration.
- 3 Enumerate and discuss the reasons for the concern about product liability and differentiate strict liability, absolute liability, and market share liability.
- 4 Outline business's responses to consumer stakeholders, including total quality management (TQM) programs, and Six Sigma.

Although product information is a pivotal issue between business and consumer stakeholders, product and service issues such as quality and safety occupy center stage. The quest to improve product and service quality has been driven by the demands of a competitive marketplace and an increasingly sophisticated consumer base. With product safety, an additional driving force has been the threat of product liability lawsuits and the damage they can wreak to both the balance sheet and the reputation.

The Ford Motor Company provides a notable example of the havoc that can result from product quality and safety problems. At the end of 2001, Ford CEO Jacques Nasser departed the post after two years in the position. His tenure had been tumultuous. Product quality problems had plagued the launches of new products, even before the problems with Firestone-brand tires hit the news in August 2000. The tire problems were eventually traced to production problems at a Bridgestone/Firestone plant, but the tire maker's accusations against Ford,

coupled with the high number of Ford recalls on other vehicles, made the Ford image easier to tarnish.¹ According to J.D. Power and Associates, the company went from the best in car quality among Detroit automakers to the worst in just three years. Ford's profits plunged 11 percent, double the decline of the other U.S. automakers.² Of course, the decline was not only due to product quality and safety; unsuccessful diversification attempts were a factor as well. However, for a company that once boasted "Quality Is Job 1," the decline in the J.D. Power ranking must have been a bitter pill to swallow.

The fall of 2001 was a difficult time for all car companies, but the host of problems Ford faced, beyond the falling economy, made it even more difficult for them to weather the storm. As *Newsweek* commented, "This hasn't been easy for Ford, which just 2 years ago was revered as America's best automaker."³ By 2003, Ford had improved by 18 percent in initial quality, a laudable achievement except in comparison to the 25 percent by which the industry average had improved.⁴ This shows how problems with quality and safety can linger for firms, even after credible efforts to improve operations are mounted. By 2007, the CEO of Ford was still trying to erase an image of inferior quality products, with critics arguing that Ford should focus on real quality improvements rather than its image.⁵

In this chapter, we will limit our discussion to product quality and safety issues. In connection with safety, we consider the product liability issue and the calls for tort reform. The Consumer Product Safety Commission and the Food and Drug Administration are also discussed. Finally, we will discuss business's response to consumer stakeholders regarding the issues introduced both in Chapter 13 and in this chapter.

Two Central Issues: Quality and Safety

The two central issues we are concerned with in this chapter represent the overwhelming attention that has been given to product and service issues over the past decade: quality and safety. Of course, quality and safety are not separate concepts—safety is one aspect of quality. Its importance, however, merits separate attention.

THE ISSUE OF QUALITY

There are several particularly important reasons for the current obsession with product quality. First, a concern for quality has been driven by the fact that the average consumer household has experienced a rise in family income and consequently demands more. With both adults often working outside the home, consumers become more demanding of a higher lifestyle. In addition, no one has surplus time to hang around repair shops or wait at home all day for service

representatives to show up. This results in a need for products to work as they should, to be durable and long lasting, and to be easy to maintain and fix. The Internet has also made it possible for customers to communicate with other customers about their satisfaction, or dissatisfaction, with a product. A *Time/CNN* survey showed that consumers were less interested in technical innovation and attractive designs than they were in the product's ability to function as promised, its durability, and its ease of maintenance and repair.⁶ A survey of households by Walker Research found that quality ranked first, price ranked second, and service ranked third among a list of factors consumers felt impacted a firm's reputation and their own purchasing decisions.⁷

Closely related to rising household expectations is the global competitiveness issue. Businesses now compete in a hypercompetitive landscape in which multinational strategies have given way to global strategies, and the solutions that once worked no longer will.⁸ As firms jockey for position in these hypercompetitive markets, they vie to attract customers by increasing the value of the product or service. Value is quality divided by price; a Sears Craftsman spark-plug wrench that sells for \$24.99 is expected to be of proportionally higher quality than a spark-plug wrench sold at Wal-Mart for \$6.95. To increase value, firms try to provide higher quality than their competitors for the same price, offer the same quality at a lower price, or some combination of the two. Each time a competitor raises the quality and/or lowers the price, other competitors scramble to catch up and the bar is raised.⁹ The greater the competition, the more firms will be jockeying for position and the more often the bar will be raised. Firms that aren't continually improving their quality are certain to be left behind. The aforementioned story about Ford shows how quickly, in this highly competitive atmosphere, a well-respected company can be derailed. Once derailed, it is difficult to catch back up because of a lag in reputations. Consumer perceptions of quality do not catch up to actual changes in quality for years after the quality improvements are made.¹⁰

It should be emphasized that our discussion of quality here includes service as well as products. We have clearly become a service economy in the United States, and poor quality of service has become one of the great consumer frustrations of all time. Still, there is reason for hope. The University of Michigan's 2007 American Customer Satisfaction Index hit an all-time high in customer satisfaction after years of decline.¹¹ This is good news for the companies performing well, because studies have shown a positive relationship between customer satisfaction and long-term stock price values.¹²

On the front line of the new economy, service—bold, fast, imaginative, and customized—is now the ultimate strategic business imperative. Consumers today seem to swap horror stories about poor service as a kind of ritualistic, cathartic exercise. Consider the following examples: repeated trips to the car dealer; poor installation of refrigerator ice makers, resulting in several visits from repair people; returned food to the supermarket, resulting in brusque treatment; fouled-up travel reservations; poorly installed carpeting; no clerk at the shoe department of your favorite department store—and on and on. Shoddy service comes at a

price. One study showed that 54 percent of the people interviewed would lose all loyalty to a company that had rude or unhelpful staff: one in ten said they would walk away if a company did not seem to listen.¹³

There are at least eight critical dimensions of product or service quality that must be understood if business is to respond strategically to this factor.¹⁴ These eight dimensions include (1) performance, (2) features, (3) reliability, (4) conformance, (5) durability, (6) serviceability, (7) aesthetics, and (8) perceived quality. *Performance* refers to a product's primary operating characteristics. For an automobile, this would include such items as handling, steering, and comfort. *Features* are the "bells and whistles" of products that supplement their basic functioning. *Reliability* reflects the probability of a product malfunctioning or failing. *Conformance* is the extent to which the product or service meets established standards. *Durability* is a measure of product life. *Serviceability* refers to the speed, courtesy, competence, and ease of repair. *Aesthetics* is a subjective factor that refers to how the product looks, feels, tastes, and so on. Finally, *perceived quality* is a subjective inference that the consumer makes on the basis of a variety of tangible and intangible product characteristics. To address the issue of product or service quality, a manager must be astute enough to appreciate these different dimensions of quality and the subtle and dynamic interplays among them.

An important question is whether quality is a social or an ethical issue or just a competitive factor that business needs to emphasize to be successful in the marketplace. Manuel Velasquez proposes three ethical theories based on the concept of duty that informs our understanding of the ethical dimensions of quality: (1) **contractual theory**, (2) **due care theory**, and (3) **social costs view**. The contractual theory focuses on the contract between the firm and the customer. Firms have a responsibility to comply with the terms of the sale, inform the customer about the nature of the product, avoid misrepresentation of any kind, and not coerce the customer in any way. The due care theory focuses on the relative vulnerability of the customer, who has less information and expertise than the firm, and the ethical responsibility that places on the firm. Customers must depend on the firm providing the product or service to live up to the claims about it and to exercise due care to avoid customer injury. The third view, social costs, extends beyond contractual theory and due care theory to suggest that, if a product causes harm, the firm should pay the costs of any injury, even if the firm had met the terms of the contract, exercised all due care, and taken all reasonable precautions. This perspective serves as the underpinning for strict liability and its extension into absolute liability, which we will discuss shortly.¹⁵

THE ISSUE OF SAFETY

Business clearly has a duty to consumer stakeholders to sell them safe products and services. The concept of safety, in a definitional sense, means "free from harm or risk" or "secure from threat of danger, harm, or loss." In reality, however, the use of virtually any consumer product or service entails some degree of risk or some chance that harm will come to the consumer who uses the product or service.

In the 1800s, the legal view that prevailed was *caveat emptor* (“let the buyer beware”). The basic idea behind this concept was that the buyer had as much knowledge of what she or he wanted as the seller and, in any event, the marketplace would punish any violators. In the 1900s, *caveat emptor* gradually lost its favor and rationale, because it was frequently impossible for the consumer to have complete knowledge about manufactured goods.¹⁶ Today, businesses are held responsible for all products placed on the market. We have a weak version of *caveat vendor*: “let the seller take care.”¹⁷

Through a series of legal developments as well as changing societal values, business has become significantly responsible for product safety. Court cases and legal doctrine now hold companies financially liable for harm to consumers. Yet this still does not answer the difficult question, “How safe are manufacturers obligated to make products?” It is not possible to make products totally “risk free”; experience has shown that consumers seem to have an uncanny ability to injure themselves in novel and creative ways, many of which cannot be anticipated. The challenge to management, therefore, is to make products as safe as possible while at the same time making them affordable and useful to consumers. Figure 14-1 presents the top 10 ways companies can avoid product recalls.

Today, the public is concerned about a variety of hazards, such as the rise in genetically modified food and the dangers of living near toxic waste dumps or nuclear plants. Food scares, both real and imagined, have occupied much of the public’s attention. They occur throughout the world. The discovery of cancer-causing dioxin in Belgian food products caused many countries to temporarily halt imports from Belgium. Then, Coca-Cola recalled 2.5 million bottles of soft drinks that originated in two Belgian factories after children who drank it complained of stomachaches, nausea, and headaches. Bovine spongiform

Figure 14-1 Top 10 List of Safety Principles

1. Build safety into product design.
2. Do product safety testing for all foreseeable hazards.
3. Keep informed about and implement latest developments in product safety.
4. Educate consumers about product safety.
5. Track and address your products’ safety performance.
6. Fully investigate product safety incidents.
7. Report product safety defects promptly.
8. If a defect occurs, promptly offer a comprehensive recall plan.
9. Work with the Consumer Product Safety Council (CPSC) to make sure your recall is effective.
10. Learn from mistakes—yours and others’.

Source: Speech given by former CPSC Commissioner Ann Brown to the Defense Research Institute, a national organization of product liability attorneys, challenging industry to implement a “Top 10 List” of safety principles aimed at reducing product defects that lead to recalls.

Ethics in Practice Case

TO CHECK OR NOT TO CHECK THE CHICKEN?

Over the Christmas break, I went back to work at a fast-food restaurant where I had been working since high school. The restaurant sold lots of chicken sandwiches. We were supposed to measure the temperature of the chicken every hour to make sure that it was below 40 degrees (I assume in response to the incident in which a few people died as a result of bacteria formed in warm meat). That responsibility was assigned to whoever was battering the chicken at the time. All that the person had to do was stick a thermometer in the chicken, measuring the bottom, middle, and top until the digital read stayed at a single temperature for about 10 to 15 seconds. The whole process took a few minutes at most. This information was then sent to the restaurant's home office every day.

Unfortunately, not everyone would keep up with taking the temperatures. As an assistant manager, I was responsible for making sure the temperatures were checked, but it was difficult when I had other things to do. For instance, if I were at the register, I could not leave the customers to go back and make sure the batterer was taking the temperatures. At the

end of the shift, I would sometimes see a sheet of paper with few or no temperatures noted on it. The store manager would have been upset had he known that I was making up temperatures I did not know to be true, but he would have been even more upset if there had been no temperatures on the sheet at all. He would just make up the numbers himself before he sent them off to the home office, with all the temperatures, of course, below 40 degrees. I have even seen the store manager make up temperatures when he was battering chicken and had forgotten to check the temperatures on the hour.

1. What is the ethical issue in this case? Is it product quality, product safety, or deceptive practices?
2. What responsibilities does the restaurant have to consumers in this situation?
3. As an assistant manager, what should I have done about this situation?

Contributed by Jason Greene

encephalopathy (BSE), or "mad cow" disease, precipitated a crisis for beef farmers throughout Europe. Beef consumption dropped by 27 percent in the 15 member states of the European Union, with Greece reporting a 50 percent drop. Foot-and-mouth disease then delivered a staggering blow to an industry that was already reeling.¹⁸ Food safety can affect international trade. Japan discontinued all U.S. beef imports after the United States experienced an incident of mad cow disease. The Bush administration resisted Japan's call for the United States to institute testing procedures comparable to those used in Japan, where all cattle are tested for disease at slaughter. Prior to the outbreak, the United States had tested 1 out of every 1,700 cattle.¹⁹ The ban was eventually lifted but with an age limit that reduces exports of U.S. beef to Japan to one-fifth the pre-ban level.²⁰

In early 2007, pets throughout the United States died after eating pet food tainted by contaminated wheat products from China. In just one month, 107 foods about to be imported to the United States from China were detained at the border; findings included dried apples preserved with a cancer-causing chemical, frozen catfish filled with banned antibiotics, scallops and sardines coated with moldering bacteria, and mushrooms mixed with illegal pesticides.²¹ Europe had a close call when harmful bacteria in vitamin A from China nearly got into infant formula; fortunately, a German company testing the vitamins spotted the bacteria before it could be added to the baby food.²² These food scares have spurred companies to renew their efforts to deal with problems in the value chain. ConAgra Foods has taken extra safety precautions since it had to recall Peter Pan peanut butter when a leaky roof in a Georgia manufacturing plant caused salmonella contamination.²³ Natural Selection Foods now spends millions on their salad greens, testing everything from seeds to irrigation water since contamination by *E. coli* resulted in 204 illnesses and three deaths.²⁴ The food safety scare has clearly struck a nerve in industry. According to Peter Kovacs, an executive with 40 years of experience in the ingredient industry, firms are “feverishly examining their own purchasing policies and trying to ensure they are followed.”²⁵

Manufacturing is another industry for which product safety is of paramount concern. Manufactured products create hazards not only because of unsafe product design but also as a result of consumers being given inadequate information regarding the hazards associated with using the products. Consequently, it is not surprising in product liability claims to find that the charges are based on one or more of several allegations. First, it may be charged that the product was improperly manufactured. Here, the producer failed to exercise due care in the product’s production, and this failure contributed directly to the accident or injury. Second, even if the product was manufactured properly, its design could have been defective in that alternative designs or devices, if used at the time of manufacture, may have prevented the accident. Third, it may be charged that the producer failed to provide satisfactory instructions and/or warnings and that the accident or injury could have been prevented if such information had been provided. Fourth, it may be charged that the producer failed to foresee a reasonable and anticipated misuse of the product and warn against such misuse.²⁶ To appreciate the “big picture” of dangerous products, it should be noted that the Consumer Product Safety Commission keeps track of injuries treated in hospital emergency rooms and identified the following categories of consumer products as being the most frequently associated with hospital-treated injuries (in order of prevalence):²⁷

1. Sports and recreational activities and equipment
2. Home structures and construction materials
3. Home furnishings and fixtures
4. Housewares
5. Personal use items
6. Home workshop apparatus, tools, and attachments

7. Packaging and containers for household products
8. Home and family maintenance products
9. Toys
10. Space heating, cooling, and ventilation equipment

Whether we are dealing with consumer products, where there is potential for harm as a result of accidents or misuse, or with food products, where not-so-visible threats to human health may exist, the field of product safety is a significant responsibility and a growing challenge for the business community. It seems that no matter how careful business is with respect to these issues, the threat of product liability lawsuits has become an industry unto itself and becomes intimately linked with discussions of product safety. Therefore, we will now turn our attention to this vital topic. Product liability has become a monumental consumer issue in the United States for several reasons.

Reasons for the Concern about Product Liability

First, product liability has become a major issue because of the sheer number of cases where products have resulted in illness, harm, or death. The United States has been a litigious society. More than in other countries, U.S. citizens tend to sue when faced with situations about which they are unhappy.

Another cause for concern is the size of the financial awards given by the courts. Perhaps the path-breaking award in the product liability category was the \$128.5 million awarded in 1978 in the case of a 19-year-old who had been severely injured at age 13. He was riding with a friend in a Ford Pinto that was struck from behind. The Pinto's gas tank ruptured, and the passenger compartment was filled with flames that killed his friend and severely burned him over 90 percent of his body. The badly scarred teenager underwent more than 50 operations. Ford was required by the jury to pay \$666,280 to the dead driver's family and to pay the survivor \$2.8 million in compensatory damages and \$125 million in punitive damages.²⁸ The Pinto case was the beginning, but the awards grew after that. The average jury award went from \$520,000 in 1993 to \$1,200,000 in 2002, an increase of 130 percent.²⁹

It has been estimated that litigation's cost to society is over \$200 billion per year, more than half of which goes to legal fees and costs, some of which could be spent to hire more teachers, police officers, and firefighters. The cost of litigation to companies has been said to represent approximately 30 percent of a stepladder's price, 50 percent of a football helmet, and 95 percent of the price of a childhood vaccine. The problem is largely confined to the United States. In a year when DuPont had nearly 5,000 personal injury lawsuits inside the United States, they had fewer than 20 outside the United States. Although half the company's sales come from overseas, 95 percent of the company's legal costs came from the United States.³⁰ A 2007 study showed that the money firms pay on lawsuit settlements, damage awards, insurance lawyers, and legal-defense costs is money they no longer have available to spend on improvements in their processes and products:

This decrease in innovation due to tort litigation carries lasting consequences for competitiveness.³¹

Since the Pinto case, multimillion-dollar lawsuits have become commonplace. Some major companies have been hit so hard by lawsuits that they have filed for protection under Chapter 11 of the federal bankruptcy law. One famous example of this is the Johns Manville Corporation, which faced an avalanche of 16,500 asbestos-related lawsuits demanding more than \$12 billion.³² Another well-known case is that of A.H. Robins, which filed for protection after facing more than five thousand product liability lawsuits in which women charged that its Dalkon Shield, an intrauterine contraceptive device, had injured them.³³ Dow Chemical, the principal manufacturer of silicone breast implants, entered Chapter 11 in 1995.³⁴ The strategy continues today. In April 2001, W.R. Grace & Co. filed for bankruptcy protection to shield it from asbestos-related claims.³⁵ In March 2004, however, the court tired of delays and refused to allow Grace a sixth extension of the proceedings.³⁶ Other companies encountering large lawsuits have included Union Carbide, with its poison gas explosion in Bhopal, India; Dow Chemical, with its Agent Orange defoliant; and Bridgestone/Firestone, with its defective tires.

The doctrine of **strict liability** and the expansion of this concept in the courts is at the heart of the litigation described. As we mentioned previously, the social costs view of product quality underlies the concept of strict liability and its extensions. In its most general form, the doctrine of strict liability holds that anyone in the value chain of a product is liable for harm caused to the user if the product as sold was unreasonably dangerous because of its defective condition. This applies to anyone involved in the design, manufacture, or sale of a defective product. Beyond manufacturing, courts have ruled against plaintiffs from a broad array of functions, such as selling, advertising, promotion, and distribution.³⁷ For example, the Department of Transportation (DOT) holds warehouses liable for violations of hazardous materials regulations even when the warehouse relied on information provided by the customer (the depositor) when documenting the shipment.³⁸ In other words, there is no legal defense for placing on the market a product that is dangerous to a consumer because of a known or knowable defect, unless the strict liability is imposed by a statute that allows for an argument of due diligence.³⁹ To prove due diligence, a company must take every precautionary step possible and follow all industry standards.

Extensions of the Strict-Liability Rule

Courts in several states and certain countries have established a standard that is much more demanding than strict liability. This concept is called **absolute liability**. The ruling that established this concept was handed down by the New Jersey Supreme Court in *Beshada v. Johns Manville Corporation* (1982). The plaintiffs in the Beshada case were employees of Johns Manville and other companies who had developed asbestos-related diseases as a result of exposure in the workplace.⁴⁰ The court ruled in this case that a manufacturer could be held strictly liable for failure to warn of a product hazard, even if the hazard was scientifically unknowable at the time of manufacture and sale. Therefore, a company cannot use as its defense the assurance that it did its best according to the state of the art in the

industry at that time. Under this ruling, the manufacturer is liable for damages even if it had no way of knowing that the product might cause a problem later. This has led to what the *Wall Street Journal* terms the “asbestos tort blob,” named for the movie blob that devours everything in its path.⁴¹

Although the United States has been rightly termed the “litigation nation,” other countries struggle with the issue as well. For example, the Supreme Court of India upheld the absolute liability of a common carrier, in this case Patel Roadways Ltd., for goods destroyed by fire. The court ruled that, in the case of damage or loss, it is not necessary for the plaintiff to establish negligence.⁴² Similarly, leading charities in Great Britain are pressuring the prime minister to institute a system of strict financial and legal liability before genetically modified crops can be introduced there.⁴³

The absolute-liability rule frequently involves cases involving chemicals or drugs. For example, a drug producer might put a drug on the market (with government approval) thinking that it is safe based on current knowledge. Under the doctrine of absolute liability, the firm could be held liable for side effects or health problems that develop years, or even decades, later. The result is that a large amount of uncertainty is injected into the production process.⁴⁴ Furthermore, the company’s association with the damaging product may be tenuous at best. Forty years ago, Crown Cork and Seal, Inc., had a brief connection with Mundet Cork Company, a maker of cork-lined bottle caps. Unfortunately for Crown Cork and Seal, Mundet also owned a small insulation company. Crown Cork’s \$7 million investment in Mundet has led to thousands of asbestos-related claims filed against it and more than \$350 million in asbestos-related payments to date.⁴⁵ The asbestos litigation now ranks as the longest running mass tort litigation in the United States: a bill to set up an asbestos trust fund failed in 2006 even as asbestos filings were increasing.⁴⁶ About a half-million claims are expected to be filed in the coming years.⁴⁷

Another extension of strict liability is known as **market share liability**. This concept evolved from **delayed manifestation cases**—situations in which delayed reactions to such products appear years later after consumption of, or exposure to, the product.⁴⁸ Market share liability was derived from the California case in which a group of women with birth defects claimed that the defects had been caused by the drug DES, which their mothers had taken while pregnant years earlier. The women could not name the company that had made the pills their mothers had taken. But in 1980, the California Supreme Court upheld a ruling that the six drug firms that made DES would be held responsible in proportion to their market shares of DES sales unless they could prove that they had not made the actual doses the women had taken.⁴⁹ When this verdict was reached, the business press expressed alarm about the potential impact of the decision. Their concern, however, was premature. With very few exceptions, market share liability has been rejected in subsequent non-DES cases and in second-generation DES cases. DES was uniquely suited to that defense because it was a generic product, the entire industry used the same formula, and it was marketed and promoted generically by all industry members. Efforts to apply the concept to cases

involving asbestos products, blood products, breast implants, DPT vaccines, polio vaccines, multipiece tire rims, lead-based paints, and benzene all failed.⁵⁰

Product Tampering and Product Extortion

Two other concerns that have contributed to the product liability discussion are *product tampering* and *product extortion*. The most well-known cases involved Tylenol in the 1980s—first in 1982, when seven Chicago people died from taking tainted Extra Strength Tylenol capsules, and again in 1986, when cyanide-laced bottles of Tylenol were found in New York and one woman died. James Burke, chairman of Johnson & Johnson, characterized the case as “terrorism, pure and simple.”⁵¹ In response to these and other incidents, firms began to employ tamper-evident packaging. Although improvements in packaging have slowed the rate of pharmaceutical product tampering, they have not stopped it. Two Australian pharmaceutical manufacturers received threats from extortionists who were believed to have bought over-the-counter analgesics, poisoned them with strychnine, and returned them to the shelves. Four people were hospitalized, and nationwide product recalls cost the firms millions of dollars.⁵² To avoid problems like these, firms have begun to institute a variety of safeguards. For example, AstraZeneca has begun a “Serialized Authentication Program,” designed to protect its products from counterfeiting and tampering. Tamper-evident seals and unique carton numbers will enable products to be authenticated at every point of the supply chain.⁵³

Adulterated and poisoned products stretch beyond pharmaceuticals. After the September 11, 2001, terrorist attacks, product tampering concerns centered on anthrax and the possible ways it could be used for extortion and terror. When attorneys at Stoel Rives in Portland, Oregon, mailed 50,000 cards in envelopes with bumpy seeds, some recipients became so scared they dialed 911. Publishers Clearing House mailed packages of powdered detergent to customers, causing alarm in the process.⁵⁴ Now that the furor over mail has subsided, attention has shifted to ways in which terrorists might tamper with the food supply. Since the September 11 attacks, food companies have spent hundreds of millions of dollars to upgrade security, institute employee background checks, and install lights and video cameras.⁵⁵

Product Liability Reform

The problems discussed up to this point have combined to generate calls from many groups for **product liability reform**, also known as **tort reform**. However, not everyone agrees that reform is needed. On one side are business groups, medical associations, local and state governments, and insurance companies that want to change the system that they claim gives costly and unfair advantage to plaintiffs in liability suits. On the other side are consumer groups and trial lawyers who defend the current system as one that protects the constitutional rights of wrongfully injured parties.⁵⁶

The business community’s criticisms of the current system illustrate some of the aspects of the controversy. Currently, we have a patchwork of state laws with the

law varying significantly from state to state. The Pacific Research Institute named Vermont as the state with the worst tort system, with Rhode Island, New York, Pennsylvania, and Maryland following close behind; the states with the best-rated tort systems were Colorado, North Dakota, Ohio, and Michigan.⁵⁷ The rankings were based on 39 variables, including factors that assessed whether a state caps punitive damage awards, as well as the product liability insurance loss ratio.⁵⁸

Business wants a uniform federal code. Business also argues for no punitive damages unless the plaintiff meets tougher standards of proof, a because meeting government standards is no defense in most states. Business thinks it should have an absolute shield against punitive damages for drugs, medical devices, and aircraft that meet government regulations. Finally, business wants victorious plaintiffs to be able to recover damages only to the extent that defendants are liable.⁵⁹ On the other side of the issue are consumer and citizen groups and others who support the current system and say the critics of the product liability laws have exaggerated the problems. These supporters of the current system point out that some of the most infamous injuries inflicted on consumers were remedied mainly through lawsuits, not regulatory action. Examples include the Dalkon Shield, a contraceptive device that made thousands of women infertile; the Pinto's exploding gas tank; the damage to workers exposed to asbestos; and many lesser-known cases.⁶⁰ According to Ralph Nader, trial lawyers are "all that is left to require wrongdoers to be held accountable."⁶¹

Perhaps the controversy played out most dramatically in the experience of Rick Santorum, the former Republican senator from Pennsylvania. Santorum has been a vocal advocate of tort reform, sponsoring several pieces of legislation that would limit claimants' options in cases of medical malpractice, including a bill that would have capped noneconomic damages at \$250,000. He also consistently voted against the Patient Bill of Rights, which would grant patients the right to sue their HMOs. However, when his wife experienced back and leg numbness after a visit to a chiropractor, she sued for \$500,000 and Santorum testified on her behalf, claiming that the injury would keep her from assisting in his campaign for reelection. A jury subsequently awarded her \$350,000. A judge reduced the award to \$175,000, and the parties eventually settled out of court.⁶² Like the Santorums, most people want to limit the cost of litigation to society without limiting our ability to sue when we believe we have been wronged; in other words, we want to have our cake and eat it, too.

It may be possible to stem the rising tide of litigation while still being responsive to individuals with valid claims. Philip K. Howard, author of *The Collapse of Common Good* (2002), is a leading voice for tort reform. He helped to found Common Good (<http://www.cgood.org>), an organization devoted to reforming the legal system. Common Good's claim to be a bipartisan effort is supported by an advisory board that includes George McGovern and Newt Gingrich, representatives of both ends of the political spectrum. Rather than advocating caps on damages, Common Good argues for a reform of the system of jurisprudence, removing education and health care claims from the court system. Cases would be settled by committees of professionals that would be able to

differentiate frivolous suits from those with merit. Howard argues that this would limit the overall cost of litigation to society without putting limits on the judgments awarded to those with valid claims. In spite of the bipartisan support, Howard is not without detractors. Ralph Nader and the American Association of Justice (<http://www.atlanet.org>) contend that Howard favors defendants at the expense of plaintiffs.⁶³

In 2007, the Supreme Court repudiated a 1957 ruling, *Conley v. Gibson*, which has provided the underpinning for much of the most egregious forms of litigation. In this ruling, the Supreme Court instructed judges to not dismiss a claim except in extreme circumstances.⁶⁴ Over the next 50 years, this ruling was cited in forty thousand decisions.⁶⁵ While gratified by this decision, Philip K. Howard is concerned that it does not go far enough. He says that judges are now trained to avoid making value judgments about cases, so changing 50 years of practice will not happen easily. Figure 14-2 provides two examples from today's courtrooms that illustrate the range of concerns tort reform must address.

The debate over product liability law is likely to continue. Business claims the current system is inherently inefficient, raises the costs of litigation, and imposes a hidden tax on consumers because it inhibits innovation and dampens competitiveness. Consumer groups argue that the current system has forced

Figure 14-2 *The Double-Edged Sword of Tort Reform*

The Pants with the Platinum Price Tag

A newly appointed Washington, D.C., administrative law judge, Roy L. Pearson, Jr., had five expensive Hickey Freeman suits, one for each day of the week. The pants had become uncomfortably tight, so he took them for alterations to a local dry cleaning service owned by a Korean couple who came to the United States in 1992. The cleaners failed to return one pair of pants and, according to Judge Pearson, tried to pass cheaper pants off as the ones he had brought to have altered. Judge Pearson sued for \$67.3 million, charging fraud because the signage in the store promised "Same Day Service" and "Satisfaction Guaranteed."

The Chemical Catch-22

Jack Cline is critically ill in an Alabama hospital; he suffers from leukemia that he claims to have contracted due to his exposure to benzene during factory work he did years earlier. Alabama law makes it impossible for Mr. Cline to have his day in court. He could not sue when he was exposed to the benzene because it would have been too early. In Alabama, people exposed to dangerous chemicals must wait until a "manifest" injury develops. However, it was too late for him to sue when his leukemia manifested years later, because Alabama has a statute of limitations that requires that suits be brought within two years of exposure.

Sources: Ariel Sabar and Suevon Lee, "Judge Tries Suing Pants Off Dry Cleaner," *New York Times* (June 13, 2007); Adam Cohen, "Editorial Observer; They Say We Have Too Many Lawsuits? Tell It to Jack Cline," *New York Times* (January 14, 2007).

Ethics in Practice Case

THE PIRATED POPCORN

Last year, I worked in a local movie theater to earn money during the summer. Part of my job was to clean the theater between showings, collecting discarded cups, napkins and popcorn tubs. I thought it was odd when my manager asked that I empty and then bring him discarded popcorn tubs that were in fairly good shape. He would then reuse them—refilling them with popcorn for unsuspecting customers.

I soon learned that the theater paid for its popcorn concession by the number of tubs it used.

By reusing the tubs, the theater was able to lower its costs. However, I was fairly certain that customers would have been upset if they knew what was happening (I knew that I would be).

1. How would you characterize the practice in which the movie theater engaged?
2. Should I have followed my manager's orders and gone along with his request? Was it really such a terrible thing to do?

companies to make safer products and listen to their customers. Studies show that both sides have valid arguments: The laws have spurred some safety improvements, but they have also hampered innovation.⁶⁶ Of course, if businesses internalize the notion of product safety and take responsibility for the products and services they sell, the need for legal redress is precluded and the entire business/consumer relationship is far better served.

We now consider two major government agencies that are dedicated to product safety: the Consumer Product Safety Commission and the Food and Drug Administration.

Consumer Product Safety Commission

The **Consumer Product Safety Commission (CPSC)** is an independent regulatory agency that was created by the Consumer Product Safety Act of 1972. CPSC works to reduce the risk of injuries and deaths from consumer products by:⁶⁷

1. Developing voluntary standards with industry
2. Issuing and enforcing mandatory standards
3. Banning consumer products if no feasible standard would adequately protect the public
4. Obtaining the recall of products or arranging for their repair
5. Conducting research on potential product hazards

Figure 14-3 CPSC: Development of Voluntary Standards

VOLUNTARY SAFETY STANDARDS			
Indoor Air Quality Hazards	Children's Product Hazards	Fire/Electrical Hazards	Other Hazards
Carbon Monoxide (CO) Detectors. Includes new alarm requirements based on both CO concentration and exposure time.	Bunk Beds. Includes provisions to prevent the collapse of the mattress and its foundation, as well as provisions to prevent entrapment or strangulation in the bunk bed's structure.	National Electrical Code. Provides added GFCI protection around household sinks, requires GFCI protection for spas and hot tubs, and adds a requirement that heat tapes be safety certified.	Automatic Garage Door Openers (two revisions). Includes cautionary labeling on the risk of entrapment.
Formaldehyde in Particleboard and Formaldehyde in Hardwood and Decorative Plywood (two standards). Specifies allowable formaldehyde emissions.	Drawstrings on Children's Clothing. Four months after CPSC presented evidence of dangers to children, manufacturers voluntarily removed drawstrings from existing children's clothing and promised that new clothing would be manufactured with safer alternatives, such as Velcro and snaps.	Handheld Hair Dryers. Includes requirements for polarized plugs, cautionary labeling on the risk of use near water, and protections from electrocution when immersed, whether the unit is turned on or off.	Aboveground/Onground Swimming Pools. Provides recommended barrier requirements (within an appendix to the standard) to prevent child drownings.

Source: U.S. Consumer Product Safety Commission, <http://www.cpsc.gov>.

6. Informing and educating consumers through the media, state and local governments, private organizations, and by responding to consumer inquiries

The CPSC points with pride to the 30 percent reduction in the rates of death and injury caused by consumer products since the agency's inception.⁶⁸ Figure 14-3 presents examples of voluntary safety standards developed by the CPSC.

The CPSC was created at the zenith of the consumer movement as a result of initiatives taken in the late 1960s. President Lyndon Johnson established a National Commission on Product Safety in 1968, and this commission recommended the creation of a permanent agency. The commission justified its recommendation by its finding that an estimated 20 million Americans were injured annually by consumer products. President Richard Nixon, who took office while the proposed agency was still being debated, supported the agency's creation, but not as an independent agency. Congress gave the agency an unusually high degree of independence and required that it open its proceedings to the public to address the often-heard criticism of regulatory agencies that they

become captives of the industries they regulate. Congress's intent was to keep business at arm's length and to involve consumers as primary participants in the agency's decision making.⁶⁹

The CPSC experienced ups and downs as various administrations came into office. The agency grew in the 1970s, became controversial in the late 1970s, and was significantly reduced in power after the 1980 election of Ronald Reagan as president. The Reagan years of the CPSC (1980–1988) were marked by drastic budget cuts, massive staff reductions, and eventual paralysis of the agency. The agency survived several attempts to dismantle it. As one indication of the downturn it took during the Reagan years, its budget steadily declined from \$40.6 million in 1980 to \$32.6 million in 1988 before experiencing an upturn.⁷⁰

Like most of the regulatory agencies in the post-Reagan environment, the CPSC began demonstrating renewed activism in the 1990s. Much of this was due to the longest-serving chairperson in CPSC history, Ann Brown, who took charge in 1994 and resigned in November 2001. During Brown's tenure, funding for the agency increased by more than 25 percent; civil penalty amounts increased 2,500 percent. Each year, CPSC announced an average of more than 300 product recalls. Upon leaving the agency, Brown formed Safer America for Everyone (SAFE), a nonprofit organization dedicated to promoting consumer health and safety. Brown was known for pursuing voluntary cooperation with industry. During her tenure, the agency agreed to five times as many voluntary standards as mandatory.⁷¹

In June 2001, President Bush selected Mary Gall to serve as the chair and commissioner of the CPSC. Two months later, Congress rejected the nomination in a strict party-line vote. Democrats charged that Gall, who was known for having a "hands-off" regulatory philosophy, placed the interests of business over the safety of consumers. Gall favored industry self-regulation and consumer responsibility over government intervention. Republicans and the White House derided the vote as "pure partisan politics." They pointed to the fact that Gall was appointed by then-President Clinton and confirmed by Congress with her current philosophy.⁷² In April 2002, former New Mexico attorney general Harold Stratton was nominated and subsequently confirmed by Congress. Although a believer in free markets, he assured skeptics that he would shut down businesses if necessary to get unsafe products off the market.⁷³ Stratton's tenure to date has both pleased and angered his critics. Just four days after taking the reins, Stratton imposed a \$1 million fine on General Electric for fire-prone dishwashers.⁷⁴ However, in November 2003, Stratton cast the deciding vote to drop the demand that Daisy recall 7.5 million BB guns. The Daisy lawsuit was filed by Stratton's predecessor, Ann Brown, in response to at least 15 deaths and 171 serious injuries stemming from a defect that caused BBs to be lodged in the magazine even when it appeared to be empty. About 80 percent of the deaths and injuries involved children under the age of 16. The CPSC agreed to a settlement requiring Daisy to post larger safety warnings and mount a five-year education campaign, a settlement the commission had rejected twice before. The settlement was opposed by the commission staff, who felt any settlement should include corrective action to repair the defect. In a scathing dissent,

commission member Thomas H. Moore said, “Bottom line is that we are not the business protection agency.”⁷⁵

Stratton resigned in July 2006, but the concern that the CPSC was biased in favor of business did not leave with him. President Bush nominated Michael Baroody to take his place, a move that was roundly criticized by consumer groups and newspaper editorialists who charged that, as executive vice-president of the National Association of Manufacturers (NAM), Baroody was too closely aligned with the industries he was supposed to oversee.⁷⁶ OMB Watch, a Washington-based Right to Know watch group, described the nomination as another example of the Bush administration’s efforts to “slow down or roll back governmental regulation. While at NAM, Baroody built a powerful lobbying and communication arm, which has had a very strong regulatory agenda.”⁷⁷ At this writing, the commission has not been able to vote or take actions because the commission’s charter only allows it to operate with vacancies for six months; there have been three vacancies on the commission for nearly a year.⁷⁸

The CPSC continues to play an important role in protecting consumers from unsafe products. The CPSC remains the only clearinghouse available for consumers who have safety concerns with the more than fifteen thousand products under its care, and it is the only mechanism available for recalling unsafe products. Figure 14-4 presents some of the challenges that will face the new CPSC commissioner.

Food and Drug Administration

The **Food and Drug Administration (FDA)** grew out of experiments with food safety by one man—Harvey W. Wiley—chief chemist for the Agricultural Department in the late 1800s. Wiley’s most famous experiments involved feeding small doses of poisons to human volunteers. The substances fed to the volunteers were similar to those found in food preservatives at the time. The volunteers became known as the “Poison Squad,” and their publicity generated a public awareness of the dangers of eating adulterated foods. The Food and Drug Act of 1906 was a direct result of the publicity created by Wiley’s experiments. The act was administered by Wiley’s Bureau of Chemistry until 1931, when the name “Food and Drug Administration” first was used. The Food and Drug Act called for the protection of the public from potential health hazards presented by adulterated or mislabeled foods, drugs, cosmetics, and medical devices. Later laws for which the FDA became responsible included the Food, Drug, and Cosmetic Act of 1938; the Public Health Service Act of 1944; the 1968 Radiation Control for Health & Safety Act; the Fair Packaging and Labeling Act of 1966; and the 1984 Drug Price Competition and Patent Restoration Act. In response to these and other major laws, the FDA regulates foods, drugs, cosmetics, and medical devices found in interstate commerce.⁷⁹ Figure 14-5 provides the mission of the FDA.

The powers of the FDA were expanded as a result of other laws and amendments. The 1958 Delaney Amendment to the Food, Drug, and Cosmetic Act

was especially notable. The Delaney Amendment requires the FDA to ban any food or color additive that has been shown to cause cancer in laboratory test animals. In 1962, amendments were passed to require drug manufacturers to prove the effectiveness as well as the safety of their products before marketing

Text not available due to copyright restrictions

Figure 14-5 *The Mission of the FDA*

The FDA is responsible for protecting the public health by assuring the safety, efficacy, and security of human and veterinary drugs, biological products, medical devices, our nation's food supply, cosmetics, and products that emit radiation. The FDA is also responsible for advancing the public health by helping to speed innovations that make medicines and foods more effective, safer, and more affordable; and helping the public get the accurate, science-based information they need to use medicines and foods to improve their health.

Source: <http://www.fda.gov>.

them. In addition, the FDA was authorized to order the withdrawal of dangerous products from the market. In 1976, Congress passed legislation requiring the regulation of complex medical products and diagnostic devices.

The FDA resides within the Health and Human Services Department and engages in three broad categories of activity: analysis, surveillance, and correction. Throughout most of the 1980s, the themes emphasized were the cutting of bureaucratic delays and red tape, the speeding up of agency decisions, and the elimination of unnecessary regulation. A major blow to the agency occurred during the 1980s, when it was disclosed that four FDA employees were accused of taking cash payoffs and illegal gifts from a major generic drug company in return for favored treatment. Major challenges the FDA faced early in the George Herbert Walker Bush administration included the AIDS epidemic, regulation of medical devices, food safety, fat substitutes, nutritional labeling, and over-the-counter drug review.⁸⁰ In 1991, under new commissioner David Kessler, the FDA embarked on an aggressive crackdown on deceptive product labels, which created a fair amount of controversy. In early 1991, the FDA targeted two highly visible products and companies to make its point. It seized Procter & Gamble's Citrus Hill "Fresh Choice" orange juice and, a few days later, Ragu "Fresh Italian" pasta sauce, the nation's leading tomato sauce brand. In both cases, the FDA forced the companies to remove the term "fresh" from their products because they thought the companies were inaccurately applying that term to their products.

The point of the FDA was clear. It was no longer going to pursue the practice, which had become commonplace throughout the 1980s, of companies suspected of violations stretching out negotiations with the agency for years while engaging in an endless back-and-forth exchange of proposals and counterproposals. The FDA was reasserting itself as an agency that was planning to take swift action against violators. In addition to the two cases cited, the FDA sent warning letters to the manufacturers of Listerine, Plax, and Viadent mouthwash brands; Weight Watchers and Kraft brands of cholesterol-free mayonnaise; and Fleischmann's reduced-calorie margarine, among other products. The agency thought that these manufacturers had made claims that misrepresented the features of their products.⁸¹

There is perhaps no other regulatory body that has become more controversial in recent years than the FDA. Under David Kessler's leadership, the FDA aggressively and zealously pursued companies it felt were out of compliance with government regulations or were taking advantage of consumers. Supporters of the FDA applauded it for relentlessly pursuing violators. In 1997, Dr. Kessler resigned and Dr. Jane Henney, vice president of research for the University of New Mexico, was nominated to be his successor.⁸² Having served under both Bush and Clinton, Henney enjoyed bipartisan credentials. However, her tenure as deputy to Dr. Kessler raised red flags for Senate Republicans, who found Republican Kessler overly quick to regulate and overly slow to approve treatments and devices.⁸³ After contentious debate, Henney was confirmed. During her tenure in office, the "abortion pill," RU-486, was approved. When the second President Bush took

office, Henney handed in her protocol resignation, which was accepted shortly thereafter, effectively firing her. Although significant lobbying to retain her occurred, she was not able to duplicate the feat of Republican David Kessler, who had been retained by the Democratic Clinton administration after being appointed by the first Bush administration. Observers felt that her failure to block the approval of RU-486 doomed her reappointment.⁸⁴ Mark McClellan became the head of the FDA in late 2002 but was tapped to head Medicare just 15 months later in March 2004. In his short tenure, McClellan drew praise for streamlining the approval process for new drug therapies—something at which the FDA had been quite bad.⁸⁵ McClellan's deputy, Les Crawford, became acting commissioner and then commissioner but was not able to hold the position for long. Just two months into his tenure, Crawford resigned abruptly. A year later, he pleaded guilty to misleading federal officials about stocks he owned in FDA-related companies: he received three years of supervised probation, 50 hours of community service, and a \$90,000 fine.⁸⁶ Andrew von Eschenbach became the acting head of the FDA upon Crawford's resignation and was subsequently confirmed as the commissioner in 2007.⁸⁷

Many observers are questioning the ability of the FDA to keep the food supply safe as food imports are rising while the ability of the FDA to police the food supply is declining.⁸⁸ To quote a *Newsweek* article on the spate of food contamination that occurred in 2007, "The hamstrung FDA may be unable to prevent a contamination crisis." As *Newsweek* notes, the problem is not due to lack of trying on the part of the FDA. Five years earlier, FDA officials developed an import safety plan that would have cost \$100 million; their plan did not receive funding. They asked for the authority to block foods from countries repeatedly linked to contaminated products until they were able to establish their own controls; Congress did not give them the authority. A key reason for this impasse is that food manufacturers spent more than \$100 million lobbying against new regulations. Caroline Smith DeWaal of the Center for Science in the Public Interest, expressed her concern: "The food supply should not be the Wild, Wild West for capitalism. If a country does not have systems in place to ensure safety, they shouldn't be able to send us food."⁸⁹

Business's Response to Consumer Stakeholders

Business's response to consumerism and consumer stakeholders has varied over the years. It has ranged from poorly conceived public relations ploys at one extreme to well-designed and implemented programs like total quality management (TQM) and Six Sigma at the other. The history of business's response to consumers parallels its perceptions of the seriousness, pervasiveness, effective-

ness, and longevity of the consumer movement. When the consumer movement first began, business's response was casual, perhaps symbolic, and hardly effective. Today, the consumer movement has matured, and formal interactions with consumer stakeholders have become more and more institutionalized. Business has realized that consumers today are more persistent than in the past, more assertive, and more likely to use or exhaust all appeal channels before being satisfied. Armed with considerable power, consumer activists have been a major stimulus to more sincere efforts on behalf of business to provided consumers with a forum. These efforts have included the creation of toll-free hot lines, user-friendly websites, and consumer service representatives. Programs like total quality management and Six Sigma have become the strategic responses. These responses merit brief consideration.

Total Quality Management Programs

Total quality management (TQM) has many different characteristics, but it essentially means that all of the functions of the business are blended into a holistic, integrated philosophy built around the concepts of quality, teamwork, productivity, and customer understanding and satisfaction.⁹⁰ Figure 14-6 depicts one useful view of the principles, practices, and techniques of TQM. It should be noted that the customer, or consumer stakeholder, is the focus of the process. Efforts to show a relationship between TQM and financial performance have met with mixed results.⁹¹ The positive impact TQM can have on safety in the workplace, in contrast, has been established.⁹²

A vital assumption and premise of TQM is that the customer is the final judge of quality. Therefore, the first part of the TQM process is to define quality in terms of customer expectations and requirements. Figure 14-7 presents several different popular definitions of quality and their strengths and weaknesses.

Customer expectations and requirements are then converted to standards and specifications. Finally, the entire organization is realigned to ensure that both conformance quality (adherence to standards and specifications) and perceived quality (meeting or exceeding customer expectations) are achieved.⁹³ It is clear in TQM that "delighted customers" is the overarching goal of management's efforts.⁹⁴ It is important to remember that customers' perceived quality is not always the same as actual quality and so firms may have to wait for customers to realize that genuine quality improvements have been made.⁹⁵

Opportunities for recognition have helped to propel quality efforts. In the United States and the rest of the industrialized world, the Malcolm Baldrige Award, ISO 9000, and the Deming Quality Award have enhanced the reputations of firms that undertake quality initiatives and complete them successfully. However, TQM became the buzzword of the 1980s, and many of its slogans, such as "Getting it right the first time" became viewed as clichés. It is against that

Figure 14-6 Principles, Practices, and Techniques of Total Quality Management

	Customer Focus	Continuous Improvement	Teamwork
Principles	<ul style="list-style-type: none"> • Paramount importance of customers • Providing products and services that fulfill customer needs; requires organization-wide focus on customers 	<ul style="list-style-type: none"> • Consistent customer satisfaction can be attained only through relentless improvement of processes that create products and services 	<ul style="list-style-type: none"> • Customer focus and continuous improvement are best achieved by collaboration throughout an organization as well as with customers and suppliers
Practices	<ul style="list-style-type: none"> • Direct customer contact • Collecting information about customer needs • Using information to design and deliver products and services 	<ul style="list-style-type: none"> • Process analysis • Reengineering • Problem solving • Plan/do/check/act 	<ul style="list-style-type: none"> • Search for arrangements that benefit all units involved in a process • Formation of various types of teams • Group skills training
Techniques	<ul style="list-style-type: none"> • Customer surveys and focus groups • Quality function deployment (translates customer information into product specifications) 	<ul style="list-style-type: none"> • Flowcharts • Pareto analysis • Statistical process control • Fishbone diagrams 	<ul style="list-style-type: none"> • Organizational development methods, such as the nominal group technique • Team-building methods (e.g., role clarification and group feedback)

Source: James W. Dean, Jr., and David E. Bowen, "Management Theory and Total Quality: Improving Research and Practice Through Theory Development," *Academy of Management Review* (Vol. 19, No. 3, July 1994), 395.

http://SEARCH THE WEB WEB

THE AMERICAN SOCIETY FOR QUALITY

The American Society for Quality (ASQ)'s mission is to make "quality a global priority, an organizational imperative, and a personal ethic." Founded in 1946, ASQ provides a range of resources for those who seek

to improve themselves and their world. Their website (<http://www.asq.org>) is a compendium of resources for improving quality and a source of links to other quality initiatives.

Figure 14-7 *Strengths and Weaknesses of Quality Definitions*

Definition	Strengths	Weaknesses
Excellence	<ul style="list-style-type: none"> • Strong marketing and human resource benefits • Universally recognizable—mark of uncompromising standards and high achievement 	<ul style="list-style-type: none"> • Provides little practical guidance to practitioners • Measurement difficulties • Attributes of excellence may change dramatically and rapidly • Sufficient number of customers must be willing to pay for excellence
Value	<ul style="list-style-type: none"> • Concept of value incorporates multiple attributes • Focuses attention on a firm's internal efficiency and external effectiveness • Allows for comparisons across disparate objects and experiences 	<ul style="list-style-type: none"> • Difficulty extracting individual components of value judgment • Questionable inclusiveness • Quality and value are different constructs
Conformance to Specifications	<ul style="list-style-type: none"> • Facilitates precise measurement • Leads to increased efficiency • Necessary for global strategy • Should force disaggregation of consumer needs • Most parsimonious and appropriate definition for some customers 	<ul style="list-style-type: none"> • Consumers do not know or care about internal specifications • Inappropriate for services • Potentially reduces organizational adaptability • Specifications may quickly become obsolete in rapidly changing markets • Internally focused
Meeting and/or Exceeding Expectations	<ul style="list-style-type: none"> • Evaluates from customer's perspective • Applicable across industries • Responsive to market changes • All-encompassing definition 	<ul style="list-style-type: none"> • Most complex definition • Difficult to measure • Customers may not know expectations • Idiosyncratic reactions • Prepurchase attitudes affect subsequent judgments • Short-term and long-term evaluations may differ • Confusion between customer service and customer satisfaction

Source: Carol A. Reeves and David A. Bednar, "Defining Quality: Alternatives and Implications," *Academy of Management Review* (Vol. 19, No. 3, July 1994), 437.

backdrop that other tools developed, such as just in time (JIT) and business process reengineering (BPR). Many were concerned about a TQM shortcoming, as described by Phil Crosby, a leading TQM consultant: “TQM never did anything to define quality, which is conformance to standards.”⁹⁶ The need for a more rigorous definition of quality was part of the appeal of Six Sigma, which we will describe briefly.

Six Sigma

Six Sigma is a development in total quality management that has become a way of life for many corporations. Basically, Six Sigma is a heading under which is grouped a body of methodologies and techniques. Scarcely a week goes by without a major corporation adopting Six Sigma as a way of improving quality and reducing costs.⁹⁷ Dow, DuPont, Sony, Honeywell, Nokia, GlaxoSmithKline, and Raytheon are but a few of the major corporations relying on the Six Sigma methodology. According to Jack Welch, former CEO of GE, “[Six Sigma—the Breakthrough Strategy] is the most important initiative GE has ever taken It is part of the genetic code of our future leadership.”⁹⁸ Although some deride Six Sigma as “TQM on steroids,” it has brought new commitment and energy to the quest for quality in the new millennium. It is even said to have brought “more prominence to the quality world than it has enjoyed since the glory days of the mid-1980s.”⁹⁹

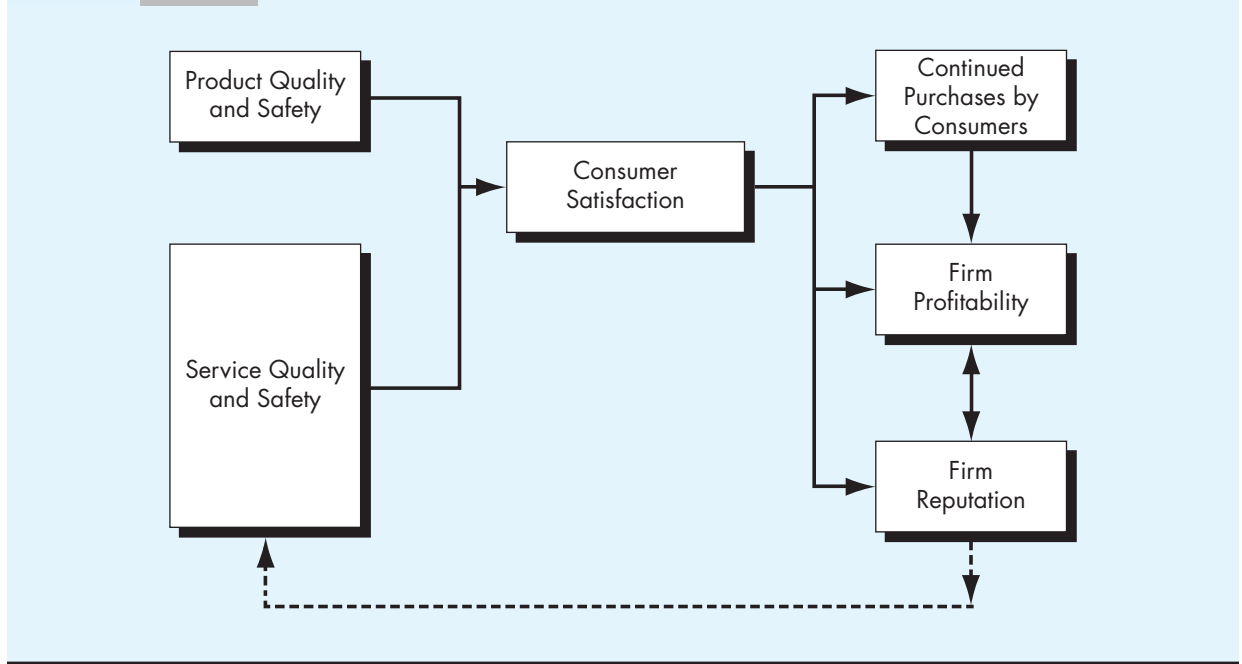
Motorola first developed Six Sigma, and Allied Signal later experimented with it, but most observers believe that GE perfected it. *Sigma* is a statistical measure of variation from the mean; higher values of sigma mean fewer defects. The six-sigma level of operation is 3.4 defects per million. Most companies operate around the four-sigma level, i.e., 6,000 defects per million. Corporations adopting the program must develop “black belts,” i.e., people specifically trained to fill sponsorship roles, provide assistance, and see the program through. They must

<http://SEARCHTHEWEBWEB>

SIX SIGMA

To learn more about Six Sigma, visit <http://www.issp.com>, the website of the International Society of Six Sigma Professionals, a professional membership organization “dedicated to the advancement of education, research and implementation of Six Sigma, as well as the integration of Six Sigma with other

business practices.” The membership of ISSSP includes corporate and affiliate participants, as well as individual members. ISSSP also offers www.sixsigma.com, which is a resource for obtaining information or materials related to Six Sigma.

Figure 14-8 A Consumer-Stakeholder Satisfaction Model

also find “champions” at senior levels of management who are committed to shepherding the program when needed.¹⁰⁰

One of Six Sigma’s strengths has been the clarity of the process and the steps companies must take to adopt it. However, Six Sigma is more than a toolbox with clear instructions. The program also represents a philosophy that stresses the importance of customers as well as careful measurement. Six Sigma practitioners look for facts rather than opinions, and they believe in fixing the process rather than the product.¹⁰¹ Of course, these underlying principles are the foundation of TQM and most other quality efforts. The basis for all of these is the satisfaction of the consumer. Figure 14-8 outlines a consumer-stakeholder satisfaction model.

Summary

Consumer stakeholders have become concerned with product quality and safety, largely because businesses have failed to meet their needs reliably on these two fronts. The situation has been the same with both manufacturing and services. One major challenge has been to identify and understand all the different dimen-

sions of the quality issue. Today, quality may mean performance, features, reliability, conformance, durability, serviceability, aesthetics, perceived quality, or some combination of these dimensions.

An extremely important legal and ethical issue has been the consumer’s right to safety. Product

safety has become one of the most crucial consumer issues for firms. The product liability crisis has been an outgrowth of business's lack of attention to this issue. Other factors contributing to the product liability crisis have been the number of harmful-product cases, our increasingly litigious society, the size of financial awards given by the courts, and rising insurance rates. A major consequence of these phenomena has been calls for tort reform. Product tampering and product extortion have also become safety-related issues. In recent years, the health and safety issues related to foods, drugs, and medical devices have propelled the Consumer Product Safety Commission and the Food and Drug Administration into prominent roles.

Quality improvement initiatives like TQM and Six Sigma have not solved all the problems. However, they and other techniques have the potential for addressing the problems in a significant way if they are properly formulated and implemented. In addition to these specific responses, a consumer focus and orientation needs to permeate management decision making if the concerns of consumers are to be handled effectively. In today's business environment, consumers have many choices. Consequently, companies have no alternative but to internalize the consumer focus if they are to succeed.

Key Terms

absolute liability (page 555)

contractual theory (page 550)

Consumer Product Safety Commission (CPSC) (page 560)

delayed manifestation cases (page 556)

due care theory (page 550)

Food and Drug Administration (FDA) (page 564)

market share liability (page 556)

product liability reform (page 557)

Six Sigma (page 570)

social costs view (page 550)

strict liability (page 555)

tort reform (page 557)

total quality management (TQM) (page 567)

Discussion Questions

1. Identify the dimensions of quality. Give an example of a product or service in which each of these characteristics is important.
2. What ethical theories can help us to better understand the issue of quality? Discuss.
3. Identify the principal reasons why we have a product liability crisis. Have any reasons been omitted? Discuss.
4. Differentiate the doctrine of strict liability from the doctrines of absolute liability and market share liability. What implications do these views have for the business community and for future products and services that might be offered?
5. Given the current business and consumer climate, what do you anticipate the future to be for the CPSC and the FDA? What role does politics play in your answer?

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The Natural Environment as Stakeholder

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Discuss the concept of sustainability.
- 2 Describe ten major natural environment issues.
- 3 Describe the NIMBY environmental problem.
- 4 Discuss the roles that business and government play in environmental issues.
- 5 Explain the concept of environmental ethics.

Sustainability means running the global environment—Earth Inc.—like a corporation: with depreciation, amortization and maintenance accounts. In other words, keeping the asset whole, rather than undermining your natural capital.¹

— Maurice Strong

For years, businesses conducted their operations with little concern about environmental consequences. Virtually every sector of business in every country was responsible for consuming significant amounts of materials and energy and causing waste accumulation and resource degradation. For instance, forestry firms and companies that process raw materials, such as uranium, coal, and oil, have caused major air, water, and land pollution problems in their extraction, transportation, and processing stages. Manufacturing firms, such as those in steel, petrochemicals, and paper products, have been major sources of air and water pollution. However, most major industry sectors have contributed significant levels of pollution with relatively little concern. Businesses would look the other way, simply labeling the negative consequences of their actions as

externalities.² **Externalities** are side effects or by-products of actions that are not included in standard cost accounting systems.³

By labeling the environmental consequences as external to the process, businesses were able to both acknowledge and dismiss the problems they created. The few business environmentalism efforts that existed tended to come from two sources, compliance and efficiency.⁴ Environmentalists had one approach available for getting most businesses to treat the environment with greater respect, “mandate, regulate and litigate”: businesses would stop damaging the environment only when it became illegal and/or unprofitable to do so.⁵ For the most part, those days are ending. Companies that were once infamous for the damage they did to the environment are now scrambling to lead the way in environmental initiatives. The reason for the change is simple—environmentalism is now profitable. Companies can make money not only by increasing efficiency but also by inventing entirely new businesses.⁶

In this chapter, we will begin by discussing the concept of sustainability and its importance to business. We will then outline the top environmental issues facing business today. Environmental ethics will begin our discussion of individual and collective responsibility for sustaining the environment. We will explore the role of the government and environmental interest groups in effecting change and then look at companies that are leaders in practicing sustainable business practices. Lastly, we will offer ways in which businesses can develop an environmental strategy aimed at achieving sustainability.

The Sustainability Imperative

There are many definitions of **sustainability**. For our purposes, we will borrow from the Brundtland Commission (formerly the World Commission on Environment and Development [WCED]) to define sustainable business as “business that meets the needs of the present without compromising the ability of future generations to meet their own needs.”⁷ The focus of sustainability is the creation of a good quality of life for both current and future generations of humans and nonhumans by achieving a balance between economic prosperity, ecosystem viability, and social justice.⁸ The concept is akin to walking lightly on the earth, taking only what is needed, and leaving behind enough for future generations to have access to the same resources.

Sustainability is not just about cutting back and limiting waste. It is a philosophy that embraces a new type of abundance that can inspire greater levels of business creativity.⁹ As the sustainability movement grows, creative businesspeople are developing new environmentally responsible ways of doing business. For example, Paul Dolan, the former president of Fetzer Vineyards, is often referred to as the “Sustainability Guru.”¹⁰ Dolan had spent decades in the wine business by the time he became president of Fetzer Vineyards. He read *The Ecology of Commerce* by Paul Hawken just before becoming president, and that book gave shape to his future plans. “It suddenly became apparent to me that sustainability was the way,” said

Figure 15-1 *Six Principles of Sustainable Success*

1. Your business is part of a much larger system.
2. The culture of your business is determined by the context you create for it.
3. The soul of a business is found in the hearts of its people.
4. True power is living what you know.
5. You can't predict the future, but you can create it.
6. There is a way to make an idea's time come.

Source: Paul Dolan, *True to Our Roots: Fermenting a Business Revolution* (New York: Bloomberg Press, 2003).

Dolan. Today, Fetzer farms all its own vineyards with certified organic practices and ranks as one of the largest growers of organic wine grapes in the world.¹¹ Fetzer recycles virtually all of their waste. According to Dolan, “We don’t have waste baskets anymore. When you finish a meal, you have either a paper basket, a plastic basket, a metal basket, or a scrap food basket—it’s gotta fit in one of those.”¹²

Recently, Dolan formed a partnership to purchase a small Mendocino County winery, Parducci Cellars. Parducci became the first **carbon neutral** winery in the United States, which means it maintains a balance between the carbon dioxide it produces and the carbon dioxide it uses.¹³ It is locally owned and operated; the partners live and work there, and so they have a commitment to the community that might not be felt by absentee corporate owners.¹⁴ The vineyard’s grapes are organically grown on family farms.¹⁵ In addition, they use solar power and earth-friendly packaging to help them achieve carbon neutrality.¹⁶ Parducci proclaims that their practices are “right for the planet and right for the wine.”¹⁷ Dolan has written a book, *True To Our Roots: Fermenting a Business Revolution*, in which he outlines six principles of sustainable success: they are listed in Figure 15-1.

A Brief Introduction to the Natural Environment

Similar to other broad terms, **environment** means many things to many people—trees in the backyard, a family’s favorite vacation spot, a mare and her colt in a pasture, a trout stream in the mountains, earth and the other planets and space objects in our solar system. This chapter focuses on the natural environment—specifically, what it is, why it is important, how it has become a major concern, and what businesses and other organizations have done both to and for it. This chapter identifies what we mean when we use the term *environment* and why it has become one of the most significant societal issues of our time. We will also describe the variety of responses human organizations, including businesses, have

developed to address this issue. Throughout the chapter, we will emphasize two themes: that humans are a part of their natural environment and that the environment itself, as well as the issues and human responses related to it, are extremely complex, defying simple analyses.

To assist you in making business environmental decisions in the future, we will present facts and figures, some of which will be technical and scientific, related to environmental issues and responses. These facts and figures are included to help you understand the complexities involved in the business and public environmental issues of today. Because of the influence of business, government, and environmental interest groups and individuals, these and many other technical terms and concepts are discussed in the media and, increasingly, in business and

Figure 15-2 *Glossary of Important and Helpful Environmental Terms*

Environment	Broadly, anything that is external or internal to an entity. For humans, the environment can include external living, working, and playing spaces and natural resources, as well as internal physical, mental, and emotional states.
Carbon Neutral	The maintenance of a balance between producing and using carbon dioxide.
Carrying Capacity	The volume of and intensity of use by organisms that can be sustained in a particular place and at a particular time without degrading the environment's future suitability for that use. A resource's carrying capacity has limits that need to be respected for continued use.
Entropy	A measure of disorder of energy, indicating its unavailability for recycling for the same use. Energy tends to break down into lower quality with each use. For instance, a kilowatt of electricity, once it is produced and consumed, can never be used as electricity again and, if stored, will allow far less than 1 kilowatt to be consumed.
Ecosystem	All living and nonliving substances present in a particular place, often interacting with others.
Niche	The role an organism plays in its natural community, including what it eats and the conditions it requires for survival. Habitats and niches are interrelated concepts.
Cycle	The continuous looplike movement of water, air, and various nutrients, such as nitrogen, phosphorous, and sulfur, through the environment. Such cycles can be impaired in performing their evolutionary roles, such as purification and sustenance, by excessive human-caused pollution and depletion.
Threshold	The point at which a particular phenomenon, previously suppressed, suddenly begins to be activated. For instance, when a population's carrying capacity threshold is exceeded, the population tends to decrease or even crash as a result of increased morbidity and mortality.
Pollution	The existence of material or energy that has gone through a transformation process and is perceived as unwanted or devalued in a particular place at a particular time.
Irreversibility	The inability of humans and nature to restore environmental conditions to a previous state within relevant time frames. Human environment-related actions that appear irreversible are the destruction of a rainforest or wilderness area and the extinction of a species.
Sustainability	The ability to meet the needs of the present without compromising the ability of future generations to meet their own needs.

society texts. Environmental literacy, whether for business, government, or individual decision making, requires, at minimum, some rudimentary knowledge. Without at least some basic technical information, would-be stakeholder managers abdicate their responsibility to make wise choices potentially critical to the survival of their organizations, as well as to the survival of humans and other species in the natural environment. We call your attention to Figure 15-2, which presents definitions of a few of the most important environmental terms that might be helpful to you now and in the future.

The Impact of Business upon the Natural Environment

We will begin with a “top 10” list of environmental issues of today.¹⁸ They are:

1. Climate Change
2. Energy
3. Water
4. Biodiversity and Land Use
5. Chemicals, Toxics, and Heavy Metals
6. Air Pollution
7. Waste Management
8. Ozone Layer Depletion
9. Oceans and Fisheries
10. Deforestation

We will discuss each of these environmental problems briefly to give the reader a sense of the issue’s complexity and its current status.

CLIMATE CHANGE

No environmental issue has been more contentious than the subject of **climate change**, which is also known as **global warming**. The debate about its existence has lessened dramatically due to a combination of factors, including Hurricane Katrina, a European heat wave, starving polar bears, and stronger scientific predictions.¹⁹ Climatologists now say with some certainty that human activities are warming the earth at a dangerous level. In 2007, the Intergovernmental Panel on Climate Change placed the probability that human activities are creating climate change at greater than 90 percent. Just six years earlier, the probability was determined to be 60 percent.²⁰ The increased confidence in their estimation stems from a longer period of data collected and a greater understanding of the climate system; those two factors have led to more reliable climate models.²¹ Business leaders are also accepting the existence of climate change. The heads of the four

top U.S. automakers, *Fortune* 500 CEOs such as General Electric's Immelt and Walmart's Scott, as well as utility industry execs like Duke Power's Jim Rogers and PG&E's Darbee all now agree that climate change is real and that business has a responsibility to respond.²²

The possibility of a swift and radical change in climate is so sufficiently real that the Pentagon's strategic planners are actively developing responses to various scenarios.²³ Scientists expect the **greenhouse effect**—that is, the prevention of solar heat absorbed by our atmosphere from returning to space—to precipitate an unprecedented rate of warming.²⁴ None of these facts had more impact, however, than the release of the movie *An Inconvenient Truth* in 2006. Presented by former U.S. Vice President Al Gore and directed by David Guggenheim, the film won the Academy Award for best documentary and earned \$49 million, making it the third-highest-grossing documentary in history. Gore released a companion book that went to #1 on the New York Times Best Seller List. Skeptics denounced the movie and its accompanying book as misleading and inaccurate.²⁵ However, the generally positive reaction to its powerful message gave global warming a center stage from which it has not retreated.

Climate change is contentious because both the cost of addressing the issue and the cost of *not* addressing the issue are likely to be quite high.²⁶ Unpredictable weather, along with an increase in temperature, threatens a range of industries from agriculture to airlines to ski resorts. Natural disasters have cost insurance companies 10 times more now than in the 1950s. To mitigate this risk, reinsurance companies like Swiss Re and Munich Re have been lobbying for action on climate change.²⁷ Europe and Japan regulate greenhouse emissions now, and most observers believe the United States will regulate emissions in the near future. At a recent meeting of power company executives, a GE executive asked for a show of hands for how many felt the United States would cap greenhouse gas emissions

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ENVIROLINK

To interact effectively with environmental stakeholders, managers must educate themselves about environmental movement issues. Hundreds of organizations and websites deal with the natural environment. A website that can point you to these other websites is EnviroLink Network, a grassroots environmental community located at <http://www.envirolink.org>.

EnviroLink is a nonprofit organization that unites hundreds of organizations and volunteers around the

world with millions of people in more than 150 countries. EnviroLink states that it “is dedicated to providing you with the most comprehensive, up-to-date environmental resources available.” To learn more about EnviroLink's purposes, news, library, services, and awards, and such topics as sustainable business, animal rights, the green marketplace, and green living, visit this interesting and comprehensive website.

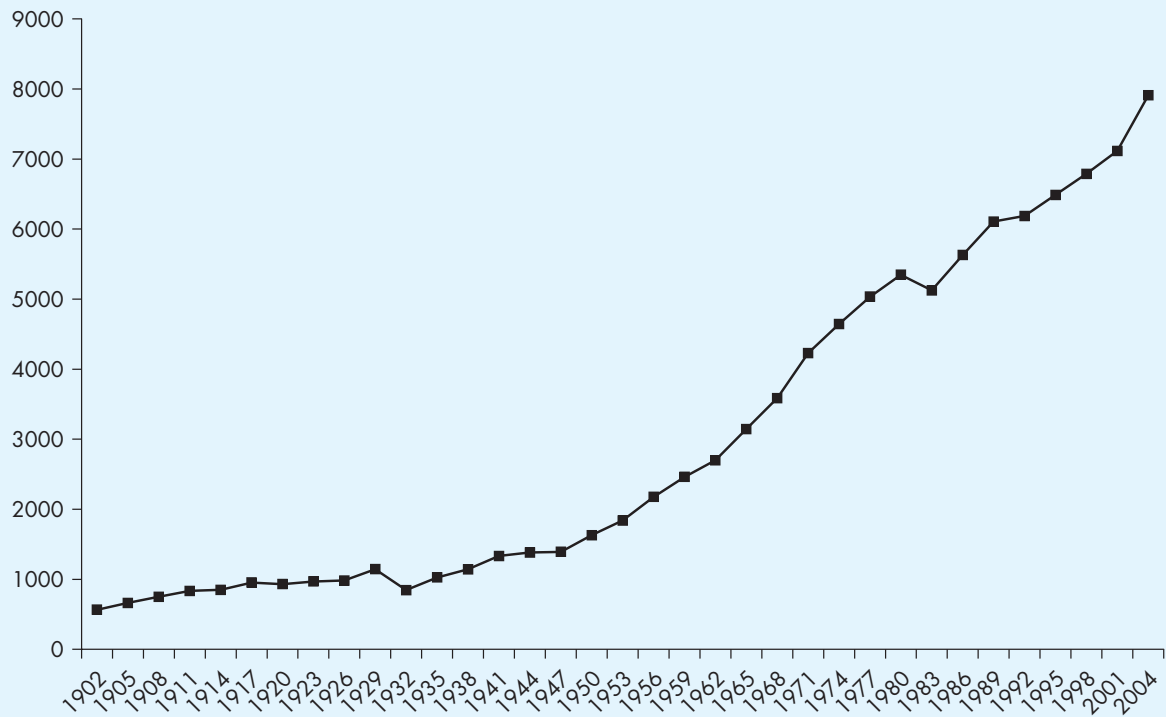
irrespective of which party wins the post-Bush presidential election. Nearly everyone raised their hands.²⁸

Figure 15-3 shows growth in global carbon dioxide emissions, measured in million metric tons, from 1900 to 2004.

ENERGY

A major environmental issue is **energy inefficiency**, or the wasting of precious nonrenewable sources of energy. Nonrenewable energy sources, such as coal, oil, and natural gas, were formed millions of years ago under unique conditions of temperature, pressure, and biological phenomena (hence the term *fossil fuels*). Once these are depleted, they will be gone forever. In addition, because these fuels are not equally distributed around the world, they are the cause of significant

Figure 15-3 *Global Carbon Dioxide Emissions*



Source: G. Marland, T.A. Boden, and R. J. Andres, "Global, Regional, and National CO₂ Emissions," in *Trends: A Compendium of Data on Global Change* (Oak Ridge, TN: Carbon Dioxide Information Analysis Center, Oak Ridge National Laboratory, U.S. Department of Energy, 2007).

power imbalances worldwide, with associated armed conflicts that are typically disastrous for both humans and the natural environment in general.²⁹

Part of the answer to the nonrenewability problem is to use as little as possible of these energy sources through implementation of sound energy conservation practices. In addition, shifting to renewable energy sources, such as solar, wind, hydroelectric, and biomass forms of energy, is important for both industrial and agricultural societies. Several technologies for tapping these renewable, low-polluting energy sources are becoming economically competitive with nonrenewable sources.³⁰ However, even though proponents argue that solar and wind power are ready for mass utilization, more than two-thirds of the electricity in the United States comes from fossil fuel combustion—51 percent from coal, 17 percent from natural gas, and 3 percent from oil.³¹ As India, China, and other fast-growth areas in the developing world increase their demand for energy, prices will continue to rise and availability will continue to fall.³²

For business, the energy issue represents not only a challenge but also an opportunity. Opportunities for new businesses abound as the demand for renewable energy rises. Many states now mandate that utilities obtain a minimum percentage of their energy supply through renewable energy, and companies ranging from Johnson & Johnson to FedEx and Starbucks have committed to buying a portion of their energy from renewable sources.³³ Wal-Mart has undertaken an unusual experiment by installing an advanced 50-kilowatt wind turbine atop a 120-foot tower in the parking lot of two experimental stores in Texas and Colorado. The two low-maintenance turbines can generate wind power from wind speeds as low as 4.5 miles per hour.³⁴ This level of interest has turned alternative energy companies into hot investments. In just two years, North American venture capital invested in clean energy technologies doubled to nearly \$3 billion.³⁵ Venture-capital investment in clean energy technologies in China has increased 147 percent from \$170 million in 2005 to \$420 million in 2006.³⁶ With the money now flowing into “clean tech” funds that focus mainly on renewable sources of energy, firms are scrambling to determine how to get a piece of the pie. Not every firm will succeed in this arena, but those that do stand to reap huge profits.³⁷

WATER

Water presents problems in both quality and quantity. The developed world has made significant progress in the quality of water—no longer are waterways so polluted that they pose a risk of catching on fire as the Cuyahoga River did in Cleveland in 1969.³⁸ Nevertheless, municipal sewage, industrial wastes, urban runoff, agricultural runoff, atmospheric fallout, and over-harvesting all continue to contribute to the degradation of the world’s oceans and waterways. So, too, do dam sedimentation, deforestation, overgrazing, and over-irrigation. As governments continue to require lower levels of pollution, companies must prepare for ever more stringent water management requirements.

The quality of the developing world's water is far worse than that in the developed world. A staggering 90 to 95 percent of sewage and 70 percent of industrial waste is untreated as it flows into rivers, lakes, and the ocean.³⁹ More than a billion people worldwide lack clean water, and the problem shows no signs of abating.⁴⁰

The earth is a closed system with a water supply that is fixed, so as populations grow and crop irrigation increases, supplies become depleted. Pollution renders existing water unusable, further diminishing the supply. A global water crisis has thus developed, brought on by a combination of drought, pollution, mismanagement, and politics.⁴¹ No country, no matter how big, is immune from this crisis. In the United States, the giant Ogallala Aquifer, which lies under parts of eight states, is diminishing dramatically due to heavy demand.⁴² In China, the Yangtze River is so heavily polluted that a 2007 World Wildlife Fund report declared the damage to the river's ecosystem to be largely irreversible.⁴³ The Yellow River has slowed to a trickle for much of the year, leaving nearly 400 million Chinese people, one-third of the country's population, without access to clean water.⁴⁴ In India, two-thirds of the 1.1 billion people lack clean water, and the water table drops six to ten feet each year. More than half the people in the world could be living in severely water-stressed areas by 2032 if current trends continue.⁴⁵

BIODIVERSITY AND LAND USE

An ecosystem's **biodiversity**, i.e., the variation of life forms inside the system, serves as a key indicator of its health. Throughout most of time, species lived an average of 1 million years, with species dying out at the rate of about one species per million years. The current rate of species extinction is well over 100 times greater than that.⁴⁶ In addition to the depletion of large mammal species, such as the elephants and black rhinos of Africa, and birds such as the California condor and mosquito-catcher, tens of thousands of other endangered species of animals around the world are in trouble because of over-hunting and poaching. Ecosystem and habitat destruction through agricultural and urban development activities and, of course, pollution have put at risk both wildlife and beneficial plants. Excesses in individual and organizational activities are responsible for significant and tragic ecosystem and species degradation.

Another disturbing environmental issue that human populations face is land degradation. Degradation includes such different multiple facets as desertification, deforestation, overgrazing, salinization, and alkalization. Soil acidification, urban sprawl, and soil sealing, or industrial soil contamination, are part of land degradation as well. In the past 40 years, nearly one-third of the world's cropland has been abandoned because erosion has made it unproductive; each year, an additional 20 million hectares of agricultural land is lost due to either becoming too degraded for crop production or being lost to urban sprawl.⁴⁷ According to the UN Millennium Declaration, this human-induced degradation of soils puts the livelihoods of nearly a billion people at risk.⁴⁸ As the population of the world continues to grow, the problems created by the loss of productive soil will only increase.

CHEMICALS, TOXICS, AND HEAVY METALS

The production of **toxic substances**, whether as constituents of intended end-products or as unwanted by-products, is an important issue because of its potential for harm. The United States Environmental Protection Agency (EPA) defines toxic substances as chemicals or compounds that may present an unreasonable threat to human health and the environment. Human exposure to toxic substances can cause a variety of health effects, including damage to the nervous system, reproductive and developmental problems, cancer, and genetic disorders.⁴⁹

Two problems are central to the toxic substances issue. First, we are not always aware of the effects, especially the long-term and interactive effects, of exposure to the thousands of chemicals that are produced each year. Even in those instances where the toxicity of a chemical is known and the chemical is banned for sale in a country, such as the pesticide DDT in the United States, the substance can still be manufactured in that country and exported, only to return when products that have been exposed to these substances are imported. As we discussed in the previous chapter, strict and absolute liability doctrines hold firms to a high degree of accountability for the effects of toxic substances.

Second, toxic substances can be associated with industrial accidents, causing unforeseen widespread biological damage. The Bhopal, India, chemical plant leak; the Chernobyl nuclear power plant meltdown in the former Soviet Union; and the Exxon *Valdez* 11-million-gallon oil spill in Alaska are three well-known environmental disasters involving toxic substances. Not so well-known are the fourteen thousand oil spills that are reported each year.⁵⁰ Although the Exxon *Valdez* spill covered 1,300 miles of Alaskan shoreline and was as wide as three football fields, that spill was only fifty-third in the rankings of worldwide oil spills.⁵¹ Even still, its impact continues. In 2006, researchers at the National Marine Fisheries Service in Juneau, Alaska, found that almost 10 kilometers of shoreline around Prince William Sound were still affected by the spill, with over 100 tons of oil remaining in the area. Almost 20 years later, the *Valdez* spill continues to wreak havoc on the marine life in Prince William Sound.⁵²

AIR POLLUTION

The short- and long-term effects of both outdoor and indoor **air pollution** are wide-ranging and severe.⁵³ Air pollution leads to acid rain, global warming, smog, the depletion of the ozone layer, and other serious conditions. It also causes serious respiratory and other illnesses, so it is not surprising that it rates high in concern according to public opinion polls.⁵⁴

In addition to causing human health problems, ambient air pollution is also responsible for a condition called **acid rain**. Acid rain refers broadly to a mixture of wet and dry deposition (deposited material) from the atmosphere containing higher than normal amounts of nitric and sulfuric acids.⁵⁵ Both natural sources, such as volcanoes and decaying vegetation, and man-made sources, primarily emissions of sulfur dioxide and nitrogen oxides from fossil fuel combustion, can

lead to acid rain.⁵⁶ Acid rain harms causes acidification of lakes and streams, contributes to the damage of trees at high elevations, and accelerates the decay of building materials and paints, including irreplaceable buildings and statues. Prior to falling to the earth, acid rain degrades visibility and harms public health.⁵⁷

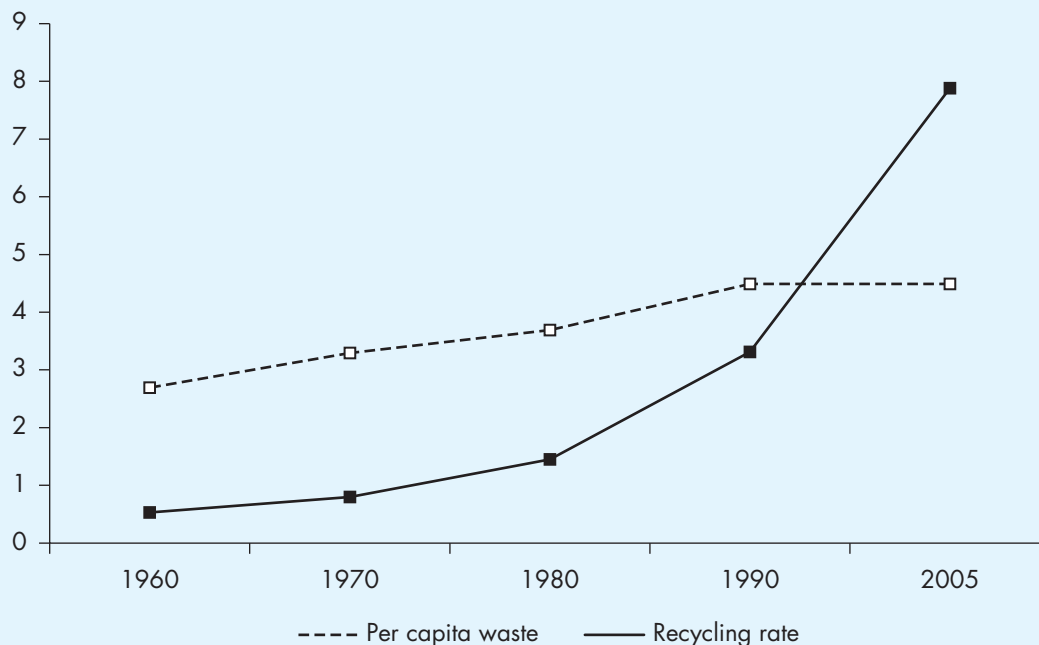
Indoor air pollution is another environmental problem that is becoming an increasing concern because most people spend the majority of their lives indoors. Indoor air pollution has a variety of sources, including oil, gas, kerosene, coal, wood, tobacco products, building materials and furnishings such as asbestos-containing insulation, damp carpets, household cleaning products, and lead-based paints.⁵⁸ The immediate effects of indoor air pollution are typically short-term and treatable; these include irritation of the eyes, nose, and throat, as well as headaches, dizziness, and fatigue. However, longer-term effects that might show up years after exposure can be severely debilitating or fatal. These effects include some respiratory diseases, heart disease, and cancer.⁵⁹

WASTE MANAGEMENT

Reduce, Re-use, and Recycle is the waste management mantra. The first goal is to reduce the amount of waste discarded, i.e., source reduction; this is the best form of waste management because in this case the waste is never generated in the first place. The next best option is to reuse containers and products—either repairing anything that is broken or giving it to someone who can repair it. Reusing is preferable to recycling because it does not require reprocessing to make the item usable again. Recycling is the third-best option but still very valuable. Recycling transforms what once might have been waste into a valuable resource.⁶⁰

In the middle of all the dire news about environmental issues, recycling stands out as a success story. Throughout the world, recycling efforts have grown. Today, Sweden recycles 90 percent of its glass and Japan recycles 86 percent of its steel.⁶¹ The United States recycles about 20 percent of its glass, 40 percent of its paper, 50 percent of aluminum, and 60 percent of steel.⁶² Business can profit greatly from the boom in recycling. By recycling, businesses are able to cut costs—producing less garbage means lower landfill fees. These efforts also present new business opportunities for the entrepreneur. The *Fortune* 100 list of fastest growing firms includes firms that recycle scrap metal into steel.⁶³ Figure 15-4 shows the growth rate of per capita waste generation in the United States as it compares to the rate of recycling. Waste generation is measured in 10-pound units to facilitate comparison with the percentage of waste that was recycled. Both lines have some good news to offer. While per capita waste generation rose steadily until 2000, it has remained stable ever since. Recycling rates have continually increased and continue to do so at an increasing rate.

Special consideration must be given to waste that is hazardous. Hazardous waste has properties that make it harmful or potentially harmful to human health or the environment. As defined by the EPA, the large and diverse world of hazardous waste includes liquids, solids, contained gases, or sludges.⁶⁴ Hazardous wastes can be generated by manufacturing processes, or they can simply result from discarded commercial products, like cleaning fluids or

Figure 15-4 Waste Trends in the United States


Source: <http://www.epa.gov>

pesticides.⁶⁵ The risks posed by these wastes create countless causes for concern. Exposure to these wastes in the environment, whether in air, water, food, or soil, can cause cancer, birth defects, and a host of other problems.⁶⁶ Because of tightening of site controls in some areas, hazardous wastes are sometimes transported away from their sources, both legally and illegally, often to sites with weaker controls.⁶⁷ Another concern is the toxicological effects of a number of new chemicals coming onto the market. Because they are new, we know less about their effects and the measures needed to protect human health and the environment from possible contamination.⁶⁸

OZONE DEPLETION

Ozone is an oxygen-related gas that is harmful to life near the earth's surface but is vital in the stratosphere in blocking dangerous ultraviolet radiation from the sun. More than 20 years ago, NASA scientists observed a huge decrease in ozone over Antarctica. They then discovered a "hole" in the ozone layer that had grown as

large as the North American continent. Their measurements showed that the flow of ultraviolet light had increased directly under the ozone hole. This phenomenon was attributed to human-produced chemicals—chlorofluorocarbons (CFCs), used in refrigeration, and halons, used in fire extinguisher systems, as well as other ozone-depleting chemicals. A thinner layer of ozone is associated with a higher rate of skin cancer and other illnesses, as well as an increase in problems with agricultural production.

The international community enacted strict controls on the use of these gasses through the 1987 United Nations Montreal Protocol. Charles Kolb, an atmospheric research specialist and president of Aerodyne, noted, “We’re all feeling very proud of the fact that we identified the problem and then the international community responded.”⁶⁹ However, a rift in the international community eventually formed. The George W. Bush administration requested that an exemption be given for methyl bromide, because they were concerned that U.S. strawberry farmers would not be able to compete effectively with Mexican farmers if they were unable to use that chemical.⁷⁰ Since then, however, the international community has moved in greater unison, with the Protocol having been ratified by more than 190 countries. The United States was one of several countries to push for an earlier date for phasing out the ozone-damaging chemicals.⁷¹

Although production of CFCs has been reduced, output is growing in developing countries such as China and India.⁷² Although great improvements have been made, the ozone crisis is not yet over. Early estimates were too optimistic and so scientists have now revised their predictions to say that the health of the Antarctic ozone layer will not return to pre-1980 levels until 2065, 15 years later than first predicted.⁷³ Recently, the ozone hole grew to a record size. According to Paul Newman, atmospheric scientist at NASA’s Goddard Space Flight Center, Greenbelt, Maryland, “From September 21–30, 2006, the average area of the ozone hole was the largest ever observed, at 10.6 million square miles.”⁷⁴ For those interested in observing the hole in process, NASA provides “Ozone Watch” (<http://ozonewatch.gsfc.nasa.gov/index.html>), a website with pictures created from satellite images that enable observers to check on the latest status of the ozone layer over the South Pole.

OCEANS AND FISHERIES

The EPA expresses it well by saying we all live in a **watershed**—an area that drains to a common waterway, such as a stream, lake, estuary, wetland, aquifer, or even the ocean.⁷⁵ Our actions affect the oceans and other waterways, and so far it has not been for the better. Many of the same factors that affect fresh water have an impact on the marine environments. Each year, trillions of gallons of sewage and industrial waste are dumped into marine waters. These and other pollutants, such as oil and plastics, have been associated with significant damage to a number of coastal ecosystems, including salt marshes, mangrove swamps, estuaries, and

coral reefs. The result has been local and regional shellfish bed closures, seafood-related illnesses, and reduced shoreline protection from floods and storms. Toxic and nutrient runoffs are resulting in algae blooms; trawling is destroying the sea floor; and climate change is warming the waters, causing coral reefs to die.⁷⁶

Once, it would have been inconceivable that the vast oceans would ever run short of fish to meet human needs. However, some observers believe that day may soon be coming. In 2006, a team of 13 researchers in four countries studied more than 50 years of global catch and other data to arrive at an unimaginable conclusion—by the middle of this century, over-fishing will have destroyed the world’s seafood supply.⁷⁷ Some industry experts find that prediction to be too pessimistic. While they acknowledge that a continuation of today’s practices would lead to that outcome, they argue that increased awareness will keep the dire prediction from coming true.⁷⁸ The jury is still out, but there is something that both businesses and consumers can do to lessen the likelihood of an end to the world’s seafood supply—only use or sell sustainably harvested seafood. Nearly 500 products bear the “Fish Forever” label of approval.⁷⁹ Retailers such as Red Lobster and Wal-Mart have committed to buying only sustainably harvested seafood.⁸⁰

DEFORESTATION

Although humans depend on forests for building materials, fuel, medicines, chemicals, food, employment, and recreation, the world’s forests can be quickly depleted by a variety of human factors. **Deforestation** adds to soil erosion problems and is a major cause of the greenhouse effect. Felled trees are no longer able to absorb carbon dioxide and are sometimes burned for land clearing and charcoal, thereby releasing rather than absorbing carbon dioxide. Moisture and nutrient ecosystem cycles can also be severely damaged in deforesting activities, negatively affecting adjacent land and water ecosystems.

Deforestation is a problem for developed and developing countries alike. A tree conservation group, American Forests, studied the financial impact of deforestation in the greater Baltimore–Washington, DC, area and assessed the economic impact of its consequences.⁸¹ Trees slow the movement of storm water and reduce the risk of flooding. The study showed that deforestation in Baltimore–Washington resulted in a 19 percent decrease in storm water flow. Replacing the storm water flow capabilities of these trees with engineered systems such as reservoirs would cost over a billion dollars. The dwindling tree canopy also made it more difficult to remove approximately 9.3 million pounds of pollutants from the air. The cost of air quality control to make up for this loss would be about \$24 million over 24 years.⁸²

Deforestation plays a key role in global warming. Few would be able to guess which country emits the third greatest greenhouse gas emissions after China and the United States. Most would guess Germany due to its industry or Japan due to its cities and high technology. The right answer is Indonesia. Indonesia releases 3.3 billion tons of carbon dioxide a year due to deforestation.⁸³ Trees absorb carbon dioxide when they are alive, and when they die, they release it into the air. As a

result, deforestation accounts for 20 percent of global carbon emissions—more than the world’s trains, boats, and planes combined.⁸⁴

Responsibility for Environmental Issues

Problems such as smog, toxic waste, and acid rain can be described as “**wicked problems**”—that is, problems with characteristics such as interconnectedness, complexity, uncertainty, ambiguity, conflict, and societal constraints. Every wicked problem seems to be a symptom of another problem.⁸⁵ Responsibility for such messy situations is difficult to affix, because solutions to wicked problems are seldom complete and final and, therefore, credit for these solutions is seldom given or taken. *Chlorofluorocarbons*, or *CFCs*, for example, were once considered to be safe alternatives to other, more toxic refrigerants, which is why these ozone destroyers are so ubiquitous in our society’s technologies.

When no one takes responsibility, a phenomenon called the **tragedy of the commons** is likely to occur.⁸⁶ A “commons” is a plot of land available to all. When the commons is large enough to accommodate the needs of everyone, no problems occur. However, as herders continue to add animals to their herds, the carrying capacity of the commons becomes strained. It is in the self-interest of each herder to allow the animals to graze, even though the cumulative grazing will inevitably destroy the commons. The analogy of a “commons” can be applied to the environment as a whole, as well as its many constituent parts. One need only look at the situation with public parks to see how unconstrained use can damage a shared resource. As Garrett Hardin points out in his classic article on the tragedy of the commons in the environment, constraints must also be placed on the use of the commons (i.e., our environment) because, in the absence of constraints, self-interest is likely to lead individuals and organizations to behave in ways that will not sustain our shared resources.⁸⁷

ENVIRONMENTAL ETHICS

Nature itself is a polluter and destroyer. The earth’s core is continually polluting many bodies of water and airsheds with a full range of toxic heavy metals. The Mount St. Helens volcanic eruption unleashed significant levels of air pollution on the state of Washington. Species have been going extinct since life evolved as, in a continuous cycle of life and death, nature acts as its own destroyer. Given this fact, what does absolute human environmental sensitivity mean? Humans must consume at least some plants and water to survive. If humans and their organizations need to pollute and destroy at least some of nature for their survival, what is the relative level of degradation that is ethical? Do nonhuman species have any “rights,” and, if so, what are they, and how can they be reconciled with human rights? Concerning human rights and the environment, how do we assess the claims of indigenous cultures to the use of their respective

environments? Is there any connection between the domination of humans by humans (for example, the domination of one nation, race, or gender by another) and the domination of nature by humans? This latter question is especially central to several schools of environmental ethical thought, including social ecology, ecofeminism, and environmental justice.

Whose standards will determine what is or is not ethical? Public opinion in the United States seems to be on the side of the environment. In a 2007 Gallup poll, 70 percent of respondents said they were active in or sympathetic to environmental causes.⁸⁸ However, how much the public will do itself or insist that governments and businesses do to protect the environment is still an unanswered question. How clean do the air and water need to be, and how much is the public willing to pay to meet these standards? As in our earlier discussion of business ethics, values play a major role and can be highly variable in breadth and depth across perspectives, situations, and time.

Following the ethical models discussed in Chapters 7 and 8, we can develop a better idea of what environmental ethics is and how it can be practiced. Kohlberg's model of moral development, for instance, can be used to identify environment-related attitudes and behaviors by developmental level. At the preconventional (infant) level in environmental ethics, humans and human organizations can be perceived as being concerned only with self or with their own species and habitats. A conventional (adolescent) level might entail some appreciation of nature, but only when and where such appreciation is commonplace or "in." A postconventional (adult) environmental ethic might include more mature attitudes and behaviors that are more universal (including all species and habitats), of greater duration (including unborn generations), and more consistent (if we humans have a right to survive as a species, why don't all species have that right?).

Similarly, the moral principle of utilitarianism—the greatest good for the greatest number—could be expanded in environmental ethics to the greatest good for the greatest numbers of species and ecosystems. The Golden Rule could read, "Do unto other species as you would have them do unto you." From a virtue ethics perspective, a "Best Self" ethical test could include the question, "Is this action or decision related to the natural environment compatible not only with my concept of myself at my best but also with my concept of myself as a human representing my species at its best?"

In "Who Speaks for the Trees," authors Sama, Welcomer, and Gerde show that integrating sustainability into a firm's philosophy is a natural extension of stakeholder theory.⁸⁹ They expand the concept of the natural environment beyond living things to the entire ecological system from which the firm obtains resources and to which it bears responsibility for the impacts, both positive and negative, that firm actions have on it. They invoke the ethic of care, discussed in Chapter 8, and explain that organizations that follow a practice of care would treat the natural environment, which they call the "silent stakeholder," with respect.⁹⁰

Ethics in Practice Case

GOING DOWN THE DRAIN

I worked at a small business that used cars in their daily deliveries. To save money, the brothers who owned the business would conduct most of their own maintenance on the vehicles. As a result, they would periodically be involved in doing tune-ups, changing oil, and other such activities. One day, I noticed that the brothers would pour the old motor oil down the drain rather than take it for recycling. This troubled me because I knew how greatly old oil can add to the degradation of the environment. I brought up the subject with them and they laughed it off. They told me that, as a small business, they did not have the time or the money to be concerned with the “niceties” of life. We discussed it several times, and they made it clear they would not change their ways.

I didn’t know what to do. I liked this job. The location was perfect and the people were nice (in every other way). I wanted to keep working there until I finished school. However, I felt that I shared in the responsibility for the damage caused by the oil if I knew it was happening and did nothing about it. If I reported it to someone, I knew they’d know the report came from me. What could I do?

1. Is NIMBY involved here? If so, in what way?
2. Do you share in the responsibility for negative action when you know it is happening and say nothing?
3. What would you do if you were in that position?

Contributed Anonymously

THE NIMBY PROBLEM

One example of this question of responsibility is the **NIMBY**, or “Not In My Back Yard,” phenomenon. This acronym, which can be found on bumper stickers and conference agendas and in newspaper articles, college courses, and many other communication vehicles, reflects human denial of responsibility for the misuse of the environment. The growth of the NIMBY attitude can be seen in the proliferation of other acronyms describing it. *NOTE* or “Not Over There Either,” *BANANA* or “Build Absolutely Nothing Near Anything,” and *NOPE* or “Not On Planet Earth” were all coined by observers frustrated with the human tendency to avoid assuming responsibility for societal costs.

Examples of NIMBY abound. One is the community that uses ever-increasing amounts of electricity but decides it does not want a power plant that produces electricity to locate nearby. Another is a company that generates increasing amounts of waste but is unwilling to pay the full cost of proper disposal. Essentially, NIMBY is an attitude/behavior set based on avoidance or denial of responsibility. When applied to the field of environmental management, NIMBY spells big trouble.

The obvious difficulty with the NIMBY syndrome is that the entities (human individuals, organizations, or both) causing environmental pollution or degradation are not identified as the sources of the problem, and therefore no action is

taken to reduce the problem. The NIMBY phenomenon avoids or denies the root cause of the damage and addresses only the symptoms with an attitude of nonresponsibility characterized by an approach of “I’ll create an environmental problem, but I want to have as little as possible to do with solving it.” One popular cartoon characterizing the NIMBY problem pictures a stream of polluting, honking cars passing along a highway in front of a huge billboard that reads, “Honk if you love the environment!”

The Role of Governments in Environmental Issues

As we mentioned earlier, governments have played major roles in environmental issues since the inception of such issues. Governments have procured, distributed, and developed habitable lands and other resources; protected, taxed, and zoned natural environment-based areas; and, more recently, exercised regulatory control over how those environments could be used. In this section, we’ll look at how governments in the United States have dealt with environmental challenges and then identify what has been done in several other countries and at the international level.

RESPONSES OF GOVERNMENTS IN THE UNITED STATES

Although the U.S. federal government has influenced environmental policy since at least 1899, with its permit requirement for discharge of hazardous materials into navigable waters, the major entrance of the U.S. government into environmental issues occurred in 1970 with the signing of PL 91-190, the *National Environmental Policy Act (NEPA)*. The second section of this act spells out its purposes: “To declare a national policy which will encourage productive and enjoyable harmony between man and his environment; to promote efforts which will prevent or eliminate damage to the environment and biosphere and stimulate the health and welfare of man; and to enrich the understanding of the ecological systems and natural resources important to the Nation.”⁹¹

In addition to establishing these broad policy goals, this legislation requires federal agencies to prepare **environmental impact statements (EISs)** for any “proposals for legislation and other major federal action significantly affecting the quality of the human environment.” Environmental impact statements are reports of studies explaining and estimating the environmental impacts of questionable practices and irreversible uses of resources and proposing detailed, reasonable alternatives to these practices and uses.

Business is affected by the NEPA in several ways. First, the federal government pays private consultants to conduct tens of billions of dollars worth of EISs each year. Second, because the federal government is the largest landholder in the United States, private businesses wishing to secure licenses and

permits to conduct timber, grazing, mining or highway, dam, and nuclear construction operations likely will be parties to the preparation of EISs. Third, private businesses working under federal government contracts are typically obliged to participate in EIS preparation. Fourth, the NEPA has been used as a model by many state governments, and therefore businesses heavily involved in significant state and local government contracts are likely to be involved in the EIS process.

Also in 1970, the U.S. **Environmental Protection Agency (EPA)** was created as an independent agency to research pollution problems, aid state and local government environmental efforts, and administer many of the federal environmental laws. These laws can be categorized into three areas—air, water, and land—even though a specific problem of pollution and/or degradation, such as acid rain, often involves two or more of these categories.

Air Quality Legislation

The key piece of federal air quality legislation, called the **Clean Air Act**, was significantly amended in 1990. The overall approach of this act is similar to that used in other areas of federal regulation, such as safety and health legislation, in that standards are set and timetables for implementation are established. In the Clean Air Act, there are two kinds of standards: primary standards, which are designed to protect human health, and secondary standards, which are intended to protect property, vegetation, climate, and aesthetic values. The EPA has set primary standards (based on health effects) and secondary standards (based on environmental effects) for a variety of air pollutants, including lead, particulates, hydrocarbons, sulfur dioxide, and nitrogen oxide. Businesses that directly produce these substances, such as electric utilities, and those whose products cause these substances to be produced when they are used, such as automobiles, must reduce their emissions to within the set standards.⁹²

The Clean Air Act introduced the concept of **emissions trading** (i.e., “cap and trade”) concept to the United States. This approach is intended to reduce a particular pollutant over an entire industrial region by treating all emission

<http://SEARCHTHEWEBWEB>

THE EPA

Laws and regulations are major tools for protecting the environment. The U.S. Environmental Protection Agency (EPA) is the primary regulatory body in the United States with responsibility for administering the country's major environmental laws. The mission of the EPA is to protect human health and to safeguard

the natural environment—air, water, and land—upon which life depends. For a review of the latest information on regulations and proposed rules, codified regulations, laws, and current legislation, visit the EPA's website at <http://www.epa.gov>.

sources as if they were all beneath one bubble. A business can increase its emissions of sulfur dioxide in one part of a plant or region if it reduces its sulfur dioxide pollution by as much or more in another part of the plant or region. In addition, and as an extension of this bubble analogy, businesses that reduce their emissions can trade these rights to other businesses that want to increase their emissions. Proponents of emissions credit trading hail these policies as free market environmentalism, whereas opponents ridicule them as licenses to pollute.

Although it was once highly controversial, emissions trading has become one of the fastest-growing financial services with a London market worth about \$30 billion in 2007 and expected to reach \$1 trillion within a decade.⁹³ The interest in emissions trading is quite recent. In 2004, former electricity trader Louis Redshaw met with five investment banks to propose carbon dioxide trading. Only one was interested. Three years later, the situation has changed, and carbon specialists like Mr. Redshaw, 34, are among the rising stars in the London financial district. According to Mr. Redshaw, head of environmental markets at Barclay Capital, "Carbon will be the world's biggest commodity market, and it could become the world's biggest market over all."⁹⁴

The emissions trading system is part of the Kyoto protocol, an international agreement that set legally binding targets and deadlines for cutting the greenhouse-gas emissions of industrialized countries.⁹⁵ Few knew, however, that emissions trading would become such a thriving market. According to Chris Leeds, head of emissions trading at Merrill Lynch, carbon could become "one of the fastest-growing markets ever, with volumes comparable to credit derivatives inside of a decade."⁹⁶ In 2000, Wall Street firms had begun investing in credit-generating projects. However, when President George W. Bush refused to submit the Kyoto Protocol for ratification in 2001, New York lost its lead in the area.⁹⁷ According to Garth Edward of Shell Trading, "Technically, U.S. companies had the expertise. Then the Europeans really delivered."⁹⁸

Water Quality Legislation

U.S. government involvement in water quality issues has followed a pattern similar to that of air quality issues. The **Clean Water Act** (also known as the Federal Water Pollution Control Act) was passed in the early 1970s with broad environmental quality goals and an implementation system, involving both the federal and state governments, designed to attain those goals. The ultimate purpose of the Clean Water Act was to achieve water quality consistent with protection of fish, shellfish, and wildlife and with safe conditions for human recreation in and on the water. The more tangible goal was to eliminate discharges of pollutants into navigable waters, which include most U.S. rivers, streams, and lakes. These goals were to be accomplished through a pollution permit system, called the National Pollutant Discharge Elimination System, which specifies maximum permissible discharge levels, and often timetables for installation of state-of-the-art pollution control equipment. Another act—the *Marine Protection, Research, and Sanctuaries Act* of 1972—sets up a similar system for control of

discharges into coastal ocean waters within U.S. territory. A third water quality law administered by the EPA, the Safe Drinking Water Act of 1974,⁹⁹ establishes maximum contaminant levels for drinking water.¹⁰⁰

Two 2006 U.S. Supreme Court cases created some confusion regarding the Clean Water Act and the U.S. Army Corps of Engineers and the EPA's scope of jurisdiction.¹⁰¹ The Clean Water Act made it unlawful for any person to pollute navigable waters without a permit, but the definition of "navigable waters" is unsettled. The key question posed to the Court was whether wetlands that adjoin unnavigable tributaries of navigable waters are included. At this writing, members of Congress are pushing legislation that would clarify the types of bodies of water under the Act's jurisdiction.¹⁰²

Land-Related Legislation

Land pollution and degradation issues differ from air and water quality issues, because land by definition is far less fluid and therefore somewhat more visible than air and water and is more amenable to local or regional problem-solving approaches. Consequently, the U.S. federal government, in the Solid Waste Disposal Act of 1965, recognized that regional, state, and local governments should have the main responsibility for nontoxic waste management. The EPA's role in this area is limited to research and provision of technical and financial assistance to these other government levels. However, a 1976 amendment to this act, called the Resource Conservation and Recovery Act, set up a federal regulatory system for tracking and reporting the generation, transportation, and eventual disposal of hazardous wastes by businesses responsible for creating these wastes.¹⁰³

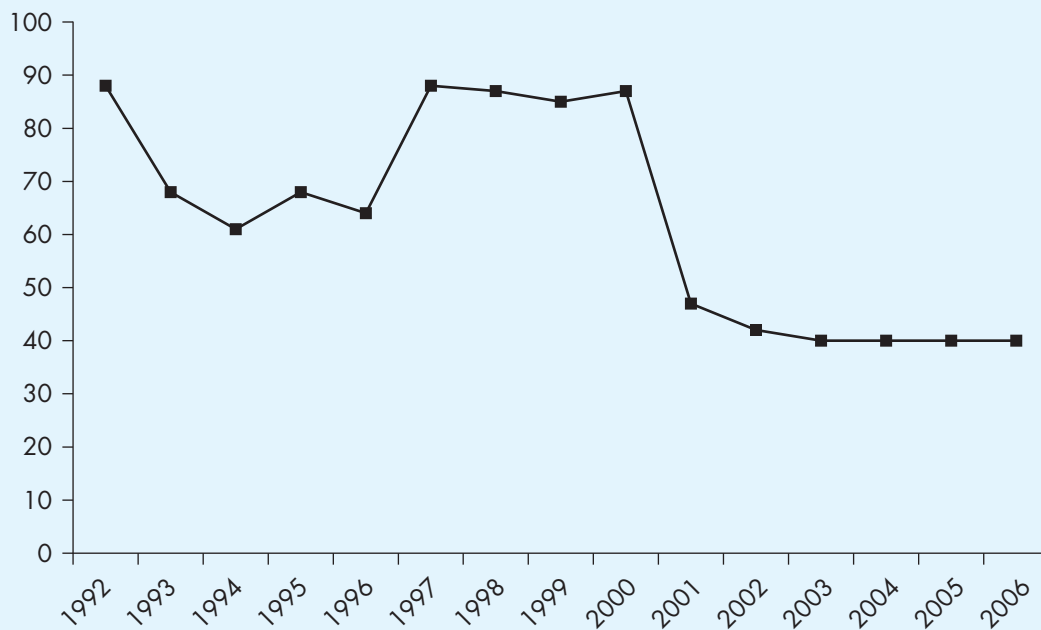
Concerning toxic wastes, however, the U.S. government has staked out a much larger role for itself. The 1976 **Toxic Substances Control Act** requires manufacturing and distribution businesses in the chemical industry to identify any chemicals that pose "substantial risks" of human or other natural environment harm. This act also requires chemical testing before commercialization and the possible halting of manufacture if the associated risks are unreasonable. Because there are more than seventy thousand chemicals already in use in the United States and more than a thousand new chemicals introduced every year, the EPA has prioritized the substances that must be tested to focus on those that might cause cancer, birth defects, or gene mutations.¹⁰⁴

The other major U.S. government activity in toxic wastes is known as **Superfund**, or, more formally, the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA). Superfund is an effort to clean up more than two thousand hazardous waste dumps and spills around the country, some dating back to the previous century. Funded by taxes on chemicals and petroleum, this program has established a National Priorities List to focus on the most hazardous sites and places legal and financial responsibility for the proper remediation of these sites on the appropriate parties. In addition, CERCLA also requires that unauthorized hazardous waste spills be reported and can order those responsible to clean up the sites.¹⁰⁵

One of the most important amendments to the Superfund law, the Emergency Planning and Community Right-to-Know Act of 1986, requires manufacturing companies to report to the federal government annually all of their releases into the environment of any of more than 500 toxic chemicals and chemical compounds. The EPA accumulates these reports and makes them available to the public (at <http://www.epa.gov/triexplorer>) with the intention that an informed public will pressure manufacturers to reduce these toxic releases.¹⁰⁶

One in four Americans lives within three miles of a Superfund site.¹⁰⁷ Thus it is not surprising that an outcry ensues when the Superfund suffers spending cuts. Until 1995, when the fees expired, the federal government collected money from polluters to help fund the Superfund cleanup. Since then, a series of EPA funding cuts have squeezed the fund.¹⁰⁸ Since the fees expired, taxpayer costs for Superfund have risen 427 percent, leaving them with higher costs for fewer services.¹⁰⁹ In 2000, the number of Superfund closures dropped dramatically and has yet to recover. Figure 15-5 shows the number of Superfund sites completed each year from 1992 to 2006.

Figure 15-5 Superfund Completions



Source: <http://www.epa.gov/superfund/sites>.

Endangered Species

The world's species are disappearing at an alarming rate, according to the World Conservation Union, which releases an annual Red List of endangered species.¹¹⁰ Their 2006 report shows that more than fifteen thousand species are now considered to be threatened with extinction—that includes one in three amphibians, almost half of all turtles and tortoises, one-fourth of all mammals, and one in eight birds.¹¹¹ “The good news,” according to Russ Mittermeier, the head of Conservation International and chairman of the World Conservation Union's primate group, “is that we still have time to save the majority of (the species), if the conservation community, governments, other organizations, and concerned individuals commit a sufficient amount of resources immediately.”¹¹²

In the United States, responsibility for endangered species is shared by two agencies, the U.S. Interior Department's Fish and Wildlife Service and the Commerce Department's National Marine Fisheries Act; they administer the 1973 **Endangered Species Act (ESA)**. This federal law assigns the responsibility of preventing harm to species considered “endangered” (that is, facing extinction) or “threatened” (likely to become endangered).¹¹³ Protection of species sometimes means moving them to safe areas when their original habitats have been destroyed by human activities, but it can also mean prevention of these activities, such as mining, construction, and fishing, before such habitat deprivation occurs. This restriction of business activities can be expected to continue as the extinction rate for species climbs, resulting in sometimes intense political conflicts between business interests and environmental groups.¹¹⁴

Some environmentalists argue that the Endangered Species Act has been weakened under the George W. Bush administration.¹¹⁵ They point to the fact that an average of 9.5 species has been added each year under the Bush administration, compared to 65 each year under the Clinton administration and 50 each year under the George H. W. Bush administration. Only half the acreage recommended has been designated as critical habitat, and important decision-making powers have been taken away from Fish and Wildlife Services and given to agencies with competing priorities.¹¹⁶ As further support for their concerns, a 2007 internal Department of the Interior (DOI) investigation found a former deputy assistant secretary guilty of altering scientific information in DOI documents and of leaking confidential information to lobbyists for industry groups. She was charged with forcing U.S. Fish and Wildlife Service (FWS) scientists to tweak their findings.¹¹⁷

INTERNATIONAL GOVERNMENT ENVIRONMENTAL RESPONSES

The *United Nations Environment Programme (UNEP)* has led the way in identifying global environmental problems and in working toward their resolution. As early as 1977, UNEP was studying the ozone problem and began to lay the groundwork for the 1987 **Montreal Protocol**, in which most of the CFC (chlorofluorocarbon) producing and consuming nations around the world agreed to a quick phaseout of these ozone-destroying substances. More than 190 countries and the European

Community ratified the Protocol, resulting in the phaseout of more than 95 percent of the consumption and production of the chemicals covered. Developing countries have come on board as well, eliminating more than one hundred and ninety thousand tons of ozone-depleting substances that had been used to produce various products; this represents more than 70 percent of the developing countries' totals. The ozone reduction brought by the Protocol has helped the world avoid millions of cases of fatal skin cancer and tens of millions of cases of nonfatal skin cancer and cataracts.¹¹⁸

UNEP is also funding research and assisting in information exchange on the protection and more sustainable use of international waters. The Global Waters Assessment will examine the problems surrounding shared transboundary waters, develop scenarios on the future condition of the world's water, and analyze various policy options. UNEP is also the driving force behind efforts to initiate global sound management of hazardous chemicals. They were an integral part of the Rotterdam Convention, which requires that countries give explicit informed consent before hazardous chemicals cross their borders. UNEP also works to protect the world's biological diversity. Their efforts helped to bring the elephant back from the brink of extinction.¹¹⁹

Another United Nations initiative is the **Global Compact**. It brings thousands of companies from throughout the world society to support universal environmental and social principles. The Global Compact works to advance ten universal principles, three of which involve environmental issues. They are: #7—Business should support a precautionary approach to environmental challenges, #8—undertake initiatives to promote greater environmental responsibility, and #9—encourage the development and diffusion of environmentally friendly technologies.

The **Global Reporting Initiative** (GRI) is a collaborating center of the UNEP. GRI spearheaded the development of a sustainability reporting framework that has become the most widely used standard in the world. The reporting framework outlines the principles and indicators that organizations can use to measure and report their economic, environmental, and social performance.

Other Environmental Stakeholders

A variety of environmental stakeholders have worked to bring environmental issues into the public consciousness. In this section, we will explore the range of stakeholder groups, the nature of their stakes, and the methods they have employed to address critical environmental problems.

ENVIRONMENTAL INTEREST GROUPS

Perhaps no force in today's society is more responsible for the "greening" of nations around the world than the many environmental interest groups making up what has come to be known as "the environmental movement." This

collection of nonprofit membership and think-tank organizations has been credited with moving the world's governments and businesses, as well as publics, in the direction of environmental responsibility through a host of activities, including demonstrations, boycotts, public education, lobbying, and research.

The history of the environmental movement is instructive. Whereas a few U.S. groups (The National Audubon Society, the Izaak Walton League, and the Sierra Club) were formed in the early 1900s during the first green wave of the century, many of the largest national and international environmental groups—such as the Environmental Defense Fund (now called Environmental Defense), Greenpeace, and the National Resources Defense Council—were created during the second environmental wave, during the late 1960s and early 1970s. Since that time, all of these groups and hundreds of other smaller, more locally focused environmental organizations have grown in size and clout. It was the century's third wave of environmentalism, beginning in the late 1980s, however, that gave many of these groups the power and legitimacy to become credible players in environmental policy making around the globe.

Environmental interest groups have been instrumental in significantly influencing business environmental policy in this third wave. For example, Environmental Defense is working with Federal Express on building a new generation of vehicles, DuPont on developing nanotech standards, and PHH Arval on becoming the first carbon-neutral fleet.¹²⁰ Other outcomes of relationships between environmental interest groups and business stakeholders have included corporate selection of environmental group representatives for corporate boards and top management positions, mutual participation in environmental "cleanup" projects, and corporate donations of time and money to environmental groups for their environmental conservation programs. This trend toward cooperation between otherwise adversarial groups is a characteristic of the third environmental or green wave that sets this wave apart from the two previous environmental eras. We discuss that collaboration in more detail in the upcoming section on business environmentalism.

The former chairman of the Sierra Club identified three types of major U.S. environmental organizations based on this criterion of cooperation with business. He labeled groups characterized by confrontational behaviors as "radicals," groups that seek pragmatic reform through a combination of confrontation and cooperation as "mainstreamers," and groups that avoid confrontation and are more trusting of corporations as "accommodators."¹²¹ As we mentioned, the differences between the types of groups are beginning to blur as business and environmental activists collaborate increasingly on shared goals. Nevertheless, it is instructive to look at some of the groups that have taken and still sometimes take a more radical approach.

One group that would fall into the radical camp is the Rainforest Action Network (RAN). RAN has been particularly successful in getting large corporations to change their ways. The ways in which RAN has accomplished their goals are described in Figure 15-6. RAN is a small organization, with a budget of only \$2.4 million and a staff of just 25. Nevertheless, they have managed

Figure 15-6 *The Mosquito in the Tent Strategy*

Street Theater	During the holiday season, RAN carolers sang “Oil Wells” to the tune of “Jingle Bells” in front of the Citigroup headquarters on Park Avenue. RAN obtained the access code to the Home Depot intercom and announced to shoppers that they should step carefully, because the wood on Aisle 13 had been ripped from the Amazon Basin and there might be blood on the floors.
Celebrity Endorsements	The night before Citigroup’s annual shareholder meeting, RAN began airing commercials showing Ed Asner, Susan Sarandon, Darryl Hannah, and Ali MacGraw cutting up their Citibank credit cards.
Coalitions	RAN doesn’t go it alone. They work with other environmental organizations, socially responsible investors, liberal philanthropists, and even sympathetic insiders (which is how they got the Home Depot access code).
Internet Organizing	RAN uses the Internet to both launch their own initiatives and support those of other groups.

Source: Marc Gunther, “The Mosquito in the Tent,” *Fortune* (March 31, 2004), 158–162; Lisa Gerwitz, “It’s Not Easy Being Green,” *Deal.com* (March 8, 2004), 1. See also <http://www.ran.org/>.

to get the attention of big business in a way that the larger, more established environmental organizations have never managed. They have been described as a mosquito in a tent—“just a nuisance when it starts, but you can wake up later with some serious welts.”¹²²

A new category that is taking on increased importance is **ecoterrorists**. Ecoterrorists are not included under the radical designation described earlier. Radical groups favor confrontation, but ecoterrorists employ violent acts that involve real or threatened damage to people or property in an attempt to achieve their goals. The FBI estimates that there have been about twelve hundred acts of ecoterrorism in the United States, with losses in the millions.¹²³ More than 20 states have passed ecoterrorism laws that increase the penalties for vandalism, arson, and trespassing when ecoterrorism is involved.¹²⁴ Debate has arisen over whether the new laws are too severe. Jeff Luers, who was 22 years old, received a sentence of 23 years for setting three pickup trucks on fire at a Chevrolet dealership in Eugene, Oregon.¹²⁵ Opponents point out that in 1998 an Oregon firefighter received three years for endangering 120 firefighters by setting 30 forest fires in an effort to earn overtime pay. At this writing, the Ecoterrorism Act (HR 4454) is working its way through the U.S. House of Representatives.¹²⁶

GREEN CONSUMERS, EMPLOYEES, AND INVESTORS

In addition to environmental groups, businesses are paying more attention to the latest green wave because of at least three other stakeholder groups: green consumers, green employees, and green investors.

Green Consumers

Individuals referred to as green consumers are actual and potential customers of retail firms, usually in the industrialized countries, who express preferences for products, services, and companies that are perceived to be more environment friendly than other competitive products, services, and firms. Marketing research firms in these countries have identified a range of green consumerism on the basis of the strengths of these preferences and reported consumer purchases. Roper Starch's *Green Gauge Report* identifies "light green" consumers (a.k.a. "greenback greens") as those who are more likely to support the environment through purchases than volunteer action.¹²⁷ They are a sought-after segment of the market—young, well-paid, highly educated, Internet-savvy, predominately female, and mostly professional or white-collar employees.¹²⁸ Experts expect an increase in green consumers over the next 15 to 25 years as Generation Y (those born between 1977 and 1994) assume positions of responsibility.¹²⁹ Nearly 100 percent of the Y generation received environmental education in school, as opposed to 19 percent of the adults in general. As a result, they have been shown to be much more likely to spend money for environmentally friendly products than their parents were.¹³⁰

Green Employees

A second stakeholder group with which most businesses are concerned is green employees. Although the popular press has not focused as much attention on green employees as it has on green consumers, there is evidence that employees are playing a major role in promoting environmentalism at work. In addition to union and general employee environmental concerns with plant, warehouse, and office safety and health, employees in many companies have assisted management in going beyond these traditional concerns into areas such as pollution prevention, recycling, energy and environmental audits, and community environmental projects. A 2007 survey of workers in the United Kingdom found that 69 percent welcomed green benefits from environmentally responsible employers, 14 percent would change jobs for a greener benefits package, and 35 percent believed that this would make them more loyal to the firm. In the United States, 33 percent would rather work for an environmentally sound company and more than half thought their company should do more to be eco-friendly.¹³¹

Green Investors

Another important business stakeholder involved in environmental issues is the green investor. Similar to investors interested in advancing social causes, individuals and organizations sometimes want to put their money where their environmental values are by identifying and utilizing financial instruments that are associated with environmentally oriented companies. A growing number of mutual funds, stock and bond offerings, money market funds, and other financial instruments have included environmental components in recent years.¹³² Shareholder resolutions address concerns that range from toxic emissions to recycling and waste to nuclear power plants and climate change. According to Meg Voorhes, director of the Investor Responsibility Research Center, climate change

has emerged in the last three years as the most widespread concern.¹³³ Some of the nation's largest investors are among those filing resolutions, including pension fund managers representing public employees in Connecticut, New York state, Maine, and New York City.¹³⁴

In her book *Vanishing Borders*, Hilary French argues that companies with strong environmental management are likely to outperform those companies that have environmental liabilities.¹³⁵ According to French, new communications technologies enable groups of investors to mount coordinated campaigns against companies with questionable practices. She calls for an increase in the quality and quantity of environmental reporting by companies.¹³⁶ Baxter Health Care is an exemplar of the environmental reporting French seeks. Baxter won the 2003 Environmental Reporting Award from *Business Ethics* for the clear environmental goals they set, as well as the honesty with which they report their results.¹³⁷

After the Exxon *Valdez* oil spill, several environmental, labor, and social investor groups formed an organization called CERES and developed a preamble and a set of 10 policy statements called the "Valdez Principles" (later renamed the

Text not available due to copyright restrictions

CERES Principles). These principles have been advanced as models for businesses to express and practice environmental sensitivity. Excerpts from these principles are listed in Figure 15-7. Companies that have endorsed the principles include American Airlines, Bank of America, Coca-Cola, General Motors, Polaroid Corporation, and Sunoco.¹³⁸

Figure 15-7 CERES Principles

By adopting these principles, we publicly affirm our belief that corporations have a responsibility for the environment by operating in a manner that protects the earth. We believe that corporations must not compromise the ability of future generations to sustain themselves. We will update our practices constantly in light of advances in technology and new understandings in health and environmental science. In collaboration with CERES, we will promote a dynamic process to ensure that the Principles are interpreted in a way that accommodates changing technologies and environmental realities. We intend to make consistent, measurable progress in implementing these Principles and to apply them to all aspects of our operations throughout the world.

1. **Protection of the Biosphere:** We will reduce and make continual progress toward eliminating the release of any substance that may cause environmental damage to the air, water, or earth or its inhabitants. We will safeguard all habitats affected by our operations and will protect open spaces and wilderness, while preserving biodiversity.
2. **Sustainable Use of Natural Resources:** We will make sustainable use of renewable natural resources, such as water, soils, and forests. We will conserve nonrenewable natural resources through efficient use and careful planning.
3. **Reduction and Disposal of Waste:** We will reduce and where possible eliminate waste, through source reduction and recycling. All waste will be handled and disposed of through safe and responsible methods.
4. **Energy Conservation:** We will conserve energy and improve the energy efficiency of our internal operations and of the goods and services we sell. We will make every effort to use environmentally safe and sustainable energy sources.
5. **Risk Reduction:** We will strive to minimize the environmental, health, and safety risks to our employees and the communities in which we operate through safe technologies, facilities, and operating procedures, and by being prepared for emergencies.
6. **Safe Products and Services:** We will reduce and where possible eliminate the use, manufacture, or sale of products and services that cause environmental damage or health or safety hazards. We will inform our customers of the environmental impacts of our products or services and try to correct unsafe use.
7. **Environmental Restoration:** We will promptly and responsibly correct conditions we have caused that endanger health, safety, or the environment. To the extent feasible, we will redress injuries we have caused to persons or damage we have caused to the environment and will restore the environment.
8. **Informing the Public:** We will inform in a timely manner everyone who may be affected by conditions caused by our company that might endanger health, safety, or the environment. We will regularly seek advice and counsel through dialogue with persons in communities near our facilities. We will not take any action against employees for reporting dangerous incidents or conditions to management or to appropriate authorities.
9. **Management Commitment:** We will implement these Principles and sustain a process that ensures that the Board of Directors and Chief Executive Officer are fully informed about pertinent environmental issues and are fully responsible for environmental policy. In selecting our Board of Directors, we will consider demonstrated environmental commitment as a factor.
10. **Audits and Reports:** We will conduct an annual self-evaluation of our progress in implementing these Principles. We will support the timely creation of generally accepted environmental audit procedures. We will annually complete the CERES Report, which will be made available to the public.

Source: CERES, <http://www.ceres.org>.

Business Environmentalism

Now that caring for the environment has become good business, there are countless examples of firms that are showing that sustainable business practices can not only help the planet but also be a source of competitive advantage. We will simply highlight a few of the many companies that are proving to be responsible environmental stewards.

Patagonia

The 2006 *CRO: Corporate Responsibility Officer* award for environmental sustainability went to Patagonia and for good reason.¹³⁹ One can't discuss business sustainability without mentioning Patagonia, the outdoor lifestyle company that is said to be "arguably one of the most environmentally focused companies in the world."¹⁴⁰ Decades before most businesses considered the possibility of recycling, Patagonia had made it an integral part of operations.¹⁴¹ The company used the mail-order catalogue to send messages about the problems of over-fishing and genetically modified foods. After discovering they could make their outdoor gear out of discarded plastic soda bottles, CEO Yvon Chouinard set about to do an environmental assessment of all their materials. He found that cotton was particularly damaging due to its dependencies on pesticides, insecticides, and defoliants. "To know this and not switch to organic cotton would be unconscionable," says Chouinard.¹⁴² He gave his managers 18 months to make the switch. This was a difficult move in 1994, even for a founder who owned most of the company's stock. Organic cotton was rare at the time, costing 50–100 percent more than traditional cotton. The risk was huge, because a fifth of Patagonia's products were made from cotton. Suppliers balked and the rank and file grumbled, but Chouinard said that they had to do it or the company would not sell cotton again. As often happens when companies take well-reasoned courageous stands, the risk paid off. Patagonia's cotton sales rose 25 percent, and the move set up an organic cotton industry that thrives today.¹⁴³

3M Company

The 3M Company is one of the best-known multinational companies to have adopted a long-term comprehensive, beyond-compliance, environmental policy and program. In their own words, "3M's leadership has recognized that the company's long-term success springs from the principles of sustainable development, which include: stewardship to the environment, contributions to society, and the creation of economic value."¹⁴⁴ Begun more than 30 years ago, 3M's Pollution Prevention Pays program was a multiproduct, multiprocess approach to manufacturing. In its first year alone, through product reformulation, process modification, equipment redesign, and waste recycling, 3M prevented seventy-three thousand tons of air emissions and twenty-eight hundred tons of sludge. They also saved more than \$700 million for the company by reducing various

pollutants at their sources. The company gives the credit (and financial rewards) for these environmental successes to its employees, who developed more than forty-five hundred subprojects under this program.¹⁴⁵

The successes of 3M's environmental efforts are numerous. 3M scientists developed 3M HFEs as a CFC replacement. From 1990 to 2005, 3M cut its volatile organic air emissions by 95 percent, its toxic releases by 94 percent, and its greenhouse gas emissions by 45 percent.¹⁴⁶ It's not surprising, therefore, that 3M has won awards for their environmental excellence. Thirty years ago, 3M's environmental efforts were focused on reducing emissions. Now the company is factoring environmental awareness into all stages of the product's life cycle. Their "Lifecycle Management" program is designed to minimize environmental impact from the product design to customer use and disposal. *Corporate Responsibility Officer (CRO)* magazine (previously *Business Ethics*) described 3M as having "sustained commitment, innovation, and substantial impact in three decades of environmental stewardship."¹⁴⁷

Stonyfield Yogurt

The makers of Stonyfield Yogurt have adopted a Climate Change Initiative. Through 10 years of energy efficiency improvements at their New Hampshire yogurt-making facility, they have saved more than \$1.7 million and 46 million kilowatt hours of electricity—enough to power forty-five hundred homes for a year and prevent more than fourteen thousand metric tons of carbon dioxide from entering the atmosphere. In 2005, they installed a 50 kilowatt solar photovoltaic array that enables them to generate some renewable power. They have been carbon neutral for more than 10 years, offsetting more than forty thousand metric tons of greenhouse gasses—equivalent to removing seventy-three hundred cars from the road for a year.¹⁴⁸ Through their reuse and recycling program, they avoided eight thousand tons of carbon dioxide emissions—the same as taking fourteen hundred cars off the road for a year. Stonyfield supports local, organic farmers, which not only saves energy but also creates a better product. For their environmental efforts, Stonyfield Yogurt won a "Renew America" award for environmental sustainability.¹⁴⁹

THE BUSINESS CASE FOR SUSTAINABILITY

With all the pressures for financial performance in the marketplace, why would businesses devote resources to achieving sustainability? In *Green to Gold*, Daniel Esty and Andrew Winston offer three basic reasons for incorporating environmental considerations into core strategy:¹⁵⁰

1. **The upside benefits.** Sustainability requires innovation and entrepreneurship that can help a firm to move ahead of competitors through new ideas, lower costs, and stronger intangibles such as trust and credibility. Companies that manage the environment carefully can even carry less risk, resulting in lower lending rates.

2. **The downside risks.** Companies that do not care for the environment run the risk of incurring society's wrath once they step over the line. Union Carbide found this out after the tragedy in Bhopal. Wal-Mart found that even the largest of firms cannot withstand negative public reactions indefinitely.
3. **The right thing to do.** Oil giant Shell uses an acronym to explain why they do some things that on the surface appear to be costly—TINA (There Is No Alternative). Sustainability is not a luxury, nor is there really a choice.¹⁵¹ As the sign in Patagonia headquarters says, "There is no business to be done on a dead planet."¹⁵²

Cost-Benefit Analysis

Although the importance of practicing sound environmental management is clear, managers are still left with the task of deciding which projects to undertake and which to forego. **Cost-benefit analysis** has been used in other areas, especially those related to public and private capital budgeting and investment; it has also received an extraordinary amount of attention in natural environmental policy decisions. For instance, most environmental impact statements, which are required by the National Environmental Policy Act, have one or more cost-benefit analyses as the basis for many of the environmental decisions resulting from these studies. The idea behind cost-benefit analysis is that, in a rational planning situation, an organization wants to ensure that an environmental project is worth the investment. Costs are totaled and compared with overall benefits. If benefits are sufficiently greater than costs, the project is given the go-ahead; if not, it is shelved, revised, or scrapped. Decision makers in many dam projects, other water reclamation projects, and land development projects in the United States have used cost-benefit analysis to determine the value of these environment-oriented projects. Environmental groups can use cost-benefit analysis to further their agenda for change. As previously discussed, the Rainforest Action Network has been able to get large corporations to make dramatic changes in the way they do business. Essentially, they do this by changing the cost-benefit equation. By upping the cost of environmental negligence, RAN tilts the business calculus, making it more likely that firms will find the results of a cost-benefit analysis indicate that an improvement in environmental performance is warranted.

Triple Bottom Line

As we discussed in Chapter 2, companies around the world are beginning to adopt the **triple bottom line (TBL)** reporting that covers not only economic performance but also social and environmental. The idea behind the TBL is that it will force corporations to focus not only on financial performance but also on the ways in which the company either adds to or detracts from society and the environment. A recent commentary in the *CPA Journal* suggested that U.S. firms would benefit if the SEC would require TBL reporting. Socially responsible firms would benefit from the exposure their activities would receive just as irresponsible

firms would be forced to own up to their failings.¹⁵³ Although the SEC is unlikely to adopt the requirement any time soon, the voluntary use of TBL as a reporting framework continues to grow.

BUSINESS AND ENVIRONMENTAL ACTIVIST PARTNERSHIPS

In the past few years, a remarkable shift in the relationship between business and environmental activists has occurred. Accommodation is replacing antagonism as the two parties begin to recognize their mutual dependence. Business needs environmental activists to both inform and validate their environmental efforts, and activists need business to change the way it operates in order to protect the planet.¹⁵⁴

Examples of this new partnership abound. Silicon Valley Toxic Coalition activists first communicated their concern to Dell by chaining themselves to computer monitors. Now they work with Dell on their innovative recycling program and other issues of sustainability.¹⁵⁵ According to Coalition founder Ted Smith, “Companies have decided it is better to invite us into the tent than have us outside picketing their keynote speeches. It’s a long way from where we started.”¹⁵⁶ In January of 2007, the CEOs of 10 major corporations met in Washington to issue a call for mandatory carbon emission limits; the presidents of Environmental Defense and the Natural Resources Defense Council (NRDC) were at the table with them.¹⁵⁷

The strangest of these new bedfellows may be the relationship between Adam Werbach, once the youngest president of the Sierra Club, and Wal-Mart, a company he once called “a new breed of toxin.”¹⁵⁸ Wal-Mart has developed a variety of partnerships. Conservation International has helped them to lower energy use, and Environmental Defense has opened an office in Bentonville, Arkansas, so that they can work more closely with Wal-Mart—though they are careful to take no money from them.¹⁵⁹ However, the partnership between Werbach and Wal-Mart is causing the greatest commotion.

Werbach has been a leader in the environmentalist community since he became the youngest Sierra Club president at the age of 23. His book’s title, *Act Now, Apologize Later*, reflects his willingness to act decisively and deal with reactions later. In the case of Wal-Mart, the reaction has been intense. Clients of his small consulting firm, Act Now, fired him because they did not want to be associated with anyone who did business with Wal-Mart. Old friends no longer speak to him, and strangers have even threatened him. He no longer speaks in public without special security.¹⁶⁰

Despite the upset it has caused, both parties remain committed to this collaboration. The benefits for Wal-Mart are clear. At a time when some observers are questioning the sincerity of their environmental initiatives, Werbach brings a perception of legitimacy to their efforts. For Werbach, the unprecedented scope of the opportunity was too much to resist. According to Werbach’s wife Lyn, Act Now’s CFO, “Imagine that struggle of knowing there’s an opportunity that has unprecedented reach and not taking it.”¹⁶¹

SYSTEMATIC BUSINESS RESPONSES TO THE ENVIRONMENTAL CHALLENGE

Various management approaches are available for use in selecting or constructing an environmental strategy. These include several management approaches that were discussed in more general terms in earlier chapters and a few that are specific to natural environment issues. In the first group are crisis management, issues management, and stakeholder management. Because these topics were addressed more fully in Chapters 5 and 6, only their applicability to environmental management will be discussed here. In the second group of decision-making tools are sustainability and strategic environmental management, which will be discussed more fully in this chapter.

Generic Management Decision-Making Tools

Managers can use crisis management in the environmental area by focusing on two factors: prevention and contingency plans. As can be seen in the Exxon *Valdez* case, Exxon, Alyeska, and the federal and state governments apparently did not pay enough attention to preventing the oil spill disaster or to implementing the inadequate contingency plan to recover the oil once it had been spilled. Although some attention had been paid to the vulnerability of the Alaskan natural environment to a small oil spill, this appears to have been understated and generally ignored. That either Exxon or Alyeska assessed its own vulnerability to a spill of any size appears doubtful. Finally, the lack of coordination between the two companies in immediately addressing the spill indicated a response plan that was only a paper tiger, never really put into practice. Had the businesses and governments followed basic crisis management principles, including vulnerability assessments and simulation drills, the outcome might have been different for both of these organizations and for Prince William Sound.

Issues management can be employed to track public interest in natural environment issues and to develop and implement plans to attempt to ensure that the scope of environmental problems is minimized and that the firm develops effective responses at each stage in the life cycles of environmental issues. Environmental issues can be developed as part of the environmental impact statement process or as part of the strategic planning macroenvironmental analysis process.

Similarly, stakeholder management applies to environmental management in that environmental stakeholders and their stakes can be identified, including the environmental public, environmental regulators, environmental groups, and various entities (human and nonhuman) across the entire natural environment. The follow-up stages of stakeholder management—that is, planning for and interacting with stakeholders—can then be conducted so that each important environmental stakeholder is given adequate attention after it is identified.

Although crisis management, issues management, and stakeholder management can be used as generic approaches to environmental management, there are other, more targeted management approaches that are consistent with a proactive approach to environmental management. These are sustainability and strategic environmental management.

Strategic Environmental Management

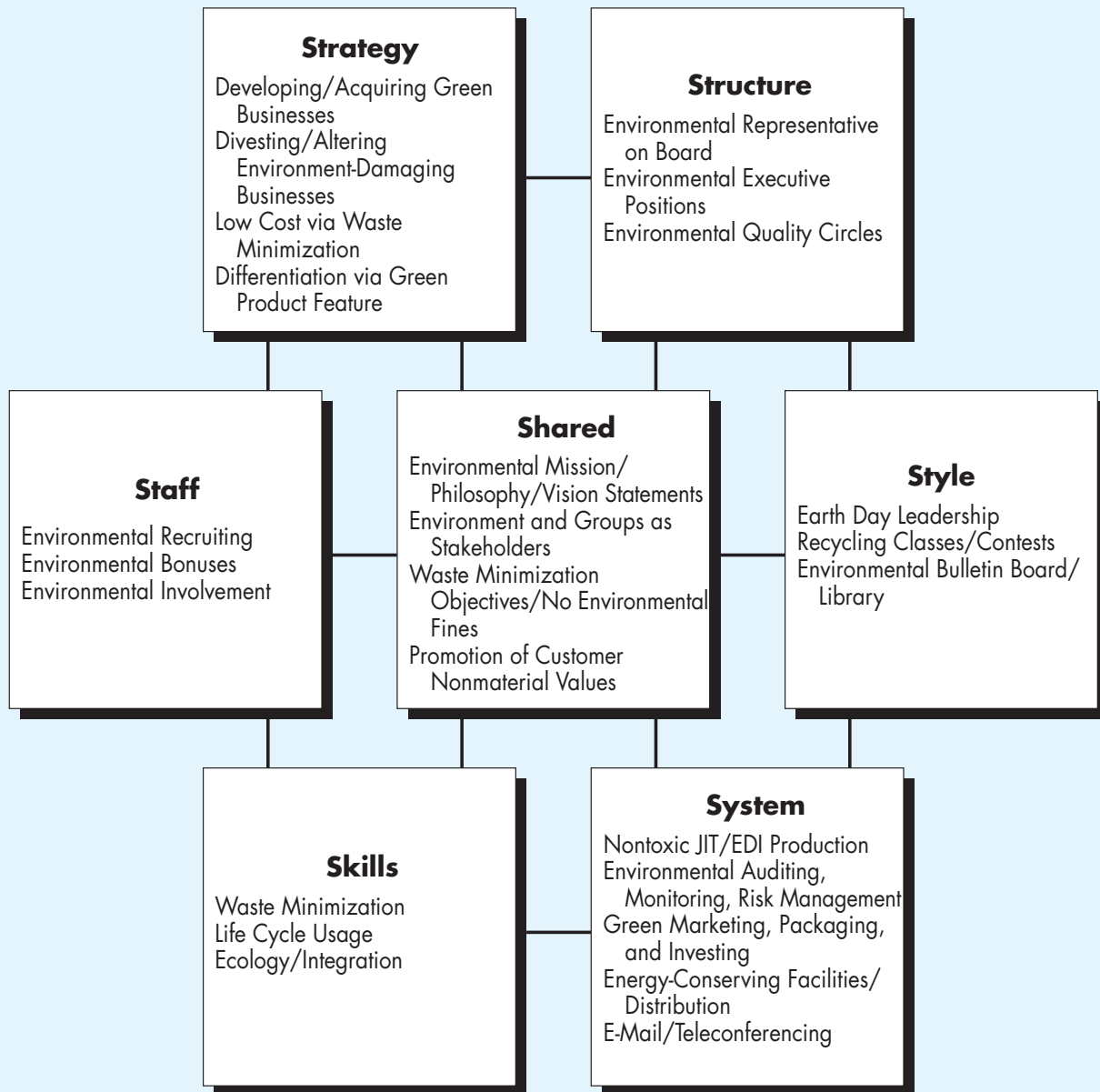
The final managerial approach to addressing the business environmental challenge presented here is a well-known organization effectiveness tool that has been adapted by the authors to assist managers in developing and implementing overall approaches to natural environment issues. This model is called **strategic environmental management (SEM)** and is presented as one way in which organizations can readily respond to their environmental challenges and integrate a wide range of responses for environmental effectiveness.

As can be seen in Figure 15-8, this method uses the McKinsey 7S framework, in which seven typical organizational components necessary for success are identified and integrated, and several green suggestions are given for each “S.” Businesses can build environmental components into their superordinate goals, strategies, structures, and so on, in order to develop an overall organizational environmental response. Superordinate goals can include an emphasis on environmental protection in a company’s mission statement, for instance, whereas one of its strategies can be developing or acquiring environmentally sensitive businesses. The key to using this model is for managers to identify opportunities for developing environmental responses in each of the S categories and to ensure that each of these responses is compatible with the others.

Using this approach, the environmental manager can incorporate concern for the environment and take environmentally sensitive actions in all organization departments and at all organizational levels. For instance, the shared value of waste minimization can translate into the low-cost strategy, enhanced by environmental quality circles structures, energy-conservation systems in manufacturing facilities, and environmentally skilled staff personnel who are motivated by incentives for meeting personal environmental objectives and by managers exhibiting an environmentally sensitive style. As mentioned in the previous chapters, each organizational department can play a role in the organization’s interaction with the natural environment. Research and development departments can work with manufacturing personnel to alter their products and processes to limit pollution and depletion. Finance and accounting personnel can develop effective environmental auditing systems and cost out the potential for environmentally damaging projects, with the aim of reducing this cost as much as possible.

Human resources managers can begin to incorporate environmental concerns in their recruitment and training programs, attempting to build an “environmental culture” in the organization. Marketers can identify their customers’ “real needs,” as opposed to their frivolous (and potentially environmentally damaging) desires for products and services, and adjust their distribution systems in transportation, packaging, and labeling so as to promote environmental sensitivity. This strategic environmental management approach is similar to the international environmental management standard called **ISO 14000**, which includes organizational environmental objectives, issues, policies, systems, and documentation aimed at continual improvement of environmental performance.”¹⁶²

Figure 15-8 *Strategic Environmental Management (SEM)*



Source: M. Starik and A. B. Carroll, "Strategic Environmental Management: Business as if the Earth Really Mattered," *Proceedings of 1991 International Association for Business and Society*, Sundance, UT (March 22–24, 1991), 28.

The limitations of the SEM approach are similar to those of the McKinsey 7S model itself, including a decidedly internal orientation (nonorganization stakeholders and forces are not explicitly emphasized) and a potential for much complexity. The prudent manager, once again, is advised to remember these weaknesses and to supplement this method with others mentioned in this section. The stakeholder management approach, with its external focus, might be a good match for the more internal SEM focus. Indeed, an eighth “S” that could be added to this model is “stakeholders,” which could include environmentally oriented suppliers, customers, investors, and regulators, as well as the natural environment itself.

An alternative way of conceptualizing the integration of environmental considerations into the strategic management process has been presented by Stead and Stead in their influential book *Sustainable Strategic Management*.¹⁶³ They develop the idea that **sustainable strategic management (SSM)** necessitates processes that seek competitive advantages that are consistent with a core value of environmental sustainability. They reason that firms that pursue SSM will base their strategies on an analysis of the ecological issues they face, the values they hold that support sustainability, and the ecological interests of their stakeholders. In their view, SSM calls for sustainable strategic managers who formulate, implement, and evaluate organizational processes with an eye toward developing sustainability-centered organizational cultures, human resources, technologies, and management systems.¹⁶⁴

The Future of Business: Greening and/or Growing?

The salient environmental question we all may need to address in the future: “How much is enough?” A common business and, indeed, public policy goal in most human societies has been economic growth. Typically, businesses and societies have needed increasing amounts of either materials or energy, or both, to achieve that economic growth. Limits on growth, similar to limits on human reproduction, at either the macro or micro level, have not been widely popular. One potential problem with unrestrained economic growth worldwide is that, unless technology or people change significantly within a generation, environmental problems change in degree from significant to severe.

The pressures on the environment come from many directions. World population is projected to continue to grow, creating greater demands on food and fuel resources. Large countries like China and India are industrializing and so they will use increasing amounts of materials and energy. The already industrialized countries continue to maintain the highly consumptive lifestyles that have strained the environment already. As the name implies, the sustainability imperative is of the essence. Business no longer has the luxury of deciding whether or not to respond to it—the environment can’t wait.

Summary

We began by discussing the concept of sustainability and its importance to business. We then outlined the top environmental issues facing business today. Environmental ethics began our discussion of individual and collective responsibility for sustaining the environment. We explored the role of governments and environmental interest groups in effecting change and then looked at companies that are leaders in practicing sustainable business practices. Lastly, we offered ways in which businesses can act toward achieving sustainability.

What themes are woven throughout this chapter that can be especially helpful to prospective managers? First, the natural environment is crucial for human survival and a number of complex and interconnected human-induced activities are threatening this environment. Problems

such as human deforestation, pollution, and expanding populations are potentially endangering nonhuman species and ecosystems and reducing the quality of human life. Individuals and their organizations, including businesses, are directly or indirectly responsible for this situation.

Second, there are significant differences of opinion on how these problems will develop in the future and, of course, what should be done to resolve them. The recent growth in partnerships between business and environmental activists is a promising sign, but more changes must come. A minimum baseline of sustainability—meeting the needs of the present without compromising the ability of future generations to meet their needs—should be the bottom line for business as it moves into the future.

Key Terms

- acid rain (page 586)
- air pollution (page 586)
- biodiversity (page 585)
- carbon neutral (page 579)
- CERES Principles (page 605)
- Clean Air Act (page 595)
- Clean Water Act (page 596)
- climate change (page 581)
- cost–benefit analysis (page 608)
- deforestation (page 590)
- ecoterrorists (page 602)
- emissions trading (page 595)
- Endangered Species Act (ESA) (page 599)
- energy inefficiency (page 583)
- environment (page 579)
- environmental impact statements (EISs) (page 594)
- Environmental Protection Agency (EPA) (page 595)
- externalities (page 578)
- Global Compact (page 600)
- Global Reporting Initiative (page 600)
- global warming (page 581)
- greenhouse effect (page 582)
- ISO 14000 (page 611)
- Montreal Protocol (page 599)
- NIMBY (page 593)
- ozone (page 588)
- strategic environmental management (SEM) (page 611)
- Superfund (page 597)
- sustainable strategic management (SSM) (page 613)
- sustainability (page 578)
- toxic substances (page 586)
- Toxic Substances Control Act (page 597)
- tragedy of the commons (page 591)
- triple bottom line (TBL) (page 608)
- watershed (page 589)
- wicked problems (page 591)

Discussion Questions

1. What is sustainability?
2. What are several of the most important environmental issues now receiving worldwide attention?
3. What are some of the causes of environmental pollution and depletion?
4. What is the future outlook for the natural environment?
5. Who has responsibility for addressing environmental issues?
6. How can ethics be applied in response to environmental issues?
7. What are some examples of sustainable business and decision models for addressing environmental concerns?
8. Should businesses and societies continue to focus on unlimited economic growth?

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Business and Community Stakeholders

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Identify and discuss two basic ways of business giving.
- 2 Discuss reasons for community involvement, various types of community projects, and management of community stakeholders.
- 3 Explain the pros and cons of corporate philanthropy, provide a brief history of corporate philanthropy, and explain why and to whom companies give.
- 4 Differentiate between strategic philanthropy, cause-related marketing, and cause branding.
- 5 Characterize the nature of, magnitude of, reasons for, and impacts of outsourcing, offshoring, and business or plant closings.
- 6 Address steps that a business or plant might take before a decision to close is made.
- 7 Identify strategies that a business or plant might employ after a decision to close has been made.

When we speak of a community, we usually mean the immediate locale—the town, city, or state—in which a business resides. In our modern age of global business, instantaneous communication, and speedy travel, however, the region, the nation, or even the world can become the relevant community. From avian flu in Asia to the AIDS epidemic in Africa, and from terrorist bombings in Europe to the September 11th World Trade Center tragedy in New York City, businesses are affected by events throughout the world. Communications technology and high-speed travel have eclipsed traditional geographic boundaries. The business community now encompasses the entire world.

When we think of business and its community stakeholders, two major kinds of relationships come to mind. One is the positive contribution business can make to the community. Examples of these positive contributions include volunteerism, company contributions, and support of programs in education, culture, urban development, the arts, civic activities, and other health and welfare endeavors. On the other hand, business can also cause harm to community stakeholders. It can pollute the environment, and it can put people out of work by outsourcing or closing a plant. Business can abuse its power and exploit consumers and employees.

In this chapter, we will concentrate on community involvement and corporate philanthropy as community stakeholder issues. In addition, we will discuss the topics of outsourcing, offshoring, and business or plant closings as community stakeholder concerns. This discussion should provide us with an opportunity to explore both the positive and the detrimental effects that characterize business/community relationships. We will begin with the positive.

In addition to being profitable, obeying the law, and being ethical, a company may create a positive impact in the community by giving in basically two ways: (1) donating the time and talents of its managers and employees and (2) making financial contributions. The first category, **community involvement**, manifests itself in a wide array of voluntary activities in the community. The second category involves corporate philanthropy or business giving. We should note that there is significant overlap between these two categories because companies quite frequently donate their time and talents and give financial aid to the same general projects. First, we will discuss community involvement and the various ways in which companies enhance the quality of life in their communities.

Community Involvement

Business must—not only for a healthier society, but also for its own well-being—be willing to give the same serious consideration to human needs that it gives to its own needs for production and profits. Barry Salzberg, chief executive officer (CEO) of Deloitte & Touche USA LLP, offers the following argument for increased community involvement:

Successful businesses thrive in healthy communities. . . . As a business, we want to share our expertise and make a positive impact on our communities. It's not only the right thing to do—it's a business strategy that means success for our organization and our clients.¹

Business involvement in the community can be enlightened self-interest because businesses are in a position to help themselves in the process of helping others. This dual objective of business clearly illustrates that making profits and addressing social concerns are not mutually exclusive endeavors. The Eli Lilly *Community Service Report* drives this point home:

Our approach to corporate citizenship is influenced by the aspirations we have for our company's reputation. We want the Lilly brand to be admired and valued. We

*endeavor to be a company with whom stakeholders—patients, employees, physicians, shareholders, and others—prefer to work and interact. And, we know this is less about what we say, and more about what we do.*²

Other rationales for business involvement in community affairs provide moral justification, beyond that of enlightened self-interest. For example, utilitarian arguments can support corporate giving in that improvement of the social fabric creates the greatest good for the greatest number. This need not contradict the mandates of self-interest, because the corporation is one of the community members that will benefit.³ Although justifications for corporate involvement in the community are possible from various perspectives, one thing is clear: Business has a moral responsibility to build a relationship with the community and to be sensitive to its impacts on the world around it. The Center for Corporate Citizenship at Boston College has developed a set of seven management practices, processes, and policies that represent a global standard of excellence in community involvement. These are listed in Figure 16-1.

Figure 16-1 *Standards of Excellence in Corporate Community Involvement*

Standard 1: Leadership

Senior executives demonstrate support, commitment, and participation in community involvement efforts.

Standard 2: Issues Management

The company identifies and monitors issues important to its operations and reputation.

Standard 3: Relationship Building

Company management recognizes that building and maintaining relationships of trust with the community is a critical component of company strategy and operations.

Standard 4: Strategy

The company develops and implements a strategic plan for community programs and responses that is based on mutual issues, goals, and concerns of the company and the community.

Standard 5: Accountability

All levels of the organization have specific roles and responsibilities for meeting community involvement objectives.

Standard 6: Infrastructure

The company incorporates systems and policies to support, communicate, and institutionalize community involvement objectives.

Standard 7: Measurement

The company establishes an ongoing process for evaluating community involvement strategies, activities, and programs and their impact on the company and the community.

Source: Center for Corporate Citizenship at Boston College, <http://www.bc.edu/corporatecitizenship>.

VOLUNTEER PROGRAMS

One of the most pervasive examples of business involvement in communities is a volunteer program. Corporate volunteer programs reflect the resourcefulness and responsiveness of business to communities in need of increasing services. They also build employee morale: almost two-thirds of the respondents to the 2007 Deloitte & Touche Volunteer IMPACT survey said they would rather work for companies that provide them with opportunities to volunteer at nonprofit organizations.⁴

There are numerous examples of corporations making a difference in communities through volunteer activities. The Longaberger Company has a long-standing commitment to the American Cancer Society to make and sell “Horizon of Hope” baskets, stuffed with breast cancer literature: the campaign has raised more than \$12 million from 1995 to 2007.⁵ Through Neighbor to Neighbor, UPS employees help to improve impoverished communities across the United States and around the world by organizing food drives, working in soup kitchens, and mentoring troubled youth.⁶

The potential results of these efforts are limitless. By joining with a community-based effort, General Electric (GE) helped convert the closed Benjamin Franklin High School in East Harlem to a center for science and mathematics. In addition to providing enrichments that made the school comparable to the best schools in the country, GE arranged for its employees to become mentors and tutors to the students. The rate of college-bound students at the school became one of the highest in the city, and that program became the starting point of GE’s award-winning College Bound initiative.⁷

Communities obviously benefit from such volunteer programs, but how do companies benefit from employee volunteerism? Business for Social Responsibility details a variety of benefits, which include:⁸

- Improving employee skills and training
- Encouraging employee teamwork

http://SEARCH THE WEB WEB

GUIDESTAR (HTTP://WWW.GUIDESTAR.ORG)

Guidestar’s mission is “to revolutionize philanthropy and nonprofit practice by providing information that advances transparency, enables users to make better decisions, and encourages charitable giving.” With a database of 1.5 million nonprofit organizations, Guidestar makes it possible to verify the claims of charities and to learn more about their activities. Guidestar obtains information from the IRS (Forms

990, 990-EZ, and 990-PF) as well as the nonprofit organization. They provide financial information and information on the organization’s programs, accomplishments, and goals. While more extensive searches are available by subscription, anyone can access the Guidestar database for free to obtain basic information about a nonprofit organization’s operations and finances.

- Developing leadership skills
- Developing the local labor pool
- Recruiting and retaining employees
- Improving corporate reputation

RESOURCE-BASED GIVING

The increasingly competitive global environment has heightened pressure for efficiency in all areas, including community service. A key goal of corporate community service is to get the most good possible from each dollar spent on giving. Companies often find that they can achieve the greatest good by providing services that fit their resources and competencies. For example, LensCrafters provides vision care because it can do so more efficiently and effectively than can a business that does not specialize in eye care. Similarly, VH1 works with music and musicians on a daily basis, so they are able to use their access to expertise and resources to support music education in the public schools.

Resource-based giving involves assessing a firm's resources and competencies and determining where sharing those resources and competencies would accomplish the most good. By drawing on its resources and capabilities, a firm is in a position to do more good than it would otherwise accomplish. Separating philanthropic efforts from a business's operations limits the firm's potential to make a positive difference: Leveraging a firm's resources and capabilities provides the greatest benefit to society.⁹

In the aftermath of the attack on the World Trade Center, rescue workers were using cell phones around the clock in a situation where they couldn't afford to have a dead battery but didn't have the time or electricity to recharge phones. Electric Fuel Corporation donated 500 Instant Power cell phone chargers and batteries to keep the phones working. With their head office located in lower Manhattan, only a 10-minute walk from the scene of the tragedy, they were able to hand over their entire inventory to the rescue effort.¹⁰

Drug companies have also found they can accomplish more by drawing on their specific resources. GlaxoSmithKline joined with the World Health Organization (WHO) to eradicate lymphatic filariasis (LF), a disease that affects about 120 million people in Asia, South America, and Africa. This effort evolved into a global alliance between international organizations in the public and private sectors, academia, and non-governmental organizations working in partnership with ministries of health in tropical countries where LF is endemic. Merck & Co., Inc., having already worked with WHO to provide free ivermectin to treat patients with river blindness in Africa, joined the Alliance when it widened the scope of its donation program to include LF in African countries where river blindness and LF coexist.¹¹

MANAGING COMMUNITY INVOLVEMENT

For discussion purposes, we are separating our treatment of managing community involvement from that of managing corporate philanthropy. In reality, however, this separation is impossible to achieve because there are significant

overlaps between these two areas. Corporate philanthropy involves primarily the giving of financial resources. Community involvement focuses on other issues in the business/community relationship, especially the contribution of managerial and employee time and talent. This section addresses these broader community issues; a later section of this chapter deals with the more specific issue of managing corporate philanthropy.

Business Stake in the Community

When one speaks with corporate executives in the fields of community and civic affairs and examines community affairs manuals and other corporate publications, one sees a broad array of reasons why companies need to keep abreast of the issues, problems, and changes expressed as community needs. Self-interest and self-preservation provide one rationale. Companies typically have a significant physical presence in the community and so they want to protect that investment. Issues of interest to them include zoning regulations, the threat of neighborhood deterioration, corporate property taxes, the community tax base, and the availability of an adequately trained workforce. Companies can support their communities through their daily activities in a variety of ways, including sourcing from local businesses, joining public policy debates, investing in local banks, and locating facilities in places that benefit community development.¹² In addition, companies can develop community action programs that transcend daily operations. Figure 16-2 presents the results of a survey of businesses, identifying

Figure 16-2 *Corporate Community Involvement: The Most Important Issues and the Most Common Methods of Addressing Them*

<u>Community Investment Issues</u>		<u>Community Investment Methods</u>	
K-12 Education	71%	Volunteerism	86%
Workforce Development	68%	Cause-related Partnerships	75%
Business Development & Growth	48%	Executive Participation in Community	71%
Higher Education	47%	Nonprofit or Community Board Participation	71%
Transportation/Public Infrastructure	38%	Cash Contributions	65%
Housing	38%	Advocacy	52%
Health & Wellness	38%	Community Advisory Panels	48%
Arts, Parks, Sports	24%	Pro Bono Work	31%
Crimes/Public Safety	22%	Donated Property/Equipment	30%
Other	19%	Community Management	28%

Source: U.S. Chamber of Commerce Survey—Summary of Findings Presented at the 2007 National Partnership Conference: Corporate Community Investment, U.S. Chamber of Commerce.

businesses' perceptions of the most important issues affecting communities as well as the methods those businesses use to address them.

Developing a Community Action Program

The motivation for developing a **community action program** is evident when one considers the stake a firm has in the community. Likewise, the community represents a major stakeholder of business. Therefore, business has an added incentive to be systematic about its relationship with the community. First, the business must get to know the community in which it intends to become involved. The next step then is to assess the company's resources to determine what the company is best able to give. Then, the company can design a community action program by matching the community needs to the resources the company has available. Finally, as with all corporate endeavors, management should monitor the performance of the community action program carefully and make adjustments where needed.

Step One: Knowing the Community. A key to developing worthwhile community involvement programs is knowing the community in which the business resides. This is a research step that requires management to assess the characteristics of the local area. Every locale has particular characteristics that can help shape social programs of involvement. Who lives in the community? What is its ethnic composition? What is its unemployment level? Are there inner-city problems or pockets of poverty? What are other organizations doing? What are the really pressing social needs of the area? What is the community's morale?

Knowledge of community leadership is another factor. Is the leadership progressive? Is the leadership cohesive and unified, or is it fragmented? If it is fragmented, the company may have to make difficult choices about the groups with which it wants to work. If the community's current approach to social issues is well organized, "jumping on the bandwagon" may be all that is necessary. If the community's leadership is not well organized, the company may want to provide an impetus and an agenda for restructuring or revitalizing the leadership.

Step Two: Knowing the Company's Resources. Effective addressing of various community needs requires an inventory and assessment of the company's resources and competencies. What are the variety, mix, and range of resources—personnel, money, meeting space, equipment, and supplies? Many companies are willing to give employees time to engage in and support community projects. This involvement may be in the form of managerial assistance, technical assistance, or personnel. Wide spectra of abilities, skills, interests, potentials, and experience exist in most organizations. To put any of these resources to work, however, it is necessary to know what is available, to what extent it is available, on what terms it is available, and over what period of time it is available.

Step Three: Selecting Projects. The selection of community projects for company involvement grows out of the matching of community stakeholders' needs with company resources. Frequently, because there are many possible

matches, the company must be selective in choosing among them. Sometimes companies develop and refine policies or guidelines to help in the selection process. These policies are extremely useful, because they further delineate areas in which the company may be involved and provide perspective for channeling the organization's energies.

Policies and guidelines can go a long way toward rationalizing and systematizing business involvement in the community. Such policy statements can provide a unified focus for company efforts. Guidelines to consider include fit with the company resources (which project is most consistent with corporate resources and goals?), the cost-effectiveness of the project (which project makes the best use of resources?), the sustainability of the project (will the project continue if the corporate involvement ends?), and employee preferences (with which projects would employees most want to get involved?).

The Ronald McDonald House Charities (RMHC) sponsored by McDonald's Corporation are an excellent example of a community project that follows these guidelines. The three core programs of RMHC—the Ronald McDonald House, Ronald McDonald Family Room, and Ronald McDonald Care Mobile—are focused on helping families in need. The well-known Ronald McDonald House program provides a “home away from home” for families of seriously ill children receiving treatment at nearby hospitals. Since its inception more than 30 years ago, more than 10 million families around the world have received shelter and solace through the program.¹³

Step Four: Monitoring Projects. Monitoring company projects involves review and control. Follow-up is necessary to ensure that the projects are being executed according to plans and on schedule. Feedback from the various steps in the process provides the information management needs to monitor progress. In later chapters, we will elaborate on the managerial approach to dealing with various social issues. The guidelines previously listed, however, provide some insights into the development of business/community stakeholder relationships. As we stated earlier, community involvement is a discretionary or philanthropic activity in our corporate social performance model. The costs are significant, but the potential returns, for both the corporation and the community, are great.

Corporate Philanthropy or Business Giving

The word *philanthropy* comes from the Greek *philien*, which means “to love,” and *anthropos*, which means “mankind.”¹⁴ Thus, the dictionary defines **philanthropy** as “a desire to help mankind as indicated by acts of charity; love of mankind.”¹⁵ One more restricted contemporary usage of the word “philanthropy” is “business giving.” In this section, we will concentrate on the voluntary giving of financial resources by business. One problem with the dictionary

definition is that the motive for the giving is characterized as charitable, benevolent, or generous. In actual practice, it is difficult to assess the true motives behind businesses'—or anyone's—giving of themselves or their financial resources.

To be sure, people value the philanthropy of the business sector. One study found that 84 percent of those surveyed factor a company's commitment to social issues into a decision of which businesses they want in their community. Furthermore, 77 percent looked at social commitment when selecting an employer, and 66 percent considered social commitment when making investment decisions. Another study found that corporate citizenship leads to more positive stakeholder attitudes toward the corporation and that these improved attitudes have positive performance consequences. For example, employees remain with the company longer, customers continue to make purchases from the company, and community leaders value the company as a neighbor.¹⁶

A BRIEF HISTORY OF CORPORATE PHILANTHROPY

Business philanthropy of one kind or another can be traced back to the 1920s, when the most significant effort to “translate the new social consciousness of management into action” emerged in the form of organized corporate philanthropy.¹⁷ Before World War I, steps had been taken toward establishing systematic, federated fund-raising for community services. The early successes of the YMCA, the war chests, welfare federations, Community Chests, colleges and universities, and hospitals provided impetus for these groups to organize their solicitations. The business response to the opportunity to help community needs varied. At one extreme, large enterprises such as the then Bell Telephone system, with branches, offices, and subsidiaries in thousands of communities, contributed to literally thousands of civic and social organizations. Smaller firms, such as the companies in small mill towns of North Carolina, supported schools, housing

<http://SEARCHTHEWEB.WEB>

WHO GIVES TO WHOM?

The Foundation Center is an independent, nonprofit information clearinghouse that collects, organizes, analyzes, and disseminates information on foundations, corporate giving, and related subjects. The center publishes the National Directory of Corporate Giving, which provides information on more than

2,900 corporate philanthropic programs, detailing more than 1,900 corporate foundations and more than 990 direct-giving programs. A wealth of information on corporate philanthropy and related topics can be found on the Foundation Center's website at <http://www.fdncenter.org>.

projects, religious activities, and community welfare agencies with a degree of enthusiasm that exceeded most nineteenth-century paternalism.

From 1918 to 1929, the Community Chest movement dominated corporate giving. In the period from 1929 to 1935, there was an attempt to allow business to deduct up to 5 percent of its pretax net income for its community donations. During the years 1935 to 1945, marked by the Great Depression and World War II, business giving did not expand, but it began to grow again from 1945 to 1960. Since about 1960, corporate giving has grown to encompass a variety of initiatives. Now, in the twenty-first century, broader social initiatives continue, but the nature of business giving has taken a turn. The corporate philanthropy watchword is now “strategic philanthropy”—philanthropy that benefits both society and the corporate entity doing the giving.

A CALL FOR TRANSPARENCY IN CORPORATE PHILANTHROPY

A major debate has arisen over proposed federal legislation that would have required companies to disclose which charities they support and how much money they give. Although companies are required to disclose the money they give through foundations because of the tax benefits derived from the foundation’s tax-exempt status, companies need not disclose direct donations. This has renewed the age-old debate about the role of business in society. Proponents of disclosure contend that the money belongs to the shareholders, and they alone have the right to determine where it will go. Representative Paul Gillmor (R-Ohio) said that he introduced the disclosure bill, which was cosponsored by Representative Michael G. Oxley (R-Ohio) and Representative Thomas Manton (D-New York), because he had sat on corporate boards and observed executives distributing corporate assets to their pet charities while ignoring shareholders.

Gillmor’s concern was shared by law professors such as Charles M. Elson of Stetson University, who argued that philanthropy often only serves to glorify corporate managers and that, unless the philanthropy clearly benefits the company, it represents a waste of corporate assets. A few nonprofits, such as the American Red Cross, also agreed that disclosure would be good public policy. Surprisingly, the National Society of Fundraising Executives even supported disclosure, arguing that it would help the image of philanthropy, which has been hurt by scandals in recent years.¹⁸ This broad-based support notwithstanding, most corporations and nonprofits had expressed concern that disclosure would have a chilling effect on corporate donations. Their arguments include that charitable giving is a business decision, that it would provide competitors with information about a firm’s strategy, that it might incite controversy with special-interest groups, and that the paperwork would become an administrative burden.¹⁹ In March 2000, Representative Gillmor withdrew the bill.

The issue resurfaced in the wake of the Enron and WorldCom accounting scandals, when there were revelations about corporations giving large donations

Ethics in Practice Case

TUGGING THE HEART OR TWISTING THE ARM?

While working for a large corporation, I received numerous e-mails telling me of the large charitable contribution fund in which the company participates. All employees were highly encouraged to attend a town-hall meeting where other employees and managers spoke of how the fund had affected their lives and showed videos of the good work the fund had done. Top executives traveled to the town-hall meetings to promote the campaign and encourage 100 percent employee participation. They told us to ask our fellow employees if they had contributed yet. They wanted to reach a goal of \$1 million and believed that everyone should be able to contribute. Furthermore, all managers were expected to contribute. There was even documentation on the company's intranet website with guidelines for how much to give. Although the company claims all donations (or lack thereof) are anonymous and have no effect on promotions or job performance ratings, many wondered if that was entirely true. This was not the first company to

encourage me strongly to contribute to its fund drive, and I doubt it will be the last.

1. Why do companies participate in charitable fund programs? Is it for societal recognition, to aid a worthy cause, or is it some combination? If different firms differ in their motivation, why might that be so?
2. Is it ethical for a company to solicit voluntary charitable contributions from employees? Can they be truly voluntary? If so, how should these campaigns be designed and implemented? Where would you draw the line?
3. If companies no longer participate in charitable fund campaigns, what would be the repercussion for the charities? Does that affect your answer?
4. If you worked in this company, what would you do? Why? If you choose to contribute, what would be your driving motivation?

Contributed by Melissa S. Magoon

to corporate officers' pet causes. For example, Enron gave large donations to a hospital chaired by a member of its audit committee. This concern was factored into the reform legislation developed to enhance corporate accountability. The House developed a bill that included a requirement for corporations to report contributions to a nonprofit organization if any of the corporation's directors or members of their immediate families are members of that nonprofit's board. This would have applied to contributions of more than \$10,000 made by the corporation or any officer of the corporation in the last five years, as well as any other activity that provides a "material benefit" to the nonprofit, including lobbying.

This House bill passed, as did a Senate version, and so a conference committee met to work out the differences between the two bills. The result, of course, was the Sarbanes-Oxley Act of 2002, which did not contain the philanthropy disclosure requirements from the original House bill.²⁰ Representative Gillmor

reintroduced his earlier bill in February 2007: the bill was referred to the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises and, at this writing, is still there. Although no real closure has been achieved, calls for transparency in corporate giving continue.

Another issue that has added to the calls for transparency is a concern that nonprofits are being set up to get around the campaign financing laws regarding “soft money” contributions. In a well-publicized case, the National Committee for Responsive Philanthropy (NCRP) and Common Cause filed complaints with the IRS and the House Ethics Committee that former House Majority Leader Tom DeLay (R-Texas) used a nonprofit organization for political purposes. They charged that DeLay’s charity, “Celebrations for Children,” provided a way for high-end donors to buy access to DeLay and other prominent politicians. According to NCRP executive director Rick Cohen, the charity evaded campaign financing laws “through political fundraising disguised as charity.” Corporations are under no obligation to report their charitable giving, nor are they obligated to report what that giving has bought them in terms of access to politicians.²¹

GIVING TO THE “THIRD SECTOR” — THE NONPROFITS

According to philanthropist John D. Rockefeller III, business giving is necessary to support what has been called the **third sector**—the nonprofit sector. The first two sectors—business and government—receive support through profits and taxes. The third sector (which includes hundreds of thousands of churches, museums, hospitals, libraries, private colleges and universities, and performing arts groups) depends on philanthropy for support. Philanthropy gives these institutions the crucial margin that assures them of their most precious asset—their independence.²²

Why Do Companies Give?

Perhaps it would be more worthwhile to know why companies give to charitable causes rather than to know how much they give. There are several ways to approach this question. We get initial insights when we consider the five categories of corporate contributions programs identified by the National Directory of Corporate Charity, as shown in Figure 16-3.²³ The motivations covered in these categories range from pure self-interest to a desire to practice good corporate citizenship by supporting both traditional and innovative programs in the community.

Recent studies of corporate philanthropy have shed light on the nature of corporate giving. One study found that corporate giving managers believe their firms are becoming more strategic in their giving and that top managers are requiring greater strategic accountability in their corporate giving programs. Also, firms that are more “exposed” to the environment, i.e., more open and vulnerable to the environment, are more likely to engage in strategic philanthropy.²⁴ In another study, researchers found that corporate contributions are motivated by

Figure 16-3 Categories of Corporate Contributions Programs

1. *The Nondonor*—This is a firm for which no evidence of charitable giving was found.
2. *The “What’s in It for Us” Donor*—With this firm, most contributions relate to the company’s direct interest or to the welfare of its employees.
3. *The “Company President Believes in Art Support” Donor*—With this firm, most contributions relate to the company’s direct interest, employees’ welfare, or management’s interest.
4. *The “We Are a Good Citizen” Donor*—Here, a substantial portion of the company’s giving provides support for traditional nonprofit institutions.
5. *The “We Care” Donor*—Here, some funds go to newer organizations and established organizations that deal with nontraditional issues.

profit considerations that influence both advertising expenditures and corporate giving. The authors concluded that corporate giving is a complement to advertising and is, therefore, a profit-motivated expense.²⁵ This perspective can certainly be supported by observing Philip Morris. In a year when they donated \$75 million to charitable causes, they spent \$100 million on advertising to publicize them.²⁶

As economic pressures and increased international competitiveness force companies to be more careful with their earnings, we should not be surprised to see the profit motive coexisting with loftier goals in corporate contributions programs. In a subsequent section of this chapter, we show that philanthropy can be “strategic,” which means that corporate giving can be aligned with the firm’s economic or profitability objectives.

To Whom Do Companies Give?

During the course of any budget year, companies receive numerous requests for contributions from a wide variety of applicants. Companies must then weigh both quantitative and qualitative factors to arrive at decisions regarding the recipients of their gifts. By looking at the beneficiaries of corporate contributions, we can estimate the value business places on various societal needs in the community. However, we should note that, because of the lack of transparency in corporate giving, which we discuss later in the chapter, our figures for giving are simply estimates, and estimates from different sources will vary.

According to the Conference Board, the majority of business giving is distributed among four major categories of recipients in the following order of emphasis: (1) health and human services, (2) education, (3) civic and community activities, and (4) culture and the arts.²⁷ A very small percentage of giving went to the environment, with the recipients being environmental interest groups such as the World Wildlife Fund, the Nature Conservatory, and Greenpeace.²⁸ The small percentage of contributions does not mean business is unconcerned about environmental issues. Business’s commitment to the environment is less likely

to show up in corporate philanthropy and more likely to be found in daily operations, as we discussed in Chapter 15. In addition, environmental issues may end up under other categories such as community improvement. A brief discussion of each of these four categories will help explain the nature of business's involvement in philanthropy.

Health and Human Services. Health and human services are critical to the welfare of a community, whether it is the local community in which a business operates or the global community of which we all are a part. Major recipients in this category include hospitals, youth agencies, and other local health and welfare agencies. Hospitals represent an obviously important need in most communities. They receive financial support for capital investments (new buildings and equipment), operating funds, and matching employee gifts. Youth agencies include such groups as the YMCA, YWCA, Boy Scouts, Girl Scouts, and Boys and Girls Clubs. These children will grow to be attending college and moving on to employment opportunities, so it is logical for business to include youth as a prominent part of its health and welfare contributions.

Another reason that health and human services is one of the largest categories of business giving is the amount donated to federated drives such as the United Way. Dating back to the Community Chest movement, business has traditionally cooperated with federated giving mechanisms. Organizations like the United Way spend the year evaluating nonprofit programs and determining where dollars would be best spent, with much of the money going to the local community. This saves businesses, particularly smaller local ones, the effort of not only trying to assess the various agencies to which they could make donations but also explaining to stakeholders why they chose one over another. Business hopes, just as the community does, that the consolidated efforts of federated drives will lend some order to the requests of major recipients in the community that business has chosen to support.

Education. Most of the corporate contributions in this category have gone to higher education, i.e., colleges and universities, but a growing percentage is going to K–12 programs.²⁹ Educational recipients include capital grants (including endowments), unrestricted operating grants, departmental and research grants, scholarships and fellowships, and employee matching gifts. Also included in this category are contributions to educational groups (for example, the United Negro College Fund and the Council for Financial Aid to Education) and to primary and secondary schools.

As we noted earlier, business has a very good reason for supporting higher education—to increase the pool of trained personnel. This has obvious credibility, because higher education institutions do form the resource base from which business fills its managerial and professional positions. K–12 institutions feed into higher education, and so strong preparation at those levels is critical to a strong professional pool down the road. In addition, many workers in the front lines will receive their education primarily from K–12 institutions, so it is vital that they, too, be in a position to provide business with a strong and capable workforce.

Civic and Community Activities. This category of business giving represents a wide variety of philanthropic activities in the community. The dominant contributions in this category are those given in support of community improvement activities, environment and ecology, nonacademic research organizations (for example, the Brookings Institution, the Committee for Economic Development, and the Urban League), and neighborhood renewal.

General Mills saw the importance of community involvement when the nickname of Minneapolis went from the “City of Nice” to “Murderapolis.” General Mills executives hired a consultant to analyze crime data and found that Hawthorne, just five miles from the company headquarters, was one of the city’s most violent neighborhoods. In what became known as the “Hawthorne Huddle,” they worked with residents, community leaders, politicians, and law enforcement to identify strategies for improvement. General Mills devoted thousands of employee hours and \$2.5 million to ridding Hawthorne of its problems. The murder rate fell 32 percent and robberies fell 56 percent. Dilapidated houses were rebuilt, and a new elementary school was built over bulldozed crack houses.³⁰

Culture and the Arts. American companies donated a total of \$3.32 billion to arts organizations in 2003, according to a survey by the Business Committee for the Arts; in 1967, the figure was \$20 million.³¹ Two of the most prominent organized efforts on the part of business to support the arts are the Business Committee for the Arts (BCA) and the Arts and Business Council, which merged with Americans for the Arts in 2005.³²

Some may wonder why business gives to the arts, because companies seem to gain none of the direct benefits that they receive from their donations to education. For this reason, the Arts and Business Council conducted a 2007 economic impact study of the nonprofit arts and culture industry in the United States and found good reason for business to support the arts as part of supporting the community. After surveying 156 communities and regions, representing all 50 states, they found that the nonprofit arts industry generated more than \$1 billion of organization and audience expenditures in Chicago, the Greater Philadelphia area, San Francisco, and the Greater Washington, DC, area. This represents an increase of 58 percent in organization expenditures, 50 percent increase in audience expenditures, and 50 percent in overall economic activity from five years earlier. They excluded the two largest U.S. cities, New York and Los Angeles, to avoid inflating the national estimates.³³

Giving in Times of Crisis. In addition to the four categories previously mentioned, firms are expected to make charitable donations when crises occur in the firm’s community, the nation, or the world at large. We covered the general issues related to responding to a crisis in Chapter 6, noting that some firms are able to respond so well to a crisis that they are in a position to lend a hand to others in need. For example, Wal-Mart and Home Depot stood out in their ability to bring some relief following the devastation of Hurricane Katrina, as did FedEx for providing FEMA with a radio antenna to set up communications. Most companies stepped up to provide contributions. Of the top 100 firms, 86 percent

made donations following the disaster while the remaining 14 percent put a link on their website to nonprofit organizations aiding rescue efforts.³⁴ This level of giving tends to follow most disasters; according to the U.S. Chamber of Commerce, U.S. businesses donated \$566 million to help communities suffering from the effects of the South Asia tsunami.³⁵

Some observers worry that in times of crisis, corporate philanthropy becomes a zero sum game in that contributions that go to alleviate the crisis then do not go to other causes that need them as well. Typically, giving has increased from year to year irrespective of external events; however, one statistic can give us pause. In the two weeks following the attack on the World Trade Center, corporations gave more than \$120 million to relief funds; this was an unprecedented level of corporate giving.³⁶ According to a survey by the Chronicle of Corporate Philanthropy, however, corporate giving subsequently declined.³⁷ Other concerns surround the possibility of donor fatigue following crises for which corporations and individuals open their checkbooks. There has been some evidence of this. While Hurricane Katrina and the tsunami in Asia received historic levels of support, Hurricane Rita and the Pakistan earthquake garnered far fewer donations.³⁸

MANAGING CORPORATE PHILANTHROPY

As performance pressures on business have continued and intensified, companies have had to turn their attention to managing corporate philanthropy. Early on, managers did not subject their contributions to the same kinds of rigorous analysis given to expenditures for plants and equipment, inventory, product development, marketing, and a host of other budgetary items. This began to change in the early 1980s because cutbacks in federal spending on charitable causes created an increasing need for contributions by business. At the same time, however, the economy was struggling through its worst recession in 50 years. It became increasingly clear that business had to reconcile its economic and social goals, both of which were essential.³⁹

Since that time, while economic situations have risen and fallen, the pressure on business to be more businesslike in their philanthropy has remained constant. There are two aspects to this. The first is to base giving on business resources and capabilities to enhance philanthropic outcomes; this was discussed earlier under “Resource-Based Giving.” The second is to focus on philanthropy that will enhance corporate profitability while also making a positive difference in the community at large. This strategic approach to philanthropy follows an ethic of enlightened self-interest and is clearly on the rise. In a 2006 Conference Board survey, almost half the companies responded said that the biggest change in corporate philanthropy in the previous five years was “its alignment with business objectives and corporate reputation and branding.”⁴⁰ More than one-third of the companies reported that measuring results and outcomes of philanthropy would be their biggest challenge going forward.⁴¹ Figure 16-4 shows that a more strategic approach to philanthropy encompasses the top four critical factors that companies consider when updating their corporate giving priorities. Note the dramatic

Figure 16-4 Critical Factors Influencing Corporate Giving Priorities

Aligning more closely with business needs	66%
Limits on budgetary resources	62%
Directions from the CEO and/or the Board	51%
Strengthening the brand	35%
Costs of responding to natural disasters	23%
Being more responsive to stakeholders	18%
Changes in the workforce	10%
Other	8%
Employee needs/requests	3%
Community needs	3%
Global giving	3%

Source: Sophia A. Muirhead, "Philanthropy and Business: The Changing Agenda," *The Conference Board* (2006), p. 5. Reprinted by permission.

difference in importance between community needs (3 percent) and business needs (66 percent). We discuss strategic philanthropy in more detail later in the chapter.

Community Partnerships

As a broad response to this growing need to reconcile financial and social goals, the concept of community partnerships evolved. A community partnership occurs when a for-profit business enters into a cooperative arrangement with a nonprofit organization for their mutual advantage. Businesses see in community partnerships the opportunity for simultaneous achievement of economic and philanthropic objectives. An example of a community partnership is the one between Home Depot and KaBOOM!, a national nonprofit organization devoted to building community through the construction of playspaces for children. As part of their 10-year partnership, Home Depot contributes in-kind, financial, and volunteer assistance to the building of playspaces across North America with initiatives that include 1,000 Playgrounds in 1,000 Days, Operation Playground, and Racing to Play. The pair received the 2006 Golden Halo award from the Cause Marketing Forum for their "long term, high impact" partnership.⁴²

Another example of a community partnership involves the Clorox Company and the East Bay Community Foundation. Community foundations are nonprofit organizations that specialize in evaluating nonprofit organizations and responding to requests for funding. Clorox knew that the knowledge and expertise that the East Bay Community Foundation had in knowing local nonprofit organizations would help them better manage their philanthropic funds. In turn, this would help to further their goal of improving the quality of life in Oakland, California, and its surrounding communities, the area in which Clorox is based.⁴³

Community partnerships take on many different forms. Two of the most important are strategic philanthropy and cause-related marketing. Other partnership options include sponsorships, vendor relationships, licensing agreements, and in-kind donations.⁴⁴ We will consider strategic philanthropy and cause-related marketing in more detail.

Strategic Philanthropy

Strategic philanthropy is an approach by which corporate giving and other philanthropic endeavors of a firm are designed in a way that best fits with the firm's overall mission, goals, or objectives. This implies that the firm has some idea of what its overall strategy is and that it is able to articulate its missions, goals, or objectives. One goal of all firms is profitability. Therefore, one requirement of strategic philanthropy is to make as direct a contribution as possible to the financial goals of the firm. Philanthropy has long been thought to be in the long-range economic interest of the firm. Strategic philanthropy simply presses for a more direct or immediate contribution of philanthropy to the firm's economic success.

An important way to make philanthropy strategic is to bring contribution programs into sharper alignment with business endeavors. This means that each firm should pursue those social programs that have a direct rather than an indirect bearing on its success. Thus, a local bank should logically pursue people-oriented projects in the community in which it resides; a manufacturer might pursue programs having to do with environmental protection or technological advancement.

A third way to make philanthropy strategic is to ensure that it is well planned and managed rather than handled haphazardly and without direction. Planning implies that it has clearly delineated goals, is properly organized and staffed, and administered in accordance with certain established policies. Figure 16-5 presents

Figure 16-5 Implementation of an Effective Strategic Philanthropy Program

An effective strategic philanthropy program should incorporate the following practices:

1. Integrate philanthropy into strategic goals and company mission.
2. Connect philanthropy with other community involvement programs.
3. Budget appropriately for philanthropy.
4. Ensure effective program infrastructure.
5. Formalize policies and guidelines for funding.
6. Involve employees in philanthropy-related activities.
7. Incorporate stakeholder communication.
8. Develop long-term business/nonprofit partnerships.

Source: BSR Staff, "BSR Issue Briefs: Philanthropy," Business for Social Responsibility, <http://www.bsr.org>.

Business for Social Responsibility's recommendations for best practices in the implementation of a philanthropy program.

Strategic philanthropy must find the place of overlap where the philanthropy provides both social and economic benefits. In a recent *Harvard Business Review* article, Michael Porter and Mark Kramer argue that few companies have effectively taken advantage of the competitive advantage corporate philanthropy can provide. They consider strategic philanthropy to be a myth—simply semantics that help companies to rationalize their contributions. To be truly strategic, philanthropy must be congruent with a company's competitive context, which consists of four interrelated elements: factor conditions, demand conditions, the context for strategy and rivalry, and related and supporting industries.⁴⁵

Factor conditions are the available inputs for productions. Porter and Kramer point to DreamWorks as an example of a company that uses strategic philanthropy to improve its factor conditions effectively. They created a program that provides training to low-income and disadvantaged youth in the skills needed to work in the entertainment industry. Of course, the societal benefits of an improved educational system are clear. While providing these social benefits, DreamWorks also enhances the labor pool from which they can draw. This not only strengthens the company but the industry as a whole as well.⁴⁶ The Clorox example of improving the community surrounding their headquarters through partnership with the community foundation also addresses factor conditions by improving the general quality of life and the local infrastructure.

Demand conditions are concerned with the nature of the company's customers and the local market. Philanthropy can influence the local market's size and quality. Porter and Kramer point to Apple's long-held policy of donating computers to public schools. By introducing young people and their teachers to computers, Apple expands their market. They also increase the sophistication of their customer base, which benefits a differentiated product like Apple sells.⁴⁷ Similarly, Burger King focuses its philanthropic efforts on highly focused programs to help students, teachers, and schools.⁴⁸ This program enhances name recognition in its target population of consumers.

Whole Foods has developed a strategic philanthropy program that affects both factor and demand conditions, enabling the company to reap benefits along the length of the value chain. In the factor market, Whole Foods has designed a system for sourcing products from developing countries while maintaining product standards. They developed a strict set of criteria to which their suppliers must adhere and contracted with TransFair USA and the Rainforest Alliance, two respected third-party certifiers, to ensure that these criteria are met. These certified products will receive a Whole Trade logo so that customers will know which products come from the developing world and meet the criteria. Their customers value these attributes, and so Whole Foods' demand conditions also improve as a result of their efforts.⁴⁹

Strategic philanthropy can also influence the context for strategy and rivalry. Porter and Kramer point to the many corporations that support Transparency International as examples of firms using philanthropy to create a better

environment for competition. Transparency International's mission is to deter and disclose corporate corruption around the world. The organization measures and publicizes corruption while pushing for stricter codes and enforcement. By supporting Transparency International, corporations are helping to build a better competitive environment—one that rewards fair competition.⁵⁰

Related and supporting industries can also be strengthened through strategic philanthropy, thereby enhancing the productivity of companies. American Express provides an excellent example of a firm that uses philanthropy to strengthen its related and supporting industries. For almost 20 years, American Express has funded travel and tourism academies in secondary schools. The program trains teachers, supports curriculums, and provides both summer internships and industry mentors. It now operates in 10 countries, works with more than three thousand schools, and has more than one hundred and twenty thousand students enrolled. A strong travel industry translates into important benefits for American Express.⁵¹

Now let us turn our attention to a special kind of strategic philanthropy that has become quite prevalent in recent years: cause-related marketing.

Cause-Related Marketing

There is some debate as to whether or not cause-related marketing is really philanthropy. Porter and Kramer argue that it is marketing and nothing more.⁵² However, because cause marketing represents a close linkage between a firm's financial objectives and corporate contributions, we will discuss it here. Stated in its simplest form, cause-related marketing is the direct linking of a business's product or service to a specified charity. Each time a consumer uses the service or buys the product, a donation is given to the charity by the business.⁵³ Thus, some observers refer to cause-related marketing as "quid pro quo strategic philanthropy."

The term **cause-related marketing** was coined by the American Express Company to describe a program it began in 1983 in which it agreed to contribute a penny to the restoration of the Statue of Liberty every time a customer used one of its credit cards to make a purchase. The project generated \$1.7 million for the statue restoration and a substantial increase in usage of the American Express card.⁵⁴ Since that time, companies have employed this same approach to raise millions of dollars for a wide variety of local and national causes.

Recently, cause-related marketing has given way to a new concept, **cause branding**. Cause branding represents a longer-term commitment than cause marketing. It also relates more directly to the firm's line of business and the target audience. Avon Products, Inc., is a recognized leader in cause branding. Their target audience is women, and so they have developed an array of programs to raise awareness of breast cancer, a disease that mostly affects women. The company raises money for programs that provide low-income women with education and free screening. Avon sells products featuring the pink ribbon that is worn for breast cancer awareness and then donates the proceeds from these products to nonprofit and university programs.⁵⁵

Text not available due to copyright restrictions

Cause branding has become a successful marketing tool. A Cone/Roper *Cause-Related Trends Report: Evolution of Cause Branding* showed that 61 percent of consumers felt companies should make cause branding part of their regular business.⁵⁶ Moreover, 83 percent of Americans feel more positively disposed toward companies that support a cause about which they care, and 76 percent of consumers are more likely to select the more socially responsible brand when price and quality are equal. The benefits do not apply only to consumers; employees react to cause branding as well. In companies with cause programs, 87 percent of employees indicate they feel strong loyalty, while only 67 percent feel strong loyalty in firms that do not have cause programs.⁵⁷ The findings of a recent Cone/Roper Executive Study show that cause branding strengthens internal corporate cultures and has a dramatic influence on employee pride, morale, and loyalty.⁵⁸

Proponents of cause-related marketing argue that everyone involved in it comes out a winner. Business enhances its public image by being associated

with a worthy cause and increases its sales at the same time. Nonprofit organizations get cash for their programs as well as enhanced marketing and public visibility made possible by business's expertise.

Critics of cause-related marketing fear that the needs of capitalism will overshadow the cause. These concerns cropped up in the recent promotion of the "Red" project. The rock star Bono devised the "Red" project, a plan to have firms launch versions of their products that follow the "Red" guidelines and donate a portion of their proceeds to The Global Fund to Fight AIDS, Tuberculosis, and Malaria. None of the brands were permitted to charge a premium for "Red" products, but the percentage of profits to be donated was not specified.⁵⁹ In March 2007, *Advertising Age* created a stir by reporting that firms involved in the project had spent as much as \$100 million to promote the product while the money raised amounted to only \$18 million.⁶⁰ Red spokespeople countered that the \$100 million estimate was high and many observers concurred; however, they were unapologetic about the possibility that expenditures might end up larger than contributions because the project was founded on the idea that self-interest can be a method of fund-raising for charity.⁶¹ Nonprofit advocates expressed concern, however, that cause-related marketing like the "Red" project might crowd out philanthropic contributions if people feel that buying a "Red" item is a substitute for charitable giving.⁶² A parody of the "Red" commercials on www.buylesscrap.org expresses the concerns of cause marketing critics and ends with an opportunity to donate directly to the nonprofit organizations that are designated to receive "Red" funds.⁶³

Global Philanthropy

The size of a company's workforce in international markets is the greatest determinant of the size of their charitable contributions to that market.⁶⁴ It should come as no surprise, then, that as corporate operations become increasingly globalized, so does corporate philanthropy. Firms responding to a Conference Board survey indicated that 20 percent of their philanthropic giving was international.⁶⁵ Seventeen percent of the respondents rated global giving as the single most important issue they would face in the coming year.⁶⁶

Businesses want to protect the communities in which they operate, keeping them healthy and environmentally sound. Businesses also develop infrastructure to facilitate the flow of goods and services. According to Stephen Jordan of the U.S. Chamber of Commerce Business Civic Leadership Center, companies are increasing their corporate philanthropy in order to "create a culture of opportunity" in the developing world. He said, "Ninety-six percent of opportunity is outside our borders. Increasingly, companies . . . want to grow their customer base in emerging markets."⁶⁷

The Loss of Jobs

We now shift our focus to the issue of job loss from outsourcing, offshoring, and business and plant closings. In the preceding sections, we considered the ways in which business firms might have positive, constructive, and creative impacts on

community stakeholders. Firms can also have detrimental impacts on communities. We see a most pervasive example of such negative effects when mass job layoffs occur because jobs are moved overseas or when a business or plant closes and its management does not carefully consider the community stakeholders affected.

The recession of the early 1980s provided a major catalyst for business and plant shutdowns. Some of the affected companies were in declining industries; some had outdated facilities or technology; some moved to less unionized regions of the country; some sought access to new markets; some were victims of the merger/acquisition frenzy; and many were victims of global competition. For most of the 1990s, plant closings were not as prevalent but outsourcing, both domestic and international, became more common. As we entered the new millennium, however, an economic recession brought the problem of closings back to the forefront. The sharp decline in the technology sector resulted in the sudden closing of dot-coms and other technology-based firms. The attack on the World Trade Center put industries such as airlines, hospitality, travel, and tourism into distress. In recent years, offshore outsourcing has emerged as a main concern as a source of job loss. We will address the issue of outsourcing first and then take a more in-depth look at business and plant closings.

OUTSOURCING

The word **outsourcing** refers to the relocation of business processes to a different company. **Offshore outsourcing** (or **offshoring**) refers to the relocation of business processes to a different country. The problems created by outsourcing aren't new. The current upswing in concern has arisen because new technologies such as high-speed data links and the Internet have made it possible to do white-collar work overseas where labor is cheaper. In the late nineteenth century, the advent of railroads had just as transforming an effect. A writer for Scribner's in 1888 said that life had changed more in the past 75 years than it had since Julius Caesar, "and the change has chiefly been made by railways."⁶⁸ Railroads destroyed industries and whole towns, in addition to jobs. There was no longer a need for icehouses or local meatpacking plants and so they closed. While new markets opened for U.S. grain, cotton farmers lost market share to cheaper Egyptian and Indian cotton. Steamboat towns faded, and struggling farmers began to resent their dependence on the wealthy railroads.⁶⁹

Thirty years ago, concerns over outsourcing focused on blue-collar occupations, primarily factory workers, and it was mostly a problem in the United States. Today, it affects blue- and white-collar workers alike, and industrial nations around the globe feel its influence. According to estimates from the McKinsey Global Institute, offshore outsourcing will continue to increase.⁷⁰ The issue of offshore outsourcing is a hot potato in the political arena.

The fact that white-collar workers are now losing their jobs has given the issue new momentum. Information technology workers have been particularly hard hit. A programmer who makes \$11,000 in India or \$8,000 in Poland and Hungary can

do the work of a programmer who makes \$80,000 in the United States.⁷¹ This represents huge savings for firms dealing with global competition. In spite of the savings involved, however, offshore outsourcing is not a panacea for companies. Some companies are finding that the problems that develop from shipping jobs overseas outweigh the cost savings. Capital One ended a contract for a 250-person call center in New Delhi when they found that workers would boost their sales by offering unauthorized lines of credit.⁷² Similarly, Dell brought a tech support center back to the United States after customers complained of thick accents and poor service.⁷³ In spite of these glitches, however, offshore outsourcing is a trend that will continue. For companies that compete in the global arena, ignoring these potential cost savings is difficult to do.

Most economists argue that international competition boosts productivity and that the long-term benefits of outsourcing will outweigh the short-term losses. They point to the difference in gains in productivity between manufacturing, which has dealt with outsourcing for decades, and the previously more protected service sector, which is new to the phenomenon. Higher costs forced U.S. manufacturing to be more productive or go under. In the 50 years from 1954 to 2004, productivity in the U.S. service sector rose by 47 percent while manufacturing's productivity rose 330 percent in the same time period.⁷⁴

Proponents of offshore outsourcing argue that the predictions of job loss are overstated. They say they are gross estimates, not net, meaning that they fail to take into account the jobs that are gained.⁷⁵ Prior debates over free trade support this point. During the 1990s, some feared the passage of NAFTA would create a "giant sucking sound" as jobs left the United States. However, many would say that tens of millions of new jobs were created instead.⁷⁶ One way to create new jobs is to take a fresh approach to the issue. "Transformational outsourcing" is the new buzzword for outsourcing that enhances innovation, speeds productivity, and not only makes better use of skilled U.S. staff but also creates new jobs at home as well as abroad.⁷⁷

Of course, the creation of new jobs is of little consolation if you are the person whose job has disappeared. It is true that outsourcing contributes to productivity, but that productivity comes at the expense of workers. After all, if gains in productivity make it possible for one worker to do the job of two, then only that one worker will be hired and the second worker will have to look for other work. Those second workers don't always land on their feet. In the United States, more than 4 million workers have exhausted their unemployment benefits without finding other work.⁷⁸ As Institute for International Economics productivity expert Martin Baily notes, for the predicted benefits of outsourcing to occur, people have to move into jobs that will pay them enough so that they can pay for the cheap imports.⁷⁹ Just as with business and plant closings, which we'll discuss later, the company has a responsibility to ascertain that outsourcing is the only option. If it is, the company's responsibility then shifts to doing everything possible to minimize outsourcing's negative impact on the workers involved. Manjeet Kripalani offers five best offshore outsourcing practices to consider when undertaking this profound change in operations.⁸⁰

1. **Go offshore for the right reasons:** Make certain that you have made every effort to increase efficiency and competitiveness at home. Consider the possible backlash and make sure operations are smooth before departure. Moving a broken process overseas won't fix it.
2. **Choose your model carefully:** The decision of whether to set up your own subsidiary or contract the work out is important. Both options have pros and cons that will have different impacts on different firms.
3. **Get your people on board:** Middle managers and employees can either facilitate the move or make certain it doesn't succeed. Intensive communication efforts, careful redeployment of retained workers, and severance with retraining for those who lose their jobs are critical to garnering support.
4. **Be prepared to invest time and effort:** Setting up relationships with offshore partners and designing the transition are time-consuming processes. Careful preparation will increase the odds of a successful program.
5. **Treat your partners as equals:** Involve the offshore partners in planning and preparation. Make them feel they are part of the team and let them know that their contributions are valued.

While nothing will make offshore outsourcing easy, these practices should assist firms in making the transition as smoothly as possible.

BUSINESS AND PLANT CLOSINGS

There is no single reason for business and plant closings. Figure 16-6 provides a window into the extent of impact that many communities are experiencing: It is a listing of some of the plant closings that happened in one small area, western North Carolina, in a matter of months and the reasons given for the action. Each job lost had a serious impact on the displaced worker, and each of these closings presented major challenges for the communities in which they occurred. In the aggregate, these closings present a major challenge for a state as workers cannot look to the neighboring town for employment if those plants and businesses are closing, too.

Although the right to close a business or plant has long been regarded as a management prerogative, the business shutdowns of the past two decades—especially their dramatic effects—have called attention to the question of what rights and responsibilities business has in relation to employee and community stakeholders. The literature of business social responsibility and policy has documented corporate concern with the detrimental impact of its actions. Indeed, business's social response patterns have borne this out. Management expert Peter Drucker suggested the following business position regarding social impacts of management decisions:

Because one is responsible for one's impacts, one minimizes them. The fewer impacts an institution has outside of its own specific purpose and mission, the better does it conduct itself, the more responsibly does it act, and the more acceptable a citizen, neighbor, and contributor it is.⁸¹

Figure 16-6 Selected Western North Carolina Business and Plant Closings and Their Reasons

Date	Product	Jobs Lost	Reason
January 2004	Fuses	290	Economic conditions
January 2004	Office furniture	480	Economic conditions
January 2004	Furniture	351	Economic conditions
December 2003	Yarn spinning/carding	53	Consolidation
November 2003	Electrical switches	313	Moving jobs to Mexico
October 2003	Milling	625	Foreign competition
September 2003	Lingerie	77	Foreign competition
September 2003	Electronic accessories	139	Outsourcing
September 2003	Furniture	506	Foreign competition
July 2003	Industrial thread	228	Foreign competition
May 2003	Auto parts	350	Moving jobs to Mexico

Source: Mark Barrett, "Burnsville Yarn Plant Closing; 163 Workers Get Pink Slip," *Citizen-times.com* (March 1, 2004).

This raises the question of whether business's responsibilities in the realm of plant closings and their impacts on employees and communities are any different from the host of responsibilities that have already been assumed in areas such as employment discrimination, employee privacy and safety, honesty in advertising, product safety, and concern for the environment. From the perspective of the employees affected, their role in plant and business closings might be considered an extension of the numerous employee rights issues.

Of the executives who have spoken out on this issue, several have indicated that there is an obligation to employees and to the community when a business opens or decides to close. As D. Kenneth Patten, former president of the Real Estate Board of New York, once stated:

A corporation has a responsibility not only to its employees but to the community involved. It's a simple question of corporate citizenship. Just as an individual must conduct himself in a way relating to the community, so must a corporation. As a matter of fact, a corporation has an even larger responsibility since it has been afforded even greater advantages than the individual. Just as a golfer must replace divots, a corporation must be prepared at all times to deal with hardships it may create when it moves or closes down.⁸²

Others have also argued that there is a moral obligation at stake in the business-closing issue. In an extensive consideration of plant closings, philosopher John Kavanagh has asserted that companies are not morally free to ignore the impact of a closing on employees and the community. His argument is similar to those that have been given on many other social issues—namely, that business should minimize the negative externalities (unintended side effects) of its actions.⁸³

Business essentially has two opportunities to be responsive to employee and community stakeholders in shutdown situations. It can take certain actions before the decision to close is made and other actions after the decision to close has been made.

Before the Decision to Close Is Made

Before a company makes a decision to close down, it has a responsibility to itself, its employees, and its community to thoroughly and diligently study whether the closing is the only option available. A decision to leave should be preceded by critical and realistic investigations of economic alternatives.

Diversification. Sometimes it is possible to find other revenue streams to help the company cope with the slim margins of manufacturing. SRC Holdings was making only 2 to 3 percent a year but needed a profit of 4 percent to compete effectively. SRC chief executive John P. Stack explains, “We took our manufacturing discipline into the service sector to develop new sources of revenue. . . . Without creating these other businesses, we couldn’t have survived. Manufacturing has very slim margins but if a company innovates the margins can be incredible.”⁸⁴

The Wisconsin-based Menasha Corporation also drew upon its expertise in manufacturing. They developed labels embedded with computer chips that use radio frequency identification technology (RFID) with the intent of making RFID capability a business they can spin off or a service they can sell.⁸⁵ Mike Johnson, a company spokesman, said: “It’s totally new for us—an Internet I.T. play that uses intellectual capital from our manufacturing to create a new stream of revenue we can plow back into the factory.”⁸⁶

New Ownership. After a careful study has been made, it may be concluded that finding new ownership for the plant or business is the only feasible alternative. Two basic options exist at this point: (1) find a new owner or (2) explore the possibility of employee ownership.⁸⁷ A company has an obligation to its employees and the community to try to sell the business as a going unit instead of shutting down. This is often not possible, but it is an avenue that should be explored. Quite often, the most promising new buyers of a firm are residents of the state who have a long-term stake in the community and are willing to make a strong commitment. Ideally, local organizations and the government will be able to offer incentives to companies willing to bring jobs to the areas.

For example, when the Grumman Olson facility closed in Lycoming County, Pennsylvania, several parties joined together to bring jobs back to the area. The local chamber of commerce worked with the state to develop an incentive package that included job creation tax credits and customized job training at the local college. Specialized Vehicles Corporation (SVC) bought the facility, promising to offer jobs first to the displaced workers of Grumman Olson.⁸⁸

Employee Ownership. The idea of a company selling a plant to the employees as a way of avoiding a closedown is appealing at first glance. Hundreds of U.S. companies with at least 10 workers are **employee owned**. Most of these

arrangements are the results of last-ditch efforts to stay in business. Such national firms as General Motors, National Steel, Sperry Rand, and Rath Packing Co. have sold plants to employees—plants that otherwise would have been closed.

The experiences of many of these firms have not always been favorable.⁸⁹ In numerous cases, employees have had to take significant wage and benefit reductions to make the business profitable. Some companies, however, have met with better success. Publix Supermarkets is both employee and family owned; employees own 31 percent of the firm, and the family of founder George W. Jenkins owns most of the remaining shares.⁹⁰ Most observers credit their employee ownership with earning Publix the number-one supermarket ranking on the American Customer Satisfaction Index for each of the 14 years the index has been in existence. Publix employees are known for bending over backward to please customers.⁹¹

In a classic case of employee ownership, negotiators worked out an agreement whereby the employees of National Steel's Weirton, West Virginia, mill would purchase the mill. The new company, Weirton Steel, became what was then the nation's largest employee-owned enterprise, as well as its eighth-largest producer of steel. Experts gave the mill a surprisingly good chance of succeeding, although Weirton's workers had to take a pay cut of about 32 percent. The mill's union president argued, "Thirty-two percent less of \$25 an hour is a whole lot better than 100 percent of nothing."⁹²

In 1990, however, as demand sank for the steel sheet it produced, Weirton Steel found itself in the unenviable position of actually having to lay off some of its employee-owners. By 1991, Weirton had eliminated 1,000 of its 8,200 jobs, had furloughed another 200 workers, and had plans to cut 700 more jobs. After a decade as owners of the company, Weirton employees became extremely frustrated and angry that employee ownership did not guarantee them that they would not lose their jobs. One employee posed the question many were asking: "How can we be laid off if we own the company?" The reality of the situation, however, is that even an employee-owned company must take whatever actions are necessary if it is to remain solvent and profitable.

One of the major pitfalls of worker ownership is that it does not rewrite the laws of capitalism—the bottom line is still the bottom line.⁹³ In 2004, Weirton sold its assets to the Cleveland-based International Steel Group. Weirton CEO D. Leonard Wise commented, "There's a great comfort in knowing that steelmaking will continue in Weirton. . . . It's quite difficult for smaller mills to survive these days. Therefore, as part of ISG, one of the nation's largest steelmakers, Weirton will have a greater chance of surviving given the worldwide consolidation of steel companies."⁹⁴ Today, Weirton Steel is the seventh-largest integrated steel producer in the nation, with 3,800 workers, and a reported revenue of \$1.1 billion. Given that Weirton survived and is now thriving, one could argue that the employees who purchased the mill made a good investment for their community.

Ten years after Weirton Steel learned that employee ownership is not a protection against difficult times, United Airlines found themselves in a similar situation. In 1994, United Airlines became America's largest employee-owned

corporation. In one of the nastiest and most prolonged corporate battles ever, shareholders of UAL Corp., the parent of United Airlines, awarded employee groups 55 percent of the company's stock in exchange for a \$4.9 billion bundle of wage and productivity concessions. U.S. labor leaders hailed this new arrangement in worker control as a model alternative to the way companies usually battle to control costs. Labor Secretary Robert Reich, whose department facilitated the deal, asserted: "If United is successful, this will be a major landmark in American business history." But the success of the new firm was by no means ensured, because the airline has been buffeted for more than a decade by infighting among employee groups, repeated forays by outside potential buyers, and takeover attempts.⁹⁵ Furthermore, it still had all the problems inherent in being a legacy carrier. From the beginning, there were problems with workers who resented taking pay cuts in exchange for loans to buy 55 percent of United's common stock and flight attendants whose union opted not to join the ESOP because of concerns about the pay cuts involved and other policies. Problems began in 2000, when the airline pilots conducted a slowdown during contract negotiations. Then the machinists' union threatened to strike, and United took them to court.⁹⁶ By 2001, when the attack on the World Trade Center shook the airline industry, the ESOP had ended and United was in no better position than firms without employee-owners. In 2002, United filed for bankruptcy.⁹⁷ It emerged from bankruptcy in 2006 after paying more than \$335 million in fees.⁹⁸

Some critics argue that United Airlines failed as an employee-owned enterprise because workers thought employee ownership would mean they no longer needed to be concerned about labor-management issues. Research has shown that employee ownership can provide a firm with competitive advantage; for employee ownership to work, however, it is critical that employees believe they have a part to play in leading the company. A positive ownership culture provides employees with access to information, the power to exert influence, a sense of fairness, and a feeling of ownership and entrepreneurship.⁹⁹ It should be noted, however, that the period following the terrorist attacks of 2001 were difficult for all large airlines and so there are limits to the inferences one can make about the impact that employee ownership had on United.

After the Decision to Close Is Made

There are a multitude of actions that a business can take once the decision has been made that a closedown or relocation is unavoidable. The overriding concern should be that the company seriously attempt to mitigate the social and economic impacts of its actions on employees and the community. Regardless of the circumstances of the move, some basic planning can help alleviate the disruptions felt by those affected. There are several actions that management can take,¹⁰⁰ including:

- Conducting a community-impact analysis
- Providing advance notice to the employees/community
- Providing transfer, relocation, and outplacement benefits

- Phasing out the business gradually
- Helping the community attract replacement industry

Community-Impact Analysis. If management is responsible for its impacts on employees and the community, as Drucker stated, a thorough community-impact analysis of a decision to close down or move is in order. The initial action should be to identify realistically those aspects of the community that would be affected by the company's plans. This would entail asking questions,¹⁰¹ such as:

- What groups will be affected?
- How will they be affected?
- What is the timing of initial and later effects?
- What is the magnitude of the effect?
- What is the duration of the impact?
- To what extent will the impact be diffused in the community?

Once these questions have been answered, management is better equipped to modify its plans so that negative impacts can be minimized and favorable impacts, if any, can be maximized.

Advance Notice. One of the most often discussed responsibilities in business- or plant-closing situations is the provision of advance notice to workers and communities. The national advance-notice law is called the **Worker Adjustment and Retraining Notification Act (WARN)**. WARN requires those firms employing 100 or more workers to provide 60 days' advance notice to employees before shutting down or conducting substantial layoffs. With WARN, the United States joined many other nations that already mandated notice of shutdowns. Canada requires one to sixteen weeks, depending on the case. Great Britain requires 60 to 90 days, depending on the case, and Japan requires "sufficient advance notice."¹⁰²

The advantages of advance notice accrue primarily to the affected employees and their communities. Workers are given time to prepare for the shutdown both emotionally and financially. Advance notice makes it easier for employees to find new jobs, because research has shown that employees have an improved chance at reemployment while they are still employed. Advance notice is motivational in that, once one joins the ranks of the unemployed, there is a tendency to coast until benefits start to be exhausted. Also, the company is in a better position to provide references, retraining, or counseling during the advance-notice period.¹⁰³

The disadvantages of advance notice—particularly long-term advance notice—accrue principally to the business firm. Once word leaks out in the community, financial institutions may be reluctant to grant credit, customers may become worried about items purchased or promised, and the overall level of business activity may decline rapidly. One of the major disadvantages of a lengthy notice is the task of motivating workers who know they are going to lose their jobs. Declines in employee morale, pride in work, and productivity can be expected. Absenteeism may increase as workers begin to seek other employment. In

addition, there is the likelihood of vandalism, pilferage, and neglect of property as employees lose interest or attempt to strike back against the employer.¹⁰⁴

Companies will sometimes try to get around the WARN requirements. A New York-based software developer was sued by its employees, who charged that the company tried to disguise mass layoffs as individual firings to avoid having to comply with the advance notice required by WARN. There is a fine line between staggering employee layoffs legally and doing it to avoid the notice requirements of WARN. Courts try to determine what employers knew at the time of the layoffs. If they deem that the employers knew they would be laying off more than 50 employees at a time, the firm is considered to be in violation of WARN. Employees who sue successfully under WARN may get back pay and benefits for up to 60 days. The penalty for not giving adequate notice is \$500 per day. The only acceptable reasons for not providing a 60-day notice are (1) action being taken by the employer, which, if successful, would have postponed or eliminated the need for layoffs; (2) unforeseen business circumstances that the employer could not reasonably have foreseen; and (3) natural disasters.¹⁰⁵

A 2007 investigation by the *Blade*, a newspaper from Toledo, Ohio, found that WARN often falls short of its goals: judges threw out more than half of the 236 lawsuits filed since 1989.¹⁰⁶ Only about one-quarter of the more than eight thousand closings in one year were subject to WARN requirements, and only about one-third of those employers subject to the requirements actually provided proper warning.¹⁰⁷ Since the bill's inception, legislators have tried to strengthen the law by closing loopholes and giving it some teeth. One key problem is that the Labor Department has no enforcement power over the WARN Act, and so displaced employees must hire their own attorneys in order to hold their former employers accountable.¹⁰⁸

Transfer, Relocation, and Outplacement Benefits. Enlightened companies are increasingly recognizing that the provision of separation or outplacement benefits is in the long-range best interest of all parties concerned. Everyone is better off if disruptions are minimized in the lives of the firm's management, the displaced workers, and the community. Outplacement benefits have been used for years as companies have attempted to remove redundant or marginal personnel with minimum disruption and cost to the company and maximum benefit to the individuals involved. Now these same benefits are being used in business and plant closings.

Gradual Phaseouts. Another management action that can significantly ameliorate the effects of a business shutdown is the gradual phasing out of the business. A gradual phaseout buys time for employees and the community to adjust to the new situation and to solve some of their problems.

Recently, when the semiconductor industry took a deep downturn, Sony Electronics found it necessary to close its plant in San Antonio. They let their employees go in phases as they gradually wrapped up their customer orders. Affected workers were given 60 days' notice. This did not come as a surprise because, as one worker noted, "it was fairly well-known that the company was

sick for a quite a while.”¹⁰⁹ When asked about worker reactions, one employee said, “There were a few who were upset but some of them actually requested to be included in Phase 1 (job cuts). They wanted to get their severance packages and get on with their lives.”¹¹⁰ Sony provided workers with severance pay based on years on the job. They also extended benefits packages, outplacement services, and job transfers, where possible, to other Sony plants in the United States. In addition, each departing worker received a DVD player.¹¹¹

Helping to Attract Replacement Industry. The principal responsibility for attracting new industry falls on the community, but the management of the closing firm can provide cooperation and assistance. The closing company can help by providing inside information on building and equipment characteristics and capabilities, transportation options based on its experience, and contacts with other firms in its industry that may be seeking facilities. Helping the community attract replacement industry has the overwhelming advantage of rapidly replacing large numbers of lost jobs. Also, because attracted businesses tend to be smaller than those that closed, this strategy enables the community to diversify its economic base while regaining jobs.¹¹²

Survivors—The Forgotten Stakeholders

When job losses occur, attention is understandably placed on the workers who lose their employment and the many repercussions that loss holds for them. Their needs must come first, because they bear the brunt of the impact. However, those who retain their jobs—whether they are the remaining employees at a downsized plant or the workers at a plant that survived consolidation—are in need of support as well. Even the managers who conducted the layoffs will not emerge unscathed. A 2006 study of managers who issued WARN notices found that they had an increase in health problems and sleep problems; they reported feelings of de-personalization and a greater intent to quit, with emotional exhaustion playing a role in their difficulties.¹¹³

All survivors are likely to evidence a variety of negative actions, perceptions, and behaviors. These include depression, guilt, stress, uncertainty, decreased loyalty, and lower enthusiasm.¹¹⁴ Firms must attend to these concerns of survivors if they are to emerge stronger after job cuts. They can do this by providing:¹¹⁵

1. Emotional support—assuring employees that they are important
2. Directional support—communicating the direction the company is going and the employees’ place in that journey
3. Tactical support—presenting new goals and objectives for the employees
4. Informational support—answering all questions about the layoff and future plans

One of the most important actions a firm can take when providing informational support is to answer employees’ questions clearly and completely. Michael Fox, senior vice president of Ogilvy Public Relations, has worked with firms that are conducting layoffs. He says, “You’ve got a good chance at

preserving loyalty and lessening anxiety if you've always been pretty open and transparent with information. Tell (remaining employees) how the decision was made, the layoffs were based on performance reviews, or longevity or the loss of a big customer. If a decision seems arbitrary or unclear, it will only make resentment worse."¹¹⁶ It is also important that the survivors believe the laid-off employees were treated well. When United Technologies paid for a year of college courses for laid-off employees, the remaining employees felt better about staying on the job.¹¹⁷

We are only just touching the surface of the stakes and stakeholders involved in the plant-closing issue, the impacts that business closings have on employees and communities, the public's reaction to the problem, and types of corresponding actions that management might take. It is important for businesses to take positive steps in order to be responsive to their employees and communities. Furthermore, business closings and their adverse consequences are issues that business should continue to address in the future, lest yet another public problem culminates in new laws or another knotty regulatory apparatus.

Summary

Community stakeholders are extremely important to companies. Companies may have positive impacts on their communities in two basic ways: donating the time and talents of managers and employees (volunteerism) and making financial contributions. Because business has a vital stake in the community, it engages in a variety of community projects. Community action programs are a key part of managing community involvement. Important components of such efforts include knowing the company's resources, selecting projects to pursue, and monitoring corporate efforts.

Business also contributes to community stakeholders through philanthropy. The third sector, or nonprofit sector, depends on business's support. Companies give for a variety of reasons—some altruistic, some self-interested. Major recipients of business giving include health and welfare, education, civic activities, and culture and the arts. As companies have attempted to manage their philanthropy, two major types of community partnerships have been emphasized: (1) strategic philanthropy, which seeks to improve the overall fit between

corporate needs and charitable programs, and (2) cause-related marketing, which tightens the linkage between a firm's profits and its contributions. Cause-related marketing represents a unique joining of business and charity with the potential for great benefit to each.

Just as firms have beneficial effects on community stakeholders, they can have detrimental effects as well. Business or plant closings are a prime example of these detrimental effects. Plant closings have a pervasive influence in the sense that a multitude of community stakeholders—employees, local government, other businesses, and the general citizenry—are affected. There is no single reason why these closings have occurred, but among the major reasons are economic conditions, consolidation of company operations, outmoded technology or facilities, changes in corporate strategy, and international competition.

Before management makes the decision to close a facility, it has a responsibility to itself, its employees, and the community to study thoroughly whether closing is the only or the best option. Finding a new owner for the business and

pursuing the possibility of employee ownership are reasonable and desirable alternatives. After the decision to close has been made, possible actions include community-impact analysis; giving advance notice; providing transfer, relocation, or outplacement benefits; phasing out operations gradually; and helping the community attract

replacement industry. Finally, the needs of survivors must be met as the firm continues operations. Companies have an added incentive to be responsive to the business-closing issue, because state and federal governments are closely watching the manner in which firms are handling this problem.

Key Terms

cause branding (page 638)

cause-related marketing (page 638)

community action program (page 625)

community involvement (page 620)

employee owned (page 645)

offshore outsourcing (page 641)

offshoring (page 641)

outsourcing (page 641)

philanthropy (page 626)

strategic philanthropy (page 636)

third sector (page 630)

Worker Adjustment and Retraining

Notification Act (WARN) (page 648)

Discussion Questions

1. Outline the essential steps involved in developing a community action program.
2. Explain the pros and cons of community involvement and corporate philanthropy, provide a brief history of corporate philanthropy, and explain why and to whom companies give.
3. Differentiate among community partnerships, strategic philanthropy, cause-related marketing, and cause branding. Provide an example of each that is not discussed in the text.
4. Identify and discuss briefly what you think are the major trade-offs that firms face as they think about outsourcing, offshoring, or plant closings. When substantial layoffs are involved, what are firms' responsibilities to their employees and their communities?
5. In your opinion, why does a business have a responsibility to employees and community stakeholders in a business-closing decision? Enumerate what you think are the major reasons.

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Internal Stakeholder Issues

CHAPTER 17 | *Employee Stakeholders and
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CHAPTER 18 | *Employee Stakeholders: Privacy,
Safety, and Health*

CHAPTER 19 | *Employment Discrimination and
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Employee Stakeholders and Workplace Issues

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Identify the major changes that are occurring in the workforce today.
- 2 Outline the characteristics of the new social contract between employers and employees.
- 3 Explain the employee rights movement and its underlying principles.
- 4 Describe and discuss the employment-at-will doctrine and its role in the employee's right not to be fired.
- 5 Discuss the right to due process and fair treatment.
- 6 Describe the actions companies are taking to make the workplace friendlier.
- 7 Elaborate on the freedom-of-speech issue and whistle-blowing.

Society's changing values are having a great impact on the workplace. Although external stakeholders such as government, consumers, the environment, and the community continue to be major facets of business's concern for the social environment, considerable attention is now being given to employee stakeholders—their status, their treatment, their rights, and their satisfaction. This should come as no surprise, because most adults spend the bulk of their daytime hours at work.

The development of employee stakeholder rights has been a direct outgrowth of the kinds of social changes that have brought other societal issues into focus. The history of work has been one of steadily improving conditions for employees. Today's issues are quite unlike the old bread-and-butter concerns of higher pay, shorter hours, more job security, and better working conditions. These expectations still exist, but they have given way to other, more complex workplace trends and issues.

In the new millennium, two major themes or trends seem to be characterizing the modern relationship between employees and their employers. First, we will discuss the dramatic changes that have been occurring in the workplace. Prominent here will be our discussion of a newly evolving **social contract** between organizations and workers that is quite different from any such contract of the past. This new social contract is being driven by global competition. Second, we will consider a continuation of a trend toward more expansive employee rights. These two trends are interrelated, and we will describe how the changes in the workplace have precipitated a renewal in the employee rights movement.

Because these topics are so extensive, we dedicate two chapters to employee stakeholders and workplace issues. In this chapter, we discuss some of the workplace changes that have been taking place, the emerging social contract, and the employee rights movement. Three employee rights issues, in particular, are treated here: the right not to be fired without good cause, the right to due process and fair treatment, and the right to freedom of speech in the workplace. In Chapter 18, we will continue our discussion of employee rights by examining the related issues of the rights of employees to privacy, safety, and health. These two chapters should be considered a continuous discussion of employee stakeholders wherein economic, legal, and ethical responsibilities are all involved in their treatment.

The New Social Contract

Thirty years ago, employees stayed in the same job at the same company for years, and those companies rewarded that loyalty by offering job stability, a decent wage, and good benefits.¹ Today's typical worker has had nine jobs by the age of 30.² The workforce of today is more mobile, less loyal, and more diverse. Their trust in their employers has eroded over the past 20 years to the point where, as shown in a recent survey, only 38 percent of employees surveyed feel their employer is committed to them.³ Individual identity has become uncoupled from the firm at which a person works.⁴ These workforce changes have contributed to a newly emerging social contract between employers and employees. CEOs and factory workers alike know that their jobs are vulnerable, and so they have come to view themselves as free agents, working for the highest bidder.⁵ As a result, today's employees aren't looking for a promise of lifetime employment. Instead, they are seeking competitive pay and benefits coupled with opportunities for professional growth. They want employers who provide them with opportunities, recognize their accomplishments, and communicate openly and honestly.⁶

What is driving the collapse of the old social contract and the emergence of the new? John A. Challenger, CEO of executive outplacement firm Challenger, Gray & Christmas, points to several forces that brought about systemic changes in the past 20 years, ultimately resulting in the business environment of today.⁷

These forces include:

1. Globalization
2. Technology and automation
3. Deregulation of protected industries
4. Shareholder activism

These forces led to a new social contract that places on employees more responsibility for their own success and prosperity in the employment relationship. Job security, compensation, and advancement depend on what the employee is contributing to the organization's mission. Challenger notes that changes in terminology reflect this change in attitude. What once was termed "personnel" is now called "human resources" and sometimes even "human capital." Businesses expect to leverage their human resources, just like any other resources, in a way that maximizes firm performance.⁸ Thus, the notion of "adding value" to the organization has become a crucial factor: the bottom line is productivity.

Figure 17-1 presents some of the characteristics of the old and new social contracts.

The extreme level of global competition that is driving this change in the social contract is, not surprisingly, affecting firms around the globe. While the U.S. workers' share of gross domestic product has fallen by 2.5 percent, German workers' share fell by 2.5 percent and Japan is down 3 points.⁹ Although this decline has an impact on workers in all nations, the United States is unique in its lack of government support. Laid-off U.S. workers not only lose their jobs and their incomes, but they also have to find a way to handle their own health benefits and retirement plans.¹⁰ This places an extreme level of stress on the laid-off worker, beyond the already significant stress of finding new employment.

Training is an area that is vital for employees if they are to navigate these new waters successfully. In this highly competitive environment, firms need workers with knowledge and the skill to provide it. To that end, employers have instituted a wide range of training programs and tuition reimbursement programs to keep their employees on the cutting edge of the changing environment.¹¹ Even when there has been a recessionary environment, training expenditures as a percentage of payrolls have continued to rise.¹² However, that only benefits workers still with the firm because the firm has no financial incentive for providing training that will enable the person to seek alternative jobs. **Outplacement**, assistance provided to laid-off employees, is an important responsibility of the ethical firm in the new environment because the duty to treat employees well does not end when they leave the firm after being laid off. In addition, workers who are no longer associated with any firm and thus ineligible for in-house or outplacement resources need other sources of retraining—some argue that this is an example of market failure and that the government should step in to help these workers.¹³

The changes in the work environment have implications for employees beyond the increased expectation of adding value to the firm. In particular, technology has blurred the boundaries between work and home. Not only are workers expected

to contribute more, but they also now have an array of new ways to continue working from wherever they are. As John Challenger opined:

*We cannot get away from work even when we are not there. Since the film 2001: A Space Odyssey debuted more than three decades ago, we have been wondering when computers would become human or superhuman. What sneaked up on us was the opposite: Human beings are becoming increasingly electronic. We carry our cell phones, beepers, fax machines, e-mail, portable CD players, and laptops—our offices—with us at all times.*¹⁴

Satellite technology means there is now no place where workers can count on getting away from work. The commute to and from work no longer provides the downtime that it once did. The only place one can count on being out of reach is on an airplane as it takes off and lands, thanks to federal regulations.¹⁵ Due to the forces of technology, globalization, and increased competition, attaining work/life balance is increasingly difficult at a time when having a balance between work and home is assuming greater importance to employees. Technology is both a help and a hindrance. Although technology makes it easier for employees to get out of the office and be at home, that same technology makes it difficult for employees to be completely at home without interference from work. This creates a new collection of challenges as the social contract between employers and employees evolves.

It is difficult to say whether the new social contract is bad or good. More than anything else, it represents an adaptation to the changing world and changing

Figure 17-1 *The Changing Social Contract between Employers and Employees*

Old Social Contract	New Social Contract
Job security; long, stable career and employment relationships	Few tenure arrangements; jobs constantly “at risk”; employment as long as you “add value” to the organization
Life careers with one employer	Fewer life careers; employer changes common; careers more dynamic
Stable positions/job assignments	Temporary project assignments
Loyalty to employer; identification	Loyalty to self and profession; diminished identification with employer
Paternalism; family-type relationships	Relationships far less warm and familial; no more parent-child relationships
Employee sense of entitlement	Personal responsibility for one’s own career/job future
Stable, rising income	Pay that reflects contributions; pay for “value added”
Job-related skill training	Learning opportunities; employees in charge of their own education and updating
Focus on individual job accomplishments	Focus on team building and projects

business circumstances. In some respects, workers may prefer the new model. Whatever turns out to be the case, we can expect free agent employees to be more proactive about their work environments than the loyal employees of the past once were. So it is clear that employee stakeholders' expectations of fair treatment will continue to rise, and we will continue to see the employee rights movement continue to grow.

The Employee Rights Movement

In our discussion of employee rights, we will be focusing on employees in the private sector because of the underlying public sector/private sector dichotomy that organizations in society face. The public sector is subject to constitutional control of its power and so government employees have more protections. In contrast, the private sector generally has not been subject to constitutional control because of the concept of **private property**. The private property concept holds that individuals and private organizations are free to use their property as they desire. As a result, private corporations historically and traditionally have not had to recognize employee rights because society honored the corporation's private property rights. The underlying issues for the private sector and its stakeholders then become why and to what extent the private property rights of business should be changed or diluted.

A brief comment on the role of labor unions is appropriate here. In general, although labor unions have been quite successful in improving the material conditions of life at work in the United States—pay, fringe benefits, and working conditions—they have not been as active in pursuing civil liberties. We must give unions credit for the gains they have made in converting what were typically regarded as management's rights or prerogatives into issues in which labor could participate. However, we should note that labor unions seem to be disappearing from the U.S. business scene. In 1953, union representation reached its highest proportion of the private employment workforce, at 36 percent.¹⁶ More than 50 years

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ALL IS FAIR?

Workplace Fairness (<http://www.workplacefairness.org>) is a nonprofit organization dedicated to promoting workplace policies and practices that support fairness in the workplace. The site is allied with the National Employment Lawyers Association. Listed as one of *PC Magazine's* top 100 sites you can't live

without and nominated for a 2007 Webbie award, the website provides access to information on a wide range of issues relating to employee rights. Recent employment-related news articles can also be accessed from this website.

Ethics in Practice Case

MANAGER'S MAKESHIFT

It is Holland Flowers' mission to deliver fresh and innovative floral designs. To achieve this, Holland Flowers hires creative university students from the local area. The company feels it is important to make every possible attempt to work around the students' schedules.

John Smith was a delivery driver for Holland Flowers and a university student. Before accepting the position with Holland Flowers, John requested several days off the week prior to Christmas. December is a very busy time at Holland Flowers. To accommodate the increase in business, Holland Flowers hires seasonal employees. That year, the owner's son, Bob, was one of the seasonal employees. Bob was to work with John and the other drivers. The week prior to Christmas, the owner informed John that Bob was sick and unable to work. Subsequently, the owner told John he was to work that week, even though before John was hired, they had agreed that John would be off. Reluctantly, John agreed to work.

The following night, John was downtown when he saw Bob with a drink in his hand and appearing quite healthy. John approached Bob, questioning his

sickness and absence from work. Bob denied his illness, acting as if being the owner's son meant he could be off when he wanted.

John was furious, because the owner had previously stressed that Holland Flowers was built on honest working relationships. John felt that this incident went against the principles on which the company was founded. John no longer felt respect for the owner or Holland Flowers; instead, he felt lied to and betrayed. John called the owner that night and informed him of his feelings. Because the owner offered no defense, John felt he could no longer work for Holland Flowers, and he resigned.

1. Did the management of Holland Flowers behave unethically with respect to employee treatment in this case?
2. Was John right in questioning the owner's employee practices?
3. If you were John, what action would you have taken in this dilemma?

Contributed by Christopher Lockett

later, the proportion of union members in the private sector has fallen to 7.4 percent, with transportation, utilities, and construction holding the highest unionization rates.¹⁷ Although the public sector union rate has a nearly fivefold higher rate of 36 percent, it does not have a significant impact on the private sector employee rights we are discussing here. Compared to other countries, the U.S. unionization rate is very low, but membership statistics suggest that union membership is beginning to decline worldwide as well.¹⁸

THE MEANING OF EMPLOYEE RIGHTS

Before we consider specific employee rights issues, we should discuss briefly what we mean by employee **rights**. A lawyer might look at employee rights as claims that one can enforce in a court of law. To many economists as well, rights are only

creations of the law. For our purposes, we will approach employee rights from the Principle of Rights perspective and so rights are justifiable claims that utility cannot override. While we will focus on moral employee rights, we will also consider where the law stands regarding the rights of employees.

Employee rights can be positive or negative. Said differently, they can focus on achieving desired outcomes or on prohibiting unwanted outcomes. Richard Edwards has grouped employee rights into three categories based on the fact that these rights find their source in law, union contracts, or employers' promises. Rights provided by law are called **statutory rights**. These rights include, for example, those rights established by the Civil Rights Act of 1964 (at a national level) or by Massachusetts' "right-to-know" law (at the state level), which grants production workers the right to be notified of specific toxic substances they may be exposed to in the workplace. Union contracts, by contrast, provide workers with rights established through the process of **collective bargaining**. Examples of these rights are seniority preferences, job security mechanisms, and grievance procedures.¹⁹

Employer promises are the third source of employees' rights categorized by Edwards. He calls these employer grants or promises **enterprise rights**. Typical examples of such enterprise rights might include the right to petition beyond one's immediate supervisor, the right to be free from physical intimidation, the right to a grievance or complaint system, the right to due process in discipline, the right to have express standards for personnel evaluation, the right to have one's job clearly defined, the right to a "just-cause" standard for dismissal, the right to be free from nepotism and unfair favoritism, and so on.²⁰ Enterprise rights are provided and justified by management and so the rationale for those rights can be as varied as the managers implementing them. They might reflect the prevailing customs and so be necessary for the firm to be competitive. They might extend above and beyond those offered by others and be used as a sort of recruiting tool. They may also be afforded on the basis of some normative ethical principle or reasoning (for example, "This is the way workers ought to be treated"). In this situation, the ethical principles of justice, rights, and utilitarianism, as well as notions of virtue ethics, may be the rationales.

In this connection, management may provide the employee rights as part of an effort to display moral management, as discussed in Chapter 7. To illustrate this point further, Figure 17-2 characterizes how moral managers, as well as amoral and immoral managers, might view employee stakeholders.

To summarize, employee rights may be provided on the basis of economic, legal, or ethical sources of justification. In a limited number of cases, companies even use philanthropic arguments as the bases for providing employee rights or benefits. For example, some companies provide day-care facilities and other benefits to employees on philanthropic grounds, though of course these benefits also help with recruitment and retention. For purposes of our discussion here, however, we will concentrate on legal and ethical bases for considering employee rights.

The job-related rights that are mentioned often enough to merit further discussion here include: (1) the *right not to be fired without good cause*; (2) the *right to due*

Figure 17-2 Three Models of Management Morality and Their Orientations toward Employee Stakeholders

Model of Management Morality	Orientation Toward Employee Stakeholders
Moral Management	Employees are a human resource that must be treated with dignity and respect. Employees' rights to due process, privacy, freedom of speech, and safety are maximally considered in all decisions. Management seeks fair dealings with employees. The goal is to use a leadership style, such as consultative/participative, that will result in mutual confidence and trust. Commitment is a recurring theme.
Amoral Management	Employees are treated as the law requires. Attempts to motivate focus on increasing productivity rather than satisfying employees' growing maturity needs. Employees are still seen as factors of production, but a remunerative approach is used. The organization sees self-interest in treating employees with minimal respect. Organization structure, pay incentives, and rewards are all geared toward short- and medium-term productivity.
Immoral Management	Employees are viewed as factors of production to be used, exploited, and manipulated for gain of individual manager or company. No concern is shown for employees' needs/rights/expectations. Short-term focus. Coercive, controlling, alienating environment.

process and fair treatment; and (3) the *right to freedom, particularly freedom of expression and freedom of speech*. In Chapter 18, we will consider the rights to privacy, safety, and health in the workplace.

The Right Not to Be Fired Without Cause

A **good cause norm** (also known as “just cause”), the belief that employees should only be discharged for good reasons, prevails in the United States today. This belief persists in spite of the fact that most U.S. employees can be fired for any reason, or for no reason, as long as the firing is not discriminatory. A range of studies have shown the good cause norm to be widely held in a variety of situations, with respondents including undergraduate and graduate students as well as both blue- and white-collar workers.²¹ Belief in the good cause norm stands in direct opposition to the employment-at-will doctrine, which many employers believe is their right. With employers and employees holding such contradictory views, it is easy to see why so many disputes occur and terms like *unjust dismissals* and *wrongful discharge* have become part of our employment language.

EMPLOYMENT-AT-WILL DOCTRINE

The central issue in the movement to protect workers' jobs surrounds changing views of the **employment-at-will doctrine**. The United States is unique in the industrialized world with the use of this doctrine, based on the private property rights of the employer and the principle that the relationship between employer and employee is a voluntary one that can be terminated at any time by either party. Just as employees are free to quit a company any time they choose, this doctrine holds that employers can discharge employees for any reason, or no reason, as long as they do not violate federal discrimination laws, state laws, or union contracts. What this doctrine means is that unless you are protected by a union contract (the vast majority of the workforce is not) or by one of the discrimination laws, your employer is free to let you go at any time, for any reason. This doctrine is not widely understood by the workforce. Studies have shown that most employees in the United States believe that employment law follows a "good cause" norm;²² nevertheless, most private employees in the United States are in an at-will employment relationship.²³

This lack of awareness about at-will employment may provide the answer to a question Louis Uchitelle poses in *The Disposable American: Why is the United States so tolerant of large-scale layoffs?*²⁴ Uchitelle, who writes on economics for the *New York Times*, details the human costs of a system that allows employers to fire or lay off employees at will. Layoffs are traumatic events that inflict significant mental health damage. In the words of Uchitelle to the American Psychiatric Association, "Why don't you put a warning label on layoffs?"²⁵

Legal Challenges to Employment-at-Will

Three broad categories of issues that illustrate the legal challenges now arising in regard to employment-at-will discharges are: (1) public policy exceptions, (2) contractual actions, and (3) breach of good faith actions.²⁶ States vary in their adoption of exceptions to employment-at-will, creating a patchwork of employment situations around the country. Only three states, Florida, Georgia, and Rhode Island, have never adopted an exception.²⁷

A major exception to the long-standing employment-at-will doctrine is known as the **public policy exception**; 43 states recognize this exception.²⁸ This exception protects employees from being fired because they refuse to commit crimes or because they try to take advantage of privileges to which they are entitled by law. The courts have held that management may not discharge an employee who refuses to commit an illegal act or performs a public obligation, such as serving on a jury or supplying information to the police. This exception sometimes covers whistle-blowers. We will further discuss the case of whistle-blowers later in the chapter.

Workers who believe they have contracts or implied contracts with their employers are protected in the 38 states that recognize the **implied contract exception**.²⁹ In some instances, the courts are holding employers to promises they do not even realize they have made. For example, statements in employee handbooks or personnel manuals, job-offer letters, and even oral assurances about job security can be interpreted as implied contracts that management is not at liberty to violate. If an employee can prove in court that the hiring manager said, "We do not fire people without a good

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ROWDY RECRUITING

Last summer, I interned for a large company. The economy was strong, and so a large part of the company's time and money were put toward recruiting. The overwhelming majority of the company's employees were under the age of 30 and so young, energetic employees, who had recently been through the hiring process, did most of the recruiting. One Thursday night, I was asked to join a group of our employees and a young prospect for dinner. The idea was to take the recruit out for a night on the town and entertain him on his first night in our city. The next morning he was scheduled to meet with a partner at 8:00 a.m. for the first of many interviews.

At 7:00 p.m. sharp, we met the recruit, Mike, in the lobby of the hotel where he was staying. My first impression was that Mike was very nervous about dining with such a large group of our workers. When we arrived at the restaurant, the waiter handed us a wine list. As usual, we ordered a few bottles of wine for the table. When Mike refused our offer of a drink, my manager assured him it was okay. He consented and started in for a long night of alcohol consumption. We hopped from the restaurant to several bars in an upscale area of the city. Eventually, it was way past our bedtime, and we had all surpassed our limit. So we walked Mike back to his hotel and reminded him that we would be back to meet him bright and early in the morning.

Early Friday morning, my manager and I pushed our way through the revolving door of the hotel that

we had just exited a few hours earlier. Though we were both feeling a bit hungover, we put on a smile and acted very professional. After a few minutes, the elevator door opened and Mike stumbled out. As he approached us, we noticed the lack of color in his face and wondered what kind of impression he would make in his interviews. As I reached out my hand to shake his, Mike turned his head and vomited on the floor of the hotel. After getting himself together, Mike began apologizing profusely. At that point, my manager informed Mike that he would no longer be interviewing with our company. I was shocked! All of us stayed out too late and had too much fun. Why would my manager punish Mike for something we had all done and even encouraged him to do?

1. Did the manager behave unethically with respect to treatment of the recruit? Does the fact that the recruit initially turned down the wine and the manager encouraged him to drink it affect your answer?
2. Do the rights of recruits differ from the rights of employees? If so, how?
3. If you were the manager, what action would you have taken in this situation? How would you handle Mike? Would you do anything to lessen the likelihood of this happening again?

Contributed Anonymously

reason," that is enough to create an implied contract. Even the use of the term *permanent employee* to mean an employee who had worked beyond a six-month probationary period can be construed as a promise of continuous employment.

Courts have also recognized that employers should hold themselves to a standard of fairness and good faith dealings with employees. This concept is probably the broadest restraint on employment-at-will terminations. The **good**

faith principle suggests that employers may run the risk of losing lawsuits to former employees if they fail to show that employees had every reasonable opportunity to improve their performance before termination. Only eleven states recognize the good faith principle.³⁰ As previously noted, however, the good faith principle reflects what many already believe is the responsibility of businesses to their employees. The good faith principle is not a problem for companies if they simply introduce fair ways of taking disciplinary measures and mechanisms for reviewing grievances that provide employees with due process. We will discuss such due-process mechanisms later in the chapter.

MORAL AND MANAGERIAL CHALLENGES TO EMPLOYMENT-AT-WILL

As previously mentioned, the United States is unique in its adherence to employment-at-will, and most people in the United States believe a norm of good cause applies to employment decisions, so it is not surprising that employment-at-will has been criticized from moral as well as legal grounds. The argument generally used in favor of employment-at-will is that employers are invoking their property rights when they terminate an employee. In an interesting rebuttal, Werhane, Radin, and Bowie suggest that the fruits of an employee's labor are that employee's property, and so property rights arguments also provide an argument against the appropriateness of employment-at-will.³¹

Using the concept of employee property rights as a foundation, Werhane et al. derive three objections to employment-at-will. First they argue that employees deserve respectful treatment, which includes explaining the reasons for termination when it occurs. Second, employees do not have the option of being arbitrary or capricious with employers and so employers should bear the same responsibility in their treatment of employees. A third issue is based on the concept of reciprocity; employees are expected to be trustworthy, loyal, and respectful in their interactions with employers and so employers should show employees the same consideration.³²

Employment-at-will can present managerial problems as well. We should not forget the impact that an employment-at-will environment can have on the culture of an organization. Most bad reasons for firing employees, such as discrimination, are already illegal, and managers can always fire an employee for good justifiable reasons, so employment-at-will simply protects the right of the employer to fire an employee for no reason at all. This creates an odd dynamic. Trust and loyalty are important to effective workplaces, but they are reciprocal relationships. For managers to be able to trust their employees, they must be willing to be trustworthy in return.³³

TERMINATING AN EMPLOYEE WITH CARE

With respect to employee termination, management needs to be aware not only of the content of the decision to terminate but also the process for doing it. Treating employees with care is not only important to the terminated employee but also to the survivors of the process, who then know they will be treated with care if a similar situation arises for them. A positive corporate culture can be preserved

even in difficult times with thoughtful treatment of employees. Steve Harrison offers some dos and don'ts for terminating employees in a decent manner. The following are some specific recommendations for actions:³⁴

1. *Fire employees in a private space.* Don't terminate employees in a way that enables coworkers to see what is happening or that forces them to "walk a gauntlet" in front of them.
2. *Be mindful of employees' logistics.* How will they get closure on their projects? How will they get home that day?
3. *Preserve the employee's dignity.* If you must lay off a trusted and valuable employee for economic reasons, don't confiscate IDs and cell phones immediately or cancel passwords immediately.
4. *Choreograph the notification in advance.* The purpose of the meeting should not be a surprise.
5. *Use transparent criteria for layoffs.* The rationale for terminations should be clear both to those laid off and the survivors.

The following are some of the actions managers should not take when terminating employees:³⁵

1. *Don't fire on a Friday.* Terminated employees would not have access to support services on weekends and so would have to cope on their own.
2. *Don't say that downsizing is finished.* It is impossible to know for sure and being wrong would make subsequent layoffs more difficult for all concerned.
3. *Don't terminate an employee via e-mail.* Although this advice seems obvious, firms have done so to the detriment of employees as well as their reputations.
4. *Stick to the topic and avoid platitudes.* For example, don't say, "This is as hard for me as it is for you"—it isn't.
5. *Don't rush through the meeting.* Being willing to give a person time is a way of communicating that the person matters. Not giving the employee the time needed for the termination puts salt in the wound.

For effective stakeholder management, organizations must always consider their obligations to employee stakeholders and their rights and expectations with respect to their jobs. Companies that are aspiring to emulate the tenets of the moral management model will need to reexamine their attitudes, perceptions, practices, and policies continuously with respect to this issue.

The Right to Due Process and Fair Treatment

One of the most frequently proclaimed employee rights issues of the past decade has been the right to due process. Basically, **due process** is the right to receive an impartial review of one's complaints and to be dealt with fairly. In the context of

the workplace, the right of due process is the right of employees to have decisions that affect them adversely reviewed by objective, impartial third parties.

One major obstacle to the due-process idea is that to some extent it is somewhat contrary to the employment-at-will principle discussed earlier. Due process is consistent with the democratic ideal that undergirds the universal right to fair treatment, and so one can argue that, without due process, employees do not receive fair treatment in the workplace. Furthermore, the fact that the courts are gradually eroding the employment-at-will principle might serve as an indication that employment-at-will is basically unfair. If this is true, the due-process concept makes more sense.

DUE PROCESS

Patricia Werhane, a leading business ethicist, contends that, procedurally, due process extends beyond simple fair treatment and should state, “Every employee has a right to a public hearing, peer evaluation, outside arbitration, or some other open and mutually agreed-upon grievance procedure before being demoted, unwillingly transferred, or fired.”³⁶ Due process can range from the expectation that the company will treat employees fairly to the position that employees deserve a fair system of decision making.

Sometimes, unfair treatment happens in such a subtle way that it is difficult to know that it has taken place. What do you do, for example, if your supervisor refuses to recommend you for promotion or permit you to transfer because she or he considers you to be exceptionally good at your job and doesn’t want to lose you? How do you prove that a manager has given you a low performance appraisal because you resisted sexual advances? The issues over which due-process questions may arise can be quite difficult and subtle.

Due process is a system for ascertaining that organizational decisions have been fair.³⁷ As such, it aligns closely with the concept of procedural justice that we discussed in Chapter 8.³⁸ The following are the main requirements of a due-process system in an organization:³⁹

1. It must be a procedure; it must follow rules. It must not be arbitrary.
2. It must be sufficiently visible and so well-known that potential violators of employee rights and victims of abuse are aware of it.
3. It must be predictably effective.
4. It must be institutionalized—a relatively permanent fixture in the organization.
5. It must be perceived as equitable.
6. It must be easy to use.
7. It must apply to all employees.

Procedural due process is a concept derived from the fifth and fourteenth amendments of the United States Constitution. In law, due process requires a balancing act between the interests of the government and the interests of the

individual. In organizations, a similar balancing act occurs. The challenge is to balance the interests of the individual employee with the interests of the organization.⁴⁰

ALTERNATIVE DISPUTE RESOLUTION

There are several ways companies can and do provide due process for their employees. The approaches described here represent some of the **alternative dispute resolution (ADR)** methods that have been employed over the past 30 years.

Common Approaches

One of the most often-used mechanisms is the **open-door policy**. This approach typically relies on a senior-level executive who asserts that her or his “door is always open” for those who think they have been treated unfairly. Alternatively, the organization might assign to a human resources department executive the responsibility for investigating employee grievances and either handling them or reporting them to higher management. From the employee’s standpoint, the major problems with these approaches are that (1) the process is closed, (2) one person is reviewing what happened, and (3) there is a tendency in organizations for one manager to support another manager’s decisions. The process is opened up somewhat by companies that use a **hearing procedure**, which permits employees to be represented by an attorney or another person, with a neutral company executive deciding the outcome based on the evidence. Similar to this approach is the use of a management *grievance committee*, which may involve multiple executives in the decision process.

The Ombudsman

An innovative due-process mechanism that has become popular for dealing with employee problems is the use of a corporate **ombudsman**, also known as *ombud* or *ombudsperson*. “Ombudsman” is a Swedish word that refers to one who investigates reported complaints and helps to achieve equitable settlements. The ombudsman approach has been used in Sweden since 1809 to curb abuses by government against individuals. In the United States, the corporate version of the ombudsman entered the scene more than 35 years ago, when the Xerox Corporation named an ombudsman for its largest division. General Electric and the Boeing Vertol division of Boeing were quick to follow.⁴¹ Today, more than 200 major corporations have ombudsmen, with 50 added in the two years after Sarbanes-Oxley (SOX) passed.⁴² SOX contains a lesser-known provision that encourages employees to report wrongdoing and prohibits corporate retaliation against those employees.⁴³

The ombudsman’s task is quite different from that of the human resources manager. Hiring, firing, setting policy, and keeping records are all the responsibility of the human resources department; the ombudsman does none of these.⁴⁴ The ombudsman, in contrast, is formally and officially neutral and promises client confidentiality.⁴⁵ Ombuds can handle the concerns of employees who believe they have witnessed wrongdoing and do so in a way that keeps the problem from getting out of hand.⁴⁶

The Peer Review Panel

The **peer review panel** is another due-process mechanism currently under use at several large companies. Eastman Kodak has made good use of the peer review concept. From 2002 to 2004, about 700 Kodak employees were involved in the program. Kodak hoped that peer review would ease the transition as it dealt with a planned workforce reduction of forty-five hundred to six thousand people.⁴⁷ As Ann Reesman, former general counsel of the Equal Employment Advisory Council, put it, “The benefit of using peer review rather than some external decision maker is that the peer review panel is well-versed in the company culture and how the company operates.”⁴⁸ Also, peers tend to find decisions handed down by peers to be trustworthy.⁴⁹

The key to a successful peer review committee is to make sure that the people involved in the process are respected members of the organization. Election rather than appointment of committee members is important for participants to trust the independence of the process. Everyone involved in peer review must receive training in relevant areas such as dispute resolution, discrimination, fairness, legalities, and ethics. Representatives of both employees and management should be involved in the decision-making process.⁵⁰

The trend toward using ADR is growing with no end in sight. This growth is spurred partly by the time and money saved by avoiding costly litigation. Brown & Root, a Houston-based construction and engineering firm, estimates that its legal fees dropped 30 to 50 percent since employing ADR, and 70 to 80 percent of the firm’s cases were settled within eight weeks (40 percent within a month). Further, the proportion of adverse settlements and the size of the judgments were no different from when they went through the court system.⁵¹ Viewed from the ethic-of-care standpoint, alternative dispute resolution is preferable to the adversarial strategies that preceded it.⁵²

Many observers have expressed concern that employers are beginning to require new hires to sign contracts waiving their right to sue the firm and accepting pre-dispute **mandatory arbitration** as the alternative. Arbitration is a process where a neutral party resolves a dispute between two or more parties and the resolution is binding. In mandatory arbitration, the parties must agree to arbitration prior to any dispute occurring. Critics of this practice argue that this robs employees of their right to due process. They say that the structure of mandatory arbitration favors the organization and not the employee. Supporters contend that the arbitration process is just as fair as a jury trial while costing much less in time and money. The war against mandatory arbitration continues to wage in the legislature and the courts.⁵³

Freedom of Speech in the Workplace

Henry Boisvert was a testing supervisor at FMC Corp., makers of the Bradley Fighting Vehicle. The Bradley was designed to transport soldiers around battlefields and, when necessary, “swim” through rivers and lakes. When Boisvert

tested the Bradley's ability to move through a pond, he found it filled quickly with water. He wrote the Army a report of his findings but was told by FMC supervisors that the report would never be sent. When Boisvert refused to sign a falsified report of his test results, he was fired.⁵⁴

About the same time that Boisvert was discovering the Bradley's inability to swim, Air Force Lieutenant Colonel James Burton found additional problems with the fighting machine. When hit by enemy fire, the Bradley's aluminum armor melted and filled the inside of the vehicle with poisonous fumes. After 17 years of development and \$14 billion for research and prototypes, the Bradley was unfit for warfare. Burton uncovered tests of the Bradley that were rigged by filling the gas tanks with water and the ammunition with noncombustible sand, making it impossible for the Bradley to explode. He also fought an attempt to transfer him to Alaska. Burton's insistence on speaking freely was successful in forcing changes to the Bradley; however, Burton was forced to take early retirement as the officers who tried to stop his investigation were promoted.⁵⁵

"Speaking truth to power" is a Quaker phrase for speaking honestly and openly even when powerful parties would prefer that you keep quiet. Both Boisvert and Burton insisted on speaking truth to power and ultimately prevailed in their fights to fix the Bradley. After a 12-year legal battle, Boisvert received one of the largest damage awards that had ever been seen in a federal case, well over \$300 million. During the trial, evidence emerged about employees using putty to fix cracks in the machine while vehicles to be selected for random inspection were marked with "X"s and worked on more carefully than the rest.⁵⁶ Burton's story also ends happily. Congress mandated that the Bradley be tested under the supervision of the National Academy of Sciences, using conditions that resembled true battlefield combat. As a result of these tests, the Bradley was redesigned and has been used successfully since then. Burton wrote a best-selling book about his experiences, *The Pentagon Wars*, which subsequently became an HBO movie.⁵⁷ It is

<http://SEARCHTHEWEB.WEB>

HELP FOR WHISTLE-BLOWERS

The National Whistleblower Center (<http://www.whistleblowers.org>) is a "nonprofit educational and advocacy organization committed to environmental protection, nuclear safety, civil rights, government accountability and protecting the rights of employee whistleblowers." The center has successfully established many of the most important precedents protecting employee whistle-blowers throughout the United States and has revolutionized the protection afforded them.

The website has a wide variety of resources related to whistle-blowing. Included among them are a whistle-blower law library, a list of whistle-blower resources, model whistle-blower laws, and sources of whistle-blower protection. In addition to educating the public, they provide counseling to whistle-blowers nationwide and support for precedent-setting litigation.

impossible to estimate how many soldiers' lives were saved by the courage and persistence of these two men.

WHISTLE-BLOWING

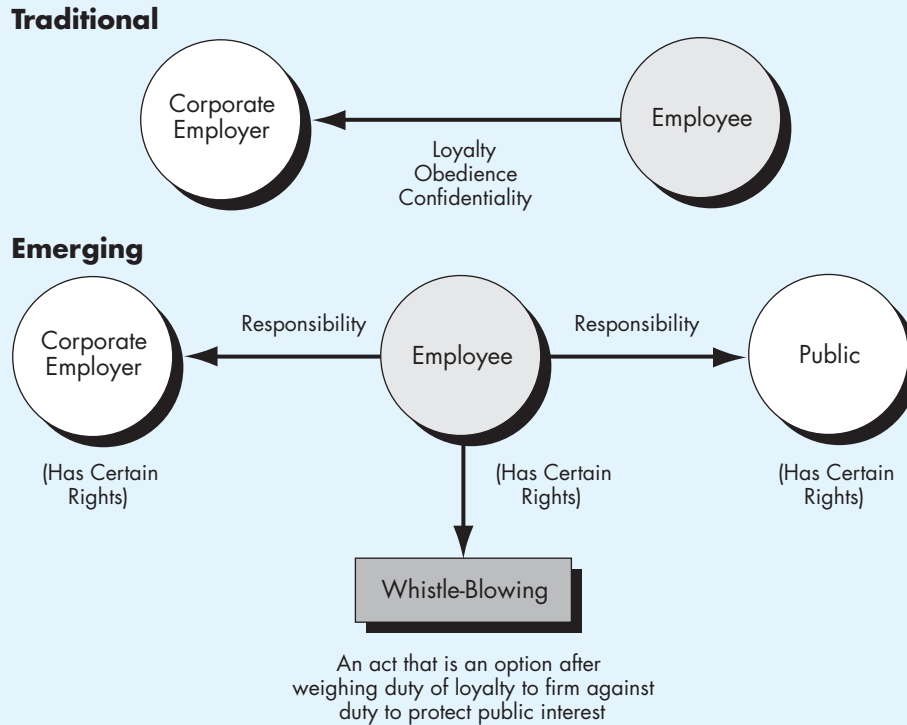
As stated earlier, the current generation of employees has a different concept of loyalty to and acceptance of authority than that of past generations. The result is an unprecedented number of employees "blowing the whistle" on their employers. A **whistle-blower** is a former or current organization member who discloses "illegal, immoral, or illegitimate practices under the control of their employers, to persons or organizations that may be able to effect action."⁵⁸

What constitutes whistle-blowing? For our purposes, we define a whistle-blower as "an individual who reports to some outside party [for example, media, government agency] some wrongdoing [illegal or unethical act] that he or she knows or suspects his or her employer of committing." An alternative but similar definition of whistle-blowing is provided by Miceli and Near, two experts on the subject, who characterize it as "the disclosure by organization members [former or current] of illegal, immoral, or illegitimate practices under the control of their employers, to persons or organizations that may be able to effect action."⁵⁹ Thus, there are four key elements in the whistle-blowing process: the whistle-blower, the act or complaint about which the whistle-blower is concerned, the party to whom the complaint or report is made, and the organization against which the complaint is made.⁶⁰

What is at stake is the employee's right to speak out in cases where she or he thinks the company or management is engaging in an unacceptable practice. Whistle-blowing is contrary to our cultural tradition that an employee does not question a superior's decisions and acts, especially not in public. The traditional view holds that the employee owes loyalty, obedience, and confidentiality to the corporate employer. The emerging view of employee responsibility holds that the employee has a duty not only to the employer but also to the public and to her or his own conscience. Whistle-blowing, in this latter situation, becomes a viable option for the employee should management not be responsive to expressed concerns. Figure 17-3 depicts these two views of employee responsibility.

Most whistle-blowers seem to be engaging in these acts out of a genuine or legitimate belief that the actions of their organizations are wrong and that they are doing the right thing by reporting them. They may have learned of the wrongful acts by being requested or coerced to participate in them, or they may have gained knowledge of them through observation or examination of company records. The genuinely concerned employee may initially express concern to a superior or to someone else within the organization. Other potential whistle-blowers may be planning to make their reports for the purpose of striking out or retaliating against the company or a specific manager for some reason. In a survey of studies of whistle-blowers, however, Near and Miceli found the latter to be uncommon. Whistle-blowers were on average more highly paid, with higher job performance than inactive observers. They were more likely to hold supervisory or professional status, and they have both the role responsibility to report wrongdoing and the knowledge of channels for doing so.⁶¹

Figure 17-3 *Two Views of Employee Responsibility in a Potential Whistle-Blowing Situation*



After Enron and the scandals that followed, whistle-blowers began to receive more recognition. The *Time* Persons of the Year were three women who fit Near and Miceli's description. The women they named "The Whistle-blowers" were former Enron vice president Sherron Watkins, who wrote a memo to Enron CEO Kenneth Lay, warning of improprieties in the firm's accounting methods; FBI staff attorney Colleen Riley, who told FBI director Robert Mueller about the bureau's having ignored the Minneapolis field office's pleas that they investigate Zacarias Moussaoui, now convicted as a September 11 co-conspirator; and WorldCom's vice president of internal audit, Cynthia Cooper, who told the board that the company had hidden \$3.8 billion in losses in falsified books.⁶² According to *Time*, these women of "ordinary demeanor but exceptional guts and sense" risked their jobs, health, privacy, and sanity to bring about sea changes in their industries.⁶³ Some have argued that the designation of whistle-blower is incorrect because they are internal whistle-blowers. Dan Ackerman of *Forbes* writes in the *Wall Street Journal*, "A whistleblower is someone who spots a criminal inside a bank and

Figure 17-4 A Checklist to Follow Before Blowing the Whistle

The following things should be considered before you blow the whistle:

1. Is there any alternative to blowing the whistle? Make sure you have tried to remedy the problem by reporting up the normal chain of command and have had no success.
2. Does the proposed disclosure advance public interest rather than personal or political gain? Don't act out of frustration or because you feel mistreated.
3. Have you thought about the outcomes of blowing the whistle for yourself and your family? Be prepared for the possibility of disapproval from friends, family, and fellow workers.
4. Have you identified the sources of support both inside and outside the organization on which you can rely during the process? Make sure you know your legal rights and have enlisted the help of others.
5. Do you have enough evidence to support your claim? Even more evidence is needed if you plan to remain anonymous.
6. Have you identified and copied all supporting records before drawing suspicion to your concerns? Remember to keep a factual log both before and after blowing the whistle.

Sources: Department of Human Services, Victoria, Australia (<http://www.dhs.vic.gov.au/whistleblowers/checklist.htm>); *BusinessWeek* (December 16, 2002), (http://www.businessweek.com/magazine/content/02_50/b3812095.htm); The Government Accountability Center (<http://www.whistleblower.org/getcat.php?cid=32>); Kenneth K. Humphreys, "A Checklist for Whistleblowers to Follow," *Cost Engineering* (October 2003), 14.

alerts the police. That's not Sherron Watkins. What she did was write a memo to the bank robber (Mr. Lay) suggesting he was about to be caught and warning him to watch out."⁶⁴ Whatever one's opinion of the nature of their disclosures, it is hard to argue their impact on the business psyche. The media coverage of their high-profile cases is likely to have contributed to a dramatic rise in public awareness of and interest in whistle-blowing. For example, whistle-blower suits filed with the Office of Special Counsel grew from 380 in fiscal year 2001 to 555 in fiscal year 2002, an increase of 46 percent.⁶⁵

Figure 17-4 identifies a checklist for whistle-blowers to follow.

CONSEQUENCES OF WHISTLE-BLOWING

What happens to employees after they blow the whistle? Unfortunately, whistle-blowers are often not rewarded for their contributions to the public interest. Although they are now more likely to get some form of protection, whistle-blowers in general have sometimes paid dearly for their actions. Short of firings, various types of corporate retaliation have been taken against whistle-blowers,⁶⁶ including:

- More stringent criticism of work
- Less desirable work assignments
- Pressure to drop charges against the company
- Heavier workloads

- Lost perquisites (for example, telephone and parking privileges)
- Exclusion from meetings previously attended

One person paying the price for speaking up is the whistle-blower whose courage drew worldwide attention when he made the abuse of Iraqi detainees at Abu Ghraib Prison in Baghdad public. Spec. Joseph M. Darby, a former reservist in the 372nd Military Police Company, found out about the abuse by accident when a friend gave him the pictures. He turned them over to the Army's Criminal Investigation Division anonymously. The photographs that documented this abuse shocked the world.⁶⁷

Darby's anonymity was short-lived after Defense Secretary Donald Rumsfeld spoke his name when giving congressional testimony—testimony that played on the TV as Darby was having lunch in the mess hall.⁶⁸ Fearing retaliation, Darby slept with a gun under his pillow. The Army soon opted to send him home ahead of his unit for his safety.⁶⁹ Unfortunately, Darby's hometown did not prove a safe haven. The commander of the local Veteran of Foreign Wars post referred to him as a "rat" and a "traitor," and his wife, Bernadette, heard people say her husband was a "dead man" and that he was "walking around with a bull's-eye on his head."⁷⁰ Relatives from both sides of the family turned against them.⁷¹

The Army concluded that the Darbys could not return home safely and so they kept them on an Army base with round-the-clock security guards. The Darbys have set up residence in a new town; they don't disclose the location due to ongoing safety concerns. Darby left the Army and misses it. They both miss their hometown, and they know they will never go home again. When asked if he wishes it were someone other than he who had been given the pictures, Darby says, "No, because if it was someone else it might not have been reported. . . . Ignorance is bliss they say but to actually know what they were doing, you can't stand by and let that happen."⁷²

Although whistle-blowers frequently do suffer severe consequences like the Darbys did for speaking out, other corporate actions are also possible. One encouraging episode is the case of Mark Jorgensen, who was a manager of real estate funds at Prudential Insurance Co. of America.⁷³ Jorgensen thought he was just being an honest guy when he exposed fraud he saw occurring in his company. His world then began to fall apart. His boss, who had once been his friend, abandoned him. His colleagues at work began to shun him. Company lawyers accused him of breaking the law. Jorgensen, who was once a powerful and respected executive in the firm, began to hide out at the local library because he had been forbidden to return to his office. His long and successful career appeared to be dwindling to a pathetic end. Finally, he was fired.

Unlike most whistle-blowers, however, Jorgensen received a phone call from the company chairman, Robert Winters, who wanted to meet with Jorgensen to tell him some startling news: the company now believed him and wanted to reinstate him. Further, the company wanted to force out the boss he had accused of falsely inflating the values of funds that he managed. The turnabout was attributed to Jorgensen's persistence in fighting all odds in his quest to justify his convictions. Coming to the realization that Jorgensen had been right in his allegations all along, Prudential found itself in an unusual situation in business

today—siding with the whistle-blower it had fought for months and eventually had fired. The company offered to reinstate Jorgensen in his job, but he elected instead to move on to another company. Prudential paid him a sizable amount to settle his lawsuit.⁷⁴ Although we do not read about many stories that end this way, it is encouraging to know that there are some stories that have happy endings. Speaking of endings (that may or may not be happy), Figure 17-5 chronicles Hollywood’s treatment of some famous whistle-blowers.

Figure 17-5 *Whistle-Blowers Get the Hollywood Treatment*

Movie	Stars	Story	Inspiration
<i>Serpico</i> (1973)	Al Pacino (title role)	Frank Serpico is a nonconformist “hippie cop” in New York City who tries to report graft and corruption to his superiors. When they don’t listen, he goes to the <i>New York Times</i> .	Based on Peter Maas’s book, the movie tells a true story from Serpico’s perspective. In the true story, another whistle-blower (David Durk) played a critical role, which is downplayed in the movie.
<i>The China Syndrome</i> (1979)	Jack Lemmon Jane Fonda Michael Douglas	Reporter (Fonda), cameraman (Douglas), and whistle-blower (Lemmon) team to expose unsafe practices in the nuclear energy industry.	Although the story is fiction, it is inspired by real events that occurred at the Browns Ferry and Dresden II reactors. Just days after the film’s release, the most serious nuclear accident in U.S. history occurred at Three Mile Island.
<i>Silkwood</i> (1983)	Meryl Streep (title role) Kurt Russell Cher Craig T. Nelson	Whistle-blowers try to expose unsafe practices at an Oklahoma nuclear parts factory. A worker becomes contaminated.	Based on the true story of Karen Silkwood, who was a chemical technician at the Kerr-McGee plutonium fuels production plant in Crescent, Oklahoma. As a union member and activist, she was critical of plant safety.
<i>The Insider</i> (1999)	Russell Crowe Al Pacino Christopher Plummer	Successful scientist is fired from major tobacco company for taking a principled stand. <i>60 Minutes</i> is due to report the story, but they cave to corporate pressure.	Based on a <i>Vanity Fair</i> article, “The Man Who Knew Too Much.” The movie tells the true story of Jeffrey Wigand, who was fired from Brown & Williamson tobacco company.

GOVERNMENT'S PROTECTION OF WHISTLE-BLOWERS

Just as employees are beginning to get some protection from the courts through the public policy exception to the employment-at-will doctrine, the same is true for whistle-blowers. The federal government was one of the first organizations to attempt to protect its own whistle-blowers. A highlight of the **1978 Civil Service Reform Act** was protection for federal employees who expose illegal, corrupt, or wasteful government activities. Unfortunately, this effort has had only mixed results.⁷⁵ It is difficult to protect whistle-blowers against retaliation because so often the reprisals are subtle. An added boost for federal employees came in 1989, when Congress passed the Whistle-Blower Protection Act and the president signed it into law. The effect of this act was to reform the Merit System Protection Board and the Office of General Counsel, the two offices that protect federal employees.⁷⁶

The **Michigan Whistle-Blowers Protection Act of 1981** became the first state law designed to protect any employee in private industry against unjust reprisals for reporting alleged violations of federal, state, or local laws to public authorities. The burden was placed on the employer to show that questionable treatment was justified on the basis of proper personnel standards or valid business reasons.⁷⁷ The Michigan act spurred similar laws in other states. Those that have explicit statutory protection for whistle-blowers include California, Connecticut, Delaware, Florida, Hawaii, Louisiana, Maine, Michigan, Minnesota, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Rhode Island, Tennessee, and Washington.⁷⁸ For example, California passed SB 777, which provides significant new protection to whistle-blowers. Among other protections, the bill expands coverage to applicants as well as employees. It shifts the burden of evidence to the employer, adding civil penalties of up to \$10,000 for any violations. It also sets up a whistle-blower hotline in the Attorney General's office. Employers are required to display a list of the whistle-blower protections and the hotline number.⁷⁹

Most state courts have recognized a public policy exception, and therefore whistle-blowers have some limited protection. The normal remedy for wrongful discharge of employees is reinstatement with back pay, with some sympathetic juries adding compensatory damages for physical suffering.⁸⁰ The problem with most laws intended to protect whistle-blowers is that they are quite spotty. Some state and federal laws, such as environmental, transportation, health, safety, and civil rights statutes, have provisions that protect whistle-blowers from retaliation, but relatively few states have provisions that protect private sector employees, and these provisions vary widely in their nature and protection coverage.

This crazy quilt of whistle-blower protections made it very difficult for employees to safely shed light on corporate wrongdoing. In some states, whistle-blowers could be fired at will; in other states, they would have to sort through a bewildering assortment of statutes to determine what, if any, protection existed. However, that was supposed to change when the Sarbanes-Oxley Act was passed.

SARBANES-OXLEY WHISTLE-BLOWER PROTECTIONS

Tom Devine, Government Accounting Project (GAP) legal director, described the Sarbanes-Oxley Act as a “lunar landing in terms of strengthening corporate responsibility to shareholders and employees alike. This is a landmark breakthrough in corporate accountability and a legal revolution for corporate freedom of speech.”⁸¹ Sarbanes-Oxley makes whistle-blowing much easier. Whistle-blowers only need to make a disclosure to a supervisor, law enforcement agency, or congressional investigator that could have a “material impact” on a company’s stock price. The Labor Department then bears responsibility for investigating any complaints of the whistle-blower being terminated, demoted, or harassed.⁸² The protections Sarbanes-Oxley provides include:⁸³

- Comprehensive coverage for all employees of publicly traded companies
- Comprehensive protection for any form of discrimination or harassment
- Any corporate conduct that could threaten shareholder value
- Timely responses through administrative investigations, temporary relief, and due-process hearings
- The right to a jury trial if an administrative ruling is not received within 180 days
- Lessened burden of proof on the employee
- Compensatory damages and judicial fees
- Criminal felony penalties of up to 10 years for retaliation
- Audit committees required to have procedures for responding to complaints

While acknowledging vast improvement, some critics still feel that the act did not go far enough. Only employees of publicly held firms are covered, and so employees of privately held firms still have limited protection. In practice, the law still does not provide the level of protection originally intended due to a combination of aggressive defense lawyer tactics, poor judicial decisions over witness protection, and confusion among judges over SOX’s intent.⁸⁴

FALSE CLAIMS ACT

A provocative piece of federal legislation that was passed to add an incentive for whistle-blowers in the public interest is the **False Claims Act**. The False Claims Act has *qui tam* (Latin shorthand for “he who sues for the king as well as himself”) provisions that allow employees to blow the whistle about contractor fraud and share with the government in any financial recoveries realized by their efforts. It dates back to the Civil War, when the Army wanted to find and prosecute profiteers who sold the same horse twice or sold boxes of sawdust while claiming they were guns. Citizens were permitted to sue on the government’s behalf and receive 50 percent of the recovery. In 1943, Congress reduced the potential payout dramatically, and so it was seldom used.⁸⁵ The act was revised in 1986 to make recoveries easier to obtain and payouts

more generous, thereby encouraging whistle-blowing against government contractor fraud.⁸⁶ The 1986 act grew out of outrage in the mid-1980s over reports of fraud and abuse on the part of military contractors, such as \$600 toilet seats and country club memberships billed to the government.⁸⁷

What is particularly controversial about the False Claims Act is the magnitude of the financial incentives that individual employees may earn as a result of their whistle-blowing efforts. The law allows individuals to be awarded as much as 15 to 25 percent of the proceeds in cases where the government joins in the action, and from 25 to 30 percent of the proceeds in actions that the government does not join.⁸⁸ Even with these incentives, however, whistle-blowing is never easy, as the experiences of James Alderson illustrate.

James Alderson had been the chief financial officer of the North Valley Hospital for 17 years when Quorum, a former division of HCA, took over management of the hospital. Quorum created a second set of books and told Alderson to use these secret books to report higher than average expenses to the government for reimbursement. Knowing this would be both illegal and unethical, Alderson refused and five days later he was fired. After learning that other Quorum hospitals were cooking the books, too, Alderson went to Washington and talked to the U.S. Department of Justice. He took documentation of the false claims being filed with him and sued Quorum and HCA under the federal False Claims Act.

HCA eventually paid a total of \$840 million, consisting of \$745 million in civil damages and \$95 million in criminal penalties. They later paid another \$881 million to settle all remaining fraud charges and other overpayment claims against the company. Thirteen years after Alderson was fired, the final settlement agreement between HCA and the U.S. Department of Justice was approved. The government received \$1.5 billion from those payments, thanks to the efforts of Alderson and other whistle-blowers involved.⁸⁹

There aren't many hospitals in Whitefish, Montana, so Alderson was forced to leave Whitefish to find work in hospital finance. For the next 10 years, Alderson tried to earn a living while continuing to gather evidence. Federal officials had told him that he needed evidence that the practices at North Valley were widespread, and the collection of that evidence was his responsibility. Building that evidence consumed Alderson's time and money. In addition to the financial drain, Alderson had made many personal sacrifices—from missing his son's football games to not being at his mother's side when she died.⁹⁰ Alderson and his wife, Connie, kept a low profile. According to Connie, it was just like being in the witness protection program: "the only difference is that we weren't receiving any protection or money to keep us going."⁹¹ Their low profile ended when the television show *60 Minutes* did a profile of Alderson. After the show aired, Alderson became a pariah in the health care industry. Says Alderson, "Even though I had a major impact in reducing health care fraud by \$10 billion annually, I had one hospital CEO tell me to my face that I had ruined the industry and that I had given it a black eye."⁹²

Under the False Claims Act, Anderson received a percentage of the proceeds from the settlement. Alderson commented, "I won't deny that money provided an incentive, but it was only part of the motivation. What Quorum and HCA were

doing was wrong, and it took me 13 years and my career to prove it. Fortunately, I received enough money from the settlement to retire.”⁹³ However, Connie Alderson says, “Knowing what I know now and knowing how long it’s been, I’m not sure I would have agreed to pursuing the case. I don’t think any amount of money is going to take care of what we’ve been through.”⁹⁴

As of this writing, the False Claims Act has returned nearly \$17 billion to the federal government, and the proceeds continue to grow.⁹⁵ Eighty percent of the recovered funds are from the health care industry.

The act continues to evolve as legislation and the court test it. In 2003, the Supreme Court ruled unanimously that municipalities are “persons” under the False Claims Act and can be held liable for damages and penalties from submitting a false claim to the federal government. States are considered co-sovereign, and so the court found that they are not liable under the FCA; however, municipalities are corporations, and so the court found that they should be treated like any other incorporated entity under the act.⁹⁶ Since that ruling, however, several states have passed their own False Claims Act and more have plans to do so in the works.⁹⁷

MANAGEMENT RESPONSIVENESS TO POTENTIAL WHISTLE-BLOWING SITUATIONS

Whistle-blowing situations occur after normal, less dramatic, channels of communication have failed. Ideally, employees should always feel free to open up to management about any concerns they have. Even in the best of organizations, however, people hesitate to speak up. Employee self-censorship is common.

In a 2007 study, workers in a leading high-technology organization were asked if they felt safe speaking up about problems in the firm. In spite of the fact that this organization had a variety of formal mechanisms such as an ombudsperson and grievance procedures, half the employees indicated that they did not feel safe speaking up.⁹⁸ Their overall concern was with self-preservation. They perceived a risk to speaking up that led them to conclude, “When in doubt, keep your mouth shut.”⁹⁹

In rare instances, employees were afraid to speak out because they had experiences with managers who responded badly to past suggestions. More often, the reticent employees were simply responding to a vague perception of a threat in the work environment. Sometimes they were put off by organizational stories about people who had spoken up and then suddenly were no longer there. Typically, their silence stemmed from untested assumptions.¹⁰⁰

The findings of this study have clear implications for encouraging free and open speech in the workplace. It isn’t enough to remove barriers or put formal mechanisms in place. Significant change in the organizational culture must occur. The following are suggestions for how to accomplish that goal:¹⁰¹

1. Managers must be clear that they do not just accept suggestions—they invite them. Not all suggestions will be implemented, but it is important for managers to acknowledge each one.
2. Managers must actively and publicly refute commonly held assumptions and organizational myths that discourage communication. For example,

they can counter the commonly held belief that employees should give managers suggestions in private by explaining that openly discussed ideas are likely to be useful.

3. Managers should tailor rewards so that employees share more directly in any cost savings or sales increase from ideas they offer. Tangible rewards can help employees to overcome intangible concerns.

In an ideal world, employees would automatically speak freely to managers if they saw something wrong happening or had an idea to improve operations. Unfortunately, this world is not ideal. Former Enron executive Lynn Brewer suggests that there may be “a little Enron in all of us.” The problem at Enron was not “dirty secrets hidden well below the surface, but an open secret.”¹⁰² She estimates that about two-thirds of the employees at Enron were aware at some time of unethical behavior in the middle ranks and believes if Enron employees had been asked if the company was ethical or not, 90 percent of the employees would have rated the company “highly unethical.”¹⁰³ In the name of solving business problems, good people will often do bad things. It is incumbent upon managers to design organizations that enable and empower employees to come forward with information that will either stop wrongdoing or improve company operations long before whistle-blowing is needed.¹⁰⁴

Summary

Employee stakeholders today are more sensitive about employee rights issues for a variety of reasons. Underlying this new concern are changes in the social contract between employers and employees. Central among the growing employee rights issues discussed in this chapter are the right not to be fired without good cause, the right to due process and fair treatment, and the right to freedom of speech.

The basis for the argument that we may be moving toward an employee’s right not to be fired is the erosion by the courts of the employment-at-will doctrine. More and more, the courts are making exceptions to this long-standing common-law principle. Three major exceptions are the public policy exception, the idea of an implied contract, and breach of good faith. Society’s concept of what represents fair treatment to employees is constantly changing.

The right to due process is concerned primarily with fair treatment. Common approaches for management responding to this concern, such as the open-door policy, have been disappointing, and so newer methods such as the ombudsman approach and peer review are becoming more prevalent. Thanks to the passage of the Sarbanes-Oxley Act, whistle-blowers in the private sector now enjoy some of the protections once accorded only to public sector employees; however, those protections have not materialized as quickly as some had hoped. Whistle-blowers still face a slew of obstacles as they seek to speak out on their concerns. Managers should be genuinely attentive to employees’ rights in this realm if they wish to avert major scandals and prolonged litigation. A stakeholder approach that emphasizes ethical relationships with employees can create an organizational environment in which employees feel free to express their concerns openly, lessening the need to blow a whistle.

Key Terms

1978 Civil Service Reform Act (page 680)
alternative dispute resolution (ADR) (page 672)
collective bargaining (page 665)
due process (page 670)
employment-at-will doctrine (page 667)
enterprise rights (page 665)
False Claims Act (page 681)
good cause norm (page 666)
good faith principle (page 669)
hearing procedure (page 672)
implied contract exception (page 667)
mandatory arbitration (page 673)

Michigan Whistle-Blowers Protection Act of 1981 (page 680)
ombudsman (page 672)
open-door policy (page 672)
outplacement (page 661)
peer review panel (page 673)
private property (page 663)
public policy exception (page 667)
rights (page 664)
social contract (page 660)
statutory rights (page 665)
whistle-blower (page 675)

Discussion Questions

- Rank the various changes that are occurring in the workplace in terms of their importance to the growth of the employee rights movement. Briefly explain your ranking.
- Explain the employment-at-will doctrine, and describe how it is being eroded. Do you think its existence is leading to a healthy or an unhealthy employment environment in the United States? Justify your reasoning.
- In your own words, explain the right to due process. What are some of the major ways management is attempting to ensure due process in the workplace?
- If you could choose only one, which form of alternative dispute resolution would be your choice as the most effective approach to employee due process? Explain.
- How do you feel about whistle-blowing now that you have read about it? Are you now more sympathetic or less sympathetic to whistle-blowers? Explain.
- What is your assessment of the value of the False Claims Act? What is your assessment of the value of the whistle-blower protections under the Sarbanes-Oxley Act?

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Employee Stakeholders: Privacy, Safety, and Health

Chapter Learning Outcomes

After studying this chapter, you should be able to:

- 1 Articulate the concerns surrounding the employee's right to privacy in the workplace.
- 2 Identify the advantages and disadvantages of polygraphs, integrity tests, and drug testing as management instruments for decision making.
- 3 Discuss the right to safety and the right to know, and summarize the role and responsibilities of OSHA.
- 4 Elaborate on the right to health in the workplace, with particular reference to violence in the workplace, smoke-free workplaces, family-friendly workplaces, and AIDS.

Employee stakeholders are concerned not only with the issues we discussed in the preceding chapter but also with several other issues. These other issues are extensions of the concept of employee rights developed in Chapter 17. In this chapter, we are concerned with the employee's rights to privacy, safety, and a healthy work environment.

The right to privacy primarily addresses the psychological dimension, whereas the rights to health and safety primarily address the physical dimension. The status of an employee's right to privacy in the workplace today is ill defined at best. Constitutional protection of privacy, such as the prohibition of unreasonable searches and seizures, applies only to the actions of government, not to those of private sector employers. From a legal standpoint, the meager amount of privacy protection that exists, as with so many employee rights, is a collection of diverse statutes that varies from issue to issue and from state to state. Hence, there is a

genuine need for management groups to impose ethical thinking and standards in this increasingly important area.

Employee rights to safety and health are issues of rising intensity, too. Today's workplace, whether in a manufacturing facility or an office complex, can expose workers to a variety of hazards, risks of accidents, and occupational diseases. If the normal hazards of work were not enough, the phenomenon of violence in the workplace should cause management to pay serious attention to this threat to workplace peace and stability. Workplace violence incidents, coupled with concerns about terrorism, have made safety in the workplace a major concern of employees today. Other workplace health issues include smoking in the workplace and the implications of AIDS. Management also has to be aware of the need for family-friendly workplaces, with particular attention given to what legal rights employees have under the Family and Medical Leave Act (FMLA).

To reiterate a point we made in the preceding chapter, the distinction between the issues discussed there and those discussed here is made for discussion purposes. With that in mind, let us continue our consideration of social and ethical issues that have become important to employee stakeholders in recent years. If managers are to be successful in dealing with employees' needs and treating them fairly as stakeholders, they must address these concerns now and in the future.

Right to Privacy in the Workplace

If you were in a private space behind partitions and knew there was no one in the outer office, would you hesitate to change into either gym clothes or more formal evening attire at the end of the day? Would you hesitate to remove some clothing behind those partitions to apply a prescription topical ointment when needed? If you believe you would be doing so in privacy, you can imagine the reaction of Gail Nelson, an administrative assistant who did exactly that, then found out her employer had secretly videotaped her for months with no justification for doing so.¹

Nelson's supervisor and co-workers knew she sometimes changed clothing in her cubicle in the office, a practice that was accepted. Her concern for privacy was such that she only did so when nobody was in the outer office, and she listened carefully for the sound of approaching footsteps. The videotaping never revealed any illegal or unauthorized activity; nevertheless, her employer continued to do it. Furthermore, numerous employees at her workplace have viewed the videotapes. The taping only came to light because a co-worker discovered it accidentally.² At this writing, the courts have upheld the legality of her employer's surveillance, saying that she did not have a reasonable expectation of privacy because other people were able to walk into the outer office.³

Technological developments have made it simpler and less expensive to conduct various types of surveillance—not only in public but also in the workplace. What was once an issue for large corporations now touches every work en-

vironment. With this growth in workplace monitoring come new ethical considerations. **Privacy in the workplace** is in flux as the implications of new technological options are considered. At this stage, the private employee has few privacy rights in (and sometimes out of) the workplace.

There are no clear legal definitions of what constitutes privacy or invasion of privacy, but everyone seems to have an opinion on when it has happened to them. Most experts say that privacy means the right to keep personal affairs to oneself and to know how information about one is being used.⁴ Patricia Werhane, a business ethicist, opts for a broader definition. She says that privacy includes (1) the right to be left alone, (2) the related right to autonomy, and (3) the claim of individuals and groups to determine for themselves when, how, and to what extent information about them is communicated to others.⁵ *Wired Magazine* asked a panel of privacy experts to rank the largest publicly held firms on their treatment of employee privacy. Figure 18-1 shows *Wired Magazine's* rankings of the five best and five worst firms.⁶

Defining privacy in this way, however, does not settle the issue. In today's world, achieving these ideals is extremely difficult and is fraught with judgment calls about our own privacy rights versus other people's rights. This problem is exacerbated by our increasingly computerized, technological world. We gain great efficiencies from computers and new technologies, but we also pay a price. Part of the price we pay is that information about us is stored in dozens of places, including federal agencies (the Internal Revenue Service and the Social Security Administration), state agencies (courts and motor vehicle departments), and many local departments and businesses (school systems, credit bureaus, banks, life insurance companies, and direct-mail companies).

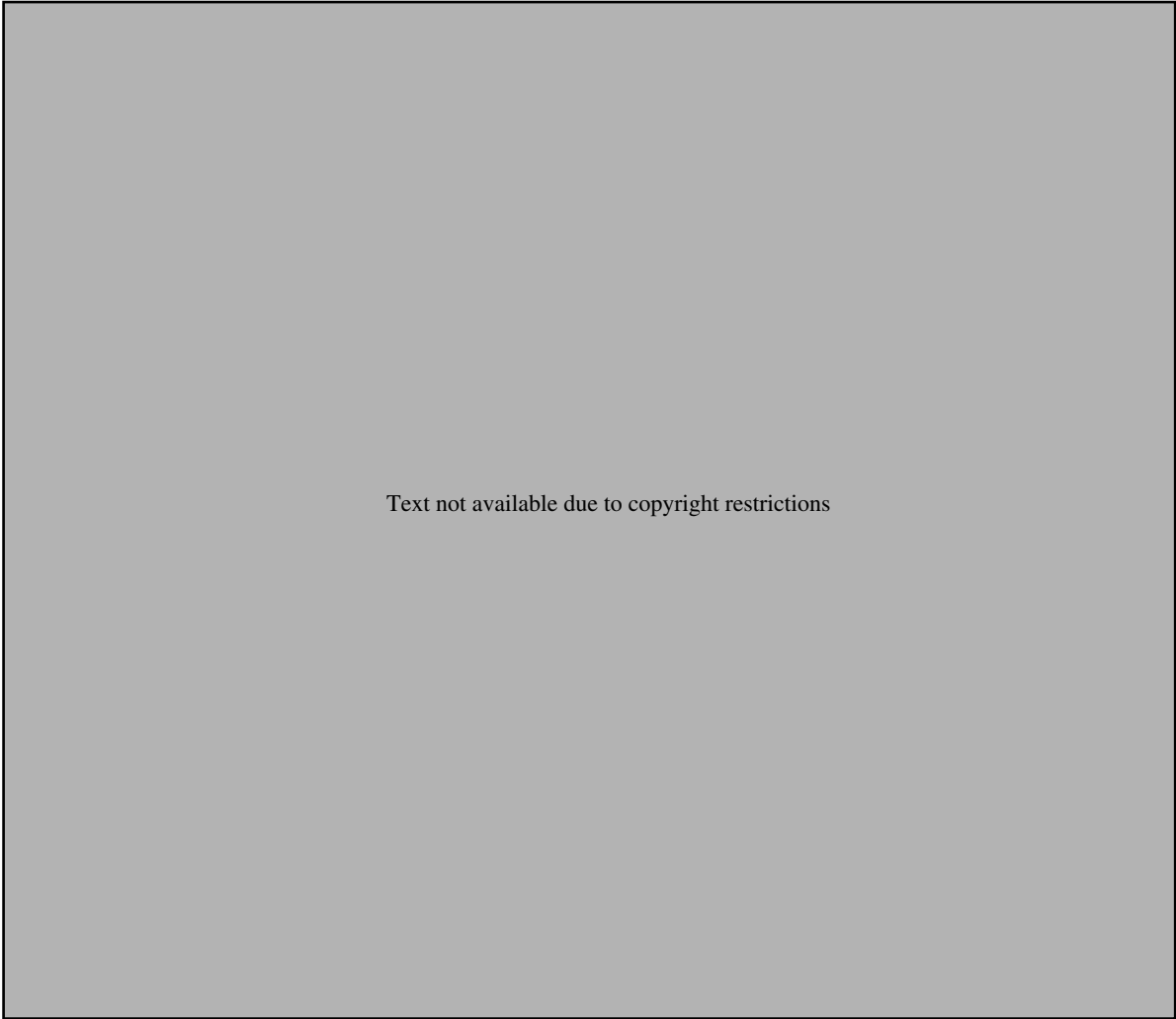
In the realm of employee privacy, which is our central concern here, the following four important issues stand out as representative of the major workplace privacy issues:

1. Collection and use of employee information in personnel files
2. Integrity testing
3. Drug testing
4. Monitoring of employee work, behavior, conversations, and location by electronic means

There are other issues that involve protection or invasion of privacy, but the four listed here account for the majority of today's concerns. Therefore, they merit separate consideration.

COLLECTION AND USE OF EMPLOYEE INFORMATION BY EMPLOYERS

The collection, use, and possible abuse of employee information is a serious public policy issue that warrants scrutiny. Today's government databases, with various agencies mixing and matching data, form a cohesive web of information on individual citizens. The **Privacy Act of 1974** set certain controls on the right of the government to collect, use, and share data about individuals. These restrictions



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were relaxed when the **USA Patriot Act** was signed into law in response to the 9/11 terrorist attacks. Although many people express concern that the Patriot Act gives the government too much latitude, restrictions still remain on how the government can collect, use, and share personal data. In contrast, very few laws protect the privacy of individuals in the workplace as monitoring of employees in the workplace grows. As many privacy advocates say, “You check your privacy rights at the door when you enter the workplace.”⁷

The necessity for guidelines regarding the collection of information became abundantly clear when the EEOC sued Burlington Northern Santa Fe Corp. for conducting secret genetic tests on workers who filed carpal tunnel syndrome

claims. The tests came to light when one of the workers, Gary Avery, went to a mandatory medical exam as a follow-up to his successful carpal tunnel surgery. His wife Janice, a registered nurse, became suspicious when he was asked to give seven vials of blood. She later was told that the blood was for tests to determine whether her husband had a genetic trait that made him susceptible to carpal tunnel syndrome.⁸ Burlington Northern ended up paying \$2.2 million to settle the charges.⁹

Background checks of both applicants and current employees are emerging as a source of concern for privacy advocates. States vary in the latitude they allow employers when checking employee backgrounds, but most give employers relatively free rein. Problems can arise when employers ask and search for information about criminal records. The Equal Employment Opportunity Commission (EEOC) has ruled that employers may not deny a person employment based on a criminal record alone: instead, it must be based on business necessity and consider both the seriousness of the offense and how long ago it occurred.¹⁰ Credit checks also can present dilemmas. Employers are free to do credit checks on applicants, as well as on current employees. If a background check is inaccurate, the employee affected can dispute its contents: however, an employer is not obligated to act upon a corrected report and reinstate a job offer.¹¹ The Fair Credit Reporting Act (FCRA) sets some requirements, but it does not restrict what employers can ask on employment applications nor does it apply when salaries are \$75,000 or more.¹²

Although there are still few guidelines for the collection of information in most professions, guidelines have been developed for the way that collected information is handled in health care. When the federal Department of Health and Human Services (HHS) first issued rules establishing privacy standards in health care, then-President Clinton described the privacy standards as making “medical records much easier to see for those who should see them and much harder to see for those who shouldn’t.”¹³ The rules stipulate that health care providers should release the minimum amount of information necessary to meet the purpose of the disclosure. Health information is not to be used for nonhealth purposes—such as disclosures to employers to make personnel decisions or to financial institutions—without explicit authorization from the patient.¹⁴ Those employers that sponsor group health plans are subject to the privacy rule’s regulations.¹⁵ Indeed, even those employers that are not covered entities under the privacy rule will likely be held to a similar standard. Another set of standards governing health care information stems from the Americans with Disabilities Act (ADA), which we discuss later in Chapter 19. The act requires employers to protect the confidentiality of applicant and employee medical information, while also making it illegal to base employment decisions on a medical condition that does not affect the employee’s ability to perform the essential functions of the job.

The overriding principle that should guide corporate decision making in regard to the collection and use of employee information is that companies should only collect that information from employees that is absolutely necessary and only use it in ways that are appropriate. Companies should be careful not to misuse this

information by employing it for purposes for which it was not intended. Employers have a duty to treat their employee's private information with care, not releasing it to others nor allowing it to become public through careless management. Employers also have a responsibility to allow employees to correct any information that is inaccurate. The requirements of the Fair Credit Reporting Act (FCRA) as it pertains to employers are detailed in Figure 18-2. The Federal

Figure 18-2 Consumer Reports for Employment

Employers in the United States may use consumer reports both to hire new employees and to evaluate current employees as long as they comply with the Fair Credit Reporting Act (FCRA). Sections 604, 606, and 615. Consumer reports are prepared by consumer reporting agencies (CRAs) and they contain private information about not only credit characteristics but also personal characteristics such as the applicant or employee's character, reputation, lifestyle. The reports may include credit payment records, driving records, criminal histories, and even interviews with neighbors, friends or any associates. The FCRA only covers those reports done by agencies. For example, if the employer checks references directly, the FCRA does not apply; however, verification by an employment or reference checking agency is covered. The following are the key provisions as written by the Federal Trade Commission (FTC) to employers.

Key Provisions of the FCRA Amendments

Written Notice and Authorization. Before you can get a consumer report for employment purposes, you must notify the individual in writing — in a document consisting solely of this notice — that a report may be used. You also must get the person's written authorization before you ask a CRA for the report. (Special procedures apply to the trucking industry.)

Adverse Action Procedures. If you rely on a consumer report for an "adverse action"—denying a job application, reassigning or terminating an employee, or denying a promotion — be aware that:

Step 1: Before you take the adverse action, you must give the individual a pre-adverse action disclosure that includes a copy of the individual's consumer report and a copy of "A Summary of Your Rights Under the Fair Credit Reporting Act"— a document prescribed by the Federal Trade Commission. The CRA that furnishes the individual's report will give you the summary of consumer rights.

Step 2: After you've taken an adverse action, you must give the individual notice—orally, in writing, or electronically—that the action has been taken in an adverse action notice. It must include:

- The name, address, and phone number of the CRA that supplied the report;

- A statement that the CRA that supplied the report did not make the decision to take the adverse action and cannot give specific reasons for it; and

- A notice of the individual's right to dispute the accuracy or completeness of any information the agency furnished, and his or her right to an additional free consumer report from the agency upon request within 60 days.

Certifications to Consumer Reporting Agencies. Before giving you an individual's consumer report, the CRA will require you to certify that you are in compliance with the FCRA and that you will not misuse any information in the report in violation of federal or state equal employment opportunity laws or regulations.

Source: <http://www.ftc.gov/bcp/contline/pubs/buspubs/credempl.shtm> (July 2007).

Trade Commission (FTC) is responsible for monitoring employer use of consumer reports in the United States.

INTEGRITY TESTS

Early efforts to judge a person's integrity focused on uncovering a lack of integrity, such as might be evidenced when a person tells lies. The notion of a "lie detector," historians tell us, is nothing new. The Bedouins of Arabia knew that certain physiological changes, triggered by guilt and fear, occurred when a person lied. The outstanding change they observed was that a liar would stop salivating. They developed a simple test in which a heated blade was passed across the tongue of a suspected liar. If innocent, the suspect would be salivating normally and the tongue would not be burned; if the person was lying, the tongue would be scorched. The ancient Chinese used dry rice powder. Someone suspected of lying was forced to keep a handful of rice powder in the mouth. If the powder was soggy when it was spat out, the truth was being told; if it was dry, the person was lying.¹⁶

In the invasion-of-privacy arena, few topics have generated as much controversy as the use of the **polygraph**, or lie detector, in business. The polygraph machine was developed by John Larson in 1929, although others trace it to an earlier date. It measures changes in blood pressure, respiration, and

Ethics in Practice Case

ARE YOU A GOOD LIAR?

My last two years of high school were spent working part-time at a country club as a cart boy. One day I was told that \$10,000 had been stolen from the golf shop the previous day and that all the employees would have to take a polygraph (lie detector) test that day. Being one of the few employees with keys to the shop and knowledge of the alarm code, I felt I would be a natural target for scrutiny. I wondered about the accuracy of those tests.

I decided to prove my innocence by telling the truth. During the test, after answering a few simple questions, I expected to be asked one question about the missing money. Instead, I was asked if I had ever stolen anything in my life, if I had ever done drugs on the job, and if I had stolen anything

from the country club. I admitted that I had taken soft drinks from the beverage cart and discarded golf balls off the used cart—actions that many people do not consider stealing.

As a result, I was called into the Head Pro's office and rebuked for taking club property—I nearly lost my job. Should I have tried to cheat the lie detector test? It turns out the thief was never caught.

1. What are the ethical issues in this situation?
2. Did the club have the right to pose questions that were unrelated to the issue at hand?
3. What would you have done if you had been in this position? Why?

Contributed by Shaun M. Bank

perspiration, sometimes called *galvanic skin response*. The theory behind polygraphy is that the act of lying causes stress, which in turn is manifested by observable physiological changes. The examiner, or machine operator, then interprets the subject's physiological responses to specific questions and makes inferences about whether or not the subject's answers indicate deception.¹⁷ The **Employee Polygraph Protection Act (EPPA)** of 1988 banned most private sector uses of the lie detector, but it can still be used by private employers that provide security services, protection of nuclear facilities, shipment or storage of radioactive or toxic waste, public water supply facilities, public transportation, precious commodities, or proprietary information. Also, employers that manufacture, distribute, or dispense controlled substances may use polygraph tests for some of their positions. Government employers are also exempt from the prohibitions on polygraph testing. The federal government may also use polygraph tests for private consultants or experts under contract to various government departments, agencies, or bureaus.¹⁸ When the U.S. Congress passed a law mandating that polygraphs be used on up to twenty thousand Department of Energy workers, angry workers wrote letters of protest and wore buttons that said "Just say no to polygraphs."¹⁹ One year later, the FBI announced that it would require 500 employees with access to confidential data to take the controversial test.²⁰ It is important to note, as Aldrich Ames wrote from the prison cell, that Ames passed the polygraph test with flying colors while selling U.S. secrets to Russia.²¹

The issue of lie detection is unlikely to go away as new technologies are created. Research is progressing on the use of magnetic resonance imaging brain scans (MRIs) to separate truth from fiction.²² Other scientists are exploring the use of voice pattern technology to develop a machine to do what a polygraph once did.²³ Still others are putting their efforts into lie detector glasses that can assess truthfulness, as well as anxiety and love.²⁴ As these new technologies for lie detection develop, new protections for employees will be needed to address them.

As criticism grew concerning the use of lie detectors, many companies anticipated an eventual elimination of lie detector use and began experimenting with **integrity tests** (also known as *honesty tests*). David Nye dubbed this type of test the "son of the polygraph."²⁵ There is a certain irony in this title, because integrity tests are subjected to the same kinds of criticisms that led to severe restriction of lie detector testing.

The format of an integrity test can be paper and pencil, computer survey, in-store kiosk, telephone interactive voice response, or an interactive webpage.²⁶ An integrity test typically poses 80 to 90 statements with which the employee or applicant is asked to agree or disagree. Some test questions are framed as yes-or-no and multiple-choice options. Examples include, "Would you tell your boss if you knew of another employee stealing from the company?" and "What percent of employee thieves are never caught?" and "What is the dollar value of cash or merchandise you have stolen from past employers?"²⁷ The tests can be customized to the needs of the company. Whereas one company might want to test for honesty and nonviolence, another might want to test for drug avoidance and turnover.²⁸

Ethics in Practice Case

GIVE ME WHAT I WANT OR I'LL TELL THE PRESIDENT!

Place yourself in the role of a personnel director for a bank. It is company policy that neither personnel files nor copies of files are to leave the personnel office. The director of accounting and computer services is due to give his employees their yearly employee evaluations and has sent a memo to your secretary requesting copies of his employees' evaluations from the previous year. Your secretary shows you the memo. You are upset that the director would send such a memo to your secretary, because he should be aware of the policy concerning employee files.

So, you decide to call the director and tell him that he is welcome to read the evaluations of his employees from the previous year in the personnel office. He tells you that he does not have the time to come to personnel and read the files and that he will speak to the president of the bank about this issue.

The working relationship between you and the director has been addressed by the president before, and she has told the two of you that you need to be able to work out problems such as this between yourselves.

The dilemma is whether you should go against company policy in an effort to avoid another lecture from the president, and let the director take the copies of the evaluations to his office, or adhere to the bank's policy on protection of employee privacy.

1. What are the main ethical dilemmas in this situation?
2. Should you report the director's threat to step over you to the president?
3. What would you do in this situation?

Contributed by Leah Herrin

Faced with the elimination of the polygraph, companies wanted to find a substitute, and integrity tests seemed to be a convenient alternative. Critics of integrity tests claim they are intrusive and invade privacy by the nature of their inquiries. Critics also say that they are unreliable and that employers use them as the sole measure of the fitness of an applicant. Even when these tests are properly administered, opponents charge that employers end up rejecting many honest applicants in their efforts to screen out the dishonest ones. Management and testing companies claim the tests are very useful in weeding out potentially dishonest applicants. They claim that each question asked has a specific purpose. They also argue that hiring by "gut feeling" is problematic, and integrity tests provide a more objective assessment.²⁹ There is evidence that integrity tests can have an impact. A major U.S. retailer used integrity tests in 600 of their 1,900 locations to reduce turnover and shrinkage. After one year, they saw inventory shrinkage fall by more than 35 percent in the stores that used the test while it rose by 10 percent in the stores that did not. Even though turnover was not a goal of the test administration, they noted a 13 percent decrease in turnover at stores that did use the test and a 14 percent increase in turnover at stores that did not.³⁰

Integrity tests are subject to the same kinds of legal and ethical hurdles that affect polygraph and drug tests. The Civil Rights Act (discussed in Chapter 19) makes it unlawful for any test to have a particularly negative impact on a protected subgroup. One integrity test, the Reid Report, has had 23 legal challenges. Administrators at Reid London House report that the EEOC or relevant state human rights agency found for each case that there was no probable cause to believe the test had disparate impact.³¹ From the Americans with Disabilities Act (ADA) perspective, medical examinations can only be given to after a conditional offer of employment has been made. The EEOC has ruled that integrity tests are not medical examinations and so they can be given to applicants: psychological examinations are only considered medical if they provide evidence of a mental disorder.³² Most states apply the federal laws to selection tools. However, Massachusetts and Rhode Island have extended the polygraph statutes to integrity tests. In Massachusetts, integrity tests are against the law, while in Rhode Island they cannot be used as the primary basis for an employment decision.³³

Although legal issues will be resolved on a case-by-case basis, the ethical issues surrounding integrity tests are likely to remain. A test that will identify many of those who would behave unethically at a cost to the firm will also yield “false positives,” people labeled as unethical who would have been good employees. In statistics, this is called a **type 1 error**, finding an innocent person to be guilty. In contrast, a **type 2 error** finds a guilty person to be innocent. The nature of testing is such that a decrease in one type of error leads to an increase in the other. In other words, the more strictly a test is used to rule out any person who would be guilty of unethical behavior, the more innocent people will be judged unethical. It is important, therefore, that integrity tests be used judiciously and that they not be the primary criterion on which employment is based.

DRUG TESTING

Drug testing is an umbrella term intended to embrace drug and alcohol testing and employer testing for any suspected substance abuse. The issue of drug testing in the workplace has many of the same characteristics as the lie detector and integrity test issues. Companies say they need to do such testing to protect themselves and the public, but opponents claim that drug tests are not accurate and invade the employee’s privacy. Concerns about drug testing center around the implications for employee privacy, the inaccuracy of tests, and the impact of drug testing on employee morale.

Quest Diagnostics, a major provider of employment-related drug-testing services, releases an annual index that shows a continued decline in drug positivity. The most recent test, in 2006, shows an all-time low of 3.8 percent, down from 4.1 percent in the prior year. This represents less than one-third of the 13.6 percent level of positivity recorded in 1988, the first year of measurement.³⁴ According to Barry Sample, Ph.D., Director of Science and Technology for Quest Diagnostics’ Employer Solutions division, “We believe this continued decline in workforce drug positivity may be driven by two factors: increased employer vigilance about the impact of workplace drug abuse on liability and the cost of decreased

productivity, and the possibility that those who abuse drugs may tend to avoid employment at companies that actively conduct drug testing.”³⁵

Arguments for Drug Testing

Proponents of drug testing argue that the costs of drug abuse on the job are staggering. The consequences range from accidents and injuries to theft, bad decisions, and ruined lives. The greatest concern is in industries where mistakes can cost lives—for example, the railroad, airline, aerospace, nuclear power, and hazardous equipment and chemicals industries. Thus, the primary ethical argument for employers conducting drug tests is the responsibility they have to their own employees and to the general public to provide safe workplaces, secure asset protection, and safe places in which to transact business.

Arguments Against Drug Testing

Opponents of drug testing see it as both a due-process issue and an invasion-of-privacy issue. The due-process issue relates to the sometimes questionable accuracy of drug tests. Common foods and medications can lead to a false positive, giving the appearance of drug use when the person being tested is completely innocent. This can create a downward spiral for that employee, causing reputational damage, lost income, and considerable expense to try to rebut the allegation of drug use.³⁶

Many legitimate questions arise in the drug-testing issue. Do employers have a right to know if their employees use drugs? Are employees performing on the job satisfactorily? Obviously, some delicate balance is needed, because employers and employees alike have legitimate interests that must be protected. If companies are going to engage in some form of drug testing, they should think carefully about developing policies that not only will achieve their intended goals but also will be fair to the employees and minimize invasions of privacy. Such a balance will not be easy to achieve but must be sought. To do otherwise will guarantee decreased employee morale, more and more lawsuits, and new government regulations.

Guidelines for Drug Testing

If management perceives the need to conduct a drug-testing program to protect other stakeholders, it should carefully design and structure the program so that it will be minimally intrusive of employees’ privacy rights. The following guidelines, reflecting the ethical aspects of drug testing, have been developed by the American College of Occupational and Environmental Medicine (ACOEM)³⁷:

1. A written company policy and procedure concerning substance abuse and screening should exist and be applied impartially.
2. The reason for any requirement for the drug-testing program should be clearly documented. Such reasons might involve safety for the individual, other employees, or the public; security needs; or requirements related to job performance.

3. Affected employees and applicants should be informed in advance about the company's policy concerning drug use, misuse, and screening. They should be made aware of their right to refuse such screening and the consequences of such refusal to their employment.
4. Where special safety or security needs justify testing for the presence of drugs on an unannounced and random basis, employees should be made aware of all aspects of the drug-testing program.
5. Care should be taken to ensure that such tests are done in a uniform and impartial manner for all employees in the affected group(s).
6. Collection, transportation, and analysis of the specimens and the reporting of the results should meet stringent legal, technical, and ethical requirements. The process should be under the supervision of a licensed physician (MD/DO).
7. A licensed physician (MD/DO) with appropriate qualifications should be designated as the medical review officer (MRO) and should evaluate positive results prior to a report being made to the employer. This may require the obtaining of supplemental information from the employee or applicant in order to ensure that a positive test does not represent appropriate use of prescription drugs, over-the-counter medication, or other substances that could cause a positive test. MRO training should include the pharmacology of substance abuse, laboratory testing methodology and quality control, forensic toxicology, pertinent federal regulations, legal and ethical requirements, chemical dependency illness, employee assistance programs and rehabilitation.
8. The affected employee or applicant should be advised of positive results by the physician and have the opportunity for explanation and discussion prior to the reporting of results to the employer, if feasible. The mechanism for accomplishing this should be clearly defined.
9. Any report to the employer should provide only the information needed for work placement purposes or as required by government regulations. Identification to the employer of the particular drug(s) found and quantitative levels should not be done unless required by law. Reports to the employer should be made by a physician sensitive to the various considerations involved.

Guidelines shift over time, so exceptions to these might be taken and/or new guidelines may develop. The major point is that management needs to think through its policies and their consequences very carefully when designing and conducting drug-testing programs.

State and Federal Legislation

Some states and cities have enacted or are considering laws to restrict workplace drug testing. Generally, these laws restrict the scope of testing by private and public employers and establish privacy protections and procedural safeguards. Some

states do not completely ban drug testing but restrict the circumstances (for reasonable cause, for example) under which it may be used. They may also restrict drug testing to reasonable suspicion and place limits on the disciplinary actions employers may take. Other states provide discounts on workers' compensation and/or incentives of another kind to organizations that implement drug testing. This patchwork of incongruous state laws complicates drug testing for employers.³⁸

At the federal level, the **Americans with Disabilities Act (ADA)** must be considered, because the definition of disability applies to drug and alcohol addiction. The ADA prohibits companies from giving applicants medical exams before they extend those applicants conditional offers of employment. Prehire drug tests, however, are permitted. Philadelphia employment lawyer Jonathan Segal advises employers to extend conditional offers before drug testing, because an innocent question on a drug test could easily become a medical question. He recommends conducting the drug test immediately after making the conditional offer and then waiting until the test results are back before beginning employment. An employer who wishes to fire or refuse to hire someone with an alcohol or a drug addiction must show that the employee poses a direct threat to others. Furthermore, if a person loses a job opportunity because of an inaccurate failed drug test, the company has committed an ADA offense by basing an action on the perception of a disability.³⁹

Several federal agencies have specific regulations for drug testing in organizations. The Department of Transportation's (DOT) drug and alcohol requirements are perhaps the most widely known, but other agencies—such as the Department of Defense (DOD), Department of Energy (DOE), Nuclear Regulatory Commission (NRC), and the National Aeronautics and Space Administration (NASA)—also have employee drug-testing requirements.⁴⁰

Employee Assistance Programs

One of the most significant strategies undertaken by corporate America to deal with the growing alcohol- and drug-abuse problem in the workplace has been **Employee Assistance Programs (EAPs)**. EAPs extend into a variety of employee problem areas such as compulsive gambling, financial stress, emotional stress, marital difficulties, aging, legal problems, AIDS, and other psychological, emotional, and social difficulties. The term **broad brush EAP** describes this comprehensive model.⁴¹ A recent major concern of EAPs has been the impact of troop deployments in the Middle East on employees. This affects not only those deployed but also their family and friends. EAPs have focused on providing resources to assist them in dealing with the stress.⁴²

EAPs represent a positive and proactive step companies can take to deal with these serious problems. EAPs are designed to be confidential and nonpunitive, and they affirm three important propositions: (1) employees are valuable members of the organization, (2) it is better to help troubled employees than to discipline or discharge them, and (3) recovered employees are better employees. It is encouraging that in an era when employees are increasingly exerting their workplace rights, enlightened companies are offering EAPs in an effort to help

solve their mutual problems. More information on EAPs can be found at <http://www.eap-association.org>, the Employee Assistance Program Association website.⁴³

MONITORING EMPLOYEES ON THE JOB

In the old days, supervisors monitored employees' work activities by peeking over their shoulders and judging how things were going. Technology changed all that as cameras and listening devices gave way to computers and satellites as options for employee monitoring. Privacy advocates are concerned about the use of technology to gather information about workers on the job and with good reason. In its most recent survey, the American Management Association (AMA) found that the vast majority of mid- to large-sized firms participate in some type of **employee monitoring**. In some cases, the method is passive, such as video cameras in a lobby. However, most use more active means of monitoring their workers, such as recording their phone calls or voice mail, reading their computer files, or videotaping them. Employer monitoring of employees has become the norm in businesses today. The consequence is that millions of workers are laboring under the relentless gaze of electronic supervision.

What Can Be Monitored?

According to the most recent AMA survey, 76 percent of companies monitor their employees' Internet connections; 55 percent store and then review their employees' e-mail. Over one-third of firms use keyword searches to review their employees' e-mail. Of the firms surveyed, 51 percent monitor telephone numbers called and time spent on the phone, and 51 percent use video surveillance.⁴⁴ Monitoring telephone conversations is a significant arena for electronic eavesdropping, with workers in telecommunications, mail-order houses, airline reservations, and brokerage firms being hit especially hard. Not only do supervisors frequently listen in on their conversations, but computers also gather and analyze data about their work habits.

As was discussed in Chapter 9, the introduction of new technologies creates new opportunities for surveillance by employers. For example, the advent of global positioning system (GPS) technology has made it possible for worker location to be monitored. In December 2003, snowplow operators in Massachusetts marched outside the state capitol to protest a new requirement that they carry cell phones with GPS receivers. As independent contractors, they feared the highway department would use the technology to squeeze their payments unfairly.⁴⁵ Of course, the advent of technology works both ways. Camera phones present the possibility of becoming a tool that employees can use to monitor their employers. Some companies have moved to ban them from the workplace due to fear of corporate espionage.⁴⁶

Along with many third world countries, the United States offers few protections for the privacy of employees in the workplace. The only federal level of privacy protection in the United States is the **Electronic Communication**

Privacy Act (ECPA) of 1986. The interception or unauthorized access of a wire, oral, or electronic communication is illegal under this act unless it is covered by one of the statutory exceptions or required by government compulsion. One of the statutory exceptions is the business use exception: The act does not apply if the interception or access occurs as part of the “ordinary course of business.” The act also does not apply if the person gives consent. An employee working at a place that has disclosed that it will do monitoring is considered to have given implicit consent. With these broad exceptions, it is not surprising that the ECPA has been ineffective in regulating the monitoring of employees in the workplace.⁴⁷ The one clear protection is that employers may not listen to phone conversations that are purely personal; however, they can monitor a conversation for the time required to determine that the call is personal.⁴⁸ States have tried to enact laws to strengthen workplace privacy but with limited success, resulting in a state law patchwork.⁴⁹

Efforts to enact a U.S. law specifically geared toward workplace privacy have always been stymied. Fifteen years ago, Senator Paul Simon (D-IL) introduced the Privacy for Consumers and Workers Act. The measure would have established use limitations as well as a standard for notice and access to information. However, the bill never left its committee.⁵⁰ Representative Charles Canady (R-FL) and Senator Charles Schumer (D-NY) introduced the Notice of Electronic Monitoring Act (NEMA) in 2000. Efforts were under way to reach a bipartisan bill, but they came to a halt when the September 11 terrorist attacks occurred.⁵¹

Effects of Being Monitored

Invasion of privacy is one major consequence of employee monitoring. Another is unfair treatment. Employees working under such systems complain about stress and tension resulting from their being expected and pressured to be more productive now that their efforts can be measured. The pressure of being constantly monitored is also producing low morale and a sense of job insecurity in

<http://SEARCHTHEWEB.WEB>

GUARDING PERSONAL PRIVACY

Privacy.Org is the site where you can find daily news, information, and initiatives on privacy. This webpage is a joint project of the Electronic Privacy Information Center (EPIC) and Privacy International. Based in Washington, D.C., EPIC is a public interest research center that focuses public attention on emerging civil liberties issues and works to protect privacy.

Based in London, and with an office in Washington, D.C., Privacy International serves as a watchdog on surveillance by governments and corporations. The website (<http://www.privacy.org>) offers a range of news, tools, resources, and links to other privacy-related websites throughout the world.

many places. Employees have good reason to be concerned. The 2005 American Management Association (AMA) survey found that not only do the vast majority of major U.S. companies engage in employee monitoring, but they are also now using their findings to make employment decisions: 26 percent have fired employees for misusing the Internet, 25 percent have terminated employees for misusing e-mail, and 6 percent have fired employees for misusing phones.⁵²

POLICY GUIDELINES ON THE ISSUE OF PRIVACY

As we have discussed various privacy issues, we have indicated steps that management might consider taking in an attempt to be responsive to employee stakeholders. Frederick S. Lane III, a law and technology expert and author of *The Naked Employee: How Technology Is Compromising Workplace Privacy*, offers an “Employee Privacy Bill of Rights” that sets forth guidelines for developing privacy policies and procedures that uphold the dignity of the employee.⁵³ To preserve employee rights, firms should:

1. Obtain informed consent from employees and applicants before acquiring information about them.
2. Disclose the nature of any surveillance that will occur.
3. Set controls so as to avoid casual and unauthorized spread of information.
4. Limit the collection and use of medical and health data to that which is relevant to the job.
5. Require reasonable suspicion before doing drug tests.
6. Respect and preserve the boundary between work and home.

Business’s concern for protection of the privacy of its employees, customers, and other stakeholders is a growing business. It is not surprising, therefore, that a new form of corporate executive has come on the horizon. As we discussed in Chapter 9, **chief privacy officers (CPOs)** are high-ranking executives responsible for monitoring and protecting the private information held by firms. They differ from security personnel in that they determine what data should be protected while the security department determines how it will be protected. The CPO is responsible for ensuring that the privacy of individuals is respected.⁵⁴

Workplace Safety

Workplace safety has taken on new importance for today’s worker. According to a recent SHRM/CNNfn survey, 62 percent of employees find feeling safe at work to be “very important.” That figure is nearly double the 36 percent who found it to be very important just a few years before.⁵⁵ “Terrorist warnings in the U.S. and the wars in the Middle East have put employees’ concerns for safety at the forefront,” said Susan R. Meisinger, CEO of SHRM. “It’s a priority for all employers to do all they can to create and maintain a safe workplace.”⁵⁶

We will begin by examining the workplace safety problem and the right-to-know laws that have evolved from it. We'll then study OSHA's rocky history and its current situation. We'll look last at the issue of workplace violence, which is a serious concern in today's workplace. We'll then turn to issues of health, specifically AIDS and smoking in the workplace, and then end with a discussion of the family-friendly workplace.

THE WORKPLACE SAFETY PROBLEM

Two events stand out as forerunners of the workplace safety problem. The first event ranks among the landmark cases on job safety. In Elk Grove Village, Illinois, Film Recovery Systems operated out of a single plant that extracted silver from used hospital X-ray and photographic film. To extract the silver, the employees first had to dump the film into open vats of sodium cyanide and then transfer the leached remnants to another tank. Employee Stefan Golab staggered outside and collapsed, unconscious. Efforts to revive him failed, and he was soon pronounced dead from what the local medical examiner labeled "acute cyanide toxicity."⁵⁹

An intensive investigation by attorneys in Cook County, Illinois, revealed a long list of incriminating details: (1) Film Recovery workers seldom wore even the most rudimentary safety equipment, (2) workers were laboring in what amounted to an industrial gas chamber, and (3) company executives played down the dangers of cyanide poisoning and removed labeling that identified it as poisonous. The prosecutors took action under an Illinois homicide statute that targets anyone who knowingly commits acts that "create a strong probability of death or serious bodily harm." Three executives at Film Recovery Systems—the president, the plant manager, and the foreman—were convicted of the murder of Stefan Golab and sentenced to 25 years in prison. Their convictions marked the first time that managers had been convicted of homicide in a corporate matter

<http://SEARCHTHEWEB.WEB>

EXPLORING OSHA

The Occupational Safety and Health Administration (OSHA) has a website that serves as a clearinghouse for information about employee safety and health on the job (<http://www.osha.gov>). On this site are OSHA manuals, continually updated statistics and inspection data, hazard information bulletins, and OSHA directives.

The main law that protects the safety and health of workers is the Occupational Safety and Health Act.

This act requires the Secretary of Labor to set safety and health standards that protect employees and their families. Every private employer who engages in interstate commerce is subject to the regulations promulgated under this act.⁵⁷ The federal agency that is responsible for overseeing the safety and health of America's workers is the **Occupational Safety and Health Administration (OSHA)**. Figure 18-3 shows OSHA's mission.⁵⁸

Figure 18-3 OSHA's Mission

OSHA's mission is to assure the safety and health of America's workers by setting and enforcing standards; providing training, outreach, and education; establishing partnerships; and encouraging continual improvement in workplace safety and health.

Our Services

OSHA and its state partners have approximately 2100 inspectors, plus complaint discrimination investigators, engineers, physicians, educators, standards writers, and other technical and support personnel spread over more than 200 offices throughout the country. This staff establishes protective standards, enforces those standards, and reaches out to employers and employees through technical assistance and consultation programs.

The Public We Serve

Nearly every working man and woman in the nation comes under OSHA's jurisdiction (with some exceptions such as miners, transportation workers, many public employees, and the self-employed). Other users and recipients of OSHA services include: occupational safety and health professionals, the academic community, lawyers, journalists, and personnel of other government entities.

Service Improvement Plan

OSHA is determined to use its limited resources effectively to stimulate management commitment and employee participation in comprehensive workplace safety and health programs.

Surveying Our Public

At OSHA, we are dedicated to improving the quality of our efforts and know that to be successful we must become an agency that is driven by commitment to public service. The first step is for OSHA to listen and respond to its customers. Accordingly, we conducted a survey to learn more about what employers and employees think of OSHA's services.

Because workplace inspections are one of OSHA's principal activities and because voluntary efforts to improve working conditions ultimately depend on strong enforcement, our survey focused primarily on the inspection process. We asked a random sample of employees and employers who had recently experienced an OSHA inspection what they thought of the inspection in particular, and of OSHA's standards and educational and other assistance activities in general.

Service Standards

We based OSHA's new standards for public service on what we learned from the survey, from meetings with employee and employer groups, and from focus group discussions with workers from many plants and industries across the country.

Our public service improvement program will be an ongoing one. We will continue to gather information on the quality of our performance in delivering services in areas not included in this year's survey, particularly in the construction sector. Next year, too, we plan to learn more about public response to our assistance and consultation programs.

Source: <http://www.osha.gov> (2007).

such as an industrial accident.⁶⁰ The Film Recovery Systems case marked a new era in managerial responsibility for job safety. A variety of other prosecutions of managers have followed the Film Recovery Systems case. What this clearly signals is not only that employees have a moral right to a safe working environment but

also that managers face prosecution if they do not ensure that employees are protected.

The second event, which we also discussed in Chapter 10, was the dramatic and catastrophic poisonous gas leak at the Union Carbide plant in Bhopal, India. The death toll topped two thousand, and tens of thousands more were injured. People around the globe were startled and shocked at what the results of one major industrial accident could be. Lawsuits sought damages that quickly exceeded the net worth of the company.⁶¹ Seven years after the leak, India's Supreme Court upheld a \$470 million settlement that Union Carbide had already paid, and it lifted the immunity from criminal prosecution that it had granted the company two years after the leak occurred. The name "Union Carbide" became inextricably linked with the Bhopal Disaster. In 2001, Union Carbide became a wholly owned subsidiary of Dow Chemical.

Of course, not all hazards can be anticipated. The 2001 terrorist attacks were a shock and surprise to the world. Shortly after the tragedy occurred, many were wondering what the impact would be on Morgan Stanley, one of the world's biggest brokerage and investment firms. The company was the largest tenant in the World Trade Center, with about 3,700 employees in two of the towers. Amazingly, fewer than 10 of their employees were among the missing, and only about 50 reported being injured. Company officials credit the evacuation procedures that Morgan Stanley developed after the 1993 bombing of the World Trade Center with saving so many of their employees' lives. The security staff used megaphones to keep people moving despite announcements over the building's public address system that instructed people to return to work. They moved their employees down the smoke-filled stairs (some more than 70 flights) and away from the twin towers. The earlier 1993 incident had alerted them to their vulnerability, and they took the steps necessary to protect the health and safety of as many of their employees as possible.⁶² In a world where the unexpected is to be expected, this is the type of preparedness all workplaces should emulate.

RIGHT-TO-KNOW LAWS

Prompted by the Union Carbide tragedy in Bhopal and other, less dramatic industrial accidents, workers have demanded to know more about the thousands of chemicals and hazardous substances they are being exposed to daily in the workplace. Experts argue that employers have a duty to provide employees with information on the hazards of workplace chemicals and to make sure that workers understand what the information means in practical terms. Since the early 1980s, many states have passed **right-to-know laws** and expanded public access to this kind of information by employees and even communities.⁶³ Although the states took the initiative on the right-to-know front, OSHA followed suit by creating a Hazard Communication Standard. This standard requires covered employers to identify hazardous chemicals in their workplaces and to provide employees with specified forms of information on such substances and their hazards. Specifically, manufacturers, whether they are

chemical manufacturers or users of chemicals, must take certain steps to achieve compliance with the standard.⁶⁴ These steps include the following:

1. Update inventories of hazardous chemicals present in the workplace.
2. Assemble material safety data sheets (MSDSs) for all hazardous chemicals.
3. Ensure that all containers and hazardous chemicals are properly labeled.
4. Provide workers with training on the use of hazardous chemicals.
5. Prepare and maintain a written description of the company's hazard communication program.
6. Consider any problems with trade secrets that may be raised by the standard's disclosure requirements.
7. Review state requirements for hazard disclosure.

In addition to the right-to-know laws, employees have certain workplace rights with respect to safety and health on the job that OSHA provides by law. As in our

Ethics in Practice Case

HOW ETHICAL VALUES VARY

During my Christmas break, I was employed at ABC Company, a caulk manufactory located in a small town. Jim Wilson, who had little or no education, was employed in the shipping department at ABC. He was also trained as a blender in case someone in the Blending Department quit, went on vacation, or was fired. Luis Alberto, who was about 58 years old, was also employed at ABC Company, as a packer. Basically, a packer operates a machine that fills the cartridges with caulk, seals the tubes, and finally places either 12 or 24 10-ounce cartridges in a box. Luis's education did not range beyond an eighth-grade level. Luis's daughter-in-law was also employed at ABC, as a chemist in the lab. She spoke up when Luis's employment situation was on the line. She even told management when it was time to consider giving Luis an increase in his earnings.

Prior to the Christmas holiday break, the hired blender quit. Knowing how hard the position was to fill, Jim was told it was a permanent position. Jim was told by his supervisor, "Jim, you can't get another job anywhere in town because you don't

have a high school diploma and you can't read, so you are up the creek if you don't take this position." Nothing was mentioned to Luis about the position. Luis's daughter-in-law made sure that the supervisor kept the opening notice out of Luis's sight. Knowing the dangers of that particular job, she thought it was in his best interest not to be made aware of it. It seems as if Jim Wilson had to do all the dirty work in the plant without being able to say anything.

1. How is ethics involved in this situation at the ABC Company?
2. If ethics is involved, what procedures should be implemented?
3. What are Jim's alternatives? What should he do? Why?
4. If you observed this situation with respect to employees as stakeholders, what would you do? Why?

Contributed by Mystro Whatley

discussion of the public policy exceptions to the employment-at-will doctrine in the preceding chapter, it should be clear that workers have a right to seek safety and health on the job without fear of punishment or recrimination.

THE HISTORY OF OSHA

OSHA was formed nearly 40 years ago. From the very beginning, OSHA was troubled by the sheer size of its task—to monitor workplace safety and health in millions of workplaces with only several thousand inspectors.⁶⁵

Nitpicking Rules

In its early years, OSHA added to its troubles by promulgating rules and standards that seemed quite trivial when compared with the larger issues of health and safety. In one example, a telephone company was instructed that it could only provide linemen with “belts that have pocket tabs that extend at least 1-1/2 inches down and 3 inches back of the inside of the circle of each D-ring for riveting on plier or tool pockets. . . . There may be no more than four tool loops on any belt.”⁶⁶ Such nuisance rules and standards created serious credibility problems for OSHA. Although nearly a thousand such rules were rescinded in OSHA’s first decade, many times that number remained on the books.

Spotty Record

Over the years, OSHA’s record has been spotty. In the mid-1980s, injuries, illnesses, and deaths in the workplace began to climb again after several years of decline.⁶⁷ There were numerous reasons for this reversal, and not all of them could be attributed to OSHA. During the recession of the early 1980s, companies sharply reduced their spending on health and safety. With the economic recovery, many employers hired inexperienced workers, which further contributed to rising accident statistics. Further, the Reagan administration deemphasized the writing and enforcement of safety rules, and employers put greater emphasis on competitiveness, often at the expense of safety and health.⁶⁸

A Rejuvenated OSHA

Like so many of the federal agencies we have discussed (FTC, FDA, CPSC), OSHA experienced a new boost of energy and enthusiasm in the post-Reagan period of the late 1980s and early 1990s. The renewed energy came at an appropriate time, because injury rates had been increasing (though part of this reported increase might have resulted from more accurate reporting).

With a new administrator and an increased budget, OSHA began taking significant actions against high-visibility employers. However, OSHA continued to suffer from a budget and staff that were inadequate for the job that Congress and the public expected it to do. One observer pointed out that the EPA’s budget was more than 21 times that of OSHA. In some states, too, there were conflicts between OSHA and state inspectors as to who had responsibility for workplace safety. In 1991, a major accident in North Carolina illustrated this point. A fire in

Ethics in Practice Case

OSHA'S SURPRISE VISIT

During the summers, Mark Price worked at a local manufacturing plant in Reddog, Georgia. One hot and busy July day, Willie Truit and Mark received a call from the plant manager's secretary authorizing them to dispose of a batch of monomers, which are a type of hazardous waste. The order was to remove them from the inspector's sight. Willie and Mark bagged them up and threw them in the Dumpster, but Mark kept asking why they were doing this. Improper disposal of hazardous materials usually results in heavy fines. This violation would have resulted in a fine of about \$20,000.

Mark asked Willie what he thought would happen if they decided not to do what they were told. Willie said that they were working in an employment-at-will state and failure to do what they were authorized to do would definitely result in termination. The OSHA inspector asked Mark if he had been

trained in handling hazardous waste. He also asked if Mark had been told to do things that he normally didn't engage in while working. Not wearing the proper clothing and disposing of the material improperly could result in danger to both Willie and Mark. It could also endanger whoever came into contact with the material not disposed of properly.

1. If Mark chose not to perform the task he was told, how could he have protected his job? Could he have lost his job because he was working in an employment-at-will situation?
2. What would you have done if you had been caught in this ethical dilemma?
3. How would you have responded to the OSHA inspector's questions?

Contributed by Mystro Whatley

a poultry-processing plant led to the deaths of 25 workers. This occurred because the plant's management kept the emergency exits padlocked to deter pilfering. Employees said there were no fire exits, no sprinkler system, and no fire drills. It was discovered that no government agency had conducted a safety inspection at that plant for 11 years. Some blamed state authorities; others blamed OSHA.⁶⁹ One thing was clear: there were simply not enough inspectors to handle all businesses, and therefore a heavy responsibility fell on business for safety in the workplace.

In the mid-nineties, OSHA turned to negotiated rule-making to develop standards for industry. Efforts at conciliation continued as Charles Jeffress, a former OSHA administrator who was known as an effective conciliator, took over the agency. Labor leaders who felt that OSHA was more concerned with its own operation than with the safety and health of workers criticized OSHA's efforts at reform. Even the U.S. Chamber of Commerce expressed concern that OSHA was putting more energy into improving its tarnished image than in reducing injuries and illness.⁷⁰ In 2007, OSHA had an authorized staff of only 2,150, including 1,100 inspectors. The agency's appropriation was \$486.9 million.⁷¹

Questions about OSHA remain today. Although the need for OSHA is evident, the way in which OSHA can meet that need most effectively has yet to be found.

There are some who think OSHA has done a credible job. In its own defense, OSHA presents statistics about its overall effectiveness. OSHA claims that workplace fatalities have been cut by 60 percent and occupational injury and illness rates by 40 percent from 1971 to 2007.⁷² However, a recent exposé by David Barstow of the *New York Times* paints a far bleaker picture. Barstow found that in a recent four-year period, OSHA investigated 1,242 incidents of employee death for which OSHA determined the death occurred because the employer had “willful safety violations.”⁷³ In 93 percent of these cases, OSHA declined to seek prosecution. Even those employers who were repeat violators, of which there were more than 70, were rarely prosecuted. This reluctance to prosecute persisted even when the victims were teenagers, the violation caused multiple deaths, and administrative judges determined there was “willful wrongdoing.”⁷⁴

OSHA helped 202 firms reduce their incident’s designation from “willful” to “unclassified,” which virtually guarantees there will be no prosecution.⁷⁵ Why do they do this? “A simple lack of guts and political will,” said John T. Phillips, a former regional OSHA administrator.⁷⁶ Barstow identified 2,197 deaths for which employers were fined \$106 million in civil OSHA fines and jail sentences that totaled fewer than 30 years. Twenty of those 30 years were from the North Carolina chicken plant fire that killed 25 people. In contrast, WorldCom paid \$750 million for misleading investors and, in one year alone, the prison sentences obtained by the EPA totaled 256 years.⁷⁷

This negative press stands in sharp contrast to the rosy picture painted in OSHA’s statistics and so numerous academic studies have tried to get at the truth behind the numbers. The findings are staggering, as separate studies seem to reach similar conclusions—that about two-thirds of all workplace injuries and illnesses go unreported due to a combination of employer failure to report all incidents, as well as OSHA’s exclusion of certain workplaces in the reporting.⁷⁸ Few observers hold out hope for substantive change in the near future at OSHA. Without accurate numbers, it is impossible to set effective priorities for employers and for OSHA.⁷⁹ In addition, the Bush administration is disinclined to strengthen government regulation. Peg Seminario, AFL-CIO director of occupational safety and health, observes that any new rules proposed are not likely to be promulgated under the Bush administration.⁸⁰

WORKPLACE VIOLENCE

One other issue is becoming a major problem and posing challenges to management—escalating violence in the workplace. “Top Security Threats,” a recent survey of *Fortune* 1000 companies, shows the seriousness of the problem. Corporate security managers rated **workplace violence** as their number-one concern. The Workplace Violence Research Institute reports that each workday an estimated 16,400 threats are made, 723 workers are attacked, and 43,800 are harassed. Each year, according to OSHA, more than 1,000 workers are victims of homicide at work. Each year, too, according to the U.S. Department of Justice, there are approximately 2 million assaults and threats of violence. Furthermore, one in four full-time workers has been harassed, threatened, or attacked, and

coworkers account for most of the harassment.⁸¹ A recent study of 280 internal workplace violence incidents showed that the majority of the perpetrators were current employees (43.6 percent) while former employees constituted 22.5 percent. The other perpetrators had relationships with the company or its employees: 22.5 percent involved domestic violence that was brought into the workplace, and 12.5 percent had a client relationship with the company.⁸²

In spite of the seriousness of the problem, companies are making too few efforts to address it. About 5 percent of the private industry U.S. businesses that filled out a recent survey on workplace violence prevention had an incident of workplace violence within the previous 12 months. Although many of these employers reported that the incident had a negative impact on their workforce, the great majority did not change their workplace violence prevention procedures following the incident. Of even greater concern is the fact that 9 percent had no program or policy addressing workplace violence.⁸³

Who Is Affected?

Approximately 2 million U.S. workers are victims of workplace violence every year.⁸⁴ Although no one is immune from workplace violence, some workers are at increased risk. According to OSHA, the workers who are more likely to experience workplace violence include:⁸⁵

- Workers who exchange money with the public
- Workers who deliver passengers, goods, or services
- Workers who work alone or in small groups
- Workers who work late at night or very early in the morning
- Workers who work in community settings and homes where they have extensive contact with the public
- Workers who work in high-crime areas

The workers who are direct targets of the violence are not the only people affected. Not only are the family and friends of the victims impacted, but those employees in the workplace who escaped the violence also experience long-term effects. These survivors often spend years dealing with the aftereffects.⁸⁶ Many fear returning to work and some never do. They will often play the event over in their minds, unable to forget what happened. Victoria Spang is a marketing director who hid in the personnel office when a client of her law firm came in with assault weapons, killing eight people and wounding six. “No one ever forgets. You’d walk by people’s cubicles, and they would keep pictures of the victims up. It’s a moment in life you’ll always remember.”⁸⁷

Corporate image can also suffer long-term effects. The term *going postal* is a thorn in the side of the U.S. Postal Service. It became part of the lexicon after a series of post office shootings. The phrase continues even after a study commissioned by the post office found that postal workers are no more likely to commit violence than employees in other professions.⁸⁸

Prevention

The federal Occupational Safety and Health Act (“OSHA”) has a “general duty clause” that mandates employers to provide safe workplaces; however, it does not set forth specific standards or requirements addressing violence.⁸⁹ According to the OSHA Directorate of Enforcement Programs, “whether or not an employer can be cited for violation of [the general duty clause] is entirely dependent upon the specific facts, which will be unique in each situation. The recognizability and foreseeability of the hazard and the feasibility of the means of abatement are some of the critical factors to be considered.”

Management has both a legal and moral duty to address the growing problem of workplace violence. Companies have barely begun to put meaningful safety measures into place, but such measures will become more important in the future. Programs that deal with crises, and long-range efforts to bring about safer workplace environments, will be essential. Figure 18-4 lists OSHA’s recommendations for what employers can do to protect their employees from workplace violence.

Figure 18-4 OSHA’s Recommendations for Preventing Workplace Violence

The best protection employers can offer is to establish a zero-tolerance policy toward workplace violence against or by their employees. The employer should establish a workplace violence prevention program or incorporate the information into an existing accident prevention program, employee handbook, or manual of standard operating procedures. It is critical to ensure that all employees know the policy and understand that all claims of workplace violence will be investigated and remedied promptly. In addition, employers can offer additional protections such as the following:

1. Provide safety education for employees so they know what conduct is not acceptable, what to do if they witness or are subjected to workplace violence, and how to protect themselves.
2. Secure the workplace. Where appropriate to the business, install video surveillance, extra lighting, and alarm systems and minimize access by outsiders through identification badges, electronic keys, and guards.
3. Provide drop safes to limit the amount of cash on hand. Keep a minimal amount of cash in registers during evenings and late-night hours.
4. Equip field staff with cellular phones and hand-held alarms or noise devices, and require them to prepare a daily work plan and keep a contact person informed of their location throughout the day. Keep employer-provided vehicles properly maintained.
5. Instruct employees not to enter any location where they feel unsafe. Introduce a “buddy system” or provide an escort service or police assistance in potentially dangerous situations or at night.
6. Develop policies and procedures covering visits by home health-care providers. Address the conduct of home visits, the presence of others in the home during visits, and the worker’s right to refuse to provide services in a clearly hazardous situation.

Source: “Workplace Violence,” *OSHA Fact Sheet*, <http://www.osha.gov>.

The Right to Health in the Workplace

As the public became more health conscious, it was not surprising that companies in the United States became much more sensitive about health issues. In efforts to control runaway health costs, which are rising an estimated 10 percent per year, these companies took drastic steps, some of which have become controversial. Two controversial issues of health in the workplace—smoking and AIDS—merit special attention. Like other issues we have examined, these issues have employee-rights, privacy, and due-process ramifications.

SMOKING IN THE WORKPLACE

The issue of **smoking in the workplace** began in the 1980s in the United States. The idea that smoking ought to be curtailed or restricted in the workplace is a direct result of the growing antismoking sentiment in society in general. Much of the antismoking sentiment crystallized a quarter century ago, when U.S. Surgeon General C. Everett Koop called for a smoke-free society. He proclaimed that smokers were hurting not only themselves but also the nonsmoking people around them, who were being harmed by secondary, or passive, smoke in the air they breathed. Koop argued that the evidence “clearly documents that nonsmokers are placed at increased risks for developing disease as the result of exposure to environmental tobacco smoke.”⁹⁰ To substantiate his point, a National Academy of Science study estimated that in one year, passive smoke was responsible for 2,400 lung cancer deaths in the United States.⁹¹

Evidence of the need to control smoking in the workplace continues to mount. A recent study reported in *Occupational Health and Environmental Medicine* studied nonsmokers in Scotland who worked around colleagues who smoked. Adjusted for age, height, gender, and socioeconomic status, the results showed that lung function was significantly impacted by the amount of secondhand smoke in the workplace. Workers exposed to the highest levels of smoke were three times more likely to have decreased lung function.⁹² The U.S. Environmental Protection Agency (EPA) classifies secondhand smoke involuntarily inhaled by nonsmokers from other people’s cigarettes as a known human carcinogen: secondhand smoke is responsible for approximately thirty-four hundred lung cancer deaths and an average of forty-six thousand heart disease deaths in adult nonsmokers annually in the United States.⁹³

Corporate Responses

Although companies did not act until considerable public sentiment against smoking had developed, they have now quickly moved to adopt policies that restrict smoking. Firms are becoming increasingly aware of the costs—higher insurance expenses and higher absenteeism—of having smokers on staff. Fifteen years ago, fewer than half of a survey’s respondents said that smoking was

restricted in public areas or their workspace at the office. Ten years later, a similar survey found that 92.3 percent of adults worked in places with a policy regulating smoking in public, common, or working areas.⁹⁴ By then, more than 70 percent of the U.S. workforce worked under a smoke-free policy, but the percentage of workers protected varies by state, ranging from a high of 83.9 percent in Utah and 81.2 percent in Maryland to 48.7 percent in Nevada.⁹⁵

A recent study illuminated a second benefit of smoke-free workplaces. Although they have been designed to protect workers from the effects of environmental tobacco smoke, there is now evidence they also support smokers in quitting. Caroline M. Fichtenberg and Stanton A. Glantz reviewed the findings of 26 studies of smoking in the workplace.⁹⁶ They found that in smoke-free workplaces, the percentage of workers who smoke drops by about 4 percent. Smokers in those workplaces reduce their smoking by about three cigarettes a day. These two effects make for a combined reduction of 29 percent in cigarette use. For the United States to achieve an equivalent reduction through taxation, the cigarette tax would have to be as high as \$3 per pack. The authors also studied smoke-restricted workplaces (e.g., where a designated smoking lounge might be provided) and found the impact was muted significantly, with only about half the impact on smoking prevalence and use. Interestingly, the findings of this study have been known to the tobacco industry for some time. The authors cite tobacco industry studies with the same finding. They cite a Phillip Morris internal memo, which said, “Milder workplace restrictions have much less impact on quitting rates [than totally smoke-free workplaces] and very little impact on consumption.”⁹⁷

Weyco, Inc., has taken the smoke-free workplace to a new level by completely eliminating tobacco use among its workforce. Its 175+ employees are entirely tobacco free, as are more than 90 percent of the employees’ spouses. They accomplished this through a gradual, and highly controversial, process. In 2003, they made a policy not to hire tobacco users, while also prohibiting smoking on campus and not allowing workers to take off-campus breaks. In 2004, they implemented voluntary testing—anyone who refused a test was fined \$50 a month. In 2005, employees were told that if they refused the test or tested positive for smoking, they would lose their jobs. Random testing ensures that employees do not waiver in their nonsmoking commitment. Those who fail a random test are sent home without pay for a month to think about what they have done. If they pass the test on return, they must sign a letter agreeing to daily testing when the company wishes. A subsequent failed test results in termination. In 2006, Weyco extended its program to spouses of employees. Those with spouses who either refuse the test or fail it are fined \$50 a month. Not surprisingly, Weyco’s approach to the issue of smoking has raised the ire of privacy advocates who note that it would be illegal in many states.⁹⁸

AIDS IN THE WORKPLACE

Medical breakthroughs have yielded dramatic improvements in the treatment of **acquired immune deficiency syndrome (AIDS)**. Although death rates have

declined, AIDS remains one of the top causes of death for Americans between the ages of 25 and 44, the age range of half the workforce.⁹⁹ Peter J. Petesch, former co-chair of the U.S. Centers for Disease Control and Prevention's Business Responds to AIDS/Labor Responds to AIDS (BRTA/LRTA) program, says that we are now in a "new era of complacency" that is undeserved, given that the number of new AIDS cases is on the rise. That fact, along with public initiatives that encourage people to know their HIV/AIDS status, means that AIDS will continue to be an important issue for employers.¹⁰⁰

Corporate Responses

When AIDS first appeared in the early 1980s, the business community was unsure of its responsibilities to employees who were diagnosed with the disease. The Justice Department initially ruled that some employers could legally fire employees diagnosed with AIDS if the employers' motive was to protect other workers.¹⁰¹ However, that judgment was reversed when the Supreme Court ruled that the Rehabilitation Act of 1973, the same law that protected handicapped workers from workplace discrimination, protected people with contagious diseases.¹⁰² With the passage of the Americans with Disabilities Act (ADA), AIDS became a recognized and covered disability.¹⁰³

In spite of the increased recognition and understanding of AIDS, corporate AIDS education and awareness programs play an important part in avoiding problems that have led to lawsuits. In one of the first lawsuits to be filed by the EEOC on behalf of a person with AIDS, a Chicago man successfully sued his employer, Nippon Express, for AIDS discrimination. The company was accused of giving meaningless work to the employee with AIDS, taking away his telephone, and forbidding coworkers from speaking with him. According to the six-year Nippon employee, workers belittled him and made cruel comments about his condition. The settlement called for Nippon Express to pay \$160,000 in damages, to donate \$25,000 to AIDS research, and to provide management employees with training as to how to deal with a person who has been diagnosed with AIDS or HIV.¹⁰⁴ In 2004, the EEOC determined there was reasonable cause to believe that Cirque de Soleil had discriminated against an acrobat who was fired because he was HIV positive. The circus agreed to rehire the acrobat and to draft an antidiscrimination policy that protects the rights of all HIV-positive athletes to perform. As part of the voluntary resolution, the circus agreed to pay \$600,000 in damages.¹⁰⁵ Another case is of a McDonald's employee who claims he was pressured to quit because of his illness. In 2001, a common pleas court awarded Russell Rich \$5 million in damages, but the verdict was overturned in 2003 by an appeals court that found McDonald's did not get a fair trial and ordered the case retried.¹⁰⁶ In 2005, Rich won the case: The court awarded him \$490,000 in damages.¹⁰⁷

Kodak is a company with an effective HIV/AIDS policy. For 20 years, the company has offered general HIV/AIDS education and awareness programs, as well as specific training for managers who must deal directly with HIV-related

issues. The company indicated it would tolerate no discrimination in its workplace and would terminate any employee who violates the company's HIV/AIDS policy.¹⁰⁸ The following quote from a Kodak employee who was diagnosed with HIV/AIDS was taken from the company's training manual:

*At first I was shaken, scared, afraid that my whole life had come apart. The stigma of HIV/AIDS was on my life and I didn't know what to do or who to tell or even who to trust. . . . My mind was a mess. But I met a lady, Lydia Casiano, who I felt very comfortable with. She works in the Human Relations Department at Kodak. She assured me of Kodak's policy of privacy and told me my job is still secure! . . . This year I've received a raise and have been given opportunities to improve myself and my workplace. We have given training classes to all [division] employees and I've told everyone about this condition. Today I work in an HIV friendly atmosphere because of the efforts made by the management and workforce of Kodak.*¹⁰⁹

Companies with operations in developing countries can be especially impacted by AIDS in the workforce. The AIDS epidemic has now surpassed the bubonic plague in the 1300s and influenza epidemic of 1917. According to UNAIDS, 40 million people around the world are now infected with HIV.¹¹⁰ Researchers from the Boston University School of Public Health's Center for International Health calculated the cost of AIDS to a corporation, the cost of prevention and treatment of employees, and the benefits that prevention and treatment can achieve. They found that the benefits of prevention and treatment outweigh the costs, making them pay off financially for most companies.¹¹¹ The bottom line was that actions that were good for public health proved to be good for business as well.

A cooperative program called Business Responds to AIDS (BRTA) was established as a joint initiative of the U.S. Centers for Disease Control and the business sector. They provide a variety of resources to help companies develop policies to deal effectively with HIV/AIDS in the workplace. BRTA recommends that, at minimum, organizations develop comprehensive programs that contain five key components, as follows:¹¹²

1. Workplace policy
2. Training (for managers, supervisors, and union leaders)
3. Employee education
4. Family education
5. Community involvement

Companies need to be extremely sensitive to the privacy and due-process aspects of AIDS, and thus it is very important that companies adopt policies for dealing with AIDS cases before they arise. Managers need to be trained and educated in how to handle AIDS cases. Policies on AIDS should not be developed in an ad hoc, spur-of-the-moment fashion but as part of an overall strategy for dealing with workplace health and safety, privacy, and employee rights.

THE FAMILY-FRIENDLY WORKPLACE

Employees are increasingly less willing to spend every waking hour at work and are more committed to having time to spend at home with family. Two recent studies document this trend. One found that family time was the most important work/life priority for 82 percent of men and 85 percent of women between the ages 20 to 39.¹¹³ Another found that 90 percent of working adults felt they did not spend enough time at home with their families.¹¹⁴ Many observers believe that the terrorist attacks of September 11 led many people to reevaluate their lives and priorities.¹¹⁵ As a result, companies are searching for more and more ways to help employees achieve **work/life balance**, which is defined as “a state of equilibrium where the demands of a person’s personal and professional life are equal.”¹¹⁶

Although programs to support employee work/life balance are good business with payoffs in employee recruitment and retention, many companies claim that they are looking out for the mental and psychological health of their employees. Whether it be for altruistic or business reasons, workplaces today are becoming more family friendly. By using this term, we are repeating a catchall phrase that refers to a host of policies and programs that today’s companies have been putting into place. According to the Society for Human Resource Management (SHRM) 2007 Benefits Survey, the percentage of firms providing **family-friendly** benefits has continued to increase. Some of the most popular family-friendly benefits (and the percentage of firms offering them) are:¹¹⁷

1. Dependent care flexible spending accounts (76 percent)
2. Flextime (58 percent)
3. Family leave above required leave of the Family and Medical Leave Act (27 percent)
4. Domestic partner benefits (33 percent)
5. Adoption assistance (20 percent)

Although not everyone thinks that companies are becoming as family friendly as they are claiming to be, it is clear that workers are talking more and more about the importance of family-friendly policies, and many leading companies are responding. With the growth in the numbers of women, single parents, and two-paycheck couples in the workforce, it seems that corporate support for families, many of whom are stressed out from their busy lives, is on the growth curve. This is further complicated by the changing nature of what constitutes a family. A recent study found that segments of society are subject to unique work/life balance pressures but receive less support. Typically, work/life balance studies and programs have focused on employed men and women who raise their children with spouses or partners. Often forgotten are single-earner mothers and fathers, single and childless employees with significant elder-care responsibilities, grandparents raising their grandchildren, and blended families with children from both partners’ other marriages.¹¹⁸

It is in the context of organizations becoming more “friendly” on their own that we want to discuss a law aimed at health-related issues in the workplace—the Family and Medical Leave Act.

Family and Medical Leave Act

The **Family and Medical Leave Act (FMLA)** was made into law in 1993. This act was designed to make life easier for employees with family or health problems.

Under the FMLA,¹¹⁹ employees are granted the following rights:

- An employee may take up to 12 weeks of unpaid leave in any 12-month period for the birth or adoption of a child or for the care of a child, spouse, or parent with a serious health condition that limits the employee’s performance.
- Employees must be reinstated in their old jobs or be given equivalent jobs upon returning to work; the employer does not have to allow employees to accrue seniority or other benefits during the leave periods.
- Employers must provide employees with health benefits during leave periods.
- Employees are protected from retaliation in the same way as under other employment laws; an employee cannot be discriminated against for complaining to other people (even the newspapers) about an employer’s family leave policy.

Employers also have rights under the FMLA.¹²⁰ These rights include the following:

- Companies with fewer than 50 workers are exempt.
- Employers may demand that employees obtain medical opinions and certifications regarding their needs for leave and may require second or third opinions.
- Employers do not have to pay employees during leave periods, but they must continue health benefits.
- If an employee and a spouse are employed at the same firm and are entitled to leave, the total leave for both may be limited to 12 weeks.

The FMLA has not necessarily been easy to implement, however, because of special and technical key definitions of such terms as *serious health condition*, *medical certification*, *reasonable prior notice*, and *equivalent position*.¹²¹ The FMLA institutionalizes at the federal level the employee’s right to unpaid leave for health and family reasons. However, more than 35 states had their own leave laws before the FMLA was passed. Therefore, many companies have had experience in facing some of the difficult cases that could arise from the implementation of this law. In addition to the complex legal environment for employee issues that many companies already face, the FMLA promises to bring new challenges on a continuing basis.¹²²

A recent study by the Department of Labor showed that the corporate views on the FMLA are mixed—still generally positive but with a downward trend that merits concern. The good news is that 87.6 percent of the businesses responding found that the FMLA had either a positive effect or no effect on business productivity, profitability, or growth. However, the paperwork is becoming a burden, with 38 percent finding it to be a problem.¹²³

In summary, the FMLA has not been the major problem that many envisioned, and it has accomplished much good. However, relieving the paperwork burden it places on business is important if it is to continue to provide workers with the opportunity to fulfill their family responsibilities without sacrificing their careers. Various efforts to pass additional family-friendly workplace legislation have been stymied by partisan conflict. The eventual outcome of the efforts to streamline and clarify the FMLA is certain to influence the direction corporate policies will take.

Summary

Critical employee stakeholder issues include the rights to privacy, safety, and health. These issues should be seen as extensions of the issues and rights outlined in Chapter 17.

With the development of new technologies, workplace privacy has increasingly become a serious workplace issue. This wealth of available technology presents new challenges for companies as they weigh the importance of knowing their workers' activities against the importance of maintaining trust and morale. Of equal, if not more, importance to employee stakeholders are the issues of workplace safety and health. The workplace safety problem led to the creation of OSHA.

In spite of its difficulties, OSHA is still the federal government's major instrument for protecting workers on the job. State-promulgated right-to-know laws, as well as federal statutes, have been passed in recent years to provide employees with an added measure of protection, especially against harmful effects of exposure to chemicals and toxic substances.

However, existing laws and regulations only deal with known problems. As the world changes, so do the threats to worker health and safety. Since the 9/11 tragedy, the threat of terrorism has made many companies reassess operations as basic as their mail rooms. Other unexpected threats to worker health and safety are certain to occur and will represent new challenges for managers.

Other major health issues in the current business/employee relationship are AIDS and workplace violence. AIDS has become the most serious health issue that business or our society has ever faced. However, violence in the workplace is exacting a heavy toll, and businesses must be responsive. Smoking in the workplace and the need for employees to take family leave also impact the work environment. Wise managers will now begin to develop policies for dealing with these issues, as well as their privacy and due-process implications.

Key Terms

acquired immune deficiency syndrome (AIDS) (page 715)
Americans with Disabilities Act (ADA) (page 701)
background checks (page 693)
broad brush EAP (page 701)
chief privacy officers (CPOs) (page 704)
drug testing (page 698)
Electronic Communication Privacy Act (ECPA) of 1986 (page 702)
Employee Assistance Programs (EAPs) (page 701)
employee monitoring (page 702)
Employee Polygraph Protection Act (EPPA) (page 696)

family-friendly (page 718)
Family and Medical Leave Act (FMLA) (page 719)
integrity tests (page 696)
polygraph (page 695)
Privacy Act of 1974 (page 691)
privacy in the workplace (page 691)
right-to-know laws (page 707)
smoking in the workplace (page 714)
type 1 error (page 698)
type 2 error (page 693)
USA Patriot Act (page 692)
workplace violence (page 711)
work/life balance (page 718)

Discussion Questions

1. In your own words, describe what privacy means and what privacy protection companies should give employees.
2. Enumerate the strengths and weaknesses of the polygraph as a management tool for decision making. What polygraph uses are legitimate? What uses of the polygraph are illegitimate?
3. What are the two major arguments for and against integrity testing by employers? Under what circumstances could management most legitimately argue that integrity testing is necessary?
4. How has technology affected workplace privacy? What are the implications for the social contract between firms and their employees?
5. How has the 9/11 tragedy affected workplace privacy? What are the long-term implications of that?
6. Which two of the four guidelines on the issue of privacy presented in this chapter do you think are the most important? Why?
7. Identify the privacy, health, and due-process ramifications of violence in the workplace and AIDS.

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Employment Discrimination and Affirmative Action

Chapter Learning Outcomes

After studying this chapter you should be able to:

- 1 Chronicle the U.S. civil rights movement and minority progress for the past 50 years.
- 2 Outline the essentials of the federal discrimination laws.
- 3 Provide two different meanings of discrimination and give examples of how each might be committed.
- 4 Elaborate on issues in employment discrimination relating to race, color, national origin, sex, age, religion, sexual orientation, and disability.
- 5 Identify different postures with respect to affirmative action, explain the concept of reverse discrimination, and provide an overview of the Supreme Court's decisions on affirmative action.

In the previous two chapters, we considered employee rights issues that affect virtually everyone in the workplace. In this chapter, we concentrate on that group of stakeholders whose rights are protected by discrimination laws. In the United States, **protected groups** are those who have legal protection from discrimination based on race, color, religion, national origin, sex, age, or disability. In addition to these federal protections, 17 states have laws protecting individuals from discrimination based on sexual orientation. Many of the issues we treat in this chapter have grown out of the general belief that certain employees are likely to face discrimination because of the above attributes and that they have workplace rights that ought to be protected.

To complicate matters, there is a group of observers who think that legitimate protective status is giving way to victim status as increasing numbers of people set

forth their claims that they, too, should have their rights as employees protected by law. Some say that the United States has become a “society of victims” with growing numbers of employees asserting claims for protected status.¹ It is within this context, in which claims to be protected by law are proliferating, that we embark on this discussion of employment discrimination and affirmative action. We must always remember that the civil rights movement, which effectively started it all, was quite legitimate and long overdue.

Federal antidiscrimination laws date back to the U.S. Constitution—in particular, the First, Fifth, and Fourteenth Amendments, which were designed to forbid religious discrimination and deprivation of employment rights without due process. There were also the Civil Rights Acts of 1866, 1870, and 1871, which were based on these amendments. However, none of these acts was ever effective. Most authorities agree that the Civil Rights Act of 1964 was the effective beginning of the employee protection movement, particularly for those special groups that we will be discussing in this chapter.

Civil rights issues among protected groups are subjects of intense debate. Although there is basic acceptance of the idea of groups’ workplace rights being protected, the extent of this protection and the degree to which governmental policy should go to accelerate the infusion of protected groups into the workforce and into higher-paying jobs remain controversial topics. To explore these and related issues, we will cover the following major topics in this chapter: the civil rights movement and minority progress, federal laws that protect against employment discrimination, the meaning of discrimination, a variety of issues related to employment discrimination, and, finally, affirmative action in the workplace.

The Civil Rights Movement and Minority Progress

It would take volumes to trace thoroughly the historical events that led ultimately to the passage of the first significant piece of civil rights legislation in the modern period—the Civil Rights Act of 1964. The act grew out of conflict that had been apparent for years but that erupted in the 1950s and 1960s in the form of protests and boycotts.²

CIVIL RIGHTS IN THE 1950s AND 1960s

Behind the American dream had historically been the belief that merit rather than privilege was the means of getting ahead. Equal opportunity was supposed to be everyone’s birthright. Blacks and other minorities, however, had not shared fully in this American dream. In the 1950s and 1960s, the disparity between American ideals and American realities became quite pronounced and evident for minorities. Americans became aware of it, not because they suddenly awoke to the realization that equal opportunity was not available to everyone, but because of individuals who had the courage to stand up for their rights as U.S. citizens.

It began on December 1, 1955, when Mrs. Rosa Parks, a black department store worker, was arrested for refusing to yield her bus seat to a white man. Out of that previously unthinkable act grew yet another—a bus boycott by blacks. One of the leaders of the boycott was a young minister, Dr. Martin Luther King, Jr. After the bus boycott came years of demonstrations, marches, and battles with police. Television coverage depicted scenes of civil rights demonstrators being attacked by officials with cattle prods, dogs, and fire hoses. Along with the violence that grew out of confrontations between protestors and authorities came the stark awareness of the economic inequality between the races that existed in the United States at that time.³

Unemployment figures for blacks were double those for whites and higher still among nonwhite youth. Blacks accounted for only 10 percent of the labor force but represented 20 percent of total unemployed and nearly 30 percent of long-term unemployed. In 1961, only about one-half of black men worked steadily at full-time jobs, whereas nearly two-thirds of white men did so. Against this backdrop of blacks and other minorities being denied their share in the American ideal of equal opportunity in employment, it should have been no surprise that Congress finally acted in a dramatic way in 1964.⁴

THE 1970s: THE WOMEN'S MOVEMENT BEGINS

The women's movement began in the 1970s. Women's groups began to see that the workplace situation was little better for women than for blacks and other minorities. Despite the fact that the labor participation rate for women was growing, women were still occupying low-paying jobs. Women were making some small inroads into managerial and professional jobs, but progress was very slow. Women, for the most part, were still in the lower-paying "women's jobs," such as bank teller, secretary, waitress, and laundry worker.⁵

At first, in the early 1970s, blacks were making strong gains in employment and earnings. From the 1973–1975 recession on, however, rampant unemployment among blacks was discouraging. By the end of the 1970s, the unemployment rate was about 12 percent for blacks, compared with 5 percent for whites.

THE 1980s: GAINS ARE MADE

In the 1980s, the circumstances of blacks and women improved, but women, in general, made greater progress in the workplace than blacks. From 1983 to 1986, the unemployment rate for all whites fell from 8.4 percent to 6.1 percent. During this same time, the unemployment rate for blacks fell from 19.5 percent to 15.1 percent. For women, it fell from 6.9 percent to 5.4 percent.⁶ From these statistics, we can see that unemployment represented a major problem for blacks but was not a major problem for women. Indeed, the unemployment rate for blacks remained more than twice that of whites.

As the mid- to late 1980s arrived, inequality in the workforce remained a serious problem. Blacks continued to have lower participation rates in the workforce.

Women did not have the labor participation rate problem of blacks but continued to be excluded from higher-paying managerial jobs. Also problematic were pay inequities between men and women, and between whites and blacks, performing essentially the same jobs.

By the end of the 1980s, the progress of blacks was mixed. There were notable gains on the education front, but the incomes of blacks continued to trail those of whites. In 1990, nearly 80 percent of blacks from the ages of 35 to 44 had completed four years of high school, compared with 63 percent in 1980. For the same period, 89 percent of whites completed high school, compared with 80 percent in 1980. In terms of college attendance, the rate for black females steadily increased from 24 percent in 1970 to 31 percent in 1988. For black males, the percent attending college declined from 29 percent in 1970 to 25 percent in 1988. The poverty rate for black Americans in 1990 remained virtually the same as it had been for the past 20 years—nearly one-third.⁷

THE 1990s: SOME PROGRESS, BUT PROBLEMS REMAINED

As the century drew to a close, 28 percent of blacks still lived in poverty, compared to 11 percent of whites.⁸ Although 12.9 percent of the employees in private companies were African American, only 5.3 percent held managerial jobs.⁹ Despite these problems, gains were being made at the highest levels of the corporate sector. According to Richard Parsons, then president of Time Warner and one of the United States' most powerful black executives:

People of color are achieving corporate positions that their parents could never have dreamed of reaching, and in unprecedented numbers. Is this trend sweeping the land? No. Are there still problems? Yes. But there's no question that the group of black leaders in business is stronger than ever.¹⁰

Mr. Parsons went on to become Time Warner's CEO in 2002 and board president in 2003, positions he still holds at this writing.¹¹

The following incident illustrates the irony inherent in the experiences of African Americans in the workplace at the end of the twentieth century. In the early nineties, six Texaco employees filed a class-action lawsuit charging racial discrimination in hiring practices and workplace treatment. Two years later, a tape of Texaco executives surfaced containing racial slurs directed at employees, as well as evidence that the executives were planning to shred incriminating documents and withhold information from the plaintiffs' lawyers. Texaco settled the suit for \$115 million.¹² When news of the tape became public, an activist friend called New York State comptroller Carl McCall, the first African American elected to statewide office in New York, and asked him to join a picket line at the company's headquarters. McCall replied, "When you own one million shares of stock, you don't have to picket." McCall oversaw a public pension fund that is one of the largest in the country and one of the few funds managed by an individual rather than by a committee. He simply called then-Texaco chairman Peter Bijur to

express his concern; after that call, Bijur updated McCall regularly on the progress of Texaco's diversity plan.¹³

THE TWENTY-FIRST CENTURY: NEW CHALLENGES ARISE WHILE OLD PROBLEMS REMAIN

One of the most significant issues in the new millennium has been the changing workforce composition. Federated Department Stores' diversity initiative covered 26 groups, including seniors, the disabled, homosexuals, the devout, atheists, marrieds, and singles at the start of the new century. That represents a dramatic growth from a decade earlier when it covered only two groups, women and minorities. This proliferation of protected groups has raised concerns that the still-prevalent problem of racism will shift to the back burner. According to Lisa Willis Johnson, diversity chair for the Society of Human Resource Management (SHRM), "Race was the sacrificial lamb to launch diversity and make it palatable to corporate America."¹⁴ Relegation of race to a back burner would be a serious mistake.¹⁵

As the numbers and percentages of workers protected by discrimination laws continue to increase, following current trends, civil rights issues will continue to be front-burner topics. Serious problems remain as new challenges arrive. Complicating matters even more has been a growing sentiment against affirmative action. The challenge for business will be to assimilate an increasingly diverse workforce while adopting a posture on affirmative action that does not engender additional resentful reactions on the part of the majority.

An indispensable way to understand the changing public policy with respect to employment discrimination is to examine the evolution of federal laws prohibiting discrimination. Once we have a better appreciation of the legal status of protected groups, we can more completely understand the complex issues that have arisen with respect to the evolving meaning of discrimination and its relationship to related workforce issues—in particular, affirmative action.

Federal Laws Prohibiting Discrimination

This section provides an overview of the major laws that have been passed in the United States to protect workers against discrimination. We will concentrate our treatment on legislation at the federal level that has been created in the past 60 years. We will discuss issues arising from the various forms of discrimination in more detail later in this chapter. We should keep in mind that there are a host of state and local laws that address many of these same topics, but space does not permit their consideration here. Our purpose in this section is to provide an overview of antidiscrimination laws and the major federal agencies that enforce those laws.

TITLE VII OF THE CIVIL RIGHTS ACT OF 1964

Title VII of the Civil Rights Act of 1964, as amended, prohibits discrimination in hiring, promotion, discharge, pay, fringe benefits, and other aspects of employment on the basis of race, color, religion, sex, or national origin. Title VII was extended to cover federal, state, and local employers and educational institutions by the Equal Employment Opportunity Act of 1972. This amendment to Title VII also gave the Equal Employment Opportunity Commission (EEOC) the authority to file suits in federal district court against employers in the private sector on behalf of individuals whose charges had not been successfully conciliated. In 1978, Title VII was amended to include the Pregnancy Discrimination Act, which requires employers to treat pregnancy and pregnancy-related medical conditions the same as any other medical disability with respect to all terms and conditions of employment, including employee health benefits.¹⁶

Title VII also prohibits firms from retaliating against employees who file discrimination claims. In 2006, the U.S. Supreme Court strengthened the anti-retaliation provisions of Title VII. The High Court ruled that an employee can establish a retaliation claim even when they were not terminated or demoted. Any action that would “cause a worker to think twice” about lodging a discrimination complaint is sufficient (e.g., being transferred to a less desirable position at the same pay).¹⁷ The high court determined that lower courts had established a “jump off the page and slap you in the face” standard that was unacceptable.¹⁸

Figure 19-1 presents an overview of Title VII’s coverage.

AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967

This law protects workers 40 years old and older from arbitrary age discrimination in hiring, discharge, pay, promotions, fringe benefits, and other aspects of employment. It is designed to promote employment of older people on the basis of ability rather than age and to help employers and workers find ways to meet problems arising from the impact of age on employment.

Like the provisions of Title VII, the **Age Discrimination in Employment Act (ADEA)** does not apply where age is a **bona fide occupational qualification (BFOQ)**—a qualification that might ordinarily be argued as being a basis for discrimination but for which a company can legitimately argue that it is job related and necessary. Neither does the act bar employers from differentiating among employees based on reasonable factors other than age.¹⁹

EQUAL PAY ACT OF 1963

As amended, this act prohibits sex discrimination in payment of wages to women and men who perform substantially equal work in the same establishment. Passage of this landmark law marked a significant milestone in helping women, who were the chief victims of unequal pay, to achieve equality in their paychecks.²⁰ Figure 19-2 summarizes other details of the **Equal Pay Act of 1963**.

Figure 19-1 Title VII of the Civil Rights Act of 1964

EMPLOYMENT discrimination based on race, color, religion, sex, or national origin is prohibited by Title VII of the Civil Rights Act of 1964.

Title VII covers private employers, state and local governments, and educational institutions that have 15 or more employees. The federal government, private and public employment agencies, labor organizations, and joint labor-management committees for apprenticeship and training also must abide by the law.

It is illegal under Title VII to discriminate in:

- Hiring and firing;
- Compensation, assignment, or classification of employees;
- Transfer, promotion, layoff, or recall;
- Job advertisements;
- Recruitment;
- Testing;
- Use of company facilities;
- Training and apprenticeship programs;
- Fringe benefits;
- Pay, retirement plans, and disability leave; or
- Other terms and conditions of employment.

Under the law, pregnancy, childbirth, and related medical conditions must be treated the same as any other nonpregnancy-related illness or disability.

Title VII prohibits retaliation against a person who files a charge of discrimination, participates in an investigation, or opposes an unlawful employment practice.

Employment agencies may not discriminate in receiving, classifying, or referring applications for employment or in their job advertisements.

Labor unions may not discriminate in accepting applications for membership; classifying members; referrals; training and apprenticeship programs; and in advertising for jobs. It is illegal for a labor union to cause or try to cause an employer to discriminate. It is also illegal for an employer to cause or try to cause a union to discriminate.

Source: <http://eeoc.gov/policy/vii.html>.

http://SEARCH THE WEB WEB

THE EEOC

The website of the U.S. Equal Employment Opportunity Commission (EEOC) is a good source for updated information about employment discrimination and litigation (<http://www.eeoc.gov>). Visitors can find

enforcement statistics, a technical assistance program, and information on how to file a charge of discrimination.

Figure 19-2 Equal Pay Act of 1963

The EQUAL PAY ACT (EPA) prohibits employers from discriminating between men and women on the basis of sex in the payment of wages where they perform substantially equal work under similar working conditions in the same establishment. The law also prohibits employers from reducing the wages of either sex to comply with the law.

A violation may exist where a different wage is paid to a predecessor or successor employee of the opposite sex. Labor organizations may not cause employers to violate the law.

Retaliation against a person who files a charge of equal pay discrimination, participates in an investigation, or opposes an unlawful employment practice also is illegal.

The law protects virtually all private employees, including executive, administrative, professional, and outside sales employees who are exempt from minimum wage and overtime laws. Most federal, state, and local government workers also are covered.

The law does not apply to pay differences based on factors other than sex, such as seniority, merit, or systems that determine wages based upon the quantity or quality of items produced or processed.

Many EPA violations may be violations of Title VII of the Civil Rights Act of 1964, which also prohibits sex-based wage discrimination. Such charges may be filed under both statutes.

Source: *Information for the Private Sector and State and Local Governments: EEOC* (Washington, DC: Equal Employment Opportunity Commission), 9.

The Equal Pay Act received a great deal of attention in 2007 when the U.S. Supreme Court ruled that a Title VII complaint must be filed within 180 days of the action that sets the discriminatory pay, irrespective of its ongoing impact on the employee. Opinions on this ruling vary widely. The National Organization for Women (NOW) called it a “near-fatal blow to our ability to use Title VII of the landmark Civil Rights Act of 1964 to remedy pay discrimination based on sex, race, national origin, and other protected grounds.”²¹ In contrast, the *Wall Street Journal* labels it a “crucial victory for the tort bar.”²² The issue remains unsettled at this writing as Congress considers a bill to remove the time limits.

REHABILITATION ACT OF 1973, SECTION 503

This law, as amended, prohibits job discrimination on the basis of a disability. It applies to employers holding federal contracts or subcontracts. In addition, it requires these employers to engage in affirmative action to employ the disabled, a concept we will discuss later in this chapter. Related to this act is the Vietnam Era Veterans Readjustment Assistance Act of 1974, which also prohibits discrimination and requires affirmative action among federal contractors or subcontractors.²³

AMERICANS WITH DISABILITIES ACT OF 1990

The most significant labor and employment statute to be enacted in the last 30 years was the 1990 **Americans with Disabilities Act (ADA)**. The ADA prohibits discrimination based on physical or mental disabilities in private places of employment and public accommodation, in addition to requiring transportation

systems and communication systems to facilitate access for the disabled. The ADA is modeled after the Rehabilitation Act of 1973, which applies to federal contractors and grantees.²⁴ The basic provisions of the ADA are detailed in Figure 19-3.

Essentially, the ADA gives individuals with disabilities civil rights protections similar to those provided to individuals on the basis of race, sex, national origin, and religion. The ADA applies not only to private employers but also to state and local governments, employment agencies, and labor unions. Employers of 15 or more employees are covered.

The ADA prohibits discrimination in all employment practices, including job application procedures, hiring, firing, advancement, compensation, training, and other terms, conditions, and privileges of employment. If a person's disability makes it difficult for that person to function, firms are expected to make **reasonable accommodations** if they do not represent an **undue hardship** for the firm. The act covers qualified individuals with disabilities. Qualified individuals are those who can perform the **essential functions** of the job.²⁵ The definition of essential function is sometimes difficult to determine. Golfer Casey Martin applied

Figure 19-3 *The Americans with Disabilities Act*

Title I of the Americans with Disabilities Act of 1990, which took effect July 26, 1992, prohibits private employers, state and local governments, employment agencies, and labor unions from discriminating against qualified individuals with disabilities in job application procedures, hiring, firing, advancement, compensation, job training, and other terms, conditions, and privileges of employment. An individual with a disability is a person who:

- Has a physical or mental impairment that substantially limits one or more major life activities;
- Has a record of such an impairment; or
- Is regarded as having such an impairment.

A qualified employee or applicant with a disability is an individual who, with or without reasonable accommodation, can perform the essential functions of the job in question. Reasonable accommodation may include, but is not limited to:

- Making existing facilities used by employees readily accessible to and usable by persons with disabilities;
- Job restructuring, modifying work schedules, reassignment to a vacant position;
- Acquiring or modifying equipment or devices; adjusting or modifying examinations, training materials, or policies; and providing qualified readers or interpreters.

An employer is required to make an accommodation to the known disability of a qualified applicant or employee if it would not impose an "undue hardship" on the operation of the employer's business. Undue hardship is defined as an action requiring significant difficulty or expense when considered in light of factors such as an employer's size, its financial resources, and the nature and structure of its operation.

An employer is not required to lower quality or production standards to make an accommodation, nor is an employer obligated to provide personal use items such as glasses or hearing aids.

Source: EEOC Fact Sheet (Washington, DC: Equal Employment Opportunity Commission).

to the PGA for permission to ride a cart in PGA tournaments when other players were walking the course. Much controversy ensued over whether walking the golf course was an essential function of playing professional golf. The Supreme Court subsequently ruled that he could use a cart, because providing the cart was a reasonable accommodation and his use of the cart would not fundamentally alter the game.

The definition of disability includes people who have physical or mental impairments that substantially limit one or more major life activities, such as seeing, hearing, speaking, walking, breathing, performing manual tasks, learning, caring for oneself, and working.²⁶ Uncertainty over the definition of “disability” sent the ADA to the courts for clarification. In June 1998, the Supreme Court decided that the definition of “disability” included both major and minor impairments. Under this ruling, the ADA applies to disabilities as diverse as HIV, diabetes, cancer, dyslexia, and bad backs.²⁷ In 2003, however, the Equal Employment Opportunity Commission (EEOC) issued enforcement guidance that restricts the definition of a disability. They ruled that an *impairment* is a *disability* only if it “substantially limits one or more of the employee’s **major life activities.**”²⁸ Major life activities include speaking and interacting with others, learning, thinking, concentrating, and working.²⁹

The Supreme Court recently upheld an individual’s right to sue under the ADA. Paraplegic and confined to a wheelchair, George Lane was ordered to appear in a court with no ramps or elevators leading to the second floor. He could not climb the steps and so he crawled up the stairs to comply with the order. When he was ordered to appear in court a second time, Lane refused to crawl or be carried. He was subsequently arrested for failing to appear in court. He charged the state of Tennessee with discrimination and sued for \$100,000. When the Supreme Court upheld his right to sue, it was seen as an indication that the high court was disinclined to let states’ rights arguments prevail over civil rights.³⁰

The ADA has been a controversial law. In the early years following the act’s passage, news reports were filled with stories of frivolous lawsuits and outrageous abuses of the protections offered by the ADA. Many fear these abuses created a backlash against people with disabilities. Kathi Wolfe, a Virginia writer with a visual handicap, recalls having an able-bodied writer tell her, “With the ADA, I’ll bet editors are scared to reject your stuff. They’d be afraid you’d sue them.” In another instance, a drugstore clerk said to Wolfe, “Please don’t sue us because we don’t have Braille signs.” Knowing that two-thirds of severely disabled individuals remain unemployed despite the ADA, Wolfe wonders if the ADA has made employers more hesitant than ever to hire individuals with disabilities.³¹

Although the stories of ADA excess remain, the evidence supporting them is thin. In a *Dateline* report for NBC News, John Hockenberry tracked down several well-known “legends of the ADA,” including a 400-pound subway worker who sued for being denied a conductor’s position because he could not fit in the cab, a man who had a deep-seated need to bring a gun to work, and a dentist whose disability would not let him stop grabbing women. Hockenberry found that the first two cases were thrown out by the EEOC and that, in the third case, the dentist never actually sued because he was self-employed and so was never fired. The

difficulty these cases had in getting past the EEOC appears to be typical. As Hockenberry reported, of the 90,000 complaints received by the EEOC at that point, only 250 ended up in court.³² Of the cases that make it to court, few are won by the plaintiffs. The American Bar Association (ABA) reviewed more than 1,200 ADA cases and found that employers won 92 percent of the cases decided by a judge and 86 percent of the cases decided by the EEOC. Don Donaldson, risk manager at the Jacksonville (Florida) Port Authority, said: “The survey findings to me are not surprising because I’ve been monitoring developments and trends on this issue. If employers make reasonable accommodations to disabled workers, then the courts would likely rely on common sense and rule in the employer’s favor.”³³

Donaldson’s remarks help to explain why the ADA found a high level of support in a Louis Harris survey of corporate employers. These corporate executives, 81 percent of whom had modified their offices since the ADA went into effect, estimated the average cost of accommodation as \$223 per disabled employee. About half of the executives (48 percent) said the ADA increased their costs a little, 82 percent reported no change in costs, and 7 percent reported that their costs increased “a lot.” Most of the executives said the ADA should be strengthened or kept as it is; only 12 percent felt it should be weakened or repealed.³⁴ The executives’ assessments of the ADA seem to be on target. A recent study by the American Bar Association found that employers won 94.5 percent of the ADA discrimination court cases and 78.1 percent of the administrative cases. As the study says, the ADA “as interpreted by the courts creates difficult obstacles for the plaintiff to overcome.”³⁵ They must now have a disability that impairs a major life activity while still being able to perform the essential functions of the job.³⁶

CIVIL RIGHTS ACT OF 1991

Between 1989 and 1991, the U.S. Supreme Court made decisions that reoriented Title VII in favor of employers. The purpose of the **Civil Rights Act of 1991** (CRA 1991) was to modify and/or reverse those decisions. The primary objective of the Civil Rights Act of 1991 was to provide increased financial damages and jury trials in cases of intentional discrimination relating to sex, religion, race, disability, and national origin. Under Title VII, monetary awards were limited to such items as back pay, lost benefits, and attorney fees and costs. The act permitted the awarding of both compensatory and punitive damages. In addition, charges of unintentional discrimination were more difficult for employers to defend, because the act shifted the burden of proof back to the employer. Initial amounts of compensatory and punitive damages an employee could receive were set at \$50,000 to \$300,000.³⁷

The laws we have just discussed constitute the backbone of federal efforts to prevent employment discrimination. Several executive orders issued by the president of the United States also prohibit discrimination. However, because these executive orders also contain provisions for affirmative action, we will discuss them during our treatment of affirmative action later in this chapter.

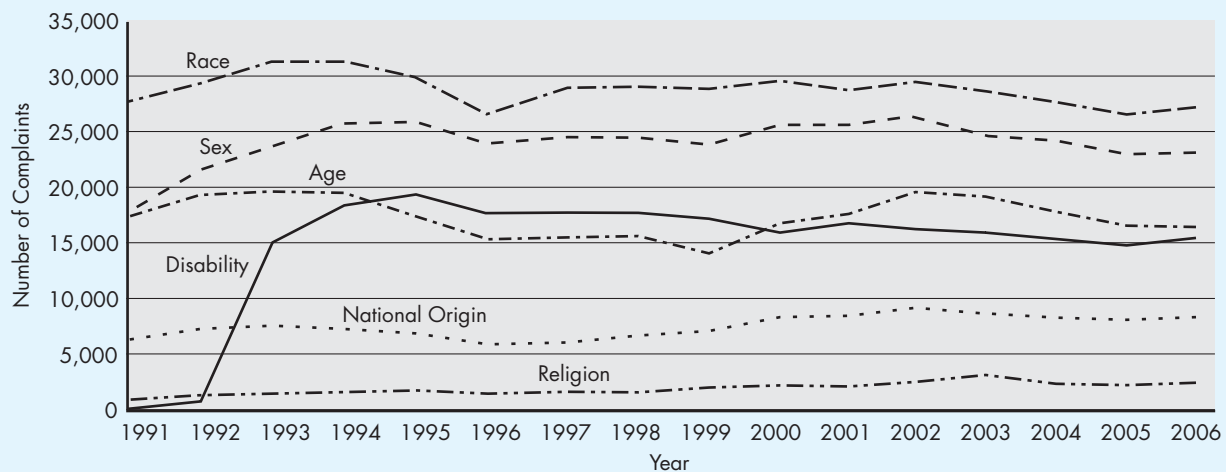
EQUAL EMPLOYMENT OPPORTUNITY COMMISSION

As the major federal body created to administer and enforce job bias laws, the **Equal Employment Opportunity Commission (EEOC)** deserves special consideration. Several other federal agencies also are charged with enforcing certain aspects of the discrimination laws and executive orders, but we will restrict our discussion to the EEOC because it is the major agency.

The EEOC has five commissioners and a general counsel appointed by the president and confirmed by the Senate. The five-member commission is responsible for making equal employment opportunity policy and approving all litigation the commission undertakes. The EEOC staff receives and investigates employment discrimination charges/complaints. If the commission finds reasonable cause to believe that unlawful discrimination has occurred, its staff attempts to conciliate the charges/complaints. When conciliation is not achieved, the EEOC may file lawsuits in federal district court against employers. Private employers may be sued under Title VII, but only the Justice Department may sue a state or local government for a violation of Title VII.³⁸

To provide some appreciation of the kinds of discrimination cases handled by the EEOC, Figure 19-4 presents a breakdown of the job-bias claims filed with the EEOC from 1991 to 2006. Discrimination complaints have begun to rise slowly after declining for three straight years. In fiscal year 2006, employees filed 75,768 discrimination complaints, still well below the 84,442 complaints filed in 2002.³⁹

Figure 19-4 *Discrimination Claims Filed with the EEOC (1991–2006)*



Source: Data from the U.S. EEOC (<http://www.eeoc.gov>).

Most of the complaints filed were about racial or sexual discrimination. Although the number of complaints received decreased, the overall payout decreased. The overall financial payout to individuals filing charges in 2006 was \$274 million, down from a record breaking \$415 million in 2004.⁴⁰

Several records were set in 2006. A record 4,901 women filed pregnancy discrimination cases. Men brought a record 15 percent of sexual harassment charges. Finally, setting another record, voluntary mediation resolved 8,201 cases.⁴¹

Like other federal regulatory bodies we have discussed, such as the EPA, FTC, and OSHA, the EEOC has had mixed success over the years. Its fortunes, successes, and failures have been somewhat dictated by the times, the administration in office, and the philosophy and zeal of its chairperson. During the late 1970s, the business community thought that the EEOC was on a “witch-hunt,” looking for violations so it could punish business for its past wrongs.⁴² In the 1980s, the Reagan administration responded to these concerns when it (1) eliminated the use of minority hiring goals and timetables used by employers to correct racial and ethnic disparities, (2) largely abandoned class-action lawsuits that relied on statistical evidence to prove widespread discrimination at large companies, and (3) yielded the EEOC’s once-dominant role on civil rights initiatives to the Justice Department.⁴³ When former President Clinton took office in 1992, the EEOC stepped up enforcement of business discrimination laws. Among the crackdown’s targets were unsettled discrimination lawsuits against major employers, polluters who dump their muck in minority neighborhoods, banks whose loan departments redline poor areas, and other forms of day-to-day discrimination.⁴⁴ The renewed effort, combined with a broadened mandate, resulted in an upsurge of cases. In fiscal year 1991, there were 63,898 new cases. By fiscal year 1994, there were 91,189 new cases. This increase in the number of new cases coincided with a reduction in staffing levels, which were at an all-time low. These combined trends resulted in a backlog of cases, which peaked at 110,000. Through an influx of capital from Congress, overall efficiency improvements, and efforts to use alternative dispute resolution (ADR), the backlog decreased by 45 percent and stood at a little over 61,000 in 1998.⁴⁵ The George W. Bush administration nominated Cari Dominguez, who served from 2001 to 2006. Her tenure was shaped dramatically by the September 11 terrorist attacks and the need to make certain that anger against the terrorists was not misdirected as national origin discrimination toward Arab Americans.⁴⁶

Naomi Earp, EEOC vice chair, took over as the new EEOC chair in August 2006. The EEOC launched a new initiative called E-Race dedicated to “Eradicating Racism and Colorism from Employment.” New technology has made it possible to discriminate in new ways, such as sorting applicants by zip codes or ethnic communities.⁴⁷ The EEOC is trying to stem the subtler means of discrimination, such as not inviting minority workers to lunches or happy hours—the sort of gathering that provides networking opportunities.⁴⁸ Her challenges will be great as she deals with a 20 percent loss of workforce, which began with a 2001 hiring freeze that has not ended as of this writing.⁴⁹

Expanded Meanings of Discrimination

Over the years, it has been left to the courts to define the word *discrimination*, because it was not defined in Title VII. Over time, it has become apparent that two specific kinds of discrimination exist. These two kinds are known as **disparate treatment** and **disparate impact**.

DISPARATE TREATMENT

Initially, the word *discrimination* meant the use of race, color, religion, sex, or national origin as a basis for treating people differently or unequally. This form of discrimination is known as “unequal treatment” or “disparate treatment.” Examples of disparate treatment might include refusing to consider blacks for a job, paying women less than men for the same work, or supporting any decision rule with a racial or sexual premise or cause.⁵⁰ According to this simple view of discrimination, the employer could impose any criteria so long as they were imposed on all groups alike.⁵¹ This view of discrimination equated nondiscrimination with color-blind decision making. In other words, to avoid this direct kind of discrimination, one would simply treat all groups or individuals equally, without regard for color, sex, or other characteristics.⁵²

DISPARATE IMPACT

Congress’s intent in prohibiting discrimination was to eliminate practices that contributed to economic inequality. What it found was that, although companies could adhere to the disparate treatment definition of discrimination, this did not eliminate all of the discrimination that existed. For example, a company could use two neutral, color-blind criteria for selection—a high school diploma and a standardized ability test. Blacks and whites could be treated the same under the criteria, but the problem arose when it became apparent that the policy of equal treatment resulted in unequal consequences for blacks and whites. Blacks were less likely to have high school diplomas, and blacks who took the test were less likely than whites to pass it. Therefore, a second, more expanded idea of what constituted discrimination was needed.

The Supreme Court had to decide whether an action was discriminatory if it resulted in unequal consequences in the *Griggs v. Duke Power Company* case.⁵³ Duke Power had required that employees transferring to other departments have a high school diploma or pass a standardized intelligence test. This requirement excluded a disproportionate number of minority workers. The court noted that there were nonminorities who performed satisfactorily and achieved promotions though they did not have diplomas. The court then reached the groundbreaking conclusion that it was the consequences of an employer’s actions, not the employer’s intentions, that determined whether discrimination had taken place. If any employment practice or test had an adverse or differential effect on minorities, then it was a

discriminatory practice. An unequal impact, or disparate impact, means that fewer minorities are included in the outcome of the test or the hiring or promotion practice than would be expected by their numerical proportion. The court also held that a policy or procedure with a disparate impact would be permissible if the employer could demonstrate that it was a business- or job-related necessity. In the *Duke Power* case, for example, a high school diploma and good scores on a general intelligence test did not have a clearly demonstrable relationship to successful performance on the job under consideration.⁵⁴

The concept of “unequal impact” is quite significant, because it runs counter to so many traditional employment practices. There are many other examples. The minimum height and weight requirements of some police departments have unequal impact and have been struck down by courts because they tend to screen out women, people of Asian heritage, and Latinos disproportionately.⁵⁵ The EEOC is currently scrutinizing credit checks for disparate impact because they fall heavily on minorities.⁵⁶ Several Supreme Court rulings have addressed the issue of the kind of evidence needed to document or prove discrimination. Typically, if a member of a minority group does not have a success rate at least 80 percent that of the majority group, the practice may be considered to have an adverse impact unless business necessity can be proven.⁵⁷ When this **four-fifths rule** is triggered, the firm will not necessarily be found guilty of having a disparate impact. However, it will be incumbent upon the firm to show that the selection practice is job related and necessary for the business.⁵⁸

The issue of disparate impact is often not easily resolved. In a 2006 ruling, the EEOC determined that a strength test given to applicants for positions in a canned meat factory had an unlawful disparate impact; the company appealed the verdict but lost.⁵⁹ The job for which the applicants were applying required them to carry 35 pounds of sausage, lift and load it, while walking the equivalent of four miles in a day. The strength test attempted to replicate the work by having applicants carry a 35-pound bar and load it onto other bars. A nurse observed the test and had ultimate hiring authority based on her observations. Before the company began using the test, about 50 percent of the hires were female. By the time of the verdict that number had dropped to 8 percent. A drop from 50 to 8 percent is dramatic and so that was the first indication that a disparate impact might be operating. On the surface, the relationship of the test to ultimate job responsibilities appeared strong, so it became necessary to determine why the percentage of women who passed the test was so low. The key problem was that the single evaluator (the nurse) added subjectivity to the process, as evidenced by the fact that the number of women hired declined with each testing and that when women and men received similar comments on their testing forms, only the men were hired.⁶⁰

With at least two different ways in which to commit discrimination, managers have to be extremely careful, because practically any action they take could possibly have discriminatory effects. Figure 19-5 summarizes the characteristics of disparate treatment and disparate impact.

Figure 19-5 Two Kinds of Employment Discrimination

Definition 1 Disparate Treatment

Direct discrimination
 Unequal treatment
 Decision rules with a racial/sexual premise or cause
 Intentional discrimination
 Prejudiced actions
 Different standards for different groups

Definition 2 Disparate Impact

Indirect discrimination
 Unequal consequences or results
 Decision rules with racial/sexual consequences or results
 Unintentional discrimination
 Neutral, color-blind actions
 Same standards, but different consequences for different groups

Source: James Ledvinka and Vida G. Scarpello, *Federal Regulation of Personnel and Human Resources Management*, 2d ed. (Boston: PWS-Kent, 1991), 48.

Issues in Employment Discrimination

We have identified the essentials of the major federal laws on discrimination and traced the evolution of the concept of discrimination. Now it is useful to discuss briefly the different issues that are related to the types of discrimination we have discussed. It is also important to indicate some of the particular problems that have arisen with respect to each of the different issues.

ISSUES OF RACIAL DISCRIMINATION

In spite of its place as one of the first forms of discrimination to be the focus of civil rights legislation, racial discrimination remains a problem in workplaces in the United States and throughout the world. Although racial discrimination is always hurtful, the nature of its form and impact has been different for people of different races. The EEOC has made race and color discrimination a priority and as part of that has clarified the definition of the terms. Race discrimination includes discrimination on the basis of ancestry or physical or cultural characteristics associated with a certain race, such as skin color, hair texture or styles, or certain facial features. Forms that collect federal data on race and ethnicity in the workforce use five racial categories: American Indian or Alaska Native; Asian; black or African American; Native Hawaiian or Other Pacific Islander; and white; and one ethnicity category, Hispanic or Latino.⁶¹

The Two Nations of Black America

In an essay for the *Brookings Review*, Henry Louis Gates, Jr., describes the present day as the “best of times and the worst of times” for the African American community. Gates, the W. E. B. Du Bois professor of the Humanities and chairman of the Department of Afro-American Studies at Harvard University, profiled the “two nations of Black America” that are separated by money, power, and

education. The two nations are reflected in the attitudes of black professionals toward corporate America. In a *Fortune* poll, most blacks indicated that they felt discrimination was still common in the workplace. However, more than two-thirds felt optimistic about the future of their careers.⁶² The situation in corporate boardrooms also provides both good news and bad news. The good news is that the number of African American board seats rose from zero in the 1960s to 260 in 2004; however, the bad news is that 32 percent of the *Fortune* 500 boardrooms still had no African American directors.

There is no shortage of support for Gates' argument that these are the "worst of times." Serious problems remain, as evidenced by a 2006 case in which the EEOC obtained a \$1 million settlement for a black man choked by a hangman's noose by white co-workers. That horrible incident was the culmination of a series of abuses. According to the EEOC, the company did not stop its employees from repeatedly harassing the complainant on the basis of his race and subjecting him to a hostile work environment with both verbal and physical abuse. As EEOC district director Jeannette Leino said, "It is shocking that such egregious racial harassment still occurs in the twenty-first century workplace, more than 40 years after passage of the landmark Civil Rights Act."⁶³

Other forms of racism are more subtle. A recent letter to Randy Cohen's "The Ethicist" column in the *New York Times Magazine* underscores the difficulties that remain for African Americans today, irrespective of their level of achievement. An

<http://SEARCHTHEWEBWEB>

MEASURE YOUR ATTITUDES

Project Implicit (<https://implicit.harvard.edu/implicit>) is a collaborative effort between researchers at Harvard University, the University of Virginia, and the University of Washington. It contains a variety of tests that you can take to assess your feeling about a range of topics, including age, race, color, gender, politics, sexuality, weight, disability, and religion. These "Implicit Association Tests" (IATs) have one thing in common—they are designed to examine thoughts and feelings that are beyond your conscious control. The tests do this by asking you to associate concepts such as "good" and "bad" with pictures, symbols, or words that reflect the concepts being tested. The researchers suggest that you take a sample test from the demonstration side and then read the information available on the IAT, because it will make more sense after you have experienced a test.

When you enter the website, you will have a choice between "Demonstration" and "Research." The

demonstration side allows you to sample the tests, choosing which one(s) you would like to take. You may be asked to complete an optional survey, but you can proceed without completing it. If you enter the research side, you can become a participant in the studies. Throughout the website, you can obtain background information about the purpose of the project, the scientists who designed it, and the nature of the tests administered.

The range of studies should provide you with an opportunity to think about topics that are very important to you or unique issues that you have not had the occasion to tackle in the past. The expressed goals of Project Implicit are to provide a safe and secure virtual environment to investigate psychological issues and, at the same time, provide visitors and participants with an engaging educational experience.

African American male was looking for Web programming work. When he used his first name on his resume, a name that identified his ethnicity, he received relatively few calls for interviews. He began to use his middle name on his resume and found that he got more interviews.⁶⁴ This man's experience underscores the challenges facing African Americans today. Those who develop professional skills and achieve a higher level of education still cannot count on their credentials opening the same doors the credentials would open for other workers in the marketplace.

In spite of these obstacles, black executives have been making their mark. *Black Enterprise* has chronicled the increase in African Americans in positions of corporate power over the years. When they began 20 years ago, their list of 25 Hottest Corporate Managers had no black chief executives. By 1993, 12 presidents and 2 CEOs were among the 40 top-tier managers they profiled. Their 2000 list of the top 50 Blacks in Corporate America contained six black CEOs. By 2005, there were 18 black CEOs (a 300 percent increase) and 26 black presidents on the list.⁶⁵

The Case of Hispanics

The word *Hispanic* fails to capture the diversity in this population. It is a term created by the government and first used in the 1980 census to categorize people from Latin America or Spain. Hispanics are the only major minority group to be classified by the language they speak. They can be black (Cuba's population is 58 percent black), Asian (Peru's former President Fujimori is 100 percent Japanese), or any of a variety of races. Accordingly, many people prefer to be described as Latino (which includes people from Portugal) or as coming from their country of origin (e.g., of Puerto Rican descent).⁶⁶

The growth rate among Hispanics in the United States is one of the most dramatic in U.S. history. The most recent census identified a Hispanic population of 35.3 million, representing one out of eight Americans and greater than the entire population of Canada. This is a 58 percent increase from the 22.4 million Hispanics 10 years before. For the first time, more people identify themselves as Hispanic (35.3 million) than identify themselves as black (34.7 million), making Hispanics the largest minority recorded by the U.S. census. However, 1.7 million people identify themselves as partly black and partly another race, and some Hispanic people are black, so the difference in sizes of the groups is largely definitional.⁶⁷

A strong work ethic is characteristic of the Hispanic population. Originally centered in a few big metropolitan areas, thousands of Hispanics have moved to small factory towns and suburban areas for employment. Workforce participation among Hispanic males is the highest of any measured group at 80 percent, with many becoming entrepreneurs. Those living in poverty use welfare less often than poor blacks or poor whites. In spite of this level of participation and success in the workforce, many Hispanics are still working in low-wage jobs. Discrimination remains a critical problem.⁶⁸ In the most recent "National Survey of Latinos," 31 percent of the 3,000 Hispanics polled said that they or someone close to them had experienced job discrimination in the past five years; 14 percent had experienced the discrimination themselves.⁶⁹ When choosing among minority employees, some employers have shown preference for Latino workers partly

because they are known for having a strong work ethic but also because those who are immigrants are more vulnerable to exploitation.⁷⁰

Asian Image of Model Minority

Asian Americans have a problem that is unique to U.S. minority groups, a stereotype that may be too positive. The popular press, many pundits, and various policy makers have portrayed Asian Americans as an ideal that should be emulated by other minorities (i.e., Asian Americans are the “Model Minority”).⁷¹ However, scholars in various disciplines, including Asian American studies, have refuted this characterization. They argue that aggregated data hide the impact of such critical factors as highly selective immigration policies, high numbers of hours worked, and high numbers of individuals per household. When these critics have disaggregated the data used to support the Model Minority characterization, they have found a bimodal distribution. One group of well-educated, higher-paid Asian American professionals does well until they reach the glass ceiling; the other group is low skilled, low paid, and generally disadvantaged.⁷²

A 2007 study showed that although Asians comprise 4.4 percent of the U.S. population, they account for only 1.5 percent of *Fortune* 500 board members.⁷³ The Committee of 100, an organization of prominent Chinese Americans, commissioned the study; they note that this under-representation on *Fortune* 500 boards has occurred in spite of the fact that Asian Americans are wealthier and better educated than whites and other minority groups. According to Wilson Chu, a Dallas lawyer, “There’s a negative perception of Asians out there. People may view them as smart people, but not as leaders.”⁷⁴

Some have argued that many of the problems of Asian Americans stem from their image as a model minority, which embraces discipline, hard work, and education. This image has a downside, because quiet achievement can be interpreted as passivity and the Asian American professional can feel invisible in the corporation.⁷⁵ The Asian American response to this had been to avoid confrontation and simply work harder, but groups like the Committee of 100 are beginning to change that. The presence of Asian Americans will continue to grow, and so their treatment in the workplace will be an issue for years to come.

ISSUES OF SEX DISCRIMINATION

Issues surrounding sex discrimination are quite different from issues involving race, color, and national origin. The major issues for women today include (1) getting into professional and managerial positions and out of traditional female-dominated positions, (2) achieving pay commensurate with that of men, (3) eliminating sexual harassment, and (4) being able to take maternity leave without losing their jobs. Some progress is being made on most of these fronts.

Moving into Professional/Managerial Positions

The 2005 Catalyst Census marked the tenth year that the group tracked women in *Fortune* 500 officer positions; they titled their report “Limited Progress, Challenges Persist” and noted that while they celebrated the 10-year milestone, there was little to celebrate in the actual data.⁷⁶ From 2002 and 2005, the percentage of corporate

officer positions held by women increased by only 0.7 percentage points to 16.4 percent. This virtual standstill carried through in all the other data they collected, leading the group to conclude that corporate did not yet realize the importance of a more diverse workforce.⁷⁷ They estimated that if the growth rate seen in the last 10 years persists, it will take 40 years for women to achieve equality with men in corporate officer ranks.⁷⁸ The glass ceiling has yet to be shattered.

When *Fortune* 1000 male CEOs and senior-level female executives were asked for their views on why glass ceilings exist, their perspectives differed. The male CEOs blamed the glass ceiling on the women's lack of experience and time "in the pipeline." The female executives disagreed sharply, citing an exclusionary corporate culture as the reason for women's lack of advancement to senior positions. They described a corporate playing field that was not level due to negative preconceptions and stereotypes. Despite their differences about the causes of the glass ceiling, the male CEOs and female executives agreed that both individuals and the organization are responsible for creating positive organizational changes.⁷⁹

Pay Equity

Pay equity can be approached from two directions: equal pay and comparable worth. Equal pay is the concept that workers doing the same job should receive the same pay, irrespective of gender. The issue of pay equity is complex, and some subgroups of women have fared better than others. In general, however, the issue of pay equity is similar to the issue described previously about the glass ceiling. Throughout the 1980s and early 1990s, the pay gap between men and women was closing gradually, from about 65 cents to every dollar earned by men in 1980 to more than 75 cents for every dollar in 1995.⁸⁰ A decade later, women are earning slightly less—74.7 cents for every dollar earned by men.⁸¹ The actual gap varies depending on who is doing the calculating and what groups they are comparing. Across groups, however, there seems to be a general consensus that improvement has slowed or possibly stopped.⁸²

Some observers have tried to explain the discrepancy by arguing that these statistics include women who lost both time and experience through extended maternity leave. However, the Bureau of Labor Statistics shows that only 5.1 percent of women take more than a week off beyond regular vacation time (for any reason), while 3.3 percent of men do the same.⁸³ A recent General Accounting Office (GAO) study controlled for external factors such as women working less, leaving the workforce for longer periods of time, and working at lower-paying jobs. They found that women still earned significantly less than men. "After accounting for so many external factors, it seems that still, at the root of it all, men get an inherent annual bonus just for being men," said Representative Carolyn B. Maloney (D-NY).⁸⁴

A recent study from the Economic Policy Institute evaluated this issue by studying highly accomplished new media workers in New York City. They found that female Internet workers were earning, on average, \$10,000 less per year than comparable male workers. According to Rosemary Batt, a coauthor of the study, "Along gender lines, the new economy doesn't seem to be very different from the old economy."⁸⁵

The causes of this inequity are complex, involving both conscious and unconscious bias. A recent series of studies, however, has cast light on a behavioral factor that may be contributing to the problem—women’s hesitation to negotiate. The first study found a significant difference in starting salaries among Carnegie Mellon MBA graduates. The starting salaries of female students were almost \$4,000 (7.6 percent) lower than those of the male students because the women had tended to accept the first salary offer. Only 7 percent of women negotiated the salary offer, while eight times as many men (57 percent) asked for more.⁸⁶ The authors then conducted a follow-up experiment in which, after playing a word game, subjects were given \$3 of the “\$3 to \$10” they were promised for participating. The experimenter said, “Here’s \$3. Is \$3 OK?” The men outnumbered the women nine to one in saying it’s not okay and asking for more money.⁸⁷

In the last study, the authors conducted an Internet survey of 291 people’s negotiation behavior. For men, the most recent negotiation was two weeks earlier; for women, it was four weeks earlier. The second most recent negotiation for men was seven weeks earlier; for women, it was twenty-four weeks earlier. Finally, when asked when they expected to negotiate next, the men expected to negotiate in one week; for women, it was in four weeks. These findings indicate that men not only negotiate more often, but they also perceive more of their situations as possible negotiations.⁸⁸ The authors suggest that these findings are driven by two factors. First, women are socialized not to negotiate from a young age. The message they receive is to place the interests of others before their own. Second, the same negotiation behavior for which men are rewarded can result in penalties for women. Behavior that in men is considered “assertive” is often perceived in women as being “pushy.” The authors put forth the following recommendations for managers to close the pay gap:⁸⁹

- Let women employees know that they should and must ask for what they want.
- Tell women employees about the benefits of negotiation.
- When men and women have comparable achievement, give them comparable raises.
- Knowing that women’s style is less assertive, don’t leave them out of things.
- Audit your and the firm’s record for advancing women employees.
- Don’t let the squeaky wheel get the grease—create a situation where equal performance receives equal rewards.

A recent study in the *Journal of Applied Psychology* sheds additional light on the pay gap. Being a woman is not the only source of discrepancy: simply working with women can lead to a lower salary for both men and women. Managers who work with more women, whether the women are subordinates or peers, have lower salaries than managers who work with mostly men. These findings held true across a variety of industries.⁹⁰ “This is a hidden phenomenon that affects both men and women managers,” says Cheri Ostroff, one of the study’s authors.⁹¹ For each 10 percent increase of women in the workplace, the managers’ pay

decreased by about \$500. Those who managed a group composed completely of women were paid \$9,000 less than those who managed a group divided evenly between men and women.⁹² Clearly, the gender gap in pay is a complex issue with a variety of causes. Addressing it will require an equally complex set of solutions.

Comparable worth presents a controversial solution to the pay-equity problem. From this perspective, workers doing different jobs should receive the same pay if those different jobs have equal inherent worth, i.e., contribute equally to the firm's performance. As previously discussed, the Equal Pay Act requires that people holding equal positions receive equal compensation. Despite the act's existence, however, the pay of men and women remains disparate, due largely to the wage effects of labor market segregation, whereby jobs traditionally held by women pay less than their requirements or contributions might indicate. The persistent disparity between men's and women's median incomes has led some legal scholars and women's advocates to recommend comparable worth.⁹³ Advocates of comparable worth argue that differences in seniority and education cannot explain the fact that women generally earn only about three-fourths of what men do. They argue that certain jobs are paid less just because they are traditionally held by women. Opponents of comparable worth counter that it is not pragmatic to apply comparable worth to the private sector, because the private sector lacks the public sector's civil service categories, which are fixed by legislation.⁹⁴ Their arguments are supported by a 2001 study that showed that inherent job worth is a subject that is difficult to measure reliably and accurately.⁹⁵

The only recent attempt to institute a system of comparable worth has been in one state, New York. The New York State Fair Pay Act specifically disallows a defense that inequitable wage rates match the prevailing market; this effectively creates a system consistent with comparable worth. The Fair Pay Act was passed by the State Assembly in April 2002 but died in a State Senate committee for the fifth year in a row due to intense business lobbying and partisan opposition.⁹⁶ In general, the concept of comparable worth is receiving little attention these days. One recent exception was the confirmation of Chief Justice Roberts to the Supreme Court. In a memo Roberts wrote as a young Reagan administration White House lawyer, he described comparable worth as "staggeringly pernicious," bringing the concept back into the media for a short while.⁹⁷

Sexual Harassment

A recent survey, sponsored by the Employment Law Alliance, found that 21 percent of women and 7 percent of men have been sexually harassed at work. In a related finding, 20 percent of the respondents said they were aware of a romantic supervisor/subordinate relationship at work, and 54 percent said supervisors are likely to retaliate if a subordinate rejects their romantic overtures.⁹⁸ The negative consequences of sexual harassment are pervasive and ongoing. A 2007 meta-analysis of sexual harassment studies found that victims of sexual harassment suffered a range of negative outcomes such as decreased job satisfaction, lower organizational commitment, withdrawal from work, poor physical and mental health, and even symptoms of posttraumatic stress disorder.⁹⁹ The study also found that the organizational climate played a part in facilitating its occurrence.¹⁰⁰

It is difficult to document fully the extent to which **sexual harassment** has become a major issue in American business today. With the increasing number of women in the workforce, however, it is understandable why sexual harassment has become a much-debated issue. Sexual harassment has been a high-profile issue ever since 1991, when Supreme Court nominee Clarence Thomas was accused of sexual harassment by Anita Hill, a former employee of the EEOC. The country witnessed days of televised hearings over the issue, and the event created a springboard for many women to come forward and publicly claim that they had been sexually harassed by co-workers in the past. The country was divided in its opinion of whether Hill had actually been sexually harassed by Thomas 10 years earlier, and Thomas was eventually confirmed to a seat on the highest court. The Thomas hearings were a watershed event for sexual harassment. The hearings catapulted sexual harassment into the limelight, just as the explosion at the Union Carbide plant in Bhopal, India, and the massive oil spill from the Exxon *Valdez* made workplace safety and environmental issues, respectively, national concerns.

Data from the EEOC report an escalating number of sexual harassment complaints. In 1986, 2,052 complaints were filed. By 2006, there were 12,025 sexual harassment complaints.¹⁰¹ Although the number of complaints in 2006 is still high, it is a decrease from the 15,889 complaints lodged in 1997.¹⁰² With this background, let us now consider what Title VII and the EEOC have to say about sexual harassment as a type of sex discrimination.

The EEOC defines sexual harassment in the following way:

Unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature constitute sexual harassment when submission to or rejection of this conduct explicitly or implicitly affects an individual's employment, unreasonably interferes with an individual's work performance, or creates an intimidating, hostile, or offensive work environment.

Implicit in this definition are two broad types of sexual harassment. First is what has been called **quid pro quo** harassment. This is a situation where something is given or received for something else. For example, a boss may make it explicit or implicit that a sexual favor is expected if the employee wants a pay raise or a promotion. Second is what has been referred to as **hostile work environment** harassment. In this type, nothing is given or received, but the employee perceives a hostile or offensive work environment by virtue of uninvited sexually oriented behaviors or materials being present in the workplace. Examples of this might include sexual teasing or jokes or sexual materials, such as pictures or cartoons, being present in the workplace.

To clear up common misconceptions, the EEOC indicates that sexual harassment can occur in a variety of circumstances that include but are not limited to the following:¹⁰³

- The victim as well as the harasser may be a woman or a man. The victim does not have to be of the opposite sex.
- The harasser can be the victim's supervisor, an agent of the employer, a supervisor in another area, a co-worker, or a nonemployee.

Figure 19-6 Examples of Sexual Harassment Complaints

- Being subjected to sexually suggestive remarks and propositions
- Being sent on unnecessary errands through work areas where men have an added opportunity to stare
- Being subjected to sexual innuendo and joking
- Being touched by a boss while working
- Co-workers' "remarks" about a person sexually cooperating with the boss
- Suggestive looks and gestures
- Deliberate touching and "cornering"
- Suggestive body movements
- Sexually oriented materials being circulated around the office
- Pornographic cartoons and pictures posted or present in work areas
- Pressure for dates and sexual favors
- Boss's cruelty after sexual advances are resisted
- A boss rubbing employee's back while she is typing

Note: It should be noted that these are "complaints." Whether each item turns out to be sexual harassment or not in the eyes of the law is determined in an official hearing or trial.

- The victim does not have to be the person harassed but could be anyone affected by the offensive conduct.
- Unlawful sexual harassment may occur without economic injury to or discharge of the victim.
- The harasser's conduct must be unwelcome.

Figure 19-6 lists the kinds of experiences women are typically talking about when they say they have been sexually harassed.

Meritor Savings Bank v. Vinson. Prior to 1986, sexual harassment was not a specific violation of federal law. In a landmark case, however, the Supreme Court ruled in 1986 in *Meritor Savings Bank v. Vinson* that sexual harassment was a violation of Title VII. In this case, the court ruled that the creation of a "hostile environment" through sexual harassment violates Title VII, even in the absence of economic harm to the employee or a demand for sexual favors in exchange for promotions, raises, or the like. Remedies made available to the victims at that time included back pay, damages for emotional stress, and attorney fees.¹⁰⁴ We should reiterate that sexual harassment can be committed by women against men or by individuals of the same sex.

Harris v. Forklift Systems. The stage was set for another major Supreme Court ruling (*Harris v. Forklift Systems*) in 1993 in what many were hoping would more

clearly define what constituted sexual harassment. The court agreed to hear the case of a Tennessee woman, Teresa Harris, who claimed her boss (at Forklift Systems) made sexual remarks about her clothing, asked her to retrieve coins from his pants pockets, and once joked about going to a motel “to negotiate your raise.” The lower courts had thrown out her lawsuit, arguing that she had only been offended and had not suffered any “severe psychological injury.”¹⁰⁵

The Supreme Court overturned the lower courts and ruled that employers can be forced to pay damages even if the workers suffered no proven psychological harm. Justice Sandra Day O’Connor, who wrote the court’s unanimous decision, said that employees can be awarded damages as long as their work “environment would reasonably be perceived, and is perceived, as hostile or abusive.”¹⁰⁶

Another key part of the Supreme Court’s ruling addressed the question of “from whose perspective is sexual harassment to be judged?” Historically, the courts had used the common-law concept of a “reasonable man.” An appeals court ruling had argued that the standards of a “reasonable woman” should prevail when women charged harassment. In *Harris v. Forklift Systems*, however, the Supreme Court decided that a “reasonable person” standard would prevail and that it would more appropriately focus on the conduct, not the victim.

Finally, the Supreme Court’s ruling on the question of “what constitutes sexual harassment” was less than definitive. Again, Justice O’Connor wrote:

*Whether an environment is “hostile” or “abusive” can be determined only by looking at all the circumstances. These may include the frequency of the discriminatory conduct; its severity; whether it is physically threatening or humiliating, or a mere offensive utterance; and whether it unreasonably interferes with an employee’s work performance.*¹⁰⁷

Title IX and Sexual Harassment. Many people do not realize that Title IX offers protection against sexual harassment in a way that is essentially similar to Title VII. Title IX, the law that bans sex discrimination at schools receiving federal funds, is best known in its sports context for the formula that determines if schools are providing women with fair opportunities to play sports. Schools can be sued for monetary damages under Title IX for knowingly allowing sexual harassment to take place. There are four parts to the burden of proof: (1) the school must be aware of the sexual harassment; (2) the school must fail to take steps to stop it; (3) the harassment must deny access to an educational opportunity; and (4) the harassment must take place in an educational setting.¹⁰⁸

The Courts

Supreme Court rulings underscore the importance of companies’ being diligent in their efforts to discourage harassing behavior. For example, the Supreme Court ruled that employers may be held liable even if they did not know about the harassment or their supervisors never carried out any threatened job actions.¹⁰⁹ Clearly, employers must develop comprehensive programs to protect their employees from harassment.

Ethics in Practice Case

MATTERS OF THE HEART

During a recent summer, I worked at the liquor store of my best friend's stepfather. Sometimes during work hours, there would be just the two of us in the store. On numerous occasions, he made sexual comments to me about my body. He would also "accidentally" brush up against the front of me. Once he called me into his office to show me graphic pictures of girls in a pornographic magazine and asked why I had not posed for one. He seemed consumed with the female anatomy. The obvious ethical question forced me to choose between my friendship with the girl I had grown up with and my self-respect, which was severely restricted at that job. A temporary hold on my ideals won out over losing the best friend I had ever had.

1. Has sexual harassment taken place in this case or is it just my imagination?
2. What would you have done in this situation?
 - a. Continued this job without confronting the owner
 - b. Quit and acted as if nothing had happened
 - c. Confronted the owner to see if anything changed
 - d. Other (describe)

Contributed Anonymously

When businesses develop comprehensive and clear programs to prevent sexual harassment, they are legally rewarded. The Supreme Court recently ruled that good faith efforts to prevent and correct harassment are one prong of an "affirmative defense" companies can employ when charged with harassment. The second prong is proving the employee failed to take advantage of opportunities the firm provided for correction or prevention.¹¹⁰

Pregnancy Discrimination

For some time, maternity leave has been an issue for women. In 1987, the Supreme Court upheld a California law that granted pregnant workers four months of unpaid maternity leave and guaranteed that their jobs would be waiting for them when they returned. Justice Thurgood Marshall argued, "By taking pregnancy into account, California's statute allows women, as well as men, to have families without losing their jobs."¹¹¹

The **Pregnancy Discrimination Act of 1978**, an amendment to Title VII, requires employers to treat pregnancy and pregnancy-related medical conditions the same as any other medical disability with respect to all terms and conditions of employment. Until recently, however, few women felt protected by this law. Although the EEOC had been empowered to protect women against discrimination in pregnancy, it was not until 1991 that it won a significant case that caught the public's attention. In 1991, after 13 years of litigation, the EEOC announced a

\$66 million settlement by which AT&T would compensate thirteen thousand employees for job discrimination during pregnancy. The settlement came as a result of AT&T discriminating against women by restricting their leaves beyond that permitted by law.¹¹² As a result of the Pregnancy Discrimination Act, the concept of maternity leave is now outdated. In fact, companies are advised to make sure they do not have “maternity leave” policies. By using the term “maternity leave,” companies imply that maternity is somehow different from other temporary disabilities.¹¹³

Pregnancy discrimination continues to present problems. According to EEOC statistics, pregnancy discrimination charges filed over the past five years have shown a steady increase, with the total claim count rising from 3,385 in 1992 to a record 4,901 in 2006.¹¹⁴ Some of the increase may have been due to demographics, with aging baby boomers starting families while a majority of them work. Another cause may be corporate downsizing as employers are forced to get more work out of fewer people. They may see pregnant employees as unreliable—no longer able to work long hours and, after the child is born, the first to run home when baby gets sick.¹¹⁵ The Family and Medical Leave Act has helped, but pregnancy discrimination remains an important issue. In recent rulings, the lower courts have not upheld “reproductive rights” as pregnancy discrimination. That means that a man who is fired because of his partner’s pregnancy is not protected.¹¹⁶ In addition, the courts have ruled that a company’s refusal to provide contraception under the health plan, for men or women, is not discriminatory under the Pregnancy Discrimination Act.¹¹⁷

A new lawsuit area is Family Responsibility Discrimination (FRD); claims that relate to an employee’s family responsibilities have grown 400 percent in the past decade. FRD is a grouping of theories rather than a specific type of claim, and so different claims fall under different federal laws.¹¹⁸ As of June 2007, only Alaska and the District of Columbia had laws against family responsibility discrimination in the workplace. However, the movement is gaining momentum and so firms would be well-advised to include a ban on family responsibility discrimination in their workplace policy and provide training for managers.¹¹⁹

Fetal Protection Policies

Another form of sex discrimination was identified as the Supreme Court ruled that **fetal protection policies** constituted sex discrimination. The decisive case was *UAW v. Johnson Controls, Inc.* Johnson Controls, like a number of other major firms, developed a policy of barring women of childbearing age from working in sites in which they, and their developing fetuses, might be exposed to such harmful chemicals as lead. Johnson Controls believed it was taking an appropriate action in protecting the women and their unborn children from exposure to chemicals. Eight current and former employees and the United Auto Workers (UAW) union, who argued that the policy was discriminatory and illegal under Title VII of the Civil Rights Act, brought a class-action lawsuit against Johnson Controls. A U.S. district court ruled in the company’s favor, and the Chicago-based U.S. Court of Appeals for the Seventh Circuit affirmed that

decision. The U.S. Supreme Court later reversed the appellate court, arguing that the policy was on its face discriminatory and that the company had not shown that women were more likely than men to suffer reproductive damage from lead.¹²⁰

Even though the Supreme Court ruled that injured children, once born, would not be able to bring lawsuits against the company, several experts think it likely that such lawsuits will indeed be filed in the future. One expert said, “A mother can waive her own right to sue, but she can’t waive the right of a child to bring suit. So, 5 or 10 years down the line you might see children born with cognitive disabilities, and they could independently sue businesses.” The UAW does not dispute this possibility and asserts that it should provide a major impetus for companies to make workplaces safer.¹²¹ OSHA has identified reproductive health hazards as an area likely to experience an increase in litigation.¹²²

An Historic Class Action

In 2007, the Ninth U.S. Circuit Court of Appeals upheld certification of the largest civil rights class action in history against a private employer. Approximately 2 million women who have worked for Wal-Mart are claiming that they were paid less than men in comparable positions, even when they achieved higher performance ratings and had greater seniority; they were promoted less often than men to in-store management positions; and they were made to wait longer to advance.¹²³ The National Organization of Women (NOW) had designated Wal-Mart as a “Merchant of Shame” for sex discrimination in pay, promotion, and compensation and exclusion of insurance coverage for women’s contraception.¹²⁴

The U.S. Chamber of Commerce filed a friend-of-the-court brief on behalf of Wal-Mart, arguing that the size of the class would “force employers to settle these huge claims no matter what their merit, effectively depriving them of their right to trial; and to encourage employers to adopt the kinds of quota-like policies that Title VII was enacted to prevent.”¹²⁵ The court disagreed, saying: “Focusing on the potential size of a punitive damage award would have the perverse effect of making it more difficult to certify a class the more egregious the defendant’s conduct or the larger the defendant. Such a result hardly squares with the remedial purposes of Title VII.”¹²⁶

OTHER FORMS OF EMPLOYMENT DISCRIMINATION

Much of the attention surrounding employment discrimination has focused on racial and sexual discrimination. There are, however, other important forms of discrimination that represent critical issues for business today. It is important for managers to understand the many forms that discrimination can take in an increasingly diverse workforce and where courts currently stand on those issues.

Age Discrimination

A recent survey by Execunet, a career networking and job search service, found that 82 percent of senior executives believed age discrimination was a serious

problem in the workplace of today. Even more telling is the fact that 94 percent of the respondents, who are almost all in their forties and fifties, felt that they had been the victim of age discrimination at some time. Specifically, they felt that age had taken them out of the running for a particular job.¹²⁷

The Supreme Court recently tackled a particularly challenging question regarding reverse age discrimination. The case stemmed from a collective bargaining agreement between General Dynamics and the United Auto Workers (UAW) that allowed the company to eliminate health benefits for future retirees while grandfathering in those who were 50 years of age or older at the time of the agreement. Dennis Cline was between 40 and 50 years old when the agreement occurred, so he would not be eligible for the benefits. He joined with other employees in the same age range to bring an action before the EEOC. The EEOC's efforts to get the parties to settle informally failed, and so the employees sued General Dynamics in federal district court. The district court dismissed the case, saying that the ADEA did not protect the younger from the older. The Sixth Circuit Court of Appeals reversed the district court, saying that the ADEA prohibits discrimination against any individual because of age. General Dynamics appealed to the Supreme Court, and they agreed to hear the case because different district courts had come to different conclusions on this issue. The EEOC filed a "friend of the court" brief in favor of the employees. Ultimately, the Supreme Court reversed the Sixth Circuit Court, saying that the ADEA does not prohibit favoring the old over the young.¹²⁸ In 2007, the EEOC revised their regulations to clarify that fact. There are some states with laws that prohibit discrimination against younger workers on the basis of age, and in those states such discrimination continues to be unlawful.¹²⁹

The revised regulations also stipulate that it is okay under the ADEA for employers to ask for date of birth or age on a job application, but the EEOC will scrutinize such applications closely to make certain the request is for permissible purposes and not those purposes prohibited by the act. Similarly, help-wanted ads that request an applicant's age are not in and of themselves a violation, but the EEOC will scrutinize them closely, too.¹³⁰

Religious Discrimination

Religious discrimination is a relatively new issue in the workplace, but it is one that is growing quickly: complaints increased 20 percent in the past five years.¹³¹ According to Jeanne Goldberg, senior attorney adviser for the EEOC, this is due to changes in the composition of the workforce, such as changing immigration patterns that have increased the number of people from parts of the world with less familiar religious beliefs and practices. For example, immigration from Asia has increased threefold while immigration from Europe has dropped to less than one-fourth of what it was 30 years ago. "The workforce also is aging," says Goldberg. "The older people get, the more important religion becomes to them."¹³²

The Workplace Religious Freedom Act has been introduced each year for nearly a decade and is still under consideration by the U.S. Congress. Its purpose is to disallow arbitrary and unfair refusal to tolerate religious expression in the workplace. According to one of the act's cosponsors, John Kerry (D-MA), "No

Ethics in Practice Case

IS RELIGION ALLOWED IN THE WORKPLACE?

For six months, I worked as a receptionist at a local doctor's office that employed about 30 people. The owner and head practitioner was a member of a religious cult. During business hours, everything seemed normal for a doctor's office of this size, but during the two-hour lunch break, all of the employees had to go upstairs and go "on course." These mandatory courses encompassed everything from communication skills to office efficiency. They were all designed by a man who founded the religious cult of which my boss was a member. Granted that they were business teachings, other staff members and I felt that these teachings were heavily weighted with religious undertones.

For example, one of the most important keys to these lessons was that you had to understand every word. After every exercise, we were individually tested to make sure that we knew all of the words. Most of the words that I didn't understand could not

be found in the dictionary, because they came straight from the man's religious teachings. Whenever I questioned my boss about a word, it usually led into a long discussion about the cult leader's works, and I would have to read paragraphs out of the religious teachings to "fully understand" the meaning. To me, it felt as though I was being brainwashed, and from then on I scheduled my university classes during this course time.

My dilemma was this: did the doctor have the right to insist that we submit to such "teachings," which made us uncomfortable?

1. Is any form of discrimination or harassment taking place in this case?
2. What ethical issues arise in this case?
3. If you were faced with this dilemma, what action would you take?

Contributed by Allison Grice

worker should have to choose between keeping a job and keeping faith with their cherished religious beliefs."¹³³ Opposition to the act comes mainly from business groups who fear it will be burdensome.¹³⁴ Backed by a broad-based coalition of religious groups, this legislation is designed to respond to the increase in incidents of religious bias by requiring employers to do more to accommodate religious beliefs. The act would allow religious expression such as taking a particular day off or dressing in a particular manner, as long as safety and health considerations were not jeopardized. According to the Title VII law, employers must make reasonable accommodations unless doing so represents an undue hardship. In 1977, the Supreme Court ruled that anything more than minimal effort or expense could be considered undue hardship. The proposed legislation would raise the definition of undue hardship to "significant difficulty or expense."¹³⁵

Accommodation often requires ingenuity. IBM was faced with a challenge when a newly hired Muslim woman showed up for work the first day and was told she had to have her picture taken for the employee identification badge. For Muslim women, wearing the veil is a sign of modesty and so the new employee

objected to showing her face on religious grounds. IBM officials came up with an accommodation that met the needs of all involved. She had her picture taken in a veil, and that was the picture on the employee identification badge she wore each day. In addition, a woman photographer took her picture without the veil for a second badge she would carry in her bag. It was agreed that if she ever needed to show that badge then she would only do so to a female security officer.¹³⁶

At the 2007 American Bar Association conference, the EEOC representatives and a group of management and plaintiff's lawyers warned companies against developing uniform "one size fits all" policies regarding religious expression, because to do so would not fulfill an employer's responsibility to make a reasonable accommodation where possible. "If there is a possibility of an accommodation, you have to explore it," said EEOC vice chair Leslie Silverman.¹³⁷

Color Bias

Color bias is another issue raising new challenges for the workplace. As part of the Civil Rights Act of 1964, discrimination based on color has been illegal for a long period of time. As a practical matter, however, color bias has been largely ignored until recently. As we mentioned previously, **color bias** is one of the focal points of the EEOC's E-Race initiative. As part of that, they have clarified the definition of color discrimination. "Color discrimination occurs when a person is discriminated against based on his/her skin pigmentation (lightness or darkness of the skin), complexion, shade, or tone. Color discrimination can occur between persons of different races or ethnicities, or even between persons of the same race or ethnicity. For example, an African American employer violates Title VII if he refuses to hire other African Americans whose skin is either darker or lighter than his own."¹³⁸

Color bias refers to the shade of a person's skin rather than a person's race. Federal law has already determined color bias to be illegal. The Civil Rights Act of 1964 prohibits discrimination based on "race, color, religion, sex or national origin."¹³⁹ Most people do not realize that race and color are considered to be separate by law and both are covered by law, so many cases go unreported.¹⁴⁰

For example, a person who favors light-skinned African Americans over those with darker skin is guilty of color bias, not racial bias. Color bias can occur among people of the same race and, according to the EEOC, the number of intrarace color bias cases is on the rise.¹⁴¹ EEOC chairwoman Cari Dominguez says we are now in the "mélange millennium." She notes, "We have a lot of racial blends, and we're trying to work out at way to determine what kind of adverse employment decisions can occur as a result."¹⁴²

Sexual Orientation and Transgender Discrimination

When Wal-Mart extended its antidiscrimination policy to gay and lesbian employees, many took it as a sign that the mainstream workplace was becoming less hostile to gay employees.¹⁴³ Wal-Mart is actually a laggard because so many companies now include sexual orientation in their categories of protected workers. As of 2007, 124 *Fortune* 500 companies included transgender people in their antidiscrimination policies; this is a 10-fold increase over the number that had such

policies in 2001. In addition, 49 of the *Fortune* 500 companies include sexual orientation in their nondiscrimination policies (ExxonMobil Corporation is the one that does not). Nearly 90 percent of the *Fortune* 500 (433 companies) include sexual orientation in their nondiscrimination policies, and a majority (254 companies) provide health benefits for same-sex domestic partners.¹⁴⁴

There is no federal antidiscrimination statute, although about one-third of the U.S. population is covered by a patchwork of state, local, and organizational protections.¹⁴⁵ Efforts are under way to provide federal protection against employment discrimination based on sexual orientation or gender identity. The federal Employment Non-Discrimination Act of 2007 (ENDA), a bipartisan piece of federal legislation, was introduced in the U.S. House of Representatives on April 24, 2007. Various versions of ENDA have been introduced in Congress every year since 1994; however, the legislation only made it out of committee once. The bill has been referred to four House committees since its 2007 introduction.¹⁴⁶

Another issue that presents special challenges for business is the treatment of transgender and transsexual employees. “Transgender” refers to a person who identifies with his or her opposite sex and acts accordingly. “Transsexual” refers to a person who is undergoing or has undergone sex-change surgery.¹⁴⁷ This is not a new workplace issue. In 1993, the Washington State Supreme Court upheld Boeing Co.’s 1985 firing of a male software engineer who dressed in women’s clothes and insisted on using the women’s restroom while the sex-change operation was pending. The court ruled that discomfort with one’s biological sex was not a handicap.¹⁴⁸ What is new is the opinion of the courts and the stance that corporations have begun to take since that day.

Twenty-six *Fortune* 500 companies have banned discrimination based on “gender identity and expression.” Sixty-seven cities and counties offer similar protections.¹⁴⁹ Fifteen states have either laws or administrative rulings that prohibit gender stereotypes and discrimination.¹⁵⁰ In June 2004, the Sixth U.S. Circuit Court of Appeals (which covers Michigan, Ohio, Kentucky, and Tennessee) heard the case of a transsexual Ohio firefighter who had been fired. In the first such action by a federal court, the court ruled that Title VII of the Civil Rights Act of 1964 protects transsexuals and that the sex-stereotyping doctrine covers people who change their sex.¹⁵¹ According to *InsideCounsel*, the oldest monthly magazine published specifically for in-house legal counsel, “Employers across the nation should be scrutinizing their policies and practices with regard to discrimination against transgender and transsexual people as states pass laws prohibiting discrimination on the basis of gender identity and courts interpret existing civil rights laws to protect those individuals.”¹⁵²

Affirmative Action in the Workplace

Affirmative action is the taking of positive steps to hire and promote people from groups previously discriminated against. The concept of affirmative action was

formally introduced to the business world in 1965, when President Lyndon B. Johnson signed Executive Order 11246, the purpose of which was to require all firms doing business with the federal government to engage in affirmative actions to accelerate the movement of minorities into the workforce. Few people realize, however, that the federal government did not make a real commitment to affirmative action until the administration of President Richard M. Nixon, who revived the practice of racial hiring preferences.¹⁵³ Companies today have affirmative action programs because they do business with the government, have begun the plans voluntarily, or have entered into them through collective bargaining agreements with labor unions.

THE RANGE OF AFFIRMATIVE ACTION POSTURES

The meaning of affirmative action has changed since its introduction. It originally referred only to special efforts to ensure equal opportunity for members of groups that had been subject to discrimination. More recently, the term has come to refer to programs in which members of such groups are given some degree of definite preference in determining access to positions from which they were formerly excluded.¹⁵⁴

Daniel Seligman identified four postures in two groupings that define the range that affirmative action may take.¹⁵⁵ He categorized the following affirmative action postures as “soft” or “weak”:

1. *Passive nondiscrimination.* This posture involves a willingness in hiring, promotion, and pay decisions to treat the races and the sexes alike. This stance fails to recognize that past discrimination leaves many prospective employees unaware of or unprepared for present opportunities.
2. *Pure affirmative action.* This posture involves a concerted effort to enlarge the pool of applicants so that no one is excluded because of past or present discrimination. At the point of decision to hire or promote, however, the company selects the most qualified applicant without regard to sex or race.

Postures that Seligman termed “hard” or “strong” were as follows:

3. *Affirmative action with preferential hiring.* Here, the company not only enlarges the labor pool but systematically favors minorities and women in the actual decisions as well. This could be thought of as a “soft” quota system.
4. *Hard quotas.* In this posture, the company specifies numbers or proportions of minority group members that must be hired.

Over the past 30 years, much confusion has surrounded the concept of affirmative action, because it was never clear which of the aforementioned views was being advocated by the government. In hindsight, we can now see that the government was advocating positions based on whichever posture it thought would work, or based on the particular candidate and political party in office at the time. Early on, “soft” or “weak” affirmative action (Postures 1 and 2) was advocated. It became

Figure 19-7 Key Supreme Court Decisions on Affirmative Action

Date	Case	Setting	General Finding
1978	Bakke	Admission to university medical school	Mildly supportive affirmative action (AA)
1979	Weber	Quota-based training program of private employer (Kaiser)	Supportive of AA
1984	Shotts	City fire department (Memphis)	Minor setback for AA; qualified seniority plans OK for layoffs
1986	Wygant	Jackson, Michigan, Board of Education—school teachers	Mixed finding; seniority system upheld, preferential treatment not always wrong
1986	Firefighters	Municipality (City of Cleveland Fire Department)	Supportive of AA; minorities may be given hiring preferences
1986	Sheet Metal Workers	Labor union	Strongly supportive of AA; court can order AA for those who were not specific victims of discrimination
1987	Alabama State Police	State police force	Strongly supportive of AA; court can order promotion quotas
1987	Johnson	County transportation department (Santa Clara)	Strongly supportive of AA; AA can promote women to remedy their historical exclusion from certain job categories
1989	<i>Richmond v. Croson</i>	City government	Mild limitation of AA
1989	<i>Martin v. Wilkes</i>	Setting unknown	Supportive of reverse discrimination charges
1995	Adarand Constructors	Federal contractors	Instituted strict scrutiny standards; set-asides did not pass test
2003	<i>Grutter v. Bollinger et al.</i>	University admissions	Upholds affirmative action policy of law school but rejects policy that automatically gives 20 points to people of color; says race can be one of many factors considered

apparent, however, that these postures were not as effective in getting the results desired. Therefore, “hard” or “strong” affirmative action (Postures 3 and 4) was later advocated. The real controversy over affirmative action began with the use of soft quotas and “preferential hiring” (Posture 3) and “hard quotas” (Posture 4). Today, when people speak of affirmative action, they are typically referring to some degree of preferential hiring, as in Postures 3 and 4. Figure 19-7 summarizes the key Supreme Court decisions on affirmative action.

THE CONCEPT OF PREFERENTIAL TREATMENT

Let us briefly consider some of the arguments that have been set forth both for and against the concept of **preferential treatment**, which undergirds affirmative action. The underlying rationale for preferential treatment is the principle of **compensatory justice**, which holds that whenever an injustice is done, just compensation or reparation is owed to the injured party or parties.¹⁵⁶ Many people believe that groups discriminated against in the past (for example, women, blacks, Native North Americans, and Mexican Americans) should be recompensed for these injustices by positive affirmative action. Over the years, deliberate barriers were placed on opportunities for minorities—especially blacks. These groups were prevented from participating in business, law, universities, and other desirable professions and institutions. Additionally, when official barriers were finally dropped, matters frequently did not improve. Inequalities became built into the system, and although mechanisms for screening and promotion did not intentionally discriminate against certain groups, they did favor other groups. Thus, the view that we can and should restore the balance of justice by showing preferential treatment became established as a viable option for moving more quickly toward economic equality in the workplace and in our society.¹⁵⁷

THE CONCEPT OF REVERSE DISCRIMINATION

The principal objection to affirmative action and the reason it has become and remained controversial is that it leads to **reverse discrimination**. This concept holds that when any sort of preference is given to minorities and women, discrimination may occur against those in the majority—often, but not always, white males. For well over a decade now, white males who feel passed over because of preferences for minorities or women have been filing reverse discrimination suits.¹⁵⁸ They argue that Title VII prohibits discrimination based on race, color, or sex and that this includes reverse discrimination as well. All of this has created an intensely controversial public policy dilemma: How can we show preferential treatment for minorities and women and at the same time not discriminate against white males? This is very difficult, if not impossible, to do. The next question then becomes a matter of public priority: Should we as a nation pursue affirmative action, even if it means that some opportunities for white males might be sacrificed in the process? There are strong opinions on both sides.

MINORITY OPPOSITION TO AFFIRMATIVE ACTION

Although it is clear that affirmative action is one of the major pillars of the mainstream civil rights agenda, during the past decade a growing and more visible number of blacks have begun to speak out against such policies.

Two prominent African American critics of affirmative action are Dr. Thomas Sowell and Professor Stephen L. Carter. Dr. Sowell has argued that blacks would be better served in the long run if affirmative action programs as we now know

them were abolished.¹⁵⁹ Stephen L. Carter, a law professor at Yale University, who says that his race helped him get into college, wrote a widely read and reported book titled *Reflections of an Affirmative Action Baby*.¹⁶⁰ Professor Carter's concern seems to be with the effects of affirmative action on those whom the policy was intended to help. According to Carter, affirmative action sets up a dichotomy between "best" and "best black." Carter recalls how, over and over, his teachers told him he was the "best black" they had enrolled. The "best black" syndrome holds that, however accomplished a black person might be, she or he is likely to be categorized as "first black," "only black," or "best black" or measured by a different, most likely inferior, standard.¹⁶¹ Carter does not want to eliminate all types of affirmative action immediately. He supports some degree of racial consciousness, particularly in admissions to colleges and professional schools, but thinks that at some point the preferences must fall away entirely. He is against turning affirmative action into a tool for representing the "points of view" of excluded groups.¹⁶²

THE ADARAND DECISION AND STRICT SCRUTINY

The 1995 case of *Adarand Constructors Inc. v. Peña* (115 S. Ct. 2097) was a turning point in affirmative action. In it, the Supreme Court ruled 5-to-4 that all government action based on race must meet the **strict scrutiny** standard of judicial review. Strict scrutiny has two components: (1) the program or policy must meet a compelling government interest, and (2) the program or policy must be tailored narrowly to meet the program or policy objectives. Although the ruling does not declare affirmative action to be unconstitutional, it sets extremely tough standards for any program to pass.¹⁶³

The effects of the Adarand decision are still being felt. An intense round of court cases followed the decision, as affirmative action programs were put to the strict scrutiny test. These cases resulted in some landmark decisions, such as *Hopwood v. the State of Texas*, in which the Fifth Circuit Court held that using race as a consideration in University of Texas Law School admissions did not pass the strict scrutiny test. In June 1995, former President Clinton issued a memorandum to all programs that use race, ethnicity, or gender as a consideration in decisions. The directive said that any program must be eliminated if it creates a quota or a preference, causes reverse discrimination, or continues after the goal of equal opportunity has been achieved. Although the Adarand decision applies to federal programs only, the private sector is feeling its effect because it sheds light on the actions the courts may take.¹⁶⁴ However, some argue that its application has been inconsistent and arbitrary, limiting its usefulness as a tool for assessing how the courts will respond to specific affirmative action programs.¹⁶⁵

THE FUTURE OF AFFIRMATIVE ACTION

The buying power of minority groups is increasing dramatically, and that has led to an increase in business's interest in diversity programs in general and affirmative action in particular. The University of Georgia's Selig Center charts the growth of consumer groups, and their findings are instructive. Hispanic buying power has grown 307 percent, from \$212 billion in 1990 to \$862 billion in 2007. In comparison, the buying power of non-Hispanics in the United States grew 125 percent during the same period. Black buying power grew 167 percent during that period, compared to 134 percent for the total population. In addition, more blacks are starting their own businesses. The number of black-owned businesses increased 45 percent from 1997 to 2002, a time period in which the overall number of U.S. businesses grew by only 10 percent. This growth in economic impact may be part of the reason that the public attitude toward affirmative action is becoming more positive. The Pew Research Center found that this "once contentious" issue no longer splits the nation as it once did. In 1995, 58 percent of respondents favored affirmative action; by 2007, the number had risen to 70 percent.¹⁶⁶ Nevertheless, resistance to affirmative action remains, as evidenced by Michigan voters who supported a ban against affirmative action after the Supreme Court upheld the right of universities to consider race in admissions.¹⁶⁷

Despite the inconsistency in public opinions, business appears to be moving toward a consensus based on bottom-line considerations. Increasing minority buying power and influence is leading companies to want to undertake voluntary programs to increase the diversity in their workforce and their bottom lines. In one of life's ironies, the EEOC has had to warn companies of the dangers of voluntary affirmative action. EEOC chair Naomi Earp said that firms must be careful to not base employment decisions on race or any other protected category, even when the goal is greater diversity. According to Earp, customer preferences have never been an acceptable reason to discriminate in employment, and reference to a global market is not sufficient justification either.¹⁶⁸ The legality of some diversity practices remains unsettled and thus they may be risky. These include offering incentives for managers to achieve a diverse workforce or promoting affinity groups formed by employees along race or gender lines.¹⁶⁹

Gilbert Casellas, a former EEOC chair who now represents employers, believes that corporate diversity policies may be "outpacing the law" because companies are now eager to improve their diversity.¹⁷⁰ Companies know that being diverse provides them with advantages, such as recruiting a diverse and talented workforce. Companies can and should still strive to achieve workforce diversity, but they must do so in a way that follows best practices such as consistent standards and transparent practices.

Summary

This chapter addresses several subgroups of employee stakeholders whose job rights are protected by law. The United States became serious about the problem of discrimination by enacting the Civil Rights Act of 1964, which prohibited discrimination on the basis of race, color, religion, sex, or national origin. Laws covering age and disabilities were passed later. The EEOC was created to assume the major responsibility for enforcing the discrimination laws. Like other federal agencies, the EEOC has had problems. However, on balance, it has done a reasonable job of monitoring the two major forms of discrimination: disparate treatment and disparate impact. Discrimination issues discussed in this chapter include the movement from civil rights to social benefits; the plights of African Americans, Asian Americans, Hispanics, and women moving

into professional/managerial positions; comparable worth; sexual harassment; fetal protection policies; and religious discrimination. In addition, new and evolving discrimination issues such as sexual orientation, gender identity, and color bias as separate from race were discussed.

Affirmative action was one of the government's answers to the problem of discrimination. Considerable controversy has surrounded the question of how far affirmative action should go. There is evidence that attitudes toward affirmative action are changing as a global economy brings a more diverse workforce and customer base. Firms should follow best practices when designing diversity programs. Sound stakeholder management requires companies to strive to be fair in their employment practices.

Key Terms

affirmative action (page 756)

Age Discrimination in Employment Act (ADEA)
(page 730)

Americans with Disabilities Act (ADA)
(page 732)

bona fide occupational qualification (BFOQ)
(page 730)

Civil Rights Act of 1991 (page 735)

color bias (page 755)

comparable worth (page 746)

compensatory justice (page 759)

disparate impact (page 738)

disparate treatment (page 738)

Equal Employment Opportunity Commission (EEOC) (page 736)

Equal Pay Act of 1963 (page 730)

essential functions (page 733)

fetal protection policies (page 751)

four-fifths rule (page 739)

hostile work environment (page 747)

major life activities (page 734)

preferential treatment (page 759)

Pregnancy Discrimination Act of 1978 (page 750)

protected groups (page 725)

quid pro quo (page 747)

reasonable accommodations (page 733)

reverse discrimination (page 759)

sexual harassment (page 747)

strict scrutiny (page 760)

Title VII of the Civil Rights Act of 1964
(page 730)

undue hardship (page 733)

Discussion Questions

1. List the major federal discrimination laws and indicate what they prohibit. Which agency is primarily responsible for enforcing these laws?
2. Give two different definitions of discrimination, and provide an example of each.
3. What effect do you think the Americans with Disabilities Act (ADA) is having on businesses? Explain your answer.
4. Explain the dilemma of affirmative action versus reverse discrimination. Do you think the Supreme Court is headed in the right direction for handling this issue? Explain.
5. To whom do you think preferential treatment should be given in university admissions? Explain your answer.

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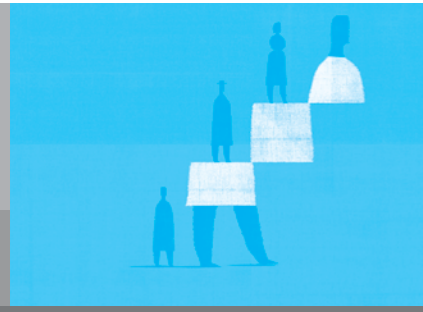
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Cases

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- Case 2** *The Body Shop: Pursuing Social and Environmental Change*
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Case Analysis Guidelines

The guidelines presented below have been designed to help the student analyze the cases that follow. They are not intended to be a rigid format. Each question is intended to bring out information that will be helpful in analyzing and resolving the case. Each case is different, and some parts of the guidelines may not apply in every case. Also, the student should be attentive to the questions for discussion at the end of each case. These questions should be answered in any complete case analysis. The heart of any case analysis is the recommendations that are made. The Issue/Problem Identification and Analysis/Evaluation steps should be focused on generating and defending the most effective set of recommendations possible. In all stages of the case analysis, the stakeholder, ethics and CSR concepts presented in the text should be used. The guidelines are presented in three stages:

ISSUE/PROBLEM IDENTIFICATION

1. **Facts and Assumptions.** What are the *central facts* of the case and the *assumptions* you are making on the basis of these facts?
2. **Major Overriding Issues/Problems.** What are the *major overriding issues* in this case? (What major questions/issues does this case address that merit(s) their/its study in this course and in connection with the chapter/material you are now covering?)
3. **Sub-issues and Related Issues.** What *sub-issues* or *related issues* are present in the case that merit consideration, discussion, and action?

ANALYSIS/EVALUATION

4. **Stakeholder Analysis.** Who are the *stakeholders* in this case, and what are their stakes? (Create a stakeholder map to depict relationships.) What *challenges/threats/opportunities* are posed by these stakeholders? What stakeholder characteristics are at work (legitimacy, power, urgency)?
5. **CSR Analysis.** What Corporate Social Responsibilities (CSR) *economic/legal/ethical/philanthropic* does the company have, and what exactly are the nature and extent of these responsibilities to the various stakeholders?
6. **Evaluations.** If the case involves a company's or manager's actions, evaluate what the company or manager did or did not do correctly in handling the issue affecting it. How should actions have been handled?

RECOMMENDATIONS

7. **Recommendations and Implementation.** What *recommendations* would you make in this case? If a company's or a manager's strategies or actions are involved, should they have acted the way they did? What actions *should* they have taken? What actions should the company or manager take now, and why? Be specific and include a discussion of alternatives (*right now, short-term and long-term*). Identify and discuss any important implementation considerations.

Case 1

Wal-Mart: The Main Street Merchant of Doom

The small town was in need of a hired gun. The people were tired of dealing with the local price-fixing merchant scum who ran the town like a company store. This low-life bunch held the people of the town in a death grip; the townspeople believed they overcharged on every purchase. In spite of what appeared to be a case of collusion, the law was powerless to do anything. What competition there was had been effectively eliminated.

Suddenly, coming over the rise and wearing white, their hired man came riding. The women and children buzzed with excitement. The men were happy. Although his methods of getting the job done turned some people's stomachs, the local watering hole buzzed with tales of how this hired gun would change their world for the better, how someday soon they would have the benefits long afforded the big city. But, others asked, at what price?

THE MODERN VERSION OF THE "HIRED GUN"

In his final days, the man appeared to be somewhat too frail to handle the enormous job. Yet, the courage and self-confidence that he instilled in his associates radiated a belief in low prices and good value for all to see. As his associates rode into town, that radiance put to rest the people's fears

that things had changed. Sam's spirit, the Wal-Mart Way, had come to town.

Sam Walton, founder, owner, and mastermind of Wal-Mart, passed away on April 5, 1992, leaving behind his spirit to ride herd on the colossal Wal-Mart organization. To the consumer in the small community, his store, Wal-Mart, was seen as a friend. On the flip side, many a small-town merchant had been the victim of Sam's blazing merchandising tactics. So what is Wal-Mart to the communities it serves? Is Wal-Mart the consumer's best friend, the purveyor of the free-enterprise system, the "Mother of All Discount Stores," or, conversely, is it really "The Main Street Merchant of Doom"?

THE MAN NAMED SAM

Samuel Moore Walton was born March 29, 1918, near Kingfisher, Kansas. His father was a salesman in the insurance, real estate, and mortgage businesses. The family moved often. Sam was a strong, lean boy who learned to work hard in order to help the family. He attended the University of Missouri starting in the fall of 1936 and graduated with a degree in business administration. During his time there, he was a member of the Beta Theta Phi fraternity, was president of the senior class, played various sports, and taught what was believed to be the largest Sunday school class in the world, numbering more than twelve hundred Missouri students.¹

At age 22, Sam joined J.C. Penney. One of his first tasks was to memorize and practice the "Penney Idea." Adopted in 1913, this credo

This case, originally prepared by William T. Rupp, University of Montevallo, was revised and updated by Archie B. Carroll, University of Georgia.

exhorts the associate to serve the public; not to demand all the profit the traffic will bear; to pack the customer's dollar full of value, quality, and satisfaction; to continue to be trained; to reward men and women in the organization through participation in what the business produces; and to test every policy, method, and act against the question: "Does it square with what is right and just?"²

Sam's First Store. In 1962, at age 44, Sam Walton opened his first Wal-Mart store in Rogers, Arkansas. He took all the money and expertise he could gather and applied the J.C. Penney Idea to Middle America. Sam first targeted small, underserved rural towns with populations of no more than ten thousand people. The people responded, and Wal-Mart soon developed a core of loyal customers who loved the fast, friendly service coupled with consistently low prices. Later, Sam expanded his company into the large cities, often with numerous Wal-Marts spread throughout every part of the city.

THE STORE THAT SAM BUILT

By 1981, Wal-Mart's rapid growth was evident to all and especially disturbing to Sears, J.C. Penney, Target, and Kmart, because Wal-Mart had become America's largest retailer. The most telling figures were those of overhead expenses and sales per employee. The overhead expenses of Sears and Kmart ran 29 and 23 percent of sales, respectively, whereas Wal-Mart's overhead expenses ran 16 percent of sales. At this time, the average Sears employee generated \$85,000 in sales per year, whereas the average Wal-Mart employee generated \$95,000.³

By 2001, Wal-Mart Stores, Inc., had become the world's largest retailer with \$191 billion in sales. The company employed 1 million associates worldwide through nearly thirty-five hundred facilities in the United States and more than one thousand stores throughout nine other countries. Wal-Mart claimed that more than 100 million customers per week visited Wal-Mart stores. The

company had four major retail divisions—Wal-Mart Supercenters, Discount Stores, Neighborhood Markets, and Sam's Club warehouses. As it entered the 2000s, Wal-Mart had been named "Retailer of the Century" by *Discount Store News*, made *Fortune* magazine's lists of the "Most Admired Companies in America" and the "100 Best Companies to Work For," and was ranked on *Financial Times'* "Most Respected in the World" list.⁴ By 2007, Wal-Mart's sales had grown to \$345 billion.⁵

Sam the Motivational Genius. Sam promoted the associate—the hourly employee—to a new level of participation within the organization. He offered profit sharing, incentive bonuses, and stock options in an effort to have his Wal-Mart associates share in the wealth. Sam, as the head cheerleader, saw his job as the chief proponent of the "Wal-Mart Way." The Wal-Mart Way reflected Sam's idea of the essential Wal-Mart culture that was needed for success. Sam felt that when a customer entered Wal-Mart in any part of the country, he or she should feel at home. Examples of the culture included "exceeding customer expectations" and "helping people make a difference." He was a proponent of the "10-Foot Rule," which meant that if a customer came within 10 feet of an associate, the associate would look the customer in the eye, greet him or her, and ask if the customer needed help.⁶

As he was growing the business, Sam, the courageous, borrowed and borrowed, sometimes just to pay other creditors. Arkansas banks that at one time had turned him down later competed with banks that Sam himself owned. Sam, the CEO, hired the best managers he could find. He let them talk him into buying an extensive computer network system. This network corporate satellite system enabled Sam to use round-the-clock inventory control and credit card sales control and provided him with information on total sales of which products where and when. This computer control center was about the size of a football field and used a Hughes satellite for uplinking and downlinking to each store.

Sam the Mortal. In 1992, Sam, the mortal, died of incurable bone cancer. At age 73, Sam Walton said that if he had to do it over again, he would not change a thing. He said, “This is still the most important thing I do, going around to the stores, and I’d rather do it than anything I know of. I know I’m helping our folks when I get out to the stores. I learn a lot about who’s doing good things in the office, and I also see things that need fixing, and I help fix them. Any good management person in retail has got to do what I do in order to keep his finger on what’s going on. You’ve got to have the right chemistry and the right attitude on the part of the folks who deal with the customers.”⁷

Sam, the innovator, developed the “store within a store” concept by training people to be merchants, not just employees. These “store within a store” managers have all the numbers for their departments—breakdowns of how they are doing in relation to the store and the company as a whole. This concept provides big opportunities by providing big responsibilities. Sam set the goal of visiting every Wal-Mart store every year. To do this, he flew his own twin-prop Cessna and visited up to five or six stores per day. Two early social responsibility innovations were Wal-Mart’s “Buy American” plan and its “Environmental Awareness” campaign.

SAM AND SOCIAL AWARENESS: THE “BUY AMERICAN” PLAN

Wal-Mart’s “Buy American” program was a result of a 1984 telephone conversation with Bill Clinton, who was then the governor of Arkansas. The program was a response to Sam’s own enlightenment: He learned that Wal-Mart was adding to the loss of American jobs by buying cheaper foreign goods. Everything Sam stood for came out of his heartfelt obligation to supply the customer with low-cost quality goods, but running counter to this inner driving force was the realization that he was responsible for the loss of American jobs. This contradiction and dilemma drove him to find a solution. His conversation with Governor Clinton inspired Sam to do something about the problem.

The goal of the Buy American plan was to support American-based manufacturers by doing business with them so that they would not go out of business. His primary method for doing this was to give the manufacturers large orders or contracts so that they could stay in business.⁸

Sam wanted other manufacturers to join him in the Buy American plan. He wrote to three thousand American manufacturers and solicited them to sell to Wal-Mart items that Wal-Mart was currently buying from overseas suppliers. Wal-Mart’s competitors did not meet the challenge to “Buy American.” Kmart stated that it would rather buy American-made goods but that it was looking for the best deal for the customer. Target said it was for free trade and that, as the customer’s representative, it just wanted the best deal for the customer. Wall Street analysts responded positively, saying that Wal-Mart’s plan was possibly the beginning of a change of direction for American retailers.⁹

In February 1986, about 12 months after the Buy American plan had begun, Sam held a press conference. He showed off all the merchandise Wal-Mart was now buying domestically. He estimated that Wal-Mart’s Buy American plan had restored 4,538 jobs to the American economy and its people.¹⁰ The Buy American plan was one of Wal-Mart’s early efforts at corporate social responsibility.

The Buy American plan morphed over the years into the well-publicized “Made in the U.S.A.” campaign in which Wal-Mart called customers’ attention to these local products with special labels. At some point in time, Wal-Mart eventually abandoned this emphasis and became one of the largest purchasers of products made overseas. In fact, the company in time became the country’s largest purchaser of Chinese goods in any industry. Some say that by taking its orders abroad, Wal-Mart forced many U.S. manufacturers out of business.¹¹

SAM AND SOCIAL CONCERNS: THE “ENVIRONMENTAL AWARENESS” CAMPAIGN

As awareness of the environment was on the rise, Sam looked for a way to involve Wal-Mart in the

environmental movement. In August 1989, an ad in the *Wall Street Journal* proclaimed Wal-Mart's "commitment to our land, air and water." Sam envisioned Wal-Mart as a leader among American companies in the struggle to clean up the environment. John Lowne, corporate vice president and division manager for Reynolds Metals Company, stated, "Wal-Mart's move will indeed set a precedent for the entire retail industry. I'm surprised it has taken other retailers this long to follow suit."¹²

Wal-Mart wanted to use its tremendous buying power to aid in the implementation of the campaign. Wal-Mart sent a booklet to manufacturers stating the following:

*At Wal-Mart we're committed to help improve our environment. Our customers are concerned about the quality of our land, air and water, and want the opportunity to do something positive. We believe it is our responsibility to step up to their challenge.*¹³

In the stores, shelf tags made from 100 percent recycled paper informed customers as to the environmental friendliness of the highlighted product. As a result of these shelf tags and Wal-Mart's advertising, customer awareness has increased, and some environmentally safe product manufacturers are reaping the rewards of increased Wal-Mart orders. Linda Downs, administrative manager of Duraflame/California, said that Duraflame logs had been proven to burn cleaner than wood and that Wal-Mart's campaign had helped Duraflame to deliver this message. She went on to say, "Wal-Mart has helped drive home the message we have been trying to promote for years. They have really given us great publicity."¹⁴

In the *Wal-Mart Associates Handbook*, new associates were indoctrinated with the "Wal-Mart spirit." The section on the environment said:

As a responsible member of the community, Wal-Mart's commitments go beyond simply selling merchandise. With environmental concerns

*mounting world-wide, Wal-Mart has taken action. Home office and store associates are taking decisive steps to help the environment by making community recycling bins available on our facility parking lots. Other action plans include "Adopt-a-Highway" and "Adopt-a-Beach" programs, tree planting and community clean up and beautification. By forming a partnership with our associates, our manufacturers and our customers, we're convinced we can make the world a better place to live.*¹⁵

SAM AND THE MERCHANTS OF MAIN STREET

Not everyone has been excited to see Sam and his mechanized Wal-Mart army arrive and succeed. Small merchants across America shudder when the winds of the "Wal-Mart Way" begin to blow. Kennedy Smith of the National Main Street Center in Washington, DC, says, "The first thing towns usually do is panic." Once Wal-Mart comes to town, Smith says, "downtowns will never again be the providers of basic consumer goods and services they once were."¹⁶

Steamboat Springs. Some towns learned to "just say 'no'" to Wal-Mart's overtures. Steamboat Springs, Colorado, is one such city. Colorado newspapers called it the "Shootout at Steamboat Springs." Wal-Mart was denied permission to build on a nine-acre parcel along U.S. Route 40. Owners of upscale shops and condos were very concerned with the image of their resort community, and Wal-Mart, with its low-cost reputation, just did not fit. The shootout lasted for two years, and finally Wal-Mart filed a damage suit against the city. Counter-suits followed. A petition was circulated to hold a referendum on the matter. This was the shot that made Wal-Mart blink and back down. Just before the vote, Don Shinkle, corporate affairs vice president, said, "A vote would not be good for Steamboat Springs, and it would not be good for Wal-Mart. I truly believe Wal-Mart is a kinder, gentler company, and, while we have the votes to win, an election would only split the town more."¹⁷

Iowa City. In Iowa City, Iowa (population 50,000+), Wal-Mart was planning an 87,000-square-foot store on the outskirts of town. A group of citizens gathered enough signatures during a petition drive to put a referendum on the ballot to block Wal-Mart and the city council from building the new store (the city council had approved the rezoning of the land Wal-Mart wanted). Jim Clayton, a downtown merchant, said, “Wal-Mart is a freight train going full steam in the opposite direction of this town’s philosophy.” If businesses wind up going down, Clayton says, “you lose their involvement in the community, involvement I promise you won’t get with some assistant manager over at Wal-Mart.”¹⁸ Wal-Mart spokesperson Brenda Lockhart commented that downtown merchants can only benefit from the increase in customer traffic, provided “they offer superior service and aren’t gouging their customers.”¹⁹ Efforts to stop Wal-Mart and the Iowa City Council were not successful. Wal-Mart opened its Iowa City store on November 5, 1991.

Pawhuska, Oklahoma. Meanwhile, in Pawhuska, Oklahoma, as a result of Wal-Mart’s entry in 1983 and other local factors, the local “five-and-dime,” J.C. Penney, Western Auto, and a whole block of other stores closed their doors. Four years later, Dave Story, general manager of the local *Pawhuska Daily Journal Capital*, wrote that Wal-Mart was a “billion-dollar parasite” and a “national retail ogre.”²⁰

Wal-Mart managers have become very active in Pawhuska and surrounding communities since that time. A conversation with the editor of the Pawhuska paper, Jody Smith, and her advertising editor, Suzy Burns, revealed that Wal-Mart sponsored the local rodeo, gave gloves to the local coat drive, and was involved with the local cerebral palsy and multiple sclerosis fund-raisers. On the other hand, Fred Wright, former owner of a TV and record store, said, “Wal-Mart really craters a little town’s downtown.”²¹

Kinder, Louisiana. Shift to Kinder, Louisiana (population 2,608). Wal-Mart moved into this

small Louisiana town in 1981. On December 31, 1990, the store was closed. During the time Wal-Mart operated in Kinder, one-third of the downtown stores closed. The downtown became three blocks of mostly run-down, redbrick buildings. The closest place to buy shoes or sewing thread was 30 miles away in Oakdale, Louisiana—at another Wal-Mart. Moreover, Kinder lost \$5,500 in annual tax revenues, which represented 10 percent of the total revenues for the city.

The tactics Wal-Mart employed during its 10 years in Kinder left a bad taste in the mouths of some small retailers. Soon after Wal-Mart’s arrival, a price war broke out between Wal-Mart and the downtown retailers. The retailers told the *Atlanta Journal-Constitution* in November 1990, “Wal-Mart sent employees, wearing name tags and smocks, into their stores to scribble down prices and list merchandise.” Lou Pearl, owner of Kinder Jewelry and Gifts, stated that Wal-Mart associates came to her store and noted the type of art supplies she was carrying. Shortly thereafter, Wal-Mart began carrying the same merchandise at discount prices. Sales at Kinder Jewelry and Gifts dropped drastically, and Pearl dropped the merchandise line. Within several weeks, so did Wal-Mart.²² Troy Marcantel, a 29-year-old downtown clothing merchant, said it best: “What really rankled me was that they used people we have known all our lives. I still don’t understand how our own people could do that to us.”²³

THE MAIN STREET MERCHANTS ORGANIZE WELCOMING COMMITTEES

By the 1990s, there were dozens of organized groups actively opposing Wal-Mart’s expansion.²⁴ Some of these groups were and still are run by social activists left over from the 1960s and 1970s. Instead of protesting the Vietnam War, nuclear proliferation, or the destruction of the environment, they have turned their efforts to Wal-Mart specifically and capitalism in general. One of these activists, Paul Glover, who was an antiwar organizer, defined Wal-Mart as the epitome of

capitalism, which he despises. For Mr. Glover and others, Wal-Mart stands for “everything they dislike about American society—mindless consumerism, paved landscapes, and homogenization of community identity.”²⁵

Boulder, Colorado. In Boulder, Colorado, Wal-Mart tried to counter these allegations by proposing a “green” store. Steven Lane, Wal-Mart’s real estate manager, said that a “green store” would be built that would be environmentally friendly, with a solar-powered sign out front and everything. His efforts were trumped by Spencer Havlick, an organizer of the first Earth Day in 1970, suggesting that the entire store be powered by solar energy. Mr. Lane did not respond.²⁶

Protest organizers united against the spread of the “Wal-Mart Way” differ from the downtown merchants in that these protesters have no financial stake. Hence, these activists are attacking on a higher plane, a philosophical plane. The accusations ring with a tone of argument that was made by other activists protesting polluting industries (e.g., the coal, nuclear, and chemical industries). These activists accuse Wal-Mart of “strip-mining” towns and communities of their culture and values.

One possible root of this culture clash may be attributed to the unique facets of the internal corporate culture at Wal-Mart’s headquarters. This is a place where competition for the reputation as the “cheapest” is practiced. An example is the competition among employees in procuring the cheapest haircut, shoes, or necktie. Wal-Mart is a place where playacting as a backwoods “hick” has been an acceptable behavior within the organization. Consequently, as a result of the internal culture of Wal-Mart and the external environment, some analysts believe that a clash of priorities was inevitable as Wal-Mart moved into larger, more urban settings.

New England Opposition. Some of the greatest opposition to Wal-Mart’s growth came from the New England area. This area holds great

promise for Wal-Mart because of the large population and the many underserved towns. These towns are typically underserved in three ways: in variety of product choices, in value, and in convenience. The opposition to Wal-Mart entering these New England markets includes some high-profile names, such as Jerry Greenfield, cofounder of Ben & Jerry’s homemade ice cream, and Arthur Frommer, a well-known travel writer.²⁷ In addition to New England, other areas, such as resort areas, opposed Wal-Marts because they wanted to insulate their unique cultures from what they considered to be the offensive consumerism that is usually generated by Wal-Mart’s presence.

Sprawl-Busters. Al Norman, a lobbyist and media consultant, turned opposition to Wal-Mart into a cottage industry. Mr. Norman publishes a monthly newsletter called *Sprawl-Busters Alert*. He has also developed a website (<http://www.sprawl-busters.com/>) that has vast information for citizens who are fighting to prevent Wal-Mart or other “big box” stores from locating in their cities or neighborhoods. Norman achieved national attention in 1993, when he stopped Wal-Mart from locating in his hometown of Greenfield, Massachusetts. Since then, he has appeared on *60 Minutes*, which called him “the guru of the anti-Wal-Mart movement,” and has gained widespread media attention. Today, Norman continues to serve as a consultant and travels throughout the United States helping dozens of coalitions fight Wal-Mart. Norman has published two books: *Slam-Dunking Wal-Mart: How You Can Stop Superstore Sprawl in Your Hometown* and *The Case Against Wal-Mart*. In his books, he lays out the arguments against urban “sprawl.”

On the Sprawl-Busters webpage, consumers around the country are given the opportunity to write in the details of their fights with Wal-Mart. Examples in 2007 included conflicts in Wailuku, Hawaii; Nashua, New Hampshire; Florence, Kentucky; and Hurricane, West Virginia.²⁸

Sprawl-Busters is not alone in its focused criticism of Wal-Mart’s presence in communities.

Another organization, Wal-Mart Watch, has an active webpage (<http://walmartwatch.com/>) that details what it believes to be Wal-Mart's threat to America. Wal-Mart Watch is a joint project of The Center for Community & Corporate Ethics, a 501c3 organization devoted to studying the impact of large corporations on society.²⁹

AGGRESSIVE GROWTH AND CONTINUING CHALLENGES

For its part, Wal-Mart has continued its aggressive diversification and growth pattern. At a retail industry convention, Lee Scott, Wal-Mart's current CEO, was asked whether Wal-Mart was trying to take over the world. Scott replied, "I don't think so. All we want to do is grow." But, as the *Economist* magazine has asked, "How big can it grow?"³⁰ The company is already the world's biggest company as measured by sales. It is estimated that eight out of ten households shop at Wal-Mart at least once a year, and more than 100 million customers worldwide visit Wal-Mart every week of every year. As a humorous aside, photos circulating over the Internet, supposedly coming from the *Exploration Rover*, show NASA's recent discovery of a Wal-Mart on Mars.³¹

A Nation Unto Itself. The *New York Times* has argued that Wal-Mart is becoming a nation unto itself. In fact, the newspaper stated that if Wal-Mart were an independent nation, it would be China's eighth-largest trading partner. In terms of its low prices and impact, some economists say that the company has single-handedly cut inflation by 1 percent in recent years as it has saved customers billions of dollars annually.³² It is little wonder the newspaper is talking about "The Wal-Martization of America."³³ Figure 1 provides some recent statistics about Wal-Mart.

As of 2007, Wal-Mart was continuing to experience a mixed reception in cities and towns across America. Many welcomed Wal-Mart with great enthusiasm. But opposition to Wal-Mart is fierce in some places. The biggest plum Wal-Mart has been seeking recently has been growth in the

state of California. Though it already has 133 Discount Stores in California, it desires to open at least 40 Supercenters there in the next three to five years. Wal-Mart's troubles are best depicted in the opposition met in suburban Los Angeles. Citizens in Inglewood, California, a suburb of Los Angeles, voted to block the company's proposed 60-acre development. The company spent \$1 million on a ballot initiative but hit a wall as the vote went 60 percent against them.³⁴ Interestingly, the opposition in California has not focused as much on urban sprawl, traffic congestion, and its impact on local retailers, as much as on Wal-Mart's low wages and employee benefits.³⁵

Global Growth. In addition to domestic growth, Wal-Mart continues its aggressive growth internationally. As of July 2007, Wal-Mart International operates more than 2,750 retail units and employs more than 500,000 associates in Argentina, Brazil, Canada, China, Costa Rica, El Salvador, Guatemala, Honduras, Japan, Mexico, Nicaragua, Puerto Rico, and the United Kingdom. And the opportunities for growth continue. The first wholesale facility in India is targeted to open in late 2008.³⁶ Just as Wal-Mart has met resistance in many communities in America, it has also met some resistance and challenges overseas. It has been quite successful in Mexico, Canada, Brazil, and Japan but has struggled in most places, often with laws or cultural practices of other countries.

United Kingdom. Wal-Mart had a smoother entry into the United Kingdom. Its strategy was the same as in Germany, buying out an established firm. In June 1999, it took over the Asda chain and now has stores and depots all over the United Kingdom. This was a perfect match because the Asda culture was modeled after that of Wal-Mart. Wal-Mart plans 10 to 12 new stores per year in the United Kingdom, where Friends of the Earth has criticized the company for planning to put mezzanine floor extensions in stores around the country. These would be internal second floors suspended above the existing floor, giving added floor space without the requirement of planning

Figure 1 Recent Statistics about Wal-Mart

- \$345 billion in net sales in 2007
- 4,000 facilities in U.S.: Discount Stores, Supercenters, SAM'S Clubs, Neighborhood Markets
- 2,700 International stores
- Customers per week: 127 million in U.S.; 176 million worldwide¹
- 335,000 shareholders of record
- 1.2 million employees in the U.S.
- 1 in 23 U.S. employees Wal-Mart employs
- 1 in 20 retail employees Wal-Mart employs²
- Feature story on the cover of *BusinessWeek*: "Is Wal-Mart Too Powerful?"³
- Feature story on the cover of the *Economist*: "Wal-Mart: Learning to Love It"⁴
- 25% of the U.S. economy's productivity gains from 1995 to 1999 came from efficiencies at Wal-Mart
- Sales are more than four times those of Home Depot⁵
- Market share: Wal-Mart's U.S. market share of selected products:⁶

Dog food	36%
Disposable diapers	32%
Photo film	30%
Toothpaste	26%
Pain remedies	21%
- Percentage of U.S. households that made a Wal-Mart purchase in 2003: 82%⁷
- Lawsuits: Just about every other hour of every day of every year, Wal-Mart gets sued. Wal-Mart is considered to be the "most sued" company in America.⁸
- "Topic A" in Business Schools—Wal-Mart has displaced perennial powerhouses General Motors and Sears as the company most studied in business schools.⁹

¹ 2007 Corporate Fact Sheet, http://walmartfacts.com/FactSheets/Corporate_Facts.pdf.

² "Wal-Mart by the Numbers," *USA Today* (June 23, 2004), 1A.

³ *BusinessWeek* (October 6, 2003).

⁴ *Economist* (April 17–23, 2004).

⁵ Bill Saporito, "Can Wal-Mart Get Any Bigger?" *Time* (January 13, 2003), 38.

⁶ Jerry Useem, "One Nation Under Wal-Mart," *Fortune* (March 3, 2003), 66.

⁷ Anthony Bianco and Wendy Zellner, "Is Wal-Mart Too Powerful?" *BusinessWeek* (October 6, 2003), 108.

⁸ James K. Glassman, "Wal-Mart's Ugly Suit," *Wall Street Journal* (May 30, 2002), A14.

⁹ Constance L. Hayes, "The Wal-Mart Way Becomes Topic A in Business Schools," *New York Times* (July 27, 2003), 10BU.

department permission. Privately, it is said that Wal-Mart plans to become the largest food retailer in the United Kingdom.³⁷

China. Difficulties in South Korea have not stopped Wal-Mart's quest in Asia and China. In July 2003, it opened its first store in Beijing, after

having already opened some 22 stores elsewhere in China. Wal-Mart, which is already the largest buyer of Chinese products, is striving to become the biggest seller to the Chinese as well. Some observers say Wal-Mart is doing well and starting to change the culture. Instead of Chinese shoppers making a daily trip to the fish market, they are

beginning to make a weekly visit to Wal-Mart. Al Norman, Wal-Mart critic, is troubled deeply by Wal-Mart's global expansion. Says he: "Wal-Mart is Americanizing retailing around the world. It is a really undesirable outcome both culturally and economically for a U.S. company to be exercising so much power."³⁸ As of 2007, Wal-Mart's presence in China included 79 Wal-Mart Supercenters, 101 Trust-Mart Hypermarts, and 38,000 associates.³⁹

Germany. Wal-Mart entered Germany in 1998 by purchasing two local retail chains. The company lost money in Germany since the very beginning. Challenges included price controls, which limited below-cost selling, rigid labor laws, and demanding zoning regulations. The company also faced well-entrenched rivals, such as Metro and discounters such as Aldi and Lidl. According to a study conducted in Germany, Wal-Mart's entry there was "nothing short of a fiasco."⁴⁰ In the beginning, Wal-Mart's expatriate managers experienced a massive culture clash. This was not helped by their refusal to learn the German language. Wal-Mart came to be seen in Germany as an unattractive employer, in part because of low wages and also because of a frugal policy on managers' business expenses.⁴¹ In the summer of 2006, Wal-Mart decided to close shop in Germany and sold its stores to Metro, one of Germany's largest retail groups. Apparently, the Wal-Mart model did not work in Germany despite best efforts to implement it there.⁴²

Japan. One of Wal-Mart's most recent battlefields has been Japan, where it has found expensive real estate and cramped space to be a challenge. Its "everyday low price" strategy has befuddled shoppers who are accustomed to poring through newspapers looking for discounts. Employees have balked at the "10-foot rule" because, in their culture, clerks typically wait for a customer to ask a question before speaking.⁴³ Wal-Mart saw the need to acquire a majority stake in supermarket chain Seiyu, Ltd., and it is gradually remodeling Seiyu's 400 food and apparel stores into the Wal-Mart

image. Discount stores are fairly new in Japan, and long-protected mom-and-pop stores make up close to 60 percent of all retailers. U.S. firms such as Gateway, Office Max, Foot Locker, and Burger King all failed in Japan. As Wal-Mart proceeds to grow in Japan, its chief competitor, Aeon, which operates 368 supermarkets, tries to respond. Aeon sent hundreds of employees to visit Wal-Marts in the United States, South Korea, and China to analyze the competition.⁴⁴

Becoming Politically Active. It was Wal-Mart's desire to grow globally that caused the company to ramp up its efforts at lobbying in Washington, D.C. The precipitating event was Wal-Mart's realization that U.S. negotiators had agreed upon a 30-store limit on retailers operating in China when it agreed to support China's entry into the World Trade Organization in the late 1990s. As a result of this realization, the company recently decided it had to get into lobbying, even though it went against founder Sam Walton's policy of staying out of politics. Today, Wal-Mart has a number of lobbyists on its payroll and a number of other hired political consultants to help it. The company's political action committee grew to become the biggest corporate donor to federal parties and candidates, with more than \$1 million in contributions.⁴⁵

Millions of Supporters. In spite of its challenges, Wal-Mart has millions of supporters, more than 100 million of them weekly are customers. Many consider the company to be socially responsible in addition to being a provider of thousands of jobs, low prices, and high value and service. As we reach the end of the first decade of the new millennium, Wal-Mart has numerous corporate citizenship initiatives at the local and national levels. Locally, Wal-Mart stores underwrite college scholarships for high school seniors, raise funds for children's hospitals through The Children's Miracle Network Telethon, provide local fund-raisers with money and manpower, and educate the public about recycling and other environmental topics with the help of

“Green Coordinators.”⁴⁶ On October 6, 1998, the Walton Family Charitable Support Foundation, the charitable program created by Sam Walton’s family, announced the largest ever single gift made to an American business school: \$50 million to the College of Business Administration of the University of Arkansas. Helen R. Walton, the “first lady” of Wal-Mart, said that she and her husband established the Foundation to support specific charities, including the University.⁴⁷

Achievements. On its own website, Wal-Mart touts in detail its achievements. It says the American public appreciates Wal-Mart’s community-involvement efforts. The following are some recent honors:⁴⁸

2007, National Bar Association Spirit of Excellence Corporate Award

2007, National Association of Female Executives Top Companies for Female Executives

2007, *Asian Enterprise* Top 20 Companies for Asian Americans

2006, *Black Enterprise* Magazine’s Top 30 Companies for Diversity

2006, Diversity Inc. Top 100 Companies for African Americans Asian

2006, *Enterprise* Magazine Noteworthy Companies for Diversity

Wal-Mart’s Power and Impact. In spite of its achievements, article titles from recent newspapers and magazines raise questions about Wal-Mart’s power and impact. Some of these include the following:

“The Wal-Martization of America”⁴⁹

“Is Wal-Mart Too Powerful?”⁵⁰

“Is Wal-Mart Good for America?”⁵¹

“One Nation Under Wal-Mart”⁵²

“Wal-Mart Gives Globalization a Bad Name”⁵³

“Attack of the Wal-Martys”⁵⁴

“Wal-Mart’s Midlife Crisis”⁵⁵

EPILOGUE

Sam, the hired gun, learned his lessons well. The people who bought at his stores were well satisfied. The downtown merchants who survived learned to coexist with the hired gun’s associates. But things would never be the same. The changes had come rapidly. The social fabric of the small town was changed forever. The larger cities continued to fight.

The hired gun rode on, searching for that next town that needed to be liberated from the downtown price-fixing bad guys. The search has become more complicated as the opposition has risen, but the spirit of Sam rides on.

AN EMBATTLED WAL-MART: A CONTINUING STREAM OF ISSUES

Wal-Mart’s size and impact on local communities is where criticism of the company began. This includes the threat of putting other merchants out of business, the creation of urban sprawl, and the traffic congestion created when the company decides to locate in a particular site. In short, the negative and positive impacts on communities have to be weighed against each other.

In the past few years, Wal-Mart has begun to face other issues that merit consideration. In addition to anti-sprawl activists and merchants, Wal-Mart is now facing new opposition from labor unions, other activist organizations, and lawsuits. Its labor practices are being increasingly questioned. The company has been accused of paying wages so low that workers cannot live off of them, making employees work “off the clock” without overtime pay, paying few or low benefits, and taking advantage of illegal immigrants. In 2004, the company was hit with a class-action lawsuit on gender discrimination against women. This class-action lawsuit covers 1.6 million current and former employees, making it the largest private civil rights case ever. In 2007, in another class-action suit, the New Jersey Supreme Court certified class-action status for a group of employees who claim that the

company denied them meal and rest breaks and forced them to work off the clock.⁵⁶

Because these issues are so expansive and important, we do not address them in the present case. Another case, focusing primarily on Wal-Mart's labor practices and the issues outlined previously, has been prepared for separate discussion. Case 38, titled "Wal-Mart and Its Associates," may be discussed immediately following this case or deferred until a more in-depth consideration of employee stakeholders is undertaken.

Questions for Discussion

1. What are the major issues in this case? Assess Wal-Mart's corporate social responsibility using the four-part CSR model. Is Wal-Mart socially responsible while it has a devastating impact on small merchants? What about its impact on communities in terms of sprawl, traffic congestion, and impact on the appearance of the environment? What responsibility, if any, does the company have to these merchants or to the communities it enters?
 2. Most of Wal-Mart's success has come at the expense of the small merchant. What should Wal-Mart do, if anything, to help other small businesses in the community survive? Why?
 3. Sam Walton has been called a motivational genius. After reading this case, and with what you have observed at your local Wal-Mart store, explain how this motivational genius empowered the employee. What is the "Wal-Mart Way"? Explain its impact on the associate and on the community. What has happened now that Sam is no longer the motivational leader?
 4. Some regard Wal-Mart as a leader in the area of corporate social responsibility. How do the "Buy American" program and the "Environmental Awareness" campaign illustrate this? Were these programs really early examples of corporate social responsibility or were they gimmicks to entice customers into the stores?
- Are the benefits of its more recent corporate citizenship programs offset by the company's detrimental impact on merchants?
5. Wal-Mart has closed five stores in its short history. What responsibility, if any, does Wal-Mart have to the employees who are let go? What about its loyal customers and the community?
 6. Wal-Mart is finding severe resistance to its expansion into New England and California. From Wal-Mart's perspective, draw the stakeholder map. Define the true goals of the opponents of Wal-Mart. Include a consideration of the following: (a) stopping Wal-Mart's expansion, (b) preserving the status quo (e.g., downtown community, social fabric), (c) developing a cause that will pay their bills, (d) fighting for an ideology, or (e) something else. What should Wal-Mart do?
 7. As Wal-Mart continues its expansion into the international arena, what problems or issues do you anticipate it will face? Why did Wal-Mart fail in Germany but succeed in so many other countries? In general, what should Wal-Mart's approach be in these other countries? Is it unethical to change another country's culture?

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Case 2

The Body Shop: Pursuing Social and Environmental Change

When North American consumers have been asked to describe the cosmetics industry, they often respond with words such as “glamour” and “beauty.” Beginning in 1976, The Body Shop International PLC provided a contrast to this image by selling a range of 400 products designed to “cleanse and polish the skin and hair.” The product line included such items as “Honeyed Beeswax, Almond, and Jojoba Oil Cleanser” and “Carrot Facial Oil.” Women’s cosmetics and men’s toiletries were also available. They were all produced without the use of animal testing and were packaged in plain-looking, recyclable packages.¹

The Body Shop’s primary channel of distribution was a network of more than 600 franchised retail outlets in Europe, Australia, Asia, and North America.² The company enjoyed annual growth rates of approximately 50 percent until 1990, when net income began to level off. Few questions were raised in the media about this decline in performance, because the firm’s social agenda and exotic product line captured most of the public’s interest. Indeed, at this point in time, The Body Shop was the poster-child company for the burgeoning corporate social responsibility (CSR) movement.

ANITA RODDICK: FOUNDER

Managing director and founder Anita Roddick was responsible for creating and maintaining much of the company’s marketing strategy and

product development.³ Roddick believed that The Body Shop was fundamentally different from other firms in the cosmetics industry because “we don’t claim that our products will make you look younger, we say they will only help you look your best.”⁴ She regularly assailed her competitors: “We loathe the cosmetics industry with a passion. It’s run by men who create needs that don’t exist.”⁵ During the 1980s, Anita Roddick became one of the richest women in the United Kingdom by challenging the well-established firms and rewriting the rules of the cosmetics industry.

Honors and Awards. Anita Roddick became admired within the business community for the conviction of her beliefs and the success of her company. She received many honors and awards, including U.K. Businesswoman of the Year in 1985, British Retailer of the Year in 1989, and the Order of the British Empire.⁶ The firm’s customers included several celebrities, including Diana, Princess of Wales; Sting; and Bob Weir of the Grateful Dead. Ben Cohen, cofounder and chairman of Ben and Jerry’s, described her as an incredibly dynamic, passionate, humorous and intelligent individual who believes it’s the responsibility of a business to give back to the community . . . she understands that a business has the power to influence the world in a positive way.⁷

Mrs. Roddick opened the first Body Shop store in Brighton, England, as a means of supporting her family while her husband was taking a year-long sabbatical in America. Her husband, Gordon Roddick, a chartered accountant by trade, was

This case was prepared by William A. Sodeman, Hawaii Pacific University, using publicly available information. Revised by Archie B. Carroll.

using much of their savings to finance his trip. Anita Roddick had little money to open a store, much less to develop products or purchase packaging materials.⁸

Field Expeditions. She called upon her previous experience as a resource. Having been a United Nations researcher for several years in the 1960s, she had had many opportunities during field expeditions to see how men and women in Africa, Asia, and Australia used locally grown plants and extracts, such as beeswax, rice grains, almonds, bananas, and jojoba, as grooming products. Roddick knew that these materials were inexpensive and readily obtainable. With some library research, she found several recipes, some of which were centuries old, that used these same ingredients to make cosmetics and skin cleansers. With the addition of inexpensive bottles and handwritten labels, Roddick quickly developed a line of products for sale in her first Body Shop. She soon opened a second store in a nearby town. When Gordon Roddick returned to the United Kingdom in 1977, The Body Shop was recording sizable profits. At Anita's request, he joined the company as its chief executive officer.⁹

Early Strategy. The Body Shop's early strategy grew out of the company's initial reliance on cost containment. Roddick was able to afford only 600 bottles when she opened her first store. Because she was looking for the cheapest packaging option, she chose urine sample bottles. Customers were offered a small discount to encourage the return of empty bottles for product refills. This offer was extended to both retail and mail-order customers.¹⁰ The Body Shop could not afford advertising, so Roddick resolved to succeed without it.¹¹

The Body Shop's retail stores were somewhat different from the cosmetic salons and counters familiar to shoppers in highly industrialized nations. The typical retail sales counter relied on high-pressure tactics that included promotions, makeovers, and an unspoken contract with the customer that virtually required a purchase in

order for the customer to receive any advice or consultation from a sales-counter employee.¹² Body Shop employees were taught to wait for the customer to ask questions, be forthright and helpful, and not to press for sales.¹³

According to Roddick, "Businesses have the power to do good. That's why The Body Shop's Mission Statement opens with the overriding commitment, 'To dedicate our business to the pursuit of social and environmental change.' We use our stores and our products to help communicate human rights and environmental issues."¹⁴

Employees. Store employees were paid a half-day's wages every week to perform community service activities. At the company headquarters in Littlehampton, England, The Body Shop employed an anthropologist, six herbalists, and a variety of others in similar fields. There was nothing that resembled a marketing department. Husbands and wives frequently worked together and could visit their children during the workday at the on-site day-care center.¹⁵ The company's hiring procedures included questions about the applicant's personal heroes and literary tastes, as well as their individual beliefs on certain social issues. At one time, Roddick was ready to hire a retail director but refused to do so when he professed his fondness for hunting, a sport that Roddick despised because of her support for animal rights.¹⁶

PROSPERITY AND SOCIAL ACTIVISM

As the company prospered, Anita Roddick used her enthusiasm and growing influence on her suppliers and customers. The Body Shop began to produce products in the country of origin when it was feasible and paid the workers wages that were comparable to those in the European Community.¹⁷ Customers were asked to sign petitions and join activist groups that The Body Shop endorsed, mostly in the areas of animal rights and environmental causes. The Body Shop contributed significant portions of its earnings to these groups, including Amnesty International and People for

the Ethical Treatment of Animals (PETA). Roddick was careful to choose causes that were “easy to understand”¹⁸ and could be communicated quickly to a customer during a visit to a Body Shop store.

Animal Testing. An example of this corporate activism was The Body Shop’s opposition to a practice that had become common in the cosmetics industry. Cosmetics firms were not required to perform animal testing of their products to comply with product safety and health regulations. Rather, companies voluntarily adopted animal-based testing procedures to guard against product liability lawsuits.¹⁹

The Body Shop was not worried about such lawsuits, because the product ingredients Roddick chose had been used safely for centuries. In addition, the older recipes had been used for many decades without incident. These circumstances led to the company’s rejection of animal-based product testing. Any supplier wishing to do business with The Body Shop had to sign a statement guaranteeing that it had done no animal testing for the previous five years and would never do such testing in the future. The Body Shop used human volunteers from its own staff and the University Hospital of Wales to test new and current products under normal use. The Body Shop also volunteered to share the results of its tests on individual ingredients with other cosmetics manufacturers.²⁰

The Draize Test. Most other cosmetics firms used a variety of procedures to determine the safety of cosmetics products, with two animal-based tests becoming the standard procedures. The Draize test involved dripping the substance in question, such as a shampoo or a detergent paste, into the eyes of conscious, restrained rabbits and measuring the resultant damage over the course of several days. Rabbits cannot cry, which allowed researchers to complete the tests quickly.

LD50 Test. Another test required researchers to force-feed large quantities of a substance to a sample of laboratory animals. The substance could be a solid (such as lipstick or shaving cream), a

paste, or a liquid. The lethal dose of a substance was determined by the amount that had been ingested by an individual surviving animal when 50 percent of the sample had died, hence the name of the test, LD50.²¹ Beginning in the 1970s, animal rights groups such as the Humane Society and PETA began protesting the use of these tests by the cosmetics industry. The Body Shop lent its support to these groups’ efforts, labeling all animal testing as “cruel and unnecessary.” By 1991, alternative procedures that involved far less cruelty to animals had already been developed but were yet to be approved for industry use.²²

THE BODY SHOP IN THE UNITED STATES

In the United States, The Body Shop’s market share was limited by two factors. First, its prices were significantly higher than those charged for mass-marketed products in drugstores, although they were generally comparable to the prices charged for cosmetics and cleansers at department store sales counters. Second, The Body Shop was constrained by the number of stores it had opened in the United States. By 1991, only 40 stores had been opened in a dozen metropolitan areas across the country. A mail-order catalog and a telephone order line were used to supplement the American retail stores, but they were inadequate substitutes for the product sampling and advice that were readily available at The Body Shop’s stores. Roddick maintained that those consumers who sampled Body Shop products became loyal customers: “Once they walk into one of our stores or buy from our catalogue, they’re hooked.”²³

Going Public. The Body Shop was taken public in London in 1984, with the Roddicks owning a combined 30 percent of the outstanding stock. The firm’s subsequent sales and net income figures grew during 1985 to 1990 from sales revenue of \$15.3 and net income of \$1.4 million to \$137.7 and \$14.7 million.²⁴ Without The Body Shop’s monetary donations to various social causes, all of these net income figures would be

higher than reported in the financial statements. Estimates of the company's annual contributions to outside organizations varied from several hundred thousand to several million dollars.

Industry analysts considered The Body Shop to be a strong performer with the potential to prosper even in an economic downturn. The exotic nature of its products, such as hair conditioner made with 10 percent real bananas and a peppermint foot lotion, would attract consumers who desired affordable luxuries. Analysts regarded the public's desire for personal care products as "insatiable," especially in North America.²⁵ The addition of the strong emotional appeal of social issues formed the basis for one of the most successful marketing and promotional concepts in the cosmetics industry in decades.

The twentieth anniversary of Earth Day, celebrated in 1990, focused media attention on many of the environmental issues that Roddick and The Body Shop regularly addressed. Further, it spurred interest in environmental issues in the commercial sector.

Competition. Several new entrants and existing competitors challenged The Body Shop in the United States and Europe. Among the largest of these firms were Estee Lauder and Revlon. The Limited had opened 50 Bath & Body Works stores, patterned after The Body Shop's outlets and located in shopping malls across the United States. In addition, an English competitor, Crabtree & Evelyn, had held a significant presence in North America and Europe since the mid-1970s.

By 1991, The Body Shop was a successful and profitable firm that had attracted a variety of well-financed competitors. The company faced a real threat from these firms because they were all well financed and had a broad range of experience in marketing cosmetics. Each of these firms was well established in the United States, yet no one firm dominated the new product segment that The Body Shop had helped create.

In addition, there were indications that the environmental concerns that attracted customers to The Body Shop might not have permanent

drawing power. Roddick had vowed never to sell anything but environmentally friendly cosmetics and grooming products in her stores, but the industry was growing and changing faster than anyone had anticipated. It seemed that The Body Shop needed to take action to ensure its long-term survival.

THE BODY SHOP'S ADVERTISING CAMPAIGN

Anita Roddick first appeared in a U.S. television commercial in 1993. This came as something of a surprise to long-time Body Shop (BSI) customers and her competitors in the cosmetics industry. These people believed that Roddick abhorred advertising as a wasteful practice that created needs. The company did promote certain non-profit groups in its stores and catalogs, including Greenpeace, People for the Ethical Treatment of Animals, and Amnesty International. However, The Body Shop had a policy of not advertising directly to consumers.²⁶

American Express Ad. Roddick agreed to lend her endorsement to an American Express marketing campaign that featured founders of fast-growing retail firms such as BSI and Crate & Barrel. Not coincidentally, all of the firms featured in the campaign accepted the American Express charge card as a payment method. The main message of the campaign was that customers of these stores preferred to use the American Express card and that the store founders also found the card useful in their day-to-day business.

Roddick appeared in three commercials and a series of print advertisements as part of this advertising campaign. The advertisements included Roddick's brief description of the company's purpose and sourcing practices and used film footage and photographs of her travels in search of exotic new ingredients.

Selling Out? Although the Roddick commercials received a positive response from advertising industry professionals, some long-time BSI cus-

tomers accused Roddick of “selling out” and breaking her promise never to advertise BSI products. Roddick responded that the commercials promoted American Express and did not specifically promote Body Shop products. The advertisements gave The Body Shop valuable publicity in much the same way that Roddick’s social activism and personal appearances had done in the past.

Ruby. In 1997, The Body Shop unveiled Ruby, a voluptuous size 18 doll created to counter media images of thin women.²⁷

RODDICK’S ROLE

When asked about her role in the company, Anita Roddick stated:

The purpose of a business isn’t just to generate profits to create an ever-larger empire. It’s to have the power to affect social change, to make the world a better place. I have always been an activist, I have always been incredibly impassioned about human rights and environmental issues. The Body Shop is simply my stage.²⁸

Questions for Discussion

- How does The Body Shop address the four components of corporate social responsibility? In The Body Shop, what tensions among these components are at work?
- Analyze The Body Shop’s power using both levels and spheres of power discussed in Chapter 1. How do you assess the company’s stated mission?
- Does The Body Shop employ any questionable practices with respect to hiring? The Body Shop asks potential employees questions about “personal heroes” and individual beliefs. Is it ethical to ask such questions of applicants? Are these questions legitimate ones to ask in the first place? Are such questions fair to the applicants?
- What is your assessment of Anita Roddick’s philosophy regarding the “purpose of a business”?
- What are Anita Roddick’s strengths and weaknesses as a leader? Should she stay on in a managing role or step aside and allow a more experienced person to run the marketing operations?
- Anita Roddick claims that her firm does not advertise, yet it receives free media exposure and publicity through the social causes it champions and her personal appearances. Is this an appropriate approach for a business to follow?
- What is your opinion of The Body Shop/American Express advertising campaign? Was it a sound business decision on Roddick’s part? What does the American Express campaign imply about The Body Shop and its customers? Is this different from the image of the nonprofit organizations that The Body Shop endorses? Did Roddick commit an ethics transgression by advertising through the American Express ad that contravened her earlier statements and policy, or was this different? How should she explain herself?
- Can a company such as The Body Shop succeed, trying to balance profitability with an obsession with social causes?

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Case 3

The Body Shop's Reputation Is Tarnished

Between 1991 and 1995, The Body Shop continued to expand its operations. The Body Shop had opened twelve hundred stores by early 1995.¹ More than 100 company-owned and franchised stores were operating in U.S. shopping malls and downtown shopping districts. During the period 1991 to 1994, sales and net income grew from \$231 million and \$41 million to \$330 million and \$47 million, respectively.

The Body Shop had moved its U.S. headquarters from Cedar Knolls, New Jersey, to a less expensive and more central location—Raleigh, North Carolina. The original location worked well when The Body Shop opened its first U.S. stores in New York City and Washington, DC, but soon proved to be a logistical problem. Roddick was frustrated that the New Jersey hires did not seem as creative or impulsive as her English staff. In retrospect, she realized that having some of her U.K. staff help train the first U.S. managers and employees or even setting up her headquarters in a college town such as Boulder, Colorado, or a city such as San Francisco would have been a better choice than starting from scratch in New Jersey.²

PROBLEMS ARISE

The Body Shop had bigger problems to deal with than the location of its national headquarters. The Limited continued to open its chain of Bath & Body Works stores on a nationwide scale. Placement of a Bath & Body Works store in a mall usually precluded The Body Shop from entering the same mall. (There were some exceptions,

most notably very large shopping malls such as the Mall of America in Bloomington, Minnesota.) All of The Limited's stores, from Express and Victoria's Secret to Structure and Lerner's, were company owned. This allowed a greater degree of flexibility and speed than The Body Shop's franchising system. Further, The Limited had started grouping its stores in malls to create its own version of the department store. During the holidays, Express and Structure stores carried special selections of Bath & Body Works products to induce customer trial and develop brand awareness. The Limited's size and power as one of the major retailers in the United States made the company a strong threat to The Body Shop's continued presence in the U.S. retail market. In an alarming move, The Limited began opening Bath & Body Works stores in the United Kingdom, which presented a direct threat to The Body Shop on the company's home soil.

Confusion. The similarities between The Body Shop and Bath & Body Works stores also created some confusion. Some less-observant customers of The Body Shop were bringing empty Bath & Body Works bottles to The Body Shop to be refilled because Bath & Body Works did not have its own refill policy and the products often seemed similar. The Body Shop protected its slogans, territory, and franchises with an aggressive legal strategy that included an out-of-court settlement with The Limited in 1993.³

Competition. Other companies had successfully introduced organic or natural beauty products in discount and drug stores, a market segment that The Body Shop had completely ignored in its

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global operations. Traditional retailers, including Woolworth's and Kmart, had also entered what had come to be known as the minimalist segment of the personal care products industry. Woolworth's entry was an expanded selection of organic bath and body care products in its deep discount Rx Place chain. Kmart's line of Naturalistic cosmetics was sold in more than eighteen hundred stores.⁴ Other new companies included H2O Plus, which sold its products in its own retail stores but did not make claims about animal testing as had The Body Shop and Bath & Body Works.

GOOD PRESS

The Body Shop continued to receive new accolades and to hit new heights of prosperity. Anita Roddick published her autobiography, *Body and Soul*, in late 1991. Roddick donated her portion of the royalties to several groups, including the Unrepresented Nations and Peoples Organization, a self-governing group that spoke for Kurds, Tibetans, and Native Americans; the Medical Foundation, which treated victims of torture; and a variety of individual political prisoners. The 256-page book, which was written and designed by Roddick, Body Shop staff, and an outside group, resembled a mixture of catalog and personal memoir. Hundreds of pictures and headlines were used throughout to emphasize and clarify particular points of interest. On the final page of the book, where one would expect to see the last page of the index, is the coda of the final chapter. The last line of text, printed in large boldface letters, reads: "Make no mistake about it—I'm doing this for me."⁵

Media Attention. Partly as a result of the book's publication, The Body Shop received a great deal of flattering media attention. *Inc.*⁶ and *Working Woman*⁷ ran cover stories featuring Anita Roddick. *Fortune*⁸ and *BusinessWeek*⁹ published shorter articles that focused on Anita Roddick and the company's performance. *Time* began its article with a story on Anita's fact-finding mission to

Oman, where she obtained a perfume recipe from a local tribe only after dropping her pants and showing the Bedouin women her pubic hair. Bedouin women pluck theirs every day.¹⁰

BAD PRESS

In 1992, some members of the media began to criticize The Body Shop and the Roddicks. The *Financial Times* gave The Body Shop the dubious honor of headlining its 1992 list of top 10 corporate losers after the price of Body Shop stock dipped from \$5.20 to \$2.70 during September.¹¹ Stock analysts had reacted to a disappointing earnings report, and the news set some minds to wondering if the company could indeed grow quickly enough to capture a leadership position in the minimalist market, or if there was a minimalist market at all.

Millennium Project. Around this time, The Body Shop invested \$5 million in a 10-part documentary series called *Millennium*. This series, which was shown around the world on television networks, including PBS and the BBC, was meant to celebrate the wisdom and history of native cultures. The director quit the project during filming, accusing the Roddicks of distorting the tribal rituals depicted in the film to suit various new-age ideals.¹² The Body Shop sold a book version of *Millennium* in its stores to help promote the series and raise funds for donations.

In 1993, a British television news magazine telecast a report on The Body Shop. The show alleged that The Body Shop knowingly sourced materials from suppliers that had recently performed animal testing. The Body Shop sued the TV station and the production company for libel and won a significant financial award after a six-week court battle. Anita Roddick sat in the courtroom every day and compared the experience to confinement in a "mahogany coffin." The Body Shop won the suit and a £276,000 settlement by proving to the British court that the company had never intentionally misled consumers about the animal-testing policy, which encouraged manufacturers to give up

animal testing but did not claim that ingredients had never been tested on animals.¹³

JON ENTINE'S EXPOSÉ

In 1994, *Business Ethics* magazine, a well-respected U.S. publication, published a cover story on The Body Shop that built upon many of the allegations that others had presented over the years. The resulting controversy engulfed the journalist, the magazine, and The Body Shop in a new wave of controversy that threatened The Body Shop's already slow expansion into the U.S. market.

In June 1993, journalist Jon Entine had first been approached by disgruntled current and former Body Shop staffers about several of the company's practices. After overcoming his initial skepticism and doing some preliminary investigations in Littlehampton, The Body Shop's headquarters, Entine was convinced he had a sound basis on which to develop a story for his current employer, the ABC news magazine *Primetime Live*. When ABC decided not to renew the contract and to drop The Body Shop story, Entine began his own investigation, which eventually resulted in the *Business Ethics* article.¹⁴ In the preface to the article, magazine editor and publisher Marjorie Kelly wrote:

Long-time readers will note that the following article represents a distinct departure from our typical editorial style. It has not been part of our mission to publish the exploits of companies that fall short of their stated social goals. But we believe the story of The Body Shop must be told, chiefly for the lessons it provides those of us who seek to promote ethical business practices. Still, we bring this story to you with mixed emotions. We have been ardent admirers of Anita Roddick and her company for many years; two years ago this month [September 1992] we featured her on our cover. But, after weeks of debate, including several conversations with Body Shop representatives, we concluded the greater good would be served by raising these issues in print. We earnestly hope this dialogue will be a constructive one.

Entine's Allegations. In the lengthy article, Entine made several claims:

- Anita Roddick had stolen the concept of The Body Shop, including the store name, recycling of bottles, store design, catalogs, and products, from a similar store she had visited in Berkeley, California, in 1971, several years before she opened her first Body Shop in Brighton in 1976.
- Roddick had not discovered exotic recipes for some of her products as she had previously claimed: some were outdated, off-the-shelf formulas that had been used by other manufacturers, whereas others featured unusual ingredients, around which Roddick and company employees had woven fanciful tales of her travels of discovery.
- Many Body Shop products were full of petrochemicals, artificial colors and fragrances, and synthetic preservatives and contained only small amounts of naturally sourced ingredients.
- Quality control was a continuing problem with instances of mold, formaldehyde, and *E. coli* contamination reported around the world, thus requiring the use of large amounts of preservatives to give the products stable shelf lives.
- The U.S. Federal Trade Commission had launched a probe into The Body Shop's franchising practices, including deceptive financial data, unfair competition, and misleading company representation. One husband-and-wife franchising team compared the company to the Gambino crime family.
- The Body Shop's "Trade Not Aid" program was a sham, providing only a small portion of The Body Shop's raw materials while failing to fulfill the company's promises to suppliers.
- Between 1986 and 1993, The Body Shop contributed far less than the average annual pretax charitable donations for U.S. companies, according to the Council on Economic Priorities.

Entine published a similar article in a trade magazine, *Drug and Cosmetic Industry*, in February 1995.¹⁵ In this article, he discussed The Body Shop's policies regarding animal testing, citing an internal memo from May 1992. At that time, 46.5 percent of The Body Shop's ingredients had been tested on animals by the ingredients' manufacturers, which was an increase from 34 percent the previous year. This and other practices raised new concerns about the company's slogan "Against Animal Testing" and tainted the company's 1993 victory in its libel suit against the TV program.¹⁶

Reaction to Entine's Article. The reaction to Entine's *Business Ethics* article was swift and furious. In June, well before the article's publication, Franklin Development and Consulting, a leading U.S.-based provider of social investment services, had sold 50,000 shares of The Body Shop because of "financial concerns."¹⁷ With rumors spreading about the article in early August, the stock fell from \$3.75 to \$3.33 per share. Ben Cohen, cofounder of Ben & Jerry's and a *Business Ethics* advisory board member, severed his ties with the magazine. The U.S. and British press ran numerous pieces on the article and its allegations. These articles appeared in newspapers and magazines such as *USA Today*,¹⁸ the *Economist*,¹⁹ the *New York Post*,²⁰ and the *San Francisco Chronicle*.²¹ The *London Daily Mail* secured an exclusive interview with one of the founders of the California Body Shop, who described the company's early years and how they eventually came to legal terms with the Roddicks over the rights to The Body Shop trademark.²²

Entine was interviewed by a small newsletter, the *Corporate Crime Reporter*, in which he defended and explained his research and the article.²³ One point of interest was Entine's claim that Body Shop products were of "drugstore quality," which he based on the company's use of obsolete ingredients and formulas and a *Consumer Reports* ranking that placed Body Shop Dewberry perfume last out of 66 tested.²⁴ Dewberry is The Body Shop's trademark scent and is used in all of its stores as

part of the "atmosphere." *Corporate Crime Reporter* also noted that another reporter, David Moberg, had brought similar allegations against The Body Shop in a separate article published the same month as Entine's.²⁵

Rift in Progressive Community. In January 1995, *Utne Reader* published a forum including commentaries by Anita Roddick, Entine, Moberg, and Franklin Research founder Joan Bavaria. The forum was remarkable in the sense that it presented a structured set of responses to the charges. Editor Eric Utne noted the rift that the article had caused in the progressive business community and described how the Roddicks, Marjorie Kelly, and other parties had begun holding face-to-face meetings to mend their relationships.²⁶ Entine described the same meetings as "a family gathering a few days after everyone's favorite uncle was found molesting a neighbor's child. The scandal was on everyone's mind, few would openly talk about it, and most hoped that ignoring it would make it fade away. It didn't."²⁷ Moberg encouraged consumer watchdog groups to do their jobs more carefully, citing the case of the British group New Consumer, which had previously given The Body Shop high ratings.²⁸ Roddick maintained that the truth had been sacrificed in a rush to judgment but that she had managed to cope with and learn from the experience.²⁹

GORDON RODDICK: DEFENDER OF THE REALM

Anita Roddick has been known to ask her employees what irritates them about their store.³⁰ Gordon, Anita's husband, was a bit more philosophical in his approach, yet he also spoke out on issues that concerned him. After their entry into the U.S. market, the Roddicks became frustrated with the regulatory barriers they encountered. Most of the problems that The Body Shop encountered were small. However, The Body Shop had two full-time employees and one lawyer devoted exclusively to regulatory compliance in the United States. Gordon Roddick estimated that it cost The Body Shop an additional 5 percent of its

revenues to do business in the United States, thus supporting his claim that the American free market economy was anything but free.³¹

Entine's *Business Ethics* article aroused Gordon to new heights of anger, according to those who knew him. Body Shop lawyers had successfully persuaded *Vanity Fair* to refrain from publishing a different version of the article earlier in the year. *Vanity Fair* compensated Entine for his work, paying him \$15,000 plus an additional \$18,000 to cover his expenses in writing and researching the article. Entine was paid only \$750 by *Business Ethics* magazine for the article.³²

Counterattack. Early in Entine's investigation, The Body Shop had hired the international public relations firm of Hill & Knowlton (H&K) to launch a counterattack on Entine's credibility and motives. H&K vice president Frank Mankiewicz, who was a former president of National Public Radio (NPR), sent letters to ABC requesting that it drop its Body Shop story.³³ He also used his contacts at NPR to place an interview with Entine and a follow-up story that included comments from Body Shop supporters on NPR news programs such as *All Things Considered*. Further attempts to intimidate *Business Ethics* magazine failed. The editor and publisher, Marjorie Kelly, knew that publishing the article was a risk, but she said she had checked and rechecked Entine's sources and was satisfied that his charges were sound. However, if The Body Shop chose to sue the magazine, she also knew that the cost of getting to the summary/judgment phase of the trial could put the small magazine out of business.³⁴

Gordon Roddick responded to the *Business Ethics* article within a month of its publication by sending a 10-page letter on Body Shop letterhead to all *Business Ethics* magazine subscribers. In this letter, he denied many of the charges made in the article. The letter offered statements by several people that appeared to contradict their own quotations in the article.

Decoys Get Letter. Several staff members at *Business Ethics* magazine were not pleased with

the letter, which they had received in the mail, because they were included as decoys on the subscriber mailing list. This is a common practice in the mailing-list industry to help prevent the misuse of subscriber addresses. The publisher of *Business Ethics* magazine could not recall authorizing the magazine's mailing-list service to rent the list to The Body Shop. It did not take long for the mailing-list company to discover that The Body Shop had obtained the magazine's subscriber list through a third party. Said Ralph Stevens, president of the mailing-list firm, "The Body Shop duped a prominent and legitimate list-brokerage company, a respected magazine, and they duped us. . . . If this is any indication of the way [The Body Shop does] business, of their regard for honesty and integrity, I give them a failing mark on all counts."³⁵ In late 1994, The Body Shop hired a business ethics expert to lead a social audit of the company.³⁶

THE SITUATION AS OF 1995

By July 1995, Anita Roddick was already considering the possibility of opening Body Shop stores in Cuba, hoping to beat her competitors to that market and at the same time convert the Cubans' social revolution into a profitable yet honorable business revolution.³⁷ The company was also considering opening retail stores in Eastern European countries. At the same time, the media attention on the company had raised serious concerns among customers, among Body Shop supporters, and within the financial community. Since August 1994, the company's stock price had plummeted by almost 50 percent to 120p, an all-time low.

Losses. The Roddicks took millions of dollars in paper losses on their holdings, despite having sold a portion of their stock in July 1994.³⁸ The company faced increased competition from several larger firms, including Procter & Gamble, Avon, Kmart, The Limited, L'Oreal, Crabtree & Evelyn, and Marks & Spencer. Other companies, such as H2O Plus, were making progress in their

efforts to open retail stores that featured products similar to those of The Body Shop. The company had hired Chiat/Day to develop advertising campaigns for worldwide use and conduct a marketing study in the United States.³⁹ There was at least one report that the company was looking for a U.S. advertising agency.⁴⁰ The questions that had been raised as a result of media investigations and The Body Shop's responses left some observers wondering what principles the company espoused and if the company could regain its earlier level of success.

Anita's Fame Continues. Anita Roddick continued to be recognized for her leadership on social and ethical causes. She won many awards in the mid-1990s. Among them were the following:⁴¹

- 1993—National Audubon Society Medal, USA
- 1994—Botwinick Prize in Business Ethics, USA
- 1994—University of Michigan's Annual Business Leadership Award, USA
- 1995—Women's Business Development Center's First Annual Woman Power Award, USA

Questions for Discussion

1. How has The Body Shop continued to address the four components of corporate social responsibility?
2. What is your assessment of The Body Shop's response to Jon Entine's *Business Ethics* article? Has The Body Shop misrepresented itself to stakeholders, and if so, how?
3. Jon Entine and others have accused The Body Shop of using intimidation to stifle critics. Does this appear to be a valid criticism? Was The Body Shop justified in hiring Hill & Knowlton to conduct a public relations campaign?
4. Has The Body Shop's reputation been damaged by the incidents in this case? How might the company improve its reputation? Do you believe the steps described in this case, including the hiring of an advertising agency, will help or hinder these efforts?
5. Describe the roles you believe Gordon and Anita Roddick should play in The Body Shop's future operations. How might a stockholder, a customer, a supplier, and an employee assess the roles that the Roddicks should play?

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Case 4

The Body Shop International PLC (1998–2007)

By 1998, The Body Shop International had grown into a multinational enterprise with almost sixteen hundred stores and five thousand employees in 47 countries.¹ That year, after several years of lackluster financial performance, Anita Roddick gave the company's CEO post to a professional manager and became executive cochairman with her husband, Gordon. Anita maintained that job titles were meaningless anyway.²

Despite the change, the company's financial performance between 1995 and 1997 continued to be unimpressive:³ worldwide sales revenue and operating profits grew from \$303 million and \$21 million in 1995 to \$377 million and \$19 million, respectively, in 1997.

MORE ADVERTISING

In 1995 to 1996, The Body Shop began to experiment with advertising in North American markets. According to one observer, The Body Shop originally thought that its brands and human-rights agenda would create valuable word-of-mouth promotion among socially conscious consumers and that advertising would not be needed. The Body Shop's anti-advertising strategy largely paid off in the United Kingdom and other European nations, where human-rights activism and commerce blended more seamlessly and consumers had fewer brands and retailers than in the United States. The strategy did not work effectively in the United States, where brand differentiation was crucial. In 1997, for example, The Body Shop's same-stores

sales in the United States dropped 6 percent, the company's worst performance since entering the U.S. market 10 years earlier.⁴

Since it has begun, U.S. advertising has been piecemeal, often targeted toward the Christmas-time holiday sales push. In addition, it has been quirky. For example, Anita Roddick taped a radio spot that slammed the cosmetics industry. In the radio spot, Roddick said, "If more men and more women understood what really makes people beautiful, most cosmetic companies would be out of business."⁵

GETTING ITS ACT TOGETHER

The Body Shop seemed to be trying hard to get its act together in the U.S. market. It hired a new CEO in fall 1998 and created the position of vice president for promotions. These were significant moves for the company, but it would take more than advertising to turn things around. The Body Shop typically plays down product efficacy in favor of hyping product ethicality. A case in point is its Mango Body Butter, the ingredients of which the company promotes as coming from a "woman's cooperative in Ghana." Sean Mehegan, a writer for *Brandweek*, summarized the company's dilemma this way: "How much American consumers care about such claims lies at the heart of whether The Body Shop can turn itself around here."⁶

THE BODY SHOP'S SOCIAL AUDITS

In 1994, perhaps in response to the *Business Ethics* magazine article by Jon Entine calling its integrity

This case was prepared by Archie B. Carroll, University of Georgia, using publicly available information.

into question and perhaps on its own initiative, The Body Shop began an elaborate program of annual social audits that examined, in particular, its environmental, social, and animal protection initiatives. Through the social audit program, which the company based on mission statements and goals in numerous social performance categories, the company established detailed social and ecological milestones for 1995–1997. In its 218-page *Values Report 1997*, the company reported its progress.⁷ This lengthy landmark document is often held out to be one of the most significant social performance reports ever prepared.

As reported in its *Values Report*, The Body Shop set policies in three areas: human and civil rights, environmental sustainability, and animal protection. In each category, the company set forth a conceptual framework for the auditing process. The auditing process in each category depended heavily on stakeholder interviews. The stakeholders who were interviewed included employees, international franchisees, customers, suppliers, shareholders, and local community/campaigning groups. The company identified the media as a potential stakeholder group for inclusion in future social auditing cycles.⁸

ALLEGATIONS CONTINUE

In 1998, The Body Shop continued to face charges that could threaten its future. The company faced a flood of allegations and lawsuits by franchisees charging fraudulent presentations by the company when they bought their franchises. A number of U.S. franchisees had been angry at what they saw as unfair buyback terms if they wanted to get out of the business. There was talk of group action that could involve claims in the hundreds of millions of dollars.⁹

An example of the kind of lawsuit being filed was that of Jim White, who was asking for \$32 million in damages. He was suing The Body Shop for fraud, fraudulent inducement, and inequitable treatment of franchisees. White claimed that the company offered rock-bottom buyback prices to franchisees caught in a five-year spiral of declining

U.S. sales. White claimed he was offered only twenty cents on the dollar and that others were offered as little as five cents on the dollar.¹⁰

INTO THE NEW MILLENNIUM

The early 2000s continued to be tumultuous for The Body Shop. The company continued to grow, but sales and profits were not strong. As a result of poor Christmas sales in 2000, its annual profits were down 55 percent as it entered 2001. In the United Kingdom, the company found itself operating in a much more competitive marketplace than at its beginnings 25 years earlier. Most high-street retail chains now are fielding their own “natural” cosmetics and toiletries, and price and promotional battles left the company’s products more expensive than its rivals.¹¹

Legal Difficulties. In September 2001, a major *Fortune* magazine article featured some of the legal difficulties The Body Shop was facing because of conflicts with franchisees. It was reported that eight U.S. Body Shop franchisees, who owned 13 locations, were accusing the parent company of impeding their business. In December 2000, this group filed a lawsuit against the company asking for damages in the neighborhood of \$2 million. One major complaint was that the company-owned stores were getting much better treatment than the franchisee-owned stores. Franchisee owners complained of the company failing to deliver them products while the company-owned stores had no problem getting products. Some franchisee owners saw this chronic out-of-stock problem as a ploy to force them to sell their franchises back for a fraction on the dollar.¹²

Roddicks Step Aside. In 2002, Anita and Gordon Roddick stepped down from their positions as cochairmen of the board of directors. Along with their friend and early investor Ian McGlenn, they maintained control of more than 50 percent of the company’s voting rights. Anita Roddick was to remain involved in a “defined consultant role.” At about this same time, the company had been in discussions with potential buyers of the company,

but these talks were abandoned when offers were less than what the company expected.¹³ Peter Saunders, former president and CEO of The Body Shop in North America, became CEO of the company.

Also during 2002, The Body Shop conducted a global campaign with Greenpeace International on promoting renewable energy. The company furthered its commitment to environmental sustainability through investments in renewable energy, funding of energy-efficient projects in the developing world, and incorporating post-consumer recycle into its packaging.¹⁴ During 2003, the company started a global campaign to stop violence in the home. In 2003, Anita Roddick was appointed as a Dame of the British Empire as part of the Queen's birthday honors.¹⁵

Sale to L'Oréal. In mid-2006, The Body Shop was sold to France's L'Oréal. Following the sale, Peter Saunders kept his CEO title and founder Dame Anita Roddick remained on the company's board. The plan was that the company was to retain its unique identify and values and continue to be based in the United Kingdom. The company operates independently within the L'Oréal Group, and it is led by its own management team, reporting directly to the CEO of L'Oréal.¹⁶ At last report, the company had 2,100 stores in 55 countries, and two-thirds of them are franchised.¹⁷ It also sells its products via The Body Shop at Home, an in-home sales program in the United Kingdom, the United States, and Australia. In 2007, the company published its *Values Report 2007*, its first since being acquired by L'Oréal. The company continues to claim five core values: Against Animal Testing, Supporting Community Trade, Activating Self-Esteem, Defending Human Rights, and Protecting the Planet.¹⁸

The company continues to face stiff competition. Its top three competitors are Bath and Body Works, Estée Lauder, and Alliance Boots (the United Kingdom's number-one retail pharmacy). But the company has dozens of other competitors, including such familiar names as Alberto-Culver, Avon, Coty, the Gap, Macy's, Mary Kay, Revlon, and Target.¹⁹

An article in the *Independent*, a newspaper in the United Kingdom, said in 2006 that The Body Shop's popularity plunged after the L'Oréal sale. The article argued that the sale had dented the company's reputation, and it was stated that Dame Anita Roddick had abandoned her principles by accepting the deal with L'Oréal. Roddick claimed that she would eventually give away the £130 million she made from the sale.²⁰

Financials. Annual sales and net income for the last four years were as follows:²¹

	2006	2005	2004	2003
Annual Sales (\$Millions)	846	804	712	600
Annual Net Income (\$Millions)	51	52	41	21

Status of Company Criticism. Much of the targeted criticism of The Body Shop for the issues raised earlier, led in part by Jon Entine, has subsided. A review of Jon Entine's website, however, shows that he continues to critique The Body Shop on his website and continues to criticize the company on Listservs. Entine's website may be accessed at <http://www.jonentine.com/index.htm>.

Roddick Turns to Publishing. Roddick published her second book, *Business as Unusual: The Triumph of Anita Roddick and the Body Shop*, in 2001. Also in 2001, she published *Take It Personally: How to Make Conscious Choices to Change the World*. She turned to writing because, she explained, "I'm at the point in my life where I want to be heard." She adds, "I have knowledge and I want to pass it on."²² In an interview with *Across the Board* magazine, Anita commented on her experiences with professional consultants and executives who are not as concerned as she is about preserving The Body Shop's values. She stated: "The hardest thing for me are the marketing people, because they focus on us as a brand and our customers as consumers. We've never called it a brand; we call it The Body Shop. In 25 years, we've never, ever, ever called a customer a consumer. Customers

aren't there to consume. They're there to live, love, die, get married, have friendships—they're not put on this planet to bloody consume."²³

In 2003, she published *A Revolution in Kindness*. Her latest book, published in 2005, is *Business as Unusual: My Entrepreneurial Journey*. She continued to speak and write and raise money for social causes and even developed her own personal website (<http://www.anitaroddick.com>), where you can track everything she had been doing for the past several years.

ANITA'S UNTIMELY DEATH

Quite unexpectedly, and as a shock to all, Anita Roddick died on September 10, 2007, even as we were revising this case. She was 64. Anita died of a brain hemorrhage, according to her family. As the *New York Times* summarized, she was "a woman of fierce passions, boundless energy, unconventional idealism, and sometimes diva-like temperament."²⁴

The Future under L'Oréal and without Anita. The future is uncertain for The Body Shop. It remains to be seen what will happen long term under the ownership of L'Oréal and upon the death of its inspirational founder. According to his website, journalist Jon Entine's last article on the Body Shop was in 2002.²⁵ Despite the criticism, the company continues to make management and strategic changes and to pursue social programs and social and sustainability audits. In the hard, cold world of global competition, founder Anita Roddick learned some tough lessons in her final decade. Although she may have believed that the purpose of a business is not just to generate profits, it has become increasingly apparent that the tension between financial and social performance requires delicate balancing of, and careful attention to, both. Even in her death, Anita Roddick stands out as the most well-known woman in business ethics and corporate responsibility circles, and only time will tell as to what her final legacy will be and what will happen to The Body Shop in her absence.

Questions for Discussion

1. Has Anita Roddick betrayed her philosophy about advertising by beginning to advertise in U.S. markets? Does this decision have ethical implications? Or is it just a business decision?
2. Would you invest in The Body Shop in North America? Why or why not?
3. Will The Body Shop's social auditing program save the firm's reputation? Has the firm "snapped back" from the damage done to its reputation in the mid-1990s?
4. Do the low buyback prices offered to U.S. franchisees reflect poor Body Shop ethics or just the economic reality of risky investments?
5. Is The Body Shop regarded today as a socially responsible and ethical firm? Research the answer to this question and be prepared to report your findings.
6. At the end of these cases, what is your impression of Anita Roddick? Comment on her strengths and weaknesses and a businessperson and a leader. Was the sale of the company to L'Oréal an indication that Roddick's philosophy had finally failed?
7. What will be the likely longer-term impact on The Body Shop's values and priorities under the leadership of L'Oréal and upon Anita Roddick's death? Would it be in L'Oréal's best interests to leave the company alone and let it go in the direction Anita had provided it, or should it be brought more into the mainstream of the company?

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Case 5

The HP Pretexting Predicament

News leaks seemed to plague Hewlett-Packard. The first leaks surrounded the ouster of chairwoman and chief executive Carly Fiorina. In the midst of this internal turmoil, the *Wall Street Journal* published an article with details of closed-door board discussions about the planned management reorganization. An external legal counsel interviewed board members but did not succeed in identifying the leak. Evidence of more leaks appeared a year later as news organizations once again described the deliberations of closed board and senior management meetings in extensive detail. It was clear that someone from inside was leaking information. In addition to board members, reporters from such publications as the *New York Times*, *Wall Street Journal*, *BusinessWeek*, and CNET became targets of the ensuing investigation into ten different leaks. The methods used to try to plug these news leaks led eventually to a board shake-up, which included the departure of non-executive chairwoman Patricia Dunn.

THE INVESTIGATION INTO THE LEAKS

Investigating board members is a difficult proposition. As the source of the potential leaks, the board could not supervise what was essentially an investigation of themselves. Neither could the employees handle the investigation, because that would have put them in the untenable position of investigating their own bosses.¹ Left with few options, HP board chairwoman Dunn turned the investigation over to a network of private investigators. According to Dunn, she could not supervise

the investigation, because she was a potential target.² Dunn asked the head of corporate security to handle the investigation, as this was the person who handled employee investigations, but he still had conflicts of interest as an employee of the board.³ So the company outsourced the investigation to a network of outside investigators, telling them to conduct it within the confines of the law.⁴

In one sense, the investigation was successful because evidence pointed to one board member, George Keyworth, as the source of seven of the ten leaks. Keyworth admitted that he was the source of the leaks: the board asked him to resign, but he refused, at which point the company said it would not nominate him for reelection. Keyworth subsequently resigned. The investigation did not uncover the source of the remaining three leaks, but it seemed that the problem was resolved.

THE FALLOUT FROM THE INVESTIGATION

The HP investigation into news leaks may be a case of the cure being worse than the disease. Although the primary source of the leaks was uncovered, questions remained about the process of the investigations. One board member, Thomas J. Perkins, resigned from the board in protest over the way in which the investigation and notification of the outcome was handled. He had wanted the matter handled privately rather than aired in front of the entire board. Perkins sought information about how Hewlett-Packard investigated the leaks, asserting that phone and e-mail communications had been recorded improperly.⁵

HP indicated that, although no recording or eavesdropping occurred, investigators had used a

This case was prepared by Ann K. Buchholtz, University of Georgia.

form of “pretexting” to elicit phone records. Pretexting is a way of obtaining information by disguising one’s identify. In this case, investigators used pretexting to obtain phone records of not only HP board members but also reporters who covered the story. In addition, investigators followed board members and journalists and watched their homes. They also planted false messages with journalists in an effort to get them to reveal their sources inadvertently through tracking software included in the fake messages.⁶

At the time of this investigation, pretexting was in a gray area of legality. Dunn reported that she consulted lawyers before approving the investigation, and they told her that pretexting was within the law.⁷ Months later, a law was passed due largely to the furor over the Hewlett-Packard investigation, as a result of which pretexting became illegal. The Telephone Records and Privacy Protection Act of 2006 specifically outlaws the use of fraud to obtain billing records and other information from phone companies about their customers.⁸ Of course, the new law is not retroactive, and so it does not impact the Hewlett-Packard controversy.

Opinions varied over what the consequences, if any, should be for Chairwoman Dunn. According to Charles Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware, “I think it’s going to be very hard for her to stay. This was a mess created in the boardroom and someone has to be responsible.” In contrast, Yale School of Management professor Jeffrey Sonnenfeld opined that Ms. Dunn should be given credit for acting against boardroom cronyism and that dismissing her would show “nothing but cowardice.”⁹

On September 22, 2006, Patricia Dunn handed in her immediate resignation at the request of the Hewlett-Packard board. In her defense, she said that, although she was responsible for identifying the leaks, she did not suggest the specific methods to be used. She said that those who performed the investigation “let me and the company down.”¹⁰ Ms. Dunn’s lawyer added that she “went to the

right people and she was assured that what they were doing was legal.¹¹ Mark V. Hurd, who served as CEO throughout the process of the investigations, succeeded Ms. Dunn. His involvement in the investigations was peripheral, as he was an employee of the board. However, e-mail and cell phone records show that he approved the “sting” operation that sent false messages and tracking software by e-mail to reporters.¹² In addition, the company’s investigators gave Mr. Hurd a copy of their report on their operations, but Mr. Hurd did not read it. “I could have and I should have,” said Mr. Hurd.¹³

Questions for Discussion

1. What are the ethical issues in this case?
2. Who are the stakeholders impacted by this situation? How would you rank their claims?
3. Was the investigation into the recurring news leaks ethical? Why or why not? What actions would you recommend that a company in a similar situation take?
4. What should happen to the people involved in the situation? Should Ms. Dunn have been asked to resign? Should Mr. Hurd be able to remain and be given the role of board chairman?
5. Where do you draw the line between personal privacy and an organization’s right to know? If something unethical is happening, to what extents should an organization be able to go to determine who is at fault?

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13. Darlin and Richtel, A1.

Case 6

Dick Grasso and the NYSE: Is It a Crime to Be Paid Well?

The former New York Stock Exchange (NYSE) Chairman Richard A. (Dick) Grasso has a personal story that is well known in Wall Street circles. His father left his family when Grasso was an infant, and so he was raised in a blue-collar neighborhood by a single mother and two unmarried aunts. After dropping out of Pace University and then serving two years in the Army, Grasso joined the NYSE as a clerk in the stock lists department. Rising through the ranks, Grasso eventually became the NYSE chairman and CEO in 1995.¹

THE PAY PACKAGE

On August 27, 2003, the details of Dick Grasso's compensation package were made public. In the four-year contract approved by NYSE directors, Grasso would receive a lump sum of \$139.5 million in deferred compensation and pension benefits. Two weeks later, on September 9, the NYSE revealed that Grasso had also been promised \$48 million more that did not include his base pay or his \$2.4 million annual bonus.² The disclosure of the package created an instant uproar. In addition to NYSE directors and seat holders, large institutional investors expressed their dismay. The Securities and Exchange Commission (SEC) began an investigation as individual investors expressed outrage at the size of his compensation package.

THE CRITICS

When critics compared Grasso's pay to that of other executives who are responsible for regulation of the securities industry, they found it excessive. Robert Glauber is chairman and chief executive of the National Association of Securities Dealers, which is responsible for regulating NASDAQ as well as many brokerage firms. His compensation package was about \$2 million. SEC chairman William Donaldson makes \$142,000 annually. Furthermore, when Donaldson headed the NYSE, he earned \$1.5 million (1991) and \$1.65 million (1992).³

Critics also noted that Grasso's 2001 pay package of \$30.5 million was nearly equal to the NYSE's net income that year. They found Grasso's one-time bonus of \$5 million for leadership on September 11 to be inappropriate. From the mayor of the city to firefighters and police officers, many exhibited leadership, but he was the only one to receive a bonus in compensation.⁴ Others point to Grasso's failure to reform the internal governance at NYSE, with the board members being hand-picked in a time when independence is expected.⁵ Phil Angelides, head of the California Public Employees' Retirement System (Calpers), found it "particularly troubling" that Grasso received his largest payouts at a time when corporate scandals were rocking the markets.⁶

THE DEFENDERS

Those who defend Grasso's compensation point to the success of the NYSE: 1,549 of its 2,800

This case was prepared by Ann K. Buchholtz, University of Georgia.

companies were added under his watch.⁷ Kenneth Langone, who chaired the NYSE compensation committee from June 1999 to June 2003, declared, “The guy earned every penny we paid him.”⁸ He pointed to Grasso’s successful handling of the Y2K concerns and the September 11 terrorist attacks and praised Grasso for helping increase the value of the NYSE’s seats. During Grasso’s tenure, the price of a seat rose from \$810,000 to \$1.9 million, reaching \$2.65 million at one point in 1999.⁹ Others have noted Grasso’s success at expanding the NYSE’s global listings and securing the NYSE’s position as the world’s leading stock market.¹⁰ A *Wall Street Journal* editorial opined that Grasso should not be faulted for taking compensation awarded him by the board: The compensation committee was filled with financial services executives who knew what they were awarding him.¹¹ In his own defense, Grasso wrote:

My record at the NYSE speaks for itself. The value of a membership seat nearly tripled during my tenure as chairman, soaring to more than \$2 million from \$700,000. The income to seat owners leasing their seats to others likewise jumped to \$300,000 from \$100,000. Under my leadership, the NYSE significantly increased its market share. It nearly doubled the number of listed companies, and the great majority of the near-500 non-U.S. companies now on the NYSE were listed during my tenure. I proudly oversaw the implementation of the Big Board’s technology platform, widely regarded as one of the most sophisticated in the world. Even in the late 1990s, when the dot-com craze gave the technology-laden NASDAQ the edge, the NYSE reigned supreme.¹²

THE FALLOUT

On September 17, 2003, less than a month after the pay package was disclosed, Grasso was ousted from his position. A NYSE press release explained Grasso’s firing by saying that the pay deal had inflicted “serious damage” on the stock exchange’s reputation.¹³ In January 2004, the NYSE asked

New York attorney general Elliott Spitzer to investigate. In February 2004, the NYSE demanded that Grasso return \$120 million, which they felt Grasso had manipulated the board into providing. Two weeks later, Grasso responded that he would not return any of the compensation in question. In May 2004, Spitzer filed a lawsuit against Grasso, the NYSE, and former NYSE compensation committee chairman Kenneth Langone, claiming that the size of the pay package violated the laws regarding compensation in not-for-profit organizations.¹⁴ The suit charged that the pay package resulted from Grasso’s manipulation and intimidation of an unaware board of directors and that Langone helped mislead the directors into voting for a package that appeared smaller than it was.¹⁵ The suit also demanded that Grasso return more than \$100 million and forego any future payments.¹⁶ Arguing that the NYSE is not a charity and that the compensation committee members are all high-level financial executives who are not easily duped, Grasso vowed to fight the lawsuit.¹⁷ The *Wall Street Journal* noted that his choice of Brendan Sullivan, who successfully defended Oliver North, as his attorney was indicative of a plan to fight rather than settle.¹⁸

At this writing, the case is still in progress. In early 2007, Grasso said that the costs from the lawsuit may have exceeded \$100 million—almost as much as New York State was trying to get back from him. According to Grasso, the lawsuit was about honor rather than money, and so he planned to continue his fight.¹⁹ Grasso’s cause gained some momentum in May 2007 when the Appellate Division for New York State’s Supreme Court threw out four of the six elements of the case. However, Attorney General Andrew Cuomo indicated that he planned to continue the fight that former attorney general Elliot Spitzer had begun.²⁰

Questions for Discussion

1. What are the ethical issues in this case?
2. Who are the stakeholders impacted by this situation? How would you rank their claims?

3. What is your reaction to Richard Grasso's compensation package? What criteria are bringing you to your conclusion?
4. Do you agree with the firing of Richard Grasso? Do you agree with Attorney General Spitzer's lawsuit? Who is to blame for this situation? Who are the victims? Irrespective of what the courts decide, who do you think is in the wrong?
5. What changes would you make so that this problem would not happen again?

Case Endnotes

1. Gary Weiss, "The \$140,000,000 Man," *BusinessWeek* (September 15, 2003), 84–90.
2. Kate Kelly, "Langone Says NYSE Wasn't Misled on Pay of Ex-Chief Grasso," *Wall Street Journal* (June 15, 2004), C1.
3. Suzanne Craig and Kate Kelly, "Large Investors Call for Grasso to Leave NYSE," *Wall Street Journal* (September 17, 2003), C1.
4. *Ibid.*
5. Weiss, 84–90.
6. Craig and Kelly, C1.
7. Weiss, 84–90.
8. Kelly, C1.
9. *Ibid.*
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11. "Spitzer v. Grasso," *Wall Street Journal* (May 25, 2004), A16.
12. Richard A. Grasso, "My Vindication Will Come in a Courtroom," *Wall Street Journal* (May 25, 2004), A16.
13. Charles Gasparino, "Dick Grasso Defending the Exchange Rate," *Newsweek* (July 26, 2004), 8.
14. Kara Scannell, "Grasso's Millions: Spitzer's Winning Streak Heads for Court," *Wall Street Journal* (May 25, 2004), C6.
15. Kate Kelly, "Money Brawl: Grasso v. Spitzer," *Wall Street Journal* (July 21, 2004), C1.
16. Kelly, June 15, 2004, C1.
17. Gasparino, 8.
18. Scannell, C6.
19. Allan Dodds Frank and Edgar Ortega, "Grasso Says Costs of NYSE Suit May Be \$100 Million," *Bloomberg.com*, January 17, 2007.
20. Aaron Lucchetti and Paul Davies, "Will Grasso Get His Pay, After All?" *Wall Street Journal* (May 9, 2007), C1–C2.

Case 7

The Waiter Rule: What Makes for a Good CEO?

As the topic of corporate governance has been in the news more and more during the past several years, it is useful to reflect on what boards of directors have to do in terms of their roles and responsibilities. Acting on behalf of shareholders, one of the board's most important jobs is selection of the CEO, who will provide strategic direction for the firm, and in turn, hire the top management team. But how does a board go about hiring a CEO? Certainly, this has got to be one of the toughest jobs of selection in the business world.

In recent years, so many contentious issues have surrounded CEOs that the board's task is no small one. So many CEOs have been implicated in ethics scandals, and so many of them have been criticized for what the public considers excessive compensation. Today especially, boards want to be sure they hire CEOs with high integrity and impeccable character. It is a lofty goal, and things don't always turn out the way boards wish. With a record number of CEO firings in the past five years, it is little wonder boards of directors are always seeking insights as to how to make these selection decisions.

Businesspeople are always on the alert for guidance, for suggestions, for tips that would make their hiring more successful or run more smoothly. But if an elusive quality such as character is so important, how does one gauge a prospective CEO's or top executive's character? Or, for that matter, how can we gauge the character of any level of management? Surely this

is a vital ingredient no matter what the level of management in the organization.

Swanson's Unwritten Rules. In a recent (2006) *USA Today* article, it was revealed that Bill Swanson, CEO of Raytheon, the defense contractor based in Waltham, Massachusetts, that has eighty thousand employees and more than \$22 billion in annual sales, had published a booklet containing 33 brief leadership observations.¹ The booklet was titled *Swanson's Unwritten Rules of Management*.² It turns out that Raytheon has given away 300,000 copies of the booklet to members of its own organization and to virtually anyone who inquires about it. The book, filled with common sense maxims, observations, rules, and guidelines, is considered to be something of a cult hit in corporate America.³ Among the 33 guidelines or rules compiled in the booklet is one rule that Swanson has said never fails in terms of helping to assess someone's character.

The Waiter Rule. Known as the "Waiter Rule," the observation basically says that "a person who is nice to you but rude to the waiter, or to others, is not a nice person." A number of CEOs and other corporate executives have all agreed with the waiter rule. They basically concur that how a privileged corporate executive treats people in subordinate roles, whether they be waiters, clerks, maids, bellmen, golf caddies, or any other service-type worker, reveals insights into the executive's character that should be taken into consideration in hiring decisions.

This case was prepared by Archie B. Carroll, University of Georgia.

Office Depot CEO Steve Odland recalls that when he was working in a restaurant in Denver many years ago, he spilled a glass of purple sorbet all over the expensive white gown of an apparently important and rich woman. Though it occurred more than 30 years ago, he can't get the spill out of his mind. But what struck him most was her reaction to his careless spill. The woman responded in a very kind and understanding way. She kept her composure and in a calm voice said, "It's okay. It wasn't your fault." Years later, the now-CEO of Office Depot recalls what he learned about this incident: "You can tell a lot about a person by the way he or she treats the waiter."⁴

Character Revealed. As it turns out, just about every CEO has a waiter story to tell. The opinion they hold in common, moreover, is that the waiter rule is a valid way to gain insights into the character of a person, especially someone who may be in a position of authority over thousands of workers. The cofounder of Au Bon Pain, the leading urban bakery and sandwich café, Ron Shaich, became CEO of Panera Bread. He tells the story of interviewing a woman for general counsel who was "sweet" to him but turned "amazingly rude" to the person cleaning tables. She didn't get the job.⁵

Author Bill Swanson is quoted as having written: "Watch out for people who have a situational value system, who can turn the charm on and off depending on the status of the person they are interacting with."⁶ Related to this observation, Steve Odland of Office Depot has

been quoted as saying, "People with situational values have situational ethics, and those are people to be avoided."⁷

Questions for Discussion

1. Is character an essential ingredient in ethical leadership? Is it especially important in managers? In leadership, especially among CEOs, is character important? Why?
2. Do you agree with the waiter rule? Does it provide useful insights into who might be an ethical or unethical leader? Should corporate boards consider character when hiring someone for the top position?
3. Is using the waiter rule too simplistic a guideline for hiring people in important positions such as CEO?

Case Endnotes

1. Del Jones, "CEOs Vouch for Waiter Rule: Watch How People Treat Staff," *USA Today* (April 14, 2006), B1.
2. William H. Swanson, *Swanson's Unwritten Rules of Management* (Raytheon, 2005).
3. David Leonhardt, "Rule No. 35: Reread Rule on Integrity," *New York Times* (May 3, 2006).
4. Jones, *ibid.*
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6. Quoted in Jones, 2006, *ibid.*
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Case 8

Do as I Say, Not as I Did

Carl Durrenbergen, an engineer in San Diego, was packing up his cubical at Hewlett-Packard to transfer to another division of the company when he came across a copy of a 1944 book given to him by a former boss. The book was titled *The Unwritten Laws of Engineering*, authored by W. J. King. As he browsed through the little book, he couldn't help but grin at the outdated language.¹

Just a few days later, he read an article in *USA Today* newspaper about Bill Swanson, CEO of Raytheon, and his 33 unwritten rules, published under the title *Swanson's Unwritten Rules of Management*.² Durrenbergen thought for a moment, paused, and then a memory flashed into his mind. He quickly found the King book in his box of packed materials, looked it over more carefully, and was "flabbergasted" to recognize that 16 of Swanson's rules were the same as King's, even down to the identical wording. He later wrote on his blog: "Bill Swanson of Raytheon is a plagiarist."³

Media Questions. Raytheon started receiving questions from the media immediately. When newspaper articles started showing up, Swanson finally released a statement. He said he regretted any reference to King's work and according to the *New York Times*, seemed to laugh off the whole thing. He was quoted as saying that this experience had taught him a valuable lesson, and he issued his new rule #34—"Regarding the truisms of human behavior, there are no original rules."⁴

Swanson's Admission. Swanson apologized for the incident but later went on to say

that the whole thing was an innocent mix-up. He said he had asked some of his staff members to compile a presentation from a file of materials he gave them, and he later admitted that "it's clear to me now that this file contained Professor King's book, as well as other published materials."⁵ It later turned out that Swanson's little booklet also contained some other rules that had been taken from published guidelines of Defense Secretary Donald Rumsfeld and also from humorist Dave Barry. This incident exploded into a full-blown embarrassment and public relations nightmare for Raytheon and for Swanson.⁶

The Board's Position. As CEO, Swanson reports to his board of directors. A board spokesman said they were not happy with the incident but had become convinced the lifting of someone else's material had been unintentional.⁷ By February 2007, the Raytheon board had decided that Swanson had been punished enough for his plagiarism. The company docked his 2006 pay by \$1 million after he admitted his guilt. A few months later, it was reported in the *New York Times* that Raytheon had raised Swanson's bonus to \$2.8 million in 2006, even though the *Boston Globe* had reported that promoting ethical behavior was one criterion the board says it uses in deciding upon bonuses. When asked why Swanson's bonus increased while his ethics had decreased, a company spokesman said that ethical behavior was just one factor the board considered.⁸

Questions for Discussion

1. Did Swanson plagiarize or was it all just an unintentional, innocent mix-up? What would

This case was written by Archie B. Carroll, University of Georgia.

happen to a college student who did what Swanson had done?

2. How would you characterize the ethical leadership style of CEO Swanson? Was Swanson denying responsibility and trying to blame staffers for the error?
3. In Case 7, Swanson spoke out about people with “situational value systems.” Has he now engaged in hypocritical behavior?
4. What is your evaluation of the reaction of the Raytheon board of directors? Was the \$1 million fine a serious attempt to punish questionable behavior, or was it a slap on the wrist administered for PR purposes?
5. What does this case tell you about corporate governance and ethical leadership?

Case Endnotes

1. Lisa Takeuchi Cullen, “Rule No. 1: Don’t Copy,” *Time* (May 15, 2006), 41.
2. Del Jones, “CEOs Vouch for Waiter Rule: Watch How People Treat Staff,” *USA Today* (April 14, 2006), B1.
3. Cullen, *ibid.*
4. David Leonhardt, “Rule No. 35: Reread Rule on Integrity,” *New York Times* (May 3, 2006).
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Case 9

Say-on-Pay

As CEO pay levels soar, shareholders have begun to question how executive pay is set and whether the widening gap between executive and average worker compensation has become too great. As owners of the firm, they are asking for greater say in the setting of executive pay. Many were surprised when Aflac, a *Fortune* 200 firm, agreed with relatively little fuss. Perhaps they should not have been surprised. *Fortune* has ranked Aflac as one of the *Best Places to Work* and *Most Admired Companies* for many years. In addition, the Aflac duck ranks highly as one of America's favorite brand icons.

THE COMPENSATION CONTROVERSY

The United States stands out as the country where corporate executives receive the highest pay, about 400 times that of the average worker. Not everyone is opposed to it. Some people argue that this level of pay is necessary in order for firms to attract the best talent. Still others maintain that high pay is acceptable because CEOs bear great responsibility for the firm's success, and the CEO's pay is not large in comparison to the overall revenues of major firms. In addition, some contend that the high level of pay creates a tournament that motivates the firm's middle managers to work extremely hard in the hopes they will become CEO one day and receive that level of pay. In contrast, critics counter that excessive pay is not necessary to attract talent nor is it needed to motivate executives, because other countries are able to find talent without paying executives at that high level. Observers also

question the role of pay consultants with lucrative contracts and note the incentives they have to keep top executives happy.

Frustrated by an executive pay spiral that continues upward even when profits head downward, shareholders are asking for greater transparency in the pay-setting process. They want to know why the firm's board selects a particular pay package and how that pay will vary with changes in firm performance. This push for more participation in the pay-setting process is known as *say-on-pay*. The say-on-pay movement began when the American Federation of State, County and Municipal Employee (AFSCME) shareholders protested the exorbitant pay package given to Home Depot's former chief executive Robert Nardelli. Richard Ferlauto, AFSCME's director of pension investment, encouraged other fund groups to join in asking about 60 companies to adopt nonbinding say-on-pay shareholder votes on executive compensation packages. Aflac was on the list, due partly to its chairman's generous pay package and due partly to its name recognition. Boston Common Asset Management holds Aflac in its portfolio, and so it sent a say-on-pay proposal for inclusion on the firm's proxy statement.¹

AFLAC'S RESPONSE

Aflac has a unique relationship with its shareholders, particularly for a large company with a \$25 billion stock market value. It takes pride in having good relationships with its investors and holding relaxed and friendly family-style annual meetings. Aflac had never had a dissident proposal on its proxy statement and did not want say-on-pay to be the first. Chairman Dan Amos called several of the

This case was prepared by Ann K. Buchholtz, University of Georgia.

major shareholders and asked their opinions of the proposal. When they told him that say-on-pay seemed reasonable, he went along. He went to the Aflac board and recommended that they accept it—which they subsequently did. The company agreed to allow Aflac shareholders to vote on the pay of the company's top five executives starting in 2009, which is when the shareholders will have three years of complete pay data as required under the new Securities and Exchange Commission (SEC) pay disclosure rules. Boston Common was happy to agree to the delayed start because they knew that, with Amos's 10 percent voting stake and the holdings of family members, they would have lost a fight if the Aflac board had opposed the proposal.²

Questions for Discussion

1. What are the ethical issues in this case?
2. Who are the stakeholders impacted by this situation? How would you rank their claims?
3. Do you agree with Aflac's decision? What are its pros and cons?
4. Should the SEC require companies to allow shareholders to vote on executive pay packages? Should the votes be binding? Why or why not?
5. Are there other decisions about which shareholders should be able to vote? What other shareholder proposals would you recommend?

Case Endnotes

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2. *Ibid.*; Del Jones, "Aflac Plans to Allow Shareholders to Vote on Pay for Top Executives," *USA Today* (February 14, 2007), 1A.

Case 10

Martha Stewart: Free Trading or Insider Trading?

A blowing gust of wind moved the trees in the courtyard where the ImClone emblem stands in front of the company's headquarters in New York. ImClone Systems Incorporated, founded in 1984, "is a biopharmaceutical company dedicated to developing breakthrough biologic medicines in the area of oncology. The Company has utilized the many advances made in the fields of molecular biology, oncology, genomics and antibody engineering to build a novel pipeline of product candidates designed to address specific genetic mechanisms involved in cancer growth and development."¹ The company's main focus is "the development of therapeutic products for the treatment of cancer and cancer-related disorders."²

Twenty stories above the courtyard, Dr. Samuel Waksal, chief executive officer and founder of ImClone, stood behind his office window watching a sunny day turn into a gloomy afternoon as the somber clouds formed at the horizon. He had just received information that the "Food & Drug Administration refused to accept an approval application for ImClone's promising new Erbitux cancer drug."³ The FDA was planning to make a public announcement of its decision the next day. Now, Dr. Waksal is pondering the future of his company and his investment. Expectations about Erbitux had been a prime reason for ImClone's soaring stock prices. Indeed, once the FDA's decision was made public, ImClone's stock prices would likely suffer.

THE DILEMMA

While there was no escape for ImClone itself from this unfortunate development, Dr. Waksal considered the alternatives available to him to minimize his losses, and maybe the losses of some family members and close friends. Dr. Waksal; his father, Jack; his daughter Aliza; and a number of close friends had significant investments in ImClone. All of them would surely incur substantial losses at the start of the trading day tomorrow. Of course, selling his stock and advising his father, daughter, and friends to sell their stock would reduce their losses. However, because these sales would be based on information not available to the public, these transactions might be deemed illegal. Dr. Waksal was faced with a tough decision. On one hand, he could refrain from engaging in questionable trading practices and thereby incur a significant amount of losses in his investment. On the other hand, he could choose to sell his stock based on the information he received, reducing his investment losses, but violating the law and ethics of fair trade.

The Decision and Its Consequences.

Soon, Dr. Waksal reached a decision. Before the day was over, he was on the phone trying to sell "\$5 million of ImClone stock through brokerage accounts at Merrill Lynch & Co. and Bank of America Corp. But the brokers wouldn't execute the order because his shares were 'restricted,' which prevented him as an ImClone insider from selling them."⁴

This case was originally prepared by Kareem M. Shabana, Indiana University—Kokomo and was revised and updated by Ann K. Buchholtz, University of Georgia, in 2007.

Before long, on Wednesday, December 12, 2002, four FBI agents visited Dr. Waksal's house at 6:30 in the morning and took him into custody after charging him with insider trading.⁵ It had been found that Dr. Waksal's father had dumped \$8.2 million in ImClone stock before the FDA announcement. Also, his daughter is believed to have dumped \$2.4 million worth of ImClone stock. A close friend of Dr. Waksal's, Martha Stewart, the founder and chief executive officer of Martha Stewart Living Omnimedia Inc. (MSO), had also sold four thousand shares just before the bad news broke.⁶ In addition, Dr. Waksal had been found to have bought "put" options that allowed him to profit from ImClone's stock decline.⁷

A PLEA BARGAIN

The government and Dr. Waksal reached a plea agreement wherein he pleaded guilty to securities fraud and other charges.⁸ Also, Dr. Waksal agreed to admit that he had tipped undisclosed individuals to dump their stock before the FDA decision was made public. Dr. Waksal's attorney, Lewis Liman, "said in a statement, 'we are glad that we have been able to reach this settlement with the SEC, and that Dr. Waksal will be able to put this part of the legal issue behind him.'"⁹ In return, his father and daughter were spared facing charges.

Concerns about the effect of Dr. Waksal's work history on the plea bargain were raised. Dr. Waksal had been "asked to leave Stanford University, the National Cancer Institute of the National Institutes of Health, Tufts University School of Medicine and Mount Sinai School of Medicine for what supervisors and others said was misleading, and in one case, falsified research."¹⁰ Dr. Waksal is now serving a seven-year prison sentence at the Federal Correctional Institution, Milan, in southeastern Michigan.¹¹

ImClone Stock Takes a Nosedive. It was the sharp decline in ImClone stock the day after the FDA made its announcement that caught the attention of compliance officers at Merrill Lynch.

The ImClone stock had dropped 16 percent.¹² Later the stock reached a low of \$7.55, down from \$62.80 on December 24.¹³

A CHAIN REACTION

The government was also suspicious of Ms. Stewart's sale of her ImClone stock. It was believed that she had sold her shares after she received information about the FDA's decision regarding Erbitux before this information was made public. A spokesperson for Ms. Stewart denied the allegations and insisted that Ms. Stewart had a prearranged agreement with her broker, Mr. Bacanovic, to sell ImClone stock if it fell below \$60. Her assistant broker, Mr. Douglas Faneuil, however, claimed that such an agreement never existed and that Ms. Stewart sold her four thousand shares of ImClone after she learned that Dr. Waksal and other family members had dumped their stock.¹⁴ In June 2003, a federal grand jury indicted Ms. Stewart on nine federal counts; she was not indicted for insider trading, the original focus of the investigation. Martha Stewart's company was built around her personal identity and achievements, and so no one was surprised when the stock took a big hit. MSO stock plummeted by 60 percent after the charges were made public. Stewart resigned as chairwoman and CEO of her company but remained chief creative officer and a board member.¹⁵

IN COURT

After the plea negotiations failed, as Ms. Stewart would not agree to any plea that required jail time, Martha Stewart appeared in the Manhattan courtroom to be charged.¹⁶ "The nine-count indictment alleged that Stewart altered evidence that she traded on inside information about the biotech company ImClone Systems, conspired with her stockbroker to lie to federal officials investigating the trade, and defrauded shareholders in her company, Martha Stewart Living Omnimedia, by misleading them about why she had sold the stock."¹⁷ In response to these

charges, Ms. Stewart's voice clearly echoed in the courtroom: "Not guilty."¹⁸

A Court Verdict. In March 2004, Judge Miriam Goldman Cedarbaum announced that Martha Stewart was guilty on four counts: obstruction of justice, conspiracy, and two counts of making false statements.¹⁹ The most serious charge of securities fraud was dropped. Martha Stewart maintained her resolve, but public opinion about the verdict was mixed. While some believed that Ms. Stewart was justly tried and convicted, others insisted that Martha Stewart was a victim of a frustrated government and a scapegoat for the big corporate scandals like Enron and WorldCom. She resigned her positions as board member for Revlon and the New York Stock Exchange.

Was Stewart a Scapegoat? Earlier, after the charges had been brought up against Ms. Stewart, James Comey, U.S. Attorney for the southern district of New York, asserted, "Martha Stewart is being prosecuted not for who she is but what she did."²⁰ In contrast, Martha Stewart fans and supporters displayed their support in different ways. Some stood outside the courthouse against police barricades chanting, "We love you, Martha."²¹ Others conveyed their message through reports. Rosie O'Donnell, a friend of Martha Stewart's, expressed her disappointment to *Newsweek*: "I am outraged and beside myself. This is a travesty. Shame on the federal government."²² Martha Stewart's retired secretary also expressed her feelings to *Newsweek*: "This is all about the need to make an example of a powerful woman. . . . Martha Stewart is not Enron."²³

Martha Stewart's public image may have played a role. Juror Hartridge expressed her perception of Martha Stewart to a *Newsweek* reporter: "She seemed to say: 'I don't have anything to worry about. I fooled the jury. I don't have anything to prove.'"²⁴ Even the support that Martha got from friends like Rosie O'Donnell and Bill Cosby seemed to have worked against her—in the words of Juror Hartridge, "Like that was supposed to sway our decision."²⁵

Martha Is Sentenced. On July 16, 2004, Ms. Stewart received the minimum sentence of five months in prison and five months in home confinement. In announcing the sentence, Judge Cedarbaum said that she had received more than 1,500 letters written on behalf of Ms. Stewart. The judge stated that it is "apparent that you have helped many people outside of your own family and that you have a supportive family and hundreds of admirers."²⁶ Ms. Stewart reiterated at that time that she would appeal her conviction. The judge decided that Ms. Stewart could remain free during her appeal, and some experts predicted this could take as long as a year.²⁷ When Ms. Stewart received the minimum sentence, the stock price of her company rose by 37 percent.²⁸

AFTER COURT

After further development of Erbitux and resubmission for FDA approval, ImClone received approval for its promising drug, and its stock soared again. Unfortunately for Dr. Waksal, he ended up losing his position as chief executive officer of ImClone, paying a hefty fine to the SEC, and receiving the maximum sentence from the court. His daughter and father, however, were spared facing charges based on the plea agreement that Dr. Waksal made with the government.

Martha's Prospects. Throughout the process of Martha Stewart's investigation, indictment, and trial, speculations about the future of her company and its future varied. Some believed that the loyalty to the Martha Stewart brand would endure the tough times. Others, like Mr. Jeff Swystun, a brand consultant with Interbrand, had different expectations. He asserted, "The parent company has got to distance itself from Martha Stewart the person pretty quickly." He then added, "They have to drop her name from everything that hits the customer."²⁹

The fans who stood outside the courthouse and those who visited the Martha Stewart website showed the strength of her loyal customer base. The business community supported her as well.

Kmart Holding Corp. continued to carry Martha Stewart products. The *Wall Street Journal* wrote, "Kmart Holding Corp. chose to stand by Martha Stewart's embattled company, extending its license agreement for two years and dropping a lawsuit over royalty payments."³⁰ By the trial's end, the future of Martha Stewart Living Omnimedia Inc. lay in the hands of the American customer. Her challenge was well depicted in the words of Jeffrey Sonnenfeld of Yale University: "Americans love to forgive. . . . But this is going to be pretty damn hard for her to get past."³¹

Martha's Decision. With Judge Cedarbaum's decision to permit Ms. Stewart to remain free during her appeal, which could take a year or longer, speculation about her company's future ran rampant. Many observers felt that her freedom would work against her company's stock because the lack of closure would trigger the stock market's dislike of uncertainty. Furthermore, with Ms. Stewart free for some undetermined length of time, the company's board would have to address a very important strategic decision regarding the extent of her involvement in the company during the appeals process.³² Nevertheless, many expressed surprise when Ms. Stewart agreed to serve a five-month prison term and reported to Alderson Federal Prison in West Virginia. She entered prison in October 2004 and was released in March 2005, after which she wore an ankle bracelet for an additional five months. In a little over three years since Martha Stewart sold her ImClone stock, her life had changed dramatically. Ironically, the loss she avoided by selling the stock was about \$50,000. The cost to her of selling that stock, factoring in penalties, restitutions, and legal costs has been estimated to be about \$300 to \$400 million.³³ Furthermore, had she held on to her shares of ImClone rather than selling them, she would have made a nice profit.

Martha's Comeback. Just two and one-half years after her release from prison, Martha Stewart was moving full force into what *Good Housekeeping*

called a "rich, packed, larger-than-life life."³⁴ She told the interviewer she was ready to go the minute she stepped out of the prison. When the interviewer asked if she had any momentary lack of confidence or panic, Ms. Stewart replied, "I've always been fearless."³⁵

Ms. Stewart is once again the driving force behind MSO, but with the title of founder rather than CEO. The magazine *Martha Stewart Living* is increasing its advertising pages and, after being removed for a period, Ms. Stewart is once again featured in photographs throughout the magazine. She has launched a Sirius satellite radio channel, a new magazine for younger people called *Blueprint*, and a line of homes in conjunction with KB Home. In 2006, she published *Martha Stewart's Home-keeping Handbook*, a 744-page guide to all things domestic. Ms. Stewart was working on two TV series just six months after leaving prison. *The Apprentice* had poor ratings and ended after one year; however, *The Martha Stewart Show* is entering its third season at this writing. Both the show and Ms. Stewart continue to earn Emmy nominations, as they did before her problems began.³⁶

Plans for the future include a line of foods to be sold at Costco and an upscale line of home products to be sold exclusively at Macy's.³⁷ On a personal note, Ms. Stewart donated \$5 million to Mount Sinai School of Medicine in Manhattan as seed money for the Martha Stewart Center for Living, a geriatrics center. Her efforts to find quality health care for her mother led her to fund this center in support of its goals of providing not only comprehensive clinical care but also new treatment approaches.³⁸

In 2006, Ms. Stewart and Mr. Bacanovic appealed their court convictions, arguing that the prosecutors should have realized that a government witness lied under oath. Both convictions were upheld.³⁹ Ms. Stewart is currently prohibited from serving as a director of a public company. Most observers believe that when that restriction is lifted in 2011, she will return to being chairwoman and CEO of MSO.⁴⁰

Questions for Discussion

1. What are the ethical issues in this case?
2. Was Martha Stewart guilty of a serious crime, or was she a scapegoat for other, more serious, CEO malfeasants who had not yet been brought to justice?
3. Was the media attention given to the Martha Stewart case excessive? Did this help or hurt her case?
4. Did Ms. Stewart's sentence seem appropriate given the magnitude of her offense? Was a prison sentence the appropriate penalty for her offenses?
5. If you were on the board of directors of Ms. Stewart's company, what role would you say she should play after the restrictions are lifted in 2011? Does her history affect your attitude toward the products with the Martha Stewart brand? Why or why not?

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Case 11

The Case of the Killer Phrases (A)

As the students of Class 35 of the Marberry Executive MBA program straggled into the classroom for their one-day workshop on business ethics, they stopped by the front set of seats to drop off their written assignments. Professor Stevens chatted with a couple of the members of the group while lining up his stack of cases and videos for the day's work. Just as the clock reached 8:00 a.m., the appointed time for the workshop to begin, Max Snell stopped and casually asked, "Gee, Professor Stevens, our study group did the case write-ups as a group effort. We weren't sure that was correct. Was it?" Taken a bit by surprise, because the written assignment was to be done by each student individually, Professor Stevens replied, "Just drop your paper on the pile and I'll look at it later."

The workshop day was filled with lectures, discussions, videos, and case discussions. Professor Stevens forgot about Max's comment, but as he got into his car to drive home after the eight-hour workshop, he realized he would have to deal with the group's nonconforming actions carefully.

BUSINESS ETHICS WORKSHOP

The business ethics workshop had been taught by a variety of people over the years. Recently, a retired professor of philosophy from New York had come in to teach it. The reviews had been mixed, so the Marberry Executive MBA (MEMBA) Academic Committee asked Bob Stevens, a tenured senior professor at Marberry State University and past president of the American

Business Ethics Academic Association, to give the workshop in addition to continuing to teach the program's Business Policy course. The Academic Committee's hope was that Professor Stevens, a past winner of the program's Best Instructor Award, would be able to strike the proper balance between theory and managerial practice.

The Marberry Executive MBA program was similar in conception to most executive MBA programs. Students were expected to be promising midlevel and senior-level executives from local and regional organizations. Each student must have an executive sponsor who commits to helping the student deal with the pressures inherent in having to continue working full-time while completing the MEMBA in two years, attending class on alternate weeks Friday/Saturday. Sponsors were expected to be informal liaisons between their firms (which were paying more than twice what the local university charged for its MBA program). The financial realities of executive MBA programs include the need to generate demand from large organizations and to maintain cordial and positive relationships so that large numbers of their employees are sent to these more expensive programs.

GRADING THE PAPER

When Professor Stevens got home around 5:45 p.m. that day, he was bushed and decided to wait until the next day to tackle the grading of the workshop's pass/fail assignment. The next morning, he went straight to the paper turned in by Max Snell, a member of the "Five Aces" study group (see Figure 1). The content was certainly well within the "pass" range. It seemed odd to him that the list of his study group members was hand-

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written at the top of the first page of Max's paper. If this was truly a group paper, why hadn't the group's names been part of the printed material?

Bob took a moment and went to a copy of the workshop assignment that read, "You are to prepare an analysis of each case consisting of . . ." Why had the other 37 students in the business ethics workshop seen this as an individual assignment, while the Five Aces concluded it was a group assignment? For group assignments, Professor Stevens had always included language such as, "Your group is to . . ." as a way of signaling only one version of the work need be submitted. There had never been this situation before.

Leafing through the pile of 42 papers, Bob selected the Five Aces' other four papers and gave them a quick look. It seemed strange that each of the five papers had both significant similarities and obvious differences. As he thought about the group's actions, he realized that each member of the Five Aces had submitted his or her own slightly modified "version" of the various assigned case analyses.

CONCLUSIONS

More careful examination of the group members' papers led to the following conclusions:

1. Only Max's paper listed the other group members. The other group members had listed themselves as the sole author of their submitted paper.
2. Each of the five papers was slightly different. For example, the ordering of the five case analyses varied among the group's set of papers. The wording of each paper's introduction was different, some had added their own analytical points, and some presented differential or supplemental recommendations.
3. There were a few phrases that seemed to be in four or all five of the papers. These phrases were essential to the communication of some key point or conclusion. Professor Stevens saw these as "killer phrases"—elements of the group's analysis that none could bring themselves to leave out of their own papers.

Reflecting on what he had just read, Professor Stevens drew some tentative conclusions. First, some

Figure

1

Faculty and Students Involved in the Case of the Killer Phrases (A) (B) and (C)

Faculty

Professor Bob Stevens	Ethics Workshop instructor and Professor of Business Policy at Marberry State University
Professor Tim James	Professor of Organizational Behavior at Marberry University and Chair of the Executive MBA Program's Academic Committee
Marjorie Washburn	Director of the Executive MBA Program jointly taught by Marberry State and Marberry University
Professor Philip Taylor	Vice Provost for Academic Affairs, Marberry University

Students

Max Snell	Member of the Five Aces study group
Alice Johnston	Member of the Five Aces study group
Richie Billingsworth	Member of the Five Aces study group
Alan Abrams	Member of the Five Aces study group
Kent Nichols	Member of the Five Aces study group
William Marshall	Member of the Fearsome Foursome study group

or all members of the Five Aces had worked together on the five case analyses (the “killer phrases” were substantial evidence of this). Second, they had planned to submit individual papers under their own names without telling the instructor (evidence for this was that only one had handwritten the other group members’ names on his paper). Third, the group may not have been “confused” about the nature of the assignment (evidence for this was the apparent attempt at individualizing each person’s paper). Fourth, a potential claim that they thought this was a group assignment was contradicted by their submitting five individual papers instead of only one group paper.

CONSIDERING ALTERNATIVES

Professor Stevens thought about what he had found and considered alternatives, but decided that he had better get the other papers graded, given the MEMBA’s expectation that grades would be ready within two days of a workshop. As he proceeded to grade the other students’ papers, he settled into a comfortable routine—reading the situation/issue description section quickly, pondering the level of analysis provided, and determining whether the recommendations were persuasive. About two-thirds of the way through the seemingly never-ending pile, Bob came upon a paper with the same “killer phrases” found in the Five Aces group’s papers. William Marshall’s paper was nearly identical to the work of the five who had worked together. Looking at Class 35’s team roster showed that Marshall was not a member of the Five Aces but was part of the “Fearsome Foursome.”

The situation had just gotten extremely complex. How had Marshall gotten the Five Aces’ work? Had he been an active participant or just found their work and used it as his own? Why hadn’t his name been placed on the paper Max Snell had submitted? Was that an oversight or a signal that he had really done nothing more than copy (with minor cosmetic changes) the work of one of the Five Aces’ members? Perhaps, even more improbably, the Five Aces could have used his paper as the basis of their work.

Bob Stevens was dumbfounded at the picture that had just emerged. Five or six members of the

Executive MBA Program might have committed plagiarism (Max’s decision to provide the full list of contributors might reduce his behavior below “plagiarism,” because he had provided an accurate picture of who had done work on his submitted paper). One (the individual from the other study group) may or may not have done any work on his paper beyond a modest attempt at concealment or may have had his paper used, with or without his knowledge, as the basis of the Five Aces’ papers. The situation seemed to demand action, but Professor Stevens realized that any explicit action on his part bringing up plagiarism could lead to a lot of work for him and serious consequences for those involved.

HOW TO PROCEED?

After completing the grading of 36 other business ethics workshop papers, Professor Stevens sat back in his home office chair and thought about how to proceed. A variety of questions raced through his brain:

- Who should he contact first (the students; Professor Tim James, the program’s academic committee chair; or Marjorie Washburn, the program’s executive director)?
- What evidence, if any, should he develop?
- Should a student’s motive or circumstances matter?
- What definition of “plagiarism” did the students have?
- Did they do something worthy of formal action?
- What impact would a formal accusation and/or determination of plagiarism have on an MEMBA student or on the MEMBA program itself?
- Was any action required, given that the “course” was a workshop and the grading was pass/fail?
- What time and effort might be required to resolve any issues raised about these papers?

Question for Discussion

1. If you were Bob Stevens, what would you do and why?

Case 12

To Hire or Not to Hire

SELECTING A NEW COMPUTER ANALYST

As a manager in human resources, part of my job is to guide the process by which my company selects new employees. Recently, we selected an applicant to fill a computer analyst position. The supervising manager and a selection panel selected this applicant over a number of others based on her superior qualifications and interview.

BACKGROUND CHECK

However, a routine background check indicated that the applicant had been convicted 18 years earlier for false check writing. The application form has a section where the applicant is asked if he or she has ever been convicted of anything other than a traffic violation. In response to that question, this applicant wrote "no." When informed of this, the supervising manager stated that she would still like to hire the applicant but asked me for my recommendation. The job does not involve money handling.

Questions for Discussion

1. If the applicant mistakenly thought that her record had been cleared over time and therefore did not lie intentionally, would that make any difference?
2. Should the fact that the applicant did not tell the truth on one part of the application automatically disqualify her from further consideration?
3. Should the supervising manager be allowed to hire this applicant despite the fact that the applicant lied on her application, provided the manager is willing to take the risk and assume responsibility for the applicant?
4. If the applicant freely admitted the conviction, should she still be considered for the position? Should a minor offense committed 18 years ago, when the applicant was in her early twenties, disqualify her when she is overall the most qualified applicant? What types of convictions, and how recent, should disqualify potential new hires?

Case 13

Does Cheating in Golf Predict Cheating in Business?

David Callahan published an influential book titled *The Cheating Culture: Why More Americans Are Doing Wrong to Get Ahead*. In this book, Callahan documents how cheating has been on the rise for the past two decades. It has been evident in business scandals, doping in sports, plagiarism by journalists, and cheating by students.¹

Callahan blames the dog-eat-dog economic climate of the past two decades for much of the cheating that is going on. He points to four reasons why we have more cheating today. *New pressures* are part of it. *Bigger rewards for winning* are also a key factor. *Temptation* is ever present. Finally, he believes *trickle down corruption* has been at work. With this fourth point, he is referring to the tendency for everyone to start cheating, because they perceive the system is stacked against them and so people start making up their own rules to justify their actions.² In short, he argues that we live in a cheating culture.

CAN ONE HOLD TWO STANDARDS?

One issue that frequently comes up in discussions of cheating and ethics is whether people can hold one set of standards or ethics in their personal lives and another set of standards or ethics in their business lives. This question is often raised about our political leaders as well. Often, the discussion

juxtaposes one's personal ethics in specific spheres of life such as dealing with family or friends or sports with one's ethics in business or some other profession of which one is a part. Debate is often continuous on this topic, and both sides are well represented in the dialogue.

A Personal Experience. Years ago, the author of this case used to play golf with a man who held impeccable golf ethics. He meticulously followed every detailed rule of the game and made sure all around him did also. Over the years, however, this man always bragged about how much he was cheating the federal government out of taxes. He proclaimed often that he had not paid his taxes in five years. It was interesting that the man never saw the disconnect between his golf ethics and his personal ethics.

To think about this topic further, it is interesting to consider the findings from a recent survey of CEOs regarding the extent to which they cheat, or bend the rules, in the game of golf—a game typically associated with business executives.

A SURVEY AND OTHER OPINIONS

A survey of prominent corporate executives commissioned by Starwood Hotels and Resorts generated some interesting findings. According to their study of 401 high-ranking corporate executives, 82 percent admit to being less than honest on the golf course. When asked whether they wager on golf, 87 percent said they did. When asked to name the largest bet they had ever made on a golf game, the average high was

This case was prepared and revised by Archie B. Carroll, University of Georgia.

\$589. For executives making more than \$250,000 per year, the average high was \$1,947.³ So, money is often at stake in the games they play. The findings of the Starwood study were summarized as follows:

- 99 percent consider themselves honest in business.
- 87 percent have played with someone who cheats at golf.
- 82 percent say they cheat at golf.
- 82 percent hate others who cheat at golf.
- 72 percent believe business and golf behavior parallel each other.⁴

Others Are Doing It. Do executives cheat at golf more frequently than other golfers? GolfDigest.com asked this question of golfers, and nearly half said they believe that fewer than 40 percent of golfers fudge at the game. *USA Today* interviewed a dozen CEOs who said they personally bend the rules—sometimes. The respondents also report, however, that they observe other CEOs bending the rules constantly. Behaviors often witnessed include the “other guy” improving their lie, hitting do-over shots (mulligans), forgetting a whiff (missed swing), forgetting to count a missed three-foot putt, and kicking their balls out of the rough or their opponent’s balls into the sand.⁵

IS GOLF ETHICS RELATED TO BUSINESS ETHICS?

One former bank president interviewed said he has declined a loan or two after witnessing a CEO cheat on the golf course. The bank president was dumbfounded when CEOs would cheat during the same time that he was judging their honesty with respect to a possible loan. The bank president concluded: “When you see what they’ll do for a \$10 bet, it makes you wonder what they’d do on a million dollar loan.”⁶

It’s a Social Thing. The CEO of Starwood is also a golfer. According to him, he doesn’t see the survey as an indictment of the character of

executives. “This is a social thing, not a corporate report card,” he says. But the former CEO of Chipshot.com says that “cheating is very much a part of the journey of golf.” Another CEO goes on: “I suspect that CEOs as a class of people have a need to appear competent at a lot of things.”⁷

In commenting further on the study’s findings, the CEO of Starwood noticed the disconnect between some of the findings. He noted that 82 percent say they under-count strokes, improve their lie, or commit some other rules violation, but when asked whether they are honest at business, 99 percent of them say they are.⁸

An organizational psychologist who has been interviewing business executives for decades observed that executives who lie do not consider themselves to be liars. It is similar to their reporting that their outstanding strength is working with people, but when you speak to their subordinates, the subordinates cite that as their biggest weakness. The consultant went on to say that “they lose their ability to distinguish what is honest and what is not.” The lies get bigger and bigger, and “we’ve seen this played out everywhere now, from Tyco to Enron.”⁹

Confirming this same point, another consultant observed an executive cheat by kicking his opponent’s ball twice, sending it into the bushes. The opponent could not find the ball and had to take a one-stroke penalty, never imagining his opponent had done this. The consultant was with the ball-kicker later and confronted him about his action. The executive-golfer humorously rationalized: “That was worth about \$75,000 per kick. That’s probably more than the top kickers in the NFL make.” The consultant was quite surprised that the executive would look him in the eye and try to make this clever comment, especially when the executive knew he did speaking and writing on ethics in management.¹⁰

Insights into Character. Interestingly, the CEOs differ about whether golf cheaters are business cheaters, but they almost all agree that the way executives handle the frustration of the game gives them insights into the executive’s

character. Another CEO observed that he really gets concerned when his golfing partners start blaming their poor shots on the sun or on some other distraction. He said you need to watch out for golfers like that. But he said that he is unconcerned about routine cheating. He concluded: "I would be suspicious of a CEO who didn't cheat. If they have a good golf game, they should be spending more time running the company."¹¹

David Rynecki, author of *Deals on the Green: Lessons on Business and Golf from America's Top Executives* (2007) likens golf to "an 18-hole character test."¹² In a friendly, uninterrupted round of golf, one can learn the following about your playing partner: Is this person honest? How passionate is this person? Does this person know how to have fun? Is this the right person for the job? Is this person a good listener?¹³

Questions for Discussion

1. What are the ethical issues in this case?
2. Do we live today in a "cheating culture?" Do you agree with Callahan's analysis of the situation?
3. Is cheating outside of work in one's personal life directly or indirectly related to cheating at work?
4. How can a person hold two sets of ethics and behave consistently in either venture? Give examples from your own personal life.
5. Could flawed ethics in golf just be considered "part of the game" and unrelated to ethics at work?
6. What insights into character, management behavior, and thinking do you get from this case?
7. Are there parallels between the experiences of executives described in this case and the lives of students? How are they similar or different?

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Case 14

The Travel Expense Billing Controversy

Early in 2000, Neal A. Roberts, an employee of PricewaterhouseCoopers LLP, the major accounting firm, learned that his employer was earning millions of dollars a year by way of a billing practice that he thought was questionable. PricewaterhouseCoopers (PwC), the accounting Goliath, had been collecting large rebates on airline tickets and other travel expenses being charged as expenses to clients of the firm. It turns out that these rebates were not being returned to the firm's clients in the form of savings, but rather, the firm was keeping these rebates for itself. In short, travel expenses had become a source of profits for the firm, and their unknowing clients were footing the bill.¹

The way this was working was that the firm would bill the clients for the full price of airline tickets and other travel-related expenses, but privately, the firm negotiated discounts and rebates that they then got at the end of the year based upon total amounts spent. The clients, of course, were unaware of the back-end discounts and rebates the firm was getting; therefore, they were being charged more than the firm's true out-of-pocket expenses for the items.

Mr. Roberts apparently made a number of attempts to object to his firm's practice but had little or mixed success. His efforts did help to generate several private lawsuits and a government investigation into PwC's rebate scheme. One case, in particular, was taking place in Texarkana, Arkansas, and it resulted in the public disclosure of numerous company documents upon which the facts of the case are being publicly established. The documents have been revealing how a number of professional firms in accounting, consulting, and

law have been turning reimbursable expenses such as airfare and hotel rooms into profit centers for themselves.²

SEVERAL FIRMS INVOLVED

The lead plaintiff in this and several other cases was Warmack-Muskogee LP. Warmack-Muskogee's lawsuits were against PwC, KPMG, and Ernst & Young, so it wasn't just PwC that had been accused of these practices. These three firms had been charged with billing their clients for the full face amount of certain travel expenses, such as airline tickets, hotel rooms, and car-rental expenses, while pocketing undisclosed rebates and volume discounts they received under various contracts they had with airline, car-rental, lodging, and other travel expense related vendors.³ One defense these firms have frequently set forth is that everyone else is also doing it.

PWC AGREES TO SETTLEMENT

Though not admitting guilt, PwC agreed in December 2003 to a settlement estimated to be worth \$54.5 million. PwC had once provided litigation-consulting services for Warmack-Muskogee. One-third of the settlement will go to the plaintiff's attorneys, and the balance will be available to current and former PwC clients in the form of cash or credits for future services.⁴

DETAILS OF THE PRICEWATERHOUSECOOPERS CASE

When Neal Roberts inadvertently discovered his firm's travel billing practices, he made an effort to

This case was prepared and updated by Archie B. Carroll, University of Georgia.

address the problem while working within the confines of his firm. Roberts raised objections to the practice. One person responding to Robert's concerns was Barbara Kipp, the partner in charge of PwC's ethics department. Kipp wrote an e-mail in April 2000 to another top partner in which she said, "Al, while I appreciate the importance of managing as tight a fiscal ship as we can, I somehow feel that we are being a bit greedy here." Kipp was addressing Albert Thiess, the New York-based partner responsible for oversight of the firm's travel department.⁵ Kipp also said in her e-mail that she thought the rebate policy looked like the firm was "double dipping."⁶

Complaint to Ethics Hotline. Roberts was not the only partner in the firm to raise questions about the travel expense rebates. Jean Joslyn, at the time a director of the firm's health-care consulting group in Chicago, earlier wrote an e-mail in February 1999 to James F. Lennon, the firm's global-travel director. Joslyn said in her e-mail: "My question is how this rebate will be allocated back to our clients?" Lennon's reply was similar to Thiess' opinion: "We negotiate these deals, not our clients." A couple days later, Joslyn, who was disturbed by the response, called the firm's ethics hotline and left a message of concern about the practice.⁷

According to the firm's documents, the ethics complaint filed by Joslyn led to a meeting in New York on March 19, 1999, in which the 14 attendees, which included members of the firm's management committee, decided that the firm would reinstate a 12.5 percent front-end discount that would lower the ticket prices to clients. What the committee did not tell Joslyn was that the total discounts, including the back-end rebates, would continue to exist and, in some instances, would be as high as 40 percent. This meant that PwC would continue to pocket substantial amounts on many of their expenditures.⁸

Roberts Continues to Push. Upon learning of the discounts and rebates the firm was keeping, Roberts sent an e-mail to a partner he was working

with in Dallas on litigation-consulting for the Federal Deposit Insurance Corporation. He said: "I cannot believe that such discounts exist since that would leave us open to billing fraud accusations on most government contracts and others as well."⁹ Next, Roberts contacted Hilary Krane, an in-house PwC lawyer, and she recommended he contact the firm's ethics department. In addition, Krane sent Roberts a copy of an earlier e-mail she had written to one of the firm's lawyers in Washington, DC, in which she expressed her own concern about the practice. In her e-mail, she expressed unease that the firm was billing government clients for plane tickets without telling them about the back-end discounts and rebates her firm was collecting.¹⁰

Policy Is Revised. By October 2000, a working group, including Kipp, Krane, Thiess, and several others, met and made the decision to do something. They decided to shift most of the discounts up front so their clients could benefit from the reduced prices. Under their revised policy, PwC would seek front-end discounts of 28 percent with 8 percent rebates remaining to "cover our costs." Under this policy, the firm would still get to keep 8 percent savings. The group announced its new policy to be effective January 1, 2001, but decided there was no need to reimburse their clients for the millions they had collected previously on the earlier rebates.¹¹

ROBERTS AND THE FALSE CLAIMS ACT

Roberts was still not satisfied with the firm's decision, and he continued to press it to refund previous clients an amount equal to the back-end rebates the firm had received. By late 2000, Roberts engaged a law firm, Packard, Packard, & Johnson, of Salt Lake City, that specialized in filing False Claims lawsuits against federal contractors, such as his firm.¹²

False Claims Act. The False Claims Act is a piece of federal legislation that is designed to help

the government ferret out fraud on the part of firms with which it does business. Under the Federal False Claims Act, private citizens who know of people or companies that are defrauding the government may sue on the government's behalf and share in the proceeds of the suit. Citizens who bring these causes of actions do so under the *qui tam* provisions of the Act.¹³ The *qui tam* provisions allow an individual, frequently acting in the role of a whistle-blower, to bring suit and share in the damages recovered as a result of the lawsuit. Over the past decade or more, hundreds of *qui tam* lawsuits have been filed, and these have resulted in \$4 billion in recoveries for the United States Treasury. The whistle-blowers who filed these suits may collect between 15 to 30 percent of the recovered taxes and penalties, and this has resulted in more than \$100 million for their efforts over this time span.¹⁴ In 2003 alone, the lawsuits filed under this act recovered \$1.5 billion.¹⁵

Back to Robert's Situation. From this point on, Roberts had a financial interest in his lawsuit against his own firm. He started cooperating with investigators who began looking into the activities of his firm. During this period, Roberts reported that his pay and status at the firm were declining, and he complained that he was being urged to retire early. His annual pay was cut by 50 percent, but a spokesman for the firm said that the pay cut started before his first complaints in early 2000. He was told by partners that he was not producing enough business for the firm.

Mr. Roberts retired from PwC in May 2001. On October 1, 2001, the firm stopped taking airline rebates completely. The company started structuring all discounts as front-end price reductions that would be passed on to the clients. They also decided to charge clients \$25 to \$60 per ticket for "transaction" fees that are disclosed to the clients.¹⁶ In 2005, PwC agreed to pay \$41.9 million to settle the allegations that it made false claims to the United States in connection with claims it made to federal agencies for travel reimbursements. Mr. Roberts was to receive an amount to be determined at a later time.¹⁷

Questions for Discussion

1. Identify the ethical issues in this case.
2. Who are the stakeholders and what are their stakes?
3. What is your appraisal of the ethics of the travel expense billing practices described in the case? What are the ethical arguments for and against them?
4. Did Roberts's complaint to the ethics department help or not? Did his firm seem receptive to his concerns?
5. What does the travel billing practice tell you about the *culture* of professional firms such as accountants, consultants, lawyers? Does it make you wonder what other practices are being used in which the clients are not being informed?
6. The case ended with the company paying a huge settlement and eventually providing the discounts to the clients that Roberts and others were calling for. Is this a case of a firm's greed and self-interest getting in the way of their sense of fairness to their customers?
7. What is your assessment of the *qui tam* provisions of the False Claims Act? Does this provide a financial incentive for employees to want to gather "dirt" on their employers and use it for their own financial gain? What are the strengths and weaknesses of such a law?

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Case 15

Phantom Expenses

Jane Adams had just completed a sales training course with her new employer, a major small appliance manufacturer. She was assigned to work as a trainee under Ann Green, one of the firm's most productive sales reps on the East Coast. At the end of the first week, Jane and Ann were sitting in a motel room filling out their expense vouchers for the week.

INFLATING EXPENSES

Jane casually remarked to Ann that the training course had stressed the importance of filling out expense vouchers accurately. Ann immediately launched into a long explanation of how the company's expense reporting resulted in underpayment of actual costs. She claimed that all the sales reps on the East Coast made up the difference by padding their expenses under \$25, which did not require receipts. A rule of thumb used was to inflate total expenses by 25 percent. When Jane questioned whether this was honest, Ann said that even if the reported expenses exceeded actual expenses, the company owed them the extra money, given the long hours and hard work they put in.

FOLLOW THE AGREED-UPON PRACTICE

Jane said that she did not believe that reporting fictitious expenses was the correct thing to do and

that she would simply report her actual expenses. Ann responded in an angry tone, saying that to do so would expose all the sales reps. As long as everyone cooperated, the company would not question the expense vouchers. However, if one person reported only actual expenses, the company would be likely to investigate the discrepancy, and all the sales reps could lose their jobs. She appealed to Jane to follow the agreed-upon practice, stating that they would all be better off, that no one would lose his or her job, and that the company did not really need the money because it was very profitable.

Questions for Discussion

1. What are the ethical issues in this case?
2. Given all the factors, what should Jane have done?
3. What would have been the consequences for Jane and the company if she had accurately reported her expenses? What would the consequences have been if she had inflated her expense account as Ann had urged her to do?
4. What ethical principles would be useful here?

Case 16

Family Business

Jane had just been hired as the head of the payroll department at R&S Electronic Service Company, a firm of 75 employees. She had been hired by Eddie, the general manager, who had informed her of the need for maintaining strict confidentiality regarding employee salaries and pay scales. He had also told her that he had fired the previous payroll department head for breaking that confidentiality by discussing employee salaries. She had also been formally introduced to Brad, the owner, who had told her to see him if she had any questions or problems. Both Brad and Eddie had made her feel welcome.

GREG'S HIGH COMMISSIONS

After three months of employment, Jane began to wonder why Greg, a service technician and Eddie's brother, made so much more in commissions than the other service technicians. She assumed that he must be highly qualified and must work rapidly because she had overheard Brad commending Greg on his performance on several occasions. She had also noticed Brad, Eddie, and Greg having lunch together frequently.

One day, Eddie gave Jane the stack of work tickets for the service technicians for the upcoming week. The technicians were to take whatever ticket was on top when they finished the job they were

working on. After putting the tickets where they belonged, Jane remembered that she had a doctor's appointment the next morning and returned to Eddie's office to tell him she would be reporting late for work.

EDDIE SHOWS FAVORITISM

When she entered Eddie's office, she saw Eddie give Greg a separate stack of work tickets. As she stood there, Eddie told her that if she mentioned this to anyone, he would fire her. Jane was upset, because she understood that Eddie was giving the easier, high-commission work to his brother. Jane also realized that Eddie had the authority to hire and fire her. Because she had been at the company for only a short time, she was still on probation. This was her first job since college. She wondered what she should do.

Questions for Discussion

1. What are the ethical issues in this case?
2. Is a family business different from other types of businesses with respect to employee treatment?
3. What was Jane's ethical dilemma?
4. What should Jane have done? Why?

Case 17

Should Business Hire Illegal Immigrants?

In June 2007, after many months of negotiations, the U.S. Senate's compromise on a comprehensive immigration bill failed to pass. The ill-fated legislation contained provisions that would have hired new border patrol agents, imposed a new system forcing employers to verify the legal status of applicants and employees electronically, established a guest worker program, and provided an avenue for legalization for the estimated 11 to 20 million illegal immigrants in the country at the time.¹ Politicians on both sides of the issue held strong positions regarding the proposed legislation. One group called it an "amnesty" bill, and another group feared it would cost Americans jobs. Politicians of various stripes supported it because either they approved of the idea or they wanted to be sure that this burgeoning group would someday vote for them.

According to *USA Today*, the "ghost of the 1986 failure" haunted the proposal for immigration reform in 2007.² As background, it is useful to know that an immigration law was passed in 1986 that was supposed to deal with the then 3 million illegal immigrants who were offered legal status in exchange for tough new enforcements that were to stop the flow of undocumented workers. The 1986 plan turned out to be a sham. A system was set up in which employers had to accept just about any document a job applicant submitted to prove his or her legal status. The by-product of that system was a booming industry in phony documents and 12 million more illegal immigrants.³ To many, the 1986 amnesty sparked the larger influx of unlaw-

ful immigration and showed would-be migrants that the United States was weak-willed and would eventually cave in and give citizenship to illegals, thus encouraging Mexicans and others to breach the U.S. borders with renewed energy.⁴

TWENTY YEARS OF UNCONTROLLED IMMIGRATION

Between 1986 and 2007, the number of illegal immigrants in the United States exploded to somewhere between 11 and 20 million. Estimates vary widely, because a valid count is not possible. Using the figure of 11 million, which is the conservative guess, estimates have been made about the magnitude of this booming population. Of that population, it has been reckoned that 56 percent are from Mexico, 22 percent are from other Latin American countries, 13 percent are from Asia, and the remainder are from Europe, Canada, Africa, and elsewhere.⁵

It is little wonder how the number of illegal immigrants grew to such a huge size in the intervening 20 years. The federal government took no action to stem the tide of illegal immigrants, and many businesses found in the workers individuals willing to take almost any job at low pay. In most cases, the workers worked hard and made very few demands. In other words, illegal immigrants became useful to business to fill many jobs, which they have said were not being filled by anyone else. Of course, that statement has been controversial. Some observers have noted that had business made working conditions better and raised the wages for some of these jobs, there would have been plenty of workers, but a black

This case was prepared by Archie B. Carroll, University of Georgia.

market of cheap labor suppressed any wage increases.

From a societal perspective, the influx of illegal immigrants has posed many issues for tax-paying Americans, who suspect the immigrants are getting a free ride. They have put pressure on local communities' social service agencies, school systems, health-care facilities, welfare systems, and have, in many places, increased the crime rate. At the same time, the number of illegal immigrants has grown so large (11 to 20 million) that rounding them up and deporting them has not been seen as a feasible solution. Many of the illegal immigrants have now had children, and some are already third-generation illegals.

Two groups have favored amnesty for the illegal immigrants more than anyone else—the business community, who sees in them a source of cheap labor, and some politicians who are looking down the road and speculating that someday these individuals will be their supporters if they are treated favorably. The business position is of interest to us here.

THE BUSINESS STAKE

Business has one of the largest stakes in the issue of what happens to illegal immigrants. Industries ranging from agriculture to construction all depend heavily on immigrant labor—legal and illegal. Business wants a reliable stream of inexpensive workers and has seemed willing to hire them even if they are undocumented. Business's preference, of course, is immigration reform whereby they may hire the workers legally. It has been clearly seen, however, that in the absence of enforcement, many businesses disregard the law and hire the illegal immigrants anyway.⁶

The business community has had a number of different groups pushing for immigration reform, but they represent a few different umbrella groups with no one clearly in charge. One lobbyist observed that there are "coalitions of coalitions." Some want to allow more uneducated, entry-level type workers who are willing to

take jobs others won't take. Others want reform allowing more educated and high-tech workers into the United States. One reason the business groups cannot come together is that most of them have some problem with different parts of proposed legislation.⁷

A CASE WITH MAJOR IMPLICATIONS

A different kind of case in Georgia may be signaling a turning point for business's experience with hiring illegal aliens. A company that has depended heavily on illegal immigrants is Mohawk Industries, Inc., the \$6.6 billion carpet maker in the small town of Calhoun, Georgia. Mohawk employs thirty-two thousand workers, and four thousand of them are in and around Calhoun. This small town has been reshaped over the past decade by an enormous influx of Latinos. At one time, the company was staffed primarily by whites, but today the workforce comes mostly from Mexico and other Latin American countries. With wage rates at \$7 an hour and higher, Hispanics now make up an estimated 12 percent of the population. In 1990, the percentage was less than 1 percent.⁸

Calhoun now finds itself in the middle of one of the most heated debates over the hiring of illegal immigrants. In 2004, tensions between immigrants and local workers turned into a legal case that could have significant implications for companies and communities all over the United States. Four current and former workers filed a class-action lawsuit against Mohawk for allegedly conspiring to depress wages by hiring illegal immigrants.⁹ The workers claimed they received lower wages because of the depression of wages caused by Mohawk's actions. The federal lawsuit claims that the company, with the help of local hiring agencies, knowingly accepted false documents, recruited illegals at the U.S.-Mexican border, and rehired undocumented workers under different names. Mohawk denies all the allegations.¹⁰ The company claims that its contracts with outside employment agencies did not cause direct harm by the conduct alleged.¹¹

Businesses are watching this case closely because it was filed under the Racketeer Influenced & Corrupt Organizations Act (RICO). This 1970 law, which was originally intended to fight the Mafia, assesses triple damages against those companies found guilty of violations. RICO was amended in 1996 to allow workers to sue corporations that knowingly hire illegal workers. It turns out there are at least three similar lawsuits making their way through the legal system.¹²

Mohawk has appealed the case all the way to the U.S. Supreme Court. In February 2007, the Supreme Court declined to consider an appeal by Mohawk. The court's decision will allow the case to move forward in federal court.¹³ Some lawyers have suggested that other potential plaintiffs around the country are considering taking action against their employers. The resolution of the Mohawk case will have significant implications for this issue in the years to come.

ENFORCEMENT STARTS TO TOUGHEN UP

Over the past several years, states, cities, and local municipalities started engaging in their own fights against illegal immigration because the federal government would never take action.¹⁴ In 2007, 18 states passed 57 immigration laws. More than 25 cities and counties passed measures. Under a Green Bay, Wisconsin, ordinance, a firm could lose its business license if it hires illegal workers. Beaufort County, South Carolina, passed an ordinance that says a business could have its license suspended for hiring illegal workers. In Payson, Arizona, business owners now have to sign affidavits that they only employ legal workers.¹⁵

Beginning in 2007, however, perhaps because of the defeat of the comprehensive immigration bill and the outpouring of citizen criticism against the federal government for doing nothing, a renewed initiative began taking place. In Portland, Oregon, federal agents raided a food processing plant over suspicions that the com-

pany hires and employs hundreds of illegal aliens. It also was reported that in a check of employee records at a Fresh Del Monte Produce Company vegetable and fruit processing plant in Florida, it was found that only 48 out of 600 workers had valid Social Security numbers.¹⁶ In Ohio, the owner of a Fairview restaurant drew a prison sentence of one year for hiring illegal aliens. He pleaded guilty to inducing, transporting, and harboring illegal aliens. He not only employed them, but he also provided them with housing and drove them to work at the restaurant each day. It turns out the business owner himself was in the United States illegally, and he faces deportation after serving his sentence.¹⁷

In August 2007, the Bush administration said it would increase its scrutiny of and impose heftier fines on U.S. businesses that employ illegal immigrants and that it would step up enforcement despite Congress's failure to pass immigration reform legislation. According to Homeland Security secretary Michael Chertoff, employers who ignore immigration laws will face an increased likelihood of criminal charges and higher financial penalties. Currently, employers must verify that their workers are in the United States legally by collecting their Social Security numbers and immigration documents. These numbers are then checked against the government's database, and employers are notified of those that do not match. Under the new rule, employers notified of a mismatch will have 90 days to confirm that the employee is in the country legally, or fire them if they are not.¹⁸ In fiscal year 2006, the government stepped up raids of companies that use illegal labor and deported a record 185,421 individuals. The new initiative drew praises from many who have long advocated using existing laws to crack down on undocumented workers but drew criticisms from illegal immigrant advocates and business groups.¹⁹

With 11 to 20 million illegal immigrants in the United States today, the resolution of this issue will not come easily. With each passing month and year, the consequences and implications of the

issue accumulate and grow more urgent. The resolution will have significant implications for all sides, not only for business, but also for communities, taxpayers, and others waiting to enter the country legally.

Questions for Discussion

1. What are the ethical issues in this case?
2. Is illegal immigration primarily an economic, legal, ethical, social, or political issue? Explain.
3. Are companies that hire illegal immigrants being socially responsible? Evaluate this practice using the Pyramid of CSR introduced in Chapter 2.
4. What are the legal and ethical arguments in favor of continuing to allow illegal immigrants to be hired by businesses? What are the legal and ethical arguments against illegal immigration? Which side are you on? Why?
5. Assess the issue of illegal immigration using a number of different ethical principles, such as the principles of rights, utilitarianism, and justice. What does each principle have to say about the issue of illegal immigration?
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Case 18

This Little Piggy: Should the Xeno-Pig Make It to Market?

Xenotransplantation is the transfer of living cells, tissue, and organs from one species to another, such as from a pig to a human for medical purposes. The transplanted material is called a *xenotransplant* and is the technological base upon which the xenotransplant industry is built.

The history of xenotransplantation dates back to the first transplant of a pig kidney into a human in 1906. Other experiments have included kidneys transplanted from goats, sheep, and chimpanzees; livers and bone marrow from baboons; and hearts and skin from pigs. In one of the field's earliest efforts, a California baby lived for three weeks with a heart transplanted from a baboon.¹

BENEFITS TO ORGAN FARMING

There are many anticipated benefits to organ and tissue transplants, including extended life expectancy and improvement of the quality of life. A severe shortage of human organs and tissue, however, has created keen interest in alternatives that might make up for this shortfall. This makes xenotransplantation, with its potentially "unlimited source" of organs and tissue, a very attractive alternative indeed.² Since the first organ transplant was performed more than fifty years ago, there have never been enough human donors to meet the demand. The United Network for Organ Sharing reported that, as of 2006, 16,445 transplant surgeries had been performed, but 95,919 patients remained on the waiting list.³ Any disease

currently treated by human-to-human transplants (e.g., diabetes, liver failure, Parkinson's disease, cancer, and AIDS) could potentially be treated by xenotransplantation, even though xenotransplantation, particularly the whole organ transplants involving baboon and chimpanzee hearts, has yet to achieve more than limited success.

Researchers in New Zealand found that a technique they developed to transplant pig cells into diabetics also may hold promise for people who suffer from brain injuries or strokes. While still in the experimental stage, the research showed that transplanting brain cells into stroke-injured rats reduced their brain damage by 40 percent.⁴ New Zealand has evolved into a center for xenotransplantation research since the New Zealand BioEthics Committee recommended that xenotransplantation be permitted on a case-by-case basis. The resultant increase in people traveling to the area for surgery has led to a new term: "xenotourism."⁵

WHY PIGS?

Pigs make a good choice because their organs are an appropriate size for adult patients. Plus, pigs have large litters, grow to adulthood quickly, are relatively easy to breed, and can be raised in sterile environments.

Although organs from animals closest to human beings are less susceptible to immune system rejection, nonhuman primates like apes and monkey are limited in number, costly to raise, and are relatively slow to mature. Another problem with primates is that they may harbor

This case was written by Joseph G. Gerard, SUNY Institute of Technology and Ann K. Buchholtz, University of Georgia.

unknown viruses that do them no harm but that may lead to devastating diseases in humans. This happens because viruses can cross the species barrier, and this technique is especially risky with nonhuman primates. It can happen with other species as well, however, and it is made more likely when living organs are placed directly into the human body. Pathogens (organisms that cause disease, such as viruses or bacteria) bypass skin and gastrointestinal tract defenses, which, in turn, trigger a response from the immune system.

PROBLEMS AND CONCERNS

Immunosuppressant drugs manage the immune system reaction fairly well in human-to-human transplants, but this rejection becomes increasingly violent in more distantly related species and requires higher-strength immunosuppressant drugs. PERV (Porcine Endogenous Retro-Virus) can infect human cells in the laboratory, supporting the belief that the same may occur with transplant recipients. Parts of pig retroviruses may also recombine with parts of human viruses to create a new virus. This effect has also been observed in the lab.⁶ One suggested solution to the PERV problem is the use of cloning technology. This would provide consistent groups of donor organs that prevent rejection while providing a known retrovirus-free organ to the donor; this approach may take several years to develop.

One of the biggest issues surrounds the fact that “to get to the point where surgeons will be good at transferring organs from pigs into humans, they will need to trial on primates. And the use of primates is rightly considered a last resort,” Michael Banner, chair of the British government’s animal procedures committee, told the *London Times*. One of the reasons for this, says Banner, is the rich social and mental life primates possess “and because they are our cousins, people rightly feel that the use of primates is of more concern than the use of other species.”⁷

Genetic engineering would increase the number of animals used because they would be cloned specifically for research. “Scientists are sometimes

too willing to overlook these issues’ ethical implications,” says Banner. “To suppose that how the public reacts to these new technologies is simply a matter of unfamiliarity is patronizing. Often, people’s unease can be spelt out perfectly coherently.”⁸

THE FUTURE

For some companies, the future of xenotransplantation seems bright and its rewards not so distant. In 2007, Living Cell Technologies (LCT) announced that they had successfully transplanted the first of six type 1 diabetes patients with their DiabeCell pig implant and that they hoped to commercialize the product for general use by 2012. LCT CEO Dr. Paul Tan said, “This transplant launches LCT’s lead product into the clinic and moves the Company into a phase for growth in the value of our business.”⁹

Questions for Discussion

1. Should companies be allowed to continue research and development in xenotransplantation? Do the benefits outweigh the risks?
2. Does xenotransplantation threaten the quality of human life? If so, what threats exist? Do similar threats exist for other species? Are quality-of-life issues less important for some species than for others? What, if anything, makes animal rights different from human rights?
3. What threats does xenotransplantation hold for the environment as a whole? Who are the different stakeholders involved? What are their stakes?
4. Given that many countries do not restrict human xenotransplantation, what threats exist globally with xenotransplant technology?
5. Is the issue more or less complicated than other bioethical topics like cloning or stem cell research? How can one make the argument that therapeutic cloning, such as that used in xenotransplantation, should be permitted?

while reproductive cloning, like that advocated by groups like the Raelians (see Chapter 9), should not?

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Case 19

Toxic Tacos? The Case of Genetically Modified Foods

In September 2000, the Genetically Engineered Food Alert Coalition, a coalition of environmental and consumer groups, accused Taco Bell of using StarLink genetically modified (GM) corn in their taco shells. The FDA had approved the StarLink gene for animal (but not human) consumption. The incident prompted the recall of 300 corn-based foods and alarmed the public about the possible dangers of genetically modified foods.¹ A 2007 study showed that the contamination led to a 6.8 percent decline in corn prices, and the suppression of corn prices lasted for a year.²

The debates surrounding genetically modified food have continued to grow since the StarLink incident. According to David Roy of the Centre for Bioethics at the Clinical Research Institute of Montreal, the debates often produce “more heat than light.” They are more emotional in nature than they are intellectual. One of the main dangers of the GM food debate is that neither side is listening to the other: involved parties “tend to let debates become excessively polarized.”³

SOME OF THE CURRENT ARGUMENTS

Proponents for GM foods argue that their potential risks should be judged once scientific consensus has been reached. In the meantime, they say these GM crops will feed a hungry world by multiplying per-acre yields and, at the same time, reduce the need for herbicides and pesticides. GM detractors,

on the other hand, claim that possible future benefits of the technology should not outweigh present dangers. They recommend a slowdown in order that society may digest innovations of past years. They want long-term outcomes to be “clearer” before anything else is done.

Scientific Evidence. There are contrasting science-based arguments for both parties as well. Governments, often citing company studies, make the claim that GM crops are similar to non-GM ones and, therefore, do not pose a threat to consumers. Environmental watchdog groups, like the U.S. Public Interest Research Group, a member of the Genetically Engineered Food Alert Coalition, disagree. Studies claiming similarity between GM and non-GM crops, they say, are flawed and conclude nontoxicity without sufficient evidence.⁴

GOING TO EXTREMES?

Neither pole is exempt from accusations of extremist thinking. Anti-“GMers” believe that researchers and developers of new technology promise too much. In recent years, a variety of plants that produce their own pesticide—as well as herbicide-resistant seed and plants, and others with more “exotic” features—have made it to the marketplace where their benefits are lauded and their deficits seem nonexistent. But, ask GM food opponents, has testing been sufficiently long term to test environmental impact thoroughly? Have possible dangers to wildlife and plants that consume or ingest GM food been tested? What is the effect of that food as it moves through the food

This case was prepared by Joseph G. Gerard, SUNY Institute of Technology, and Ann K. Buchholtz, University of Georgia.

chain? Has gene flow been controlled? Some say that new reports provide evidence that studies are often too limited in both space and time to reach a conclusion.⁵

Industry's Response. GM proponents respond that their detractors often exaggerate environmental hazards, do not substantiate their claims with scientific evidence, and are simply reacting out of fear. Those who stand by GM technology then point to examinations by government agencies "so long and rigorous that many standard foods wouldn't pass." Their field research never uncovers even a slight headache. Some even say it would be wrong to try to replicate the research.⁶

THE PROBLEM CONTINUES

In September 2006, a contaminated rice scandal bore an eerie resemblance to the StarLink situation. Greenpeace found U.S. rice on European store shelves that contained illegally genetically engineered rice. The German company Bayer was responsible for the contamination. They had ended their U.S. field trials of LL601 and LL604 over five years earlier, but some of the LL601 rice escaped the field trials and contaminated conventional U.S. rice fields.

In response to this contamination, Ebro Puleva, the world's largest rice importer, stopped the shipment of U.S. rice to Europe. LL601 rice had not been approved for human consumption when Bayer conducted their trials. When it was found that the genetically altered rice infiltrated the U.S. conventional rice crop, Bayer hastily filed an application for approval by the USDA. The USDA approved LL601 for human consumption in November 2006. No other country in the world has approved LL601 for human consumption. Neither the United States nor any other country has approved LL604 for human consumption.⁷

Questions for Discussion

1. What are the ethical issues in this case?

2. Do you think that either group, pro-GM or anti-GM foods, is correct while the other group is wrong? If so, what reasoning do you give for supporting the position of one group over the other? Is it possible for both to be right? What ethical concepts help you decide?
3. Is there any way to bridge the gap between these groups? If so, what would the advantages and disadvantages be?
4. If you were crafting GMO (genetically modified organism) public policy, what would you recommend?

Case Endnotes

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2. Colin A. Carter and Aaron Smith, "Estimating the Market Effect of a Food Scare: The Case of Genetically Modified StarLink Corn," *Review of Economics & Statistics* (August 2007), 522–533.
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7. Marc Gunther, "Attack of the Mutant Rice," *Fortune* (July 9, 2007), 20–25; "Une Contamination De Riz Par Des Ogm Est Decouverte Dans Trois Pays D'europe," *Le Monde* (September 7, 2006), 7; "Banned: GE Rice Imports," <http://www.greenpeace.org/international/news/banned-29096>; <http://www.jlbreport.com/2007/08/16/cases-against-bayer-crops-science-consolidated-in-stlouis-federal-court/>.

Case 20

Something's Rotten in Hondo

George Mackee thought of himself as bright, energetic, and with lots of potential. "So why is this happening to me?" he thought. George, with his wife, Mary, and his two children, had moved to Hondo, Texas, from El Paso four years earlier and was now the manager of the Ardnak Plastics plant in Hondo, a small plant that manufactured plastic parts for small equipment. The plant employed several hundred workers, which was a substantial portion of the population of Hondo. Ardnak Plastics Inc. had several other small plants the size of Hondo's. George had a good relationship with Bill, his boss, in Austin, Texas.

THE EMISSIONS PROBLEM

One of the problems George's plant had was that the smokestack emissions were consistently above EPA guidelines. Several months ago, George got a call from Bill, stating that the EPA had contacted him about the problem and fines would be levied. George admitted the situation was a continual problem, but because headquarters would not invest in new smokestack scrubbers, he didn't know what to do. Bill replied by saying that margins were at their limits and there was no money for new scrubbers. Besides, Bill commented, other plants were in worse shape than his and they were passing EPA standards.

A QUESTIONABLE SOLUTION

George ended the conversation by assuring Bill that he would look into the matter. He immediately started calling his contemporaries at other Ardnak plants. He found they were scheduling their heavy emissions work at night so that during the day, when the EPA took their sporadic

readings, they were within standards. George contemplated this option, even though it would result in increasing air contamination levels.

THE DOUBLE BIND

A month went by, and George still had not found a solution. The phone rang; it was Bill. Bill expressed his displeasure with the new fines for the month and reminded George that there were very few jobs out in the industry. That's when Bill dropped the whole thing into George's lap. Bill had been speaking to the Mexican government and had received assurances that no such clean air restrictions would be imposed on Ardnak if they relocated 15 miles south of Hondo in Mexico. However, Ardnak must hire Mexican workers. Bill explained that the reason for relocating would be to eliminate the EPA problems. Bill told George he had one week to decide whether to eliminate the fines by correcting the current problems or by relocating.

George knew that relocating the plant on the Mexican side would devastate the infrastructure of the city of Hondo and would continue to put contaminants into the air on the U.S. side. When he mentioned the possibility to Mary, she reinforced other concerns. She did not want him to be responsible for the loss of the jobs of their friends and extended families.

Questions for Discussion

1. Who are the stakeholders in this situation, and what are their stakes?
2. What social responsibility, if any, does Ardnak Plastics Inc. have to the city of Hondo?
3. What are the ethical issues in this case?
4. What should George do? Why?

This case was written by Geoffrey P. Lantos, Stonehill College. Permission to reprint granted by Arthur Andersen & Co. SC.

Case 21

Sweetener Gets Bitter Reaction

Sodium cyclamate has not received so much attention since being banned in the United States in 1969. Valued for its lack of a strong aftertaste, the sweetener achieved great popularity in the United States until the Food and Drug Administration ruled it unsafe due to cancer concerns. Some recent studies have concluded that it can be safe in low doses, but the Center for Science in the Public Interest still warns against its use. The sweetener is now legal in more than 50 nations, including Canada and the European Union. It became legal in Mexico shortly before the Coca-Cola Company launched a Mexican version of Coca-Cola Zero.¹

The Coca-Cola Company uses different ingredients to sweeten Coke Zero in different countries and already used sodium cyclamate in several countries that have legalized it prior to their Coke Zero introduction in Mexico. These product introductions received little attention, and so the reception their Mexican Coke Zero product introduction received may have been a surprise.²

THE REACTION IN MEXICO

The introduction of sodium cyclamate-sweetened Coke Zero in Mexico created a maelstrom of consumer resentment. Mexican consumers asked why something that is considered unsafe for consumers north of the border might be considered safe for them. According to the *Atlanta Journal-Constitution*:

*The Mexican blogosphere has been heating up with diatribes against Coke. One Web site calls Coca-Cola Zero "poison," while another accuses Coke of using sodium cyclamate in Mexico because it is cheaper than other sweeteners.*³

Rafael Fernandez, director of communication for Coke Mexico, attributed the negative reaction to "an organized Internet campaign aimed at hurting sales of Coke Zero."⁴ He said that sodium cyclamate is unquestionably safe and that the ban is based on old information.

Alejandro Cavillo, director of the Power of the Consumer organization, speculates about the timing of the Mexican approval of sodium cyclamate—right before the Mexican introduction of Coke Zero. Former Mexican president Vicente Fox was a Coke executive before entering politics. Cavillo speculates that Coke may have used this relationship to encourage the acceptance of sodium cyclamate. The Mexican market would certainly be worth the effort. One study showed that Mexicans spend twice as much on soda as on milk, and a typical Mexican family spends almost \$500 each year on soda products.⁵

Questions for Discussion

1. Are the consumer groups justified in their negative reaction to Coke Zero? Do you believe Coke may have had any involvement in the approval of sodium cyclamate for use in Mexico? If you knew that Coke used influence to have the sweetener approved, would that affect your assessment of how justified the consumer groups are?
2. Should the Coca-Cola Company have anticipated the reaction to their introduction of Coke Zero with sodium cyclamate? Is there anything they could have done to avoid the backlash?
3. What should Coke do now?

This case was written by Ann K. Buchholtz, University of Georgia.

Case Endnotes

1. Jeremy Schwartz, "Sweetener Causes Fuss in Mexico," *Atlanta Journal-Constitution* (August 29, 2007), C1–C4.
2. *Ibid.*
3. *Ibid.*, C1
4. *Ibid.*, C4
5. *Ibid.*

Case 22

Nike, Inc., and Sweatshops

Jonah Peretti decided to customize his Nike shoes and visited the Nike iD website. The company allows customers to personalize their Nikes with the colors of their choice and their own personal 16-character message. Peretti chose the word “sweatshop” for his Nikes.

After receiving his order, Nike informed Peretti via e-mail that the term “sweatshop” represents “inappropriate slang” and is not considered viable for print on a Nike shoe. Thus, his order was summarily rejected. Peretti e-mailed Nike, arguing that the term “sweatshop” is present in Webster’s dictionary and could not possibly be considered inappropriate slang. Nike responded by quoting the company’s rules, which state that the company can refuse to print anything on its shoes that it does not deem appropriate. Peretti replied that he was changing his previous order and would instead like to order a pair of shoes with a “color snapshot of the 10-year-old Vietnamese girl who makes my shoes.” He never received a response.¹

THE PR NIGHTMARE BEGINS

Before Nike could blink an eye, the situation turned into a public relations nightmare. Peretti forwarded the e-mail exchange to a few friends, who forwarded it to a few friends, and so forth. Within six weeks of his initial order, the story appeared in the *Wall Street Journal*, *USA Today*, and the *Village Voice*. Peretti himself appeared on the *Today Show*, and he estimates that 2 million people have seen the e-mail. At the height of the incident, Peretti was receiving 500 e-mails a day from people who had read the e-mail from as far

away as Asia, Australia, Europe, and South America.^{2,3}

Nike refused to admit any wrongdoing in the incident and stated that they reserve the right to refuse any order for whatever reason. Beth Gourney, a spokesperson for Nike, had the following to say regarding the incident:

Clearly, he [Peretti] was attempting to stir up trouble; he has admitted it. He’s not an activist. Mr. Peretti does not understand our labor policy. If he did, he would know that we do not hire children; our minimum age for hiring is 18 . . . and we don’t apologize for not putting the word “sweatshop” because our policy clearly states: “We reserve the right to cancel any order up to 24 hours after it has been submitted.”⁴

Nike, Inc., is no stranger to sweatshop allegations. Ever since the mid-1990s, the company has been subject to negative press, lawsuits, and demonstrations on college campuses alleging that the firm’s overseas contractors subject employees to working in inhumane conditions for low wages. As Philip Knight, the CEO and founder of Nike, once lamented, “The Nike product has become synonymous with slave wages, forced overtime, and arbitrary abuse.”⁵

HISTORY OF NIKE, INC.

Philip Knight started his own athletic shoe distribution company in 1964. Using his Plymouth Reliant as a warehouse, he began importing and distributing track shoes from Onitsuka Company, Ltd., a Japanese manufacturer. First-year sales of \$8,000 resulted in a profit of \$254. After eight

This case was written by Bryan S. Dennis, Idaho State University, and revised by Archie B. Carroll, University of Georgia.

years, annual sales reached \$2 million, and the firm employed 45 people. However, Onitsuka saw the huge potential of the American shoe market and dropped Knight's relatively small company in favor of larger, more experienced distributors. Knight was forced to start anew. However, instead of importing and distributing another firm's track shoes, he decided to design his own shoes and create his own company. The name he chose for his new company was "Nike."⁶

Nike's Use of Contract Labor. When the company began operations, Knight contracted the manufacture of Nike's shoes to two firms in Japan. Shortly thereafter, Nike began to contract with firms in Taiwan and Korea. In 1977, Nike purchased two shoe manufacturing facilities in the United States—one in Maine, the other in New Hampshire. Eventually, the two plants became so unprofitable that the firm was forced to close them. The loss due to the write-off of the plants was approximately \$10 million in a year in which the firm's total profit was \$15 million. The firm had a successful IPO in 1980, eight years after the company was founded. Nike became the largest athletic shoe company in the world.⁷

Nike does not own a single shoe or apparel factory. Instead, the firm contracts the production of its products to independently owned manufacturers. Today, practically all Nike subcontracted factories are in countries such as Indonesia, Vietnam, China, and Thailand, where the labor costs are significantly less than those in the United States. Worldwide, more than five hundred and thirty thousand people are employed in factories that manufacture Nike products. On an earlier website that is no longer available, the company gave the following as a rough breakdown of the costs per shoe. With inflation ever with us, these figures increase over the years, but these data give us an idea of total costs relative to selling price:

Consumer pays:	\$65
Retailer pays:	\$32.50 to Nike, and then doubles the price for retail

Nike pays:	\$16.25 and then doubles the price to retailers for shipping, insurance, duties, R&D, marketing, sales, administration, and profits
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The \$16.25 price paid to the factory includes:

Materials:	\$10.75
Labor:	\$2.43
Overhead + Depreciation:	\$2.10
Factory Profit:	\$0.97
Total Costs:	\$16.25 ⁸

Even in today's high-tech environment, the production of athletic shoes is still a labor-intensive process. For example, for practically all athletic shoes, the upper portion of the shoe must be sewn together with the lower portion by hand. The soles must be manually glued together. Although most leaders in the industry are confident that practically the entire production process will someday be automated, it will still be years before the industry will not have to rely upon human labor.

Other Firms in the Industry. Nike's use of overseas contractors is not unique in the athletic shoe and apparel industry. All other major athletic shoe manufacturers also contract with overseas manufacturers, albeit to various degrees. One athletic shoe firm, New Balance Inc., is somewhat of an anomaly, as it continues to operate five factories in the United States.⁹

Nike spends heavily on endorsements and advertising and pays several top athletes well over a million dollars a year in endorsement contracts. In contrast, New Balance has developed a different strategy. They do not use professional athletes to market their products. According to their "Endorsed by No One" policy, New Balance instead chooses to invest in product research and development and foregoes expensive endorsement contracts.¹⁰

THE SWEATSHOP MOVEMENT VS. NIKE

One pivotal event is largely responsible for introducing the term “sweatshop” to the American public. In 1996, Kathie Lee Gifford, cohost of the formerly syndicated talk show *Live with Regis and Kathie Lee*, endorsed her own line of clothing for Wal-Mart. During that same year, labor rights activists disclosed that her “Kathie Lee Collection” was made in Honduras by seamstresses who earned 31 cents an hour and were sometimes required to work 20-hour days. Traditionally known for her pleasant, jovial demeanor and her love of children, Kathie Lee was outraged. She tearfully informed the public that she was unaware that her clothes were being made in so-called sweatshops and vowed to do whatever she could to promote the antisweatshop cause.¹¹

Nike Is Accused. In a national press conference, Gifford named Michael Jordan as another celebrity who, like herself, endorsed products without knowing under what conditions the products were made. At the time, Michael Jordan was Nike’s premier endorser and was reportedly under a \$20-million-per-year contract with the firm.¹² Nike, the number-one athletic shoe brand in the world, soon found itself under attack by the rapidly growing antisweatshop movement.

Shortly after the Gifford story broke, Joel Joseph, chairman of the Made in the USA Foundation, accused Nike of paying underage Indonesian workers 14 cents an hour to make the company’s line of Air Jordan Shoes. He also claimed that the total payroll of Nike’s six Indonesian subcontracted factories was less than the reported \$20 million per year that Jordan received from his endorsement contract with Nike. The Made in the USA Foundation is one of the organizations that ignited the Gifford controversy and is largely financed by labor unions and U.S. apparel manufacturers that are against free trade with low-wage countries.¹³

Nike quickly pointed out that Air Jordan shoes are made in Taiwan, not Indonesia. Additionally,

the company maintained that employee wages are fair and higher than the government-mandated minimum wage in all of the countries where the firm has contracted factories. The company released the following data about its wages:

Country	Minimum Monthly Wage	Average Monthly Wage at Nike Factories
Taiwan	14,124 NT\$	25,609 NT\$
South Korea	Won 306,030	Won 640,000
Indonesia	115,000 rupiah	239,800 rupiah
China	RMB 276	RMB 636
Thailand	2,950–3,150 baht	4,435 baht
Vietnam	331.050 VND\$	640.030 VND\$

Nike asserted that the entry-level income of an Indonesian factory worker is five times that of a farmer. The firm also claimed that an assistant line supervisor in a Chinese subcontracted factory earns more than a surgeon with 20 years of experience.¹⁴ In response to the allegations regarding Michael Jordan’s endorsement contract, Nike stated that the total wages in Indonesia are \$50 million a year, which is well over what the firm paid Jordan.¹⁵

Nike soon faced more negative publicity. Michael Moore, the movie director whose documentary *Roger and Me* shed light on the plight of laid-off auto workers in Flint, Michigan, and damaged the reputation of General Motors chairman Roger Smith, interviewed Philip Knight for his movie *The Big One*. On camera, Knight referred to some employees at subcontracted factories as “poor little Indonesian workers.” Moore’s cameras also recorded the following exchange between Moore and Knight:

- Moore: Twelve-year-olds working in [Indonesian] factories? That’s OK with you?
- Knight: They’re not 12-year-olds working in factories . . . the minimum age is 14.

Moore: How about 14, then? Doesn't that bother you?

Knight: No.¹⁶

Knight, the only CEO interviewed in the movie, received harsh criticism for his comments. Nike alleged that the comments were taken out of context and were deceitful because Moore failed to include Knight's pledge to make a transition from a 14- to a 16-year-old minimum age labor force. Nike prepared its own video that includes the entire interview.¹⁷

Thomas Nguyen, founder of Vietnam Labor Watch, inspected several of Nike's plants in Vietnam in 1998 and reported cases of worker abuse. At one factory that manufactures Nike products, a supervisor punished 56 women for wearing inappropriate work shoes by forcing them to run around the factory in the hot sun. Twelve workers fainted and were taken to the hospital. Nguyen also reported that workers were only allowed one bathroom break and two drinks of water during each eight-hour shift. Nike responded that the supervisor who was involved in the fainting incident has been suspended and that the firm had hired an independent accounting firm to look into the matters further.¹⁸

Nike Responds. In 1997, Nike hired former Atlanta mayor Andrew Young, a vocal opponent of sweatshops and child labor, to review the firm's overseas labor practices. Neither party disclosed the fee that Young received for his services. Young toured 12 factories in Vietnam, Indonesia, and China and was reportedly given unlimited access. However, he was constantly accompanied by Nike representatives during all factory tours. Furthermore, Young relied upon Nike translators when communicating with factory workers.¹⁹

In his 75-page report, Young concluded that "Nike is doing a good job, but it can do better." He provided Nike with six recommendations for improving the working conditions at subcontracted factories. Nike immediately responded to the report and agreed to implement all six recommendations. Young did not address the issue of wages and

standards of living because he felt he lacked the "academic credentials" for such a judgment.²⁰

Public reaction to Young's report was mixed. Some praised Nike. However, many of Nike's opponents disregarded Young's report as biased and incomplete. One went so far as to state the report could not have been better if Nike had written it themselves and questioned Young's independence.^{21,22}

In 1998, Nike hired Maria Eitel to fill the newly created position of vice president for corporate and social responsibility. Eitel was formerly a public relations executive for Microsoft. Her responsibilities were to oversee Nike's labor practices, environmental affairs, and involvement in the global community. Although this move was applauded by some, others were skeptical and claimed that Nike's move was nothing more than a publicity stunt.²³

Later that same year, Philip Knight gave a speech at the National Press Club in Washington, DC, and announced six initiatives that were intended to improve the working conditions in its overseas factories. The firm chose to raise the minimum hiring age from 16 to 18 years of age. Nike also decided to expand its worker education program so that all workers in Nike factories would have the option to take middle and high school equivalency tests.²⁴ The director of Global Exchange, one of Nike's staunchest opponents, called the initiatives "significant and very positive." He also added that "we feel that the measures—if implemented—could be exciting."²⁵

COLLEGE STUDENTS, ORGANIZED LABOR, AND NIKE

Colleges and universities have direct ties to the many athletic shoe and apparel companies (such as Nike, Champion, and Reebok) that contract with overseas manufacturers. Most universities receive money from athletic shoe and apparel corporations in return for outfitting the university's sports teams with the firm's products. In 1997, Nike gave \$7.1 million to the University of North Carolina for the right to outfit all of UNC's

sports teams with products bearing the Nike Swoosh logo.²⁶ Additionally, academic institutions allow firms to manufacture apparel bearing the university's official name, colors, and insignias in return for a fee. In 1998, the University of Michigan received \$5.7 million dollars in licensing fees.²⁷ Most of these contract and licensing fees are allocated toward scholarships and other academic programs. Today, these practices continue and the amounts of money are much larger.

Organized Labor. In 1995, the Union of Needletrades, Industrial and Textile Employees (UNITE) was founded. The union, a member of the AFL-CIO, was formed by the merger of The International Ladies' Garment Workers' Union and the Amalgamated Clothing and Textile Workers Union and represented two hundred and fifty thousand workers in North America and Puerto Rico. Most of the union members work in the textile and apparel industry. In 1996, UNITE launched a "Stop Sweatshops" campaign after the Kathy Lee Gifford story broke to "link union, consumers, student, civil rights and women's groups in the fight against sweatshops at home and abroad."²⁸

In 1997, UNITE, along with the AFL-CIO, recruited dozens of college students for summer internships. Many of the students referred to that summer as "Union Summer." For the students involved, it had the same impact that "Freedom Summer" did for students during the civil rights movement.²⁹ The United Students Against Sweatshops (USAS) organization was formed the following year. The USAS was founded and was led by former UNITE summer interns.³⁰

University Organizations. The USAS has chapters at dozens of universities across the United States. Since its inception, the organization has staged a large number of campus demonstrations that are reminiscent of the 1960s. One notable demonstration occurred on the campus of UNC in 1997. Students of the Nike Awareness Campaign

protested against the university's contract with Nike due to the firm's alleged sweatshop abuses. More than 100 students demanded that the university not renew its contract with Nike and rallied outside the office of the university's chancellor. More than 50 other universities, such as the University of Wisconsin and Duke, staged similar protests and sit-ins.³¹

In response to the protests at UNC, Nike invited the editor of the university's student newspaper to tour Nike's overseas contractors to examine the working conditions firsthand. Nike offered to fund the trip by pledging \$15,000 toward the students' travel and accommodations costs. Ironically, Michael Jordan is an alumnus of UNC.³²

Critics of the USAS contend that the student organization is merely a puppet of UNITE and organized labor. They cite the fact that the AFL-CIO has spent more than \$3 million on internships and outreach programs with the alleged intent of interesting students in careers as union activists. The founders of the USAS are former UNITE interns. The USAS admits that UNITE has tipped off the student movement as to the whereabouts of alleged sweatshop factories. Also, in an attempt to spur campus interest in the sweatshop cause, UNITE sent two sweatshop workers on a five-campus tour. They have also coached students via phone during sit-ins and paid for regularly scheduled teleconferences between antisweatshop student leaders on different campuses. According to Allan Ryan, a Harvard University lawyer who has negotiated with the USAS, "[T]he students are vocal, but it's hard to get a viewpoint from them that does not reflect that of UNITE."³³

Many students have denied allegations that they are being manipulated by organized labor and claim that they discovered the sweatshop issues on their own. Others acknowledge the assistance of organized labor but claim it is "no different from [student] civil rights activists using the NAACP in the 1960s."³⁴ John Sweeney, president of the AFL-CIO, claims the role of organized labor is not one of manipulation but of

motivation. Others assert that the union merely provides moral support.³⁵

Regardless of the AFL-CIO's intentions, the students have had a positive impact upon the promotion of organized labor's antisweatshop agenda over the years. According to the director of one of the several human rights groups that are providing assistance to the students:

*At this moment, the sweatshop protest is definitely being carried on the backs of university students. If a hundred students hold a protest, they get a page in the New York Times. If a hundred union people did that, they'd be locked up.*³⁶

By 2007, United Students Against Sweatshops claimed to have approximately 200 affiliated high schools, colleges, and universities, and contacts on more than 400 campuses. USAS currently has four staff members and offices in Washington, DC, and New York City. Today, USAS promotes The Sweat-Free Campus Campaign as a multifaceted, extremely successful program in which students organize antisweatshop campaigns on their campuses, mandating that the clothes bearing their collegiate logos be manufactured under fair and ethical conditions.³⁷

THE FAIR LABOR ASSOCIATION AND THE WORKER RIGHTS CONSORTIUM

In 1996, a presidential task force of industry and human rights representatives was given the job of addressing the sweatshop issue. The key purpose of this task force was to develop a workplace code of conduct and a system for monitoring factories to ensure compliance. In 1998, the task force created the Fair Labor Association (FLA) to accomplish these goals. This organization is made up of consumer and human rights groups as well as footwear and apparel manufacturers. Nike was one of the first companies to join the FLA. Many other major manufacturers (Levi Strauss & Co., Liz Claiborne, Patagonia, Polo Ralph Lauren, Reebok,

Eddie Bauer, and Phillips-Van Heusen) along with hundreds of colleges and universities have also joined the FLA.³⁸

FLA Requirements. Members of the FLA must follow the principles set forth in the organization's Workplace Code of Conduct. The FLA Workplace Code of Conduct sets member standards in the following areas: forced labor, child labor, harassment or abuse, nondiscrimination, health and safety, freedom of association, wages and benefits, hours of work, and overtime compensation. Member organizations that license or contract with overseas manufacturers or suppliers are responsible for ensuring that factory employees are paid either the minimum wage as required by law or the average industry wage, whichever is higher. Additionally, the code of conduct sets limits on the number of hours employees can work, allows workers the right to collective bargaining, and forbids discrimination.³⁹

Each member firm must conduct an internal audit of every manufacturing facility on a yearly basis. Furthermore, members of the FLA must disclose to the FLA the location of all subcontracted factories. This information will not be made public. The FLA uses a team of external auditors to monitor the compliance of these factories with the FLA's code of conduct. These monitoring activities consist of a combination of announced and unannounced factory visits, and results are made available to the public.⁴⁰

The WRC Alternative. The USAS opposed several of the FLA's key components and created the Worker Rights Consortium (WRC) as an alternative to the FLA. The WRC asserts that the prevailing industry or legal minimum wage in some countries is too low and does not provide employees with the basic human needs. They propose that factories should instead pay a higher "living wage" that takes into account the wage required to provide factory employees with enough income to afford housing, energy, nutrition, clothing, health care, education, potable water, child care, transportation, and savings.

Additionally, the WRC supports public disclosure of all factory locations and the right to monitor any factory at any time. As of August 2007, 174 colleges and universities had joined the WRC and agreed to adhere to its policies.⁴¹

Nike, a member and supporter of the FLA, has opposed the Worker Rights Consortium. The firm states that a concept of a living wage is impractical, as “there is no common, agreed-upon definition of the living wage. Definitions range from complex mathematical formulas to vague philosophical notions.” Additionally, Nike was once opposed to the WRC’s proposal that the location of all factories be publicly disclosed. Nike also has claimed that the monitoring provisions set out by the WRC are unrealistic and biased toward organized labor.⁴²

The University of Oregon, Philip Knight’s alma mater, joined the WRC in the year 2000. Alumnus Knight had previously contributed more than \$50 million to the university—\$30 million for academics and \$20 million for athletics. Upon hearing that his alma mater had joined the WRC, Knight was shocked. He withdrew a proposed \$30 million donation and stated that “the bonds of trust, which allowed me to give at a high level, have been shredded” and “there will be no further donations of any kind to the University of Oregon.”^{43,44}

NIKE COMES AROUND

In May 2001, Harsh Saini, Nike’s corporate and social responsibility manager, acknowledged that the firm may not have handled the sweatshop issue as well as it could have and stated that Nike had not been adequately monitoring its subcontractors in overseas operations until the media and other organizations revealed the presence of sweatshops.

We were a bunch of shoe geeks who expanded so much without thinking of being socially responsible that we went from being a very big sexy brand name to suddenly becoming the poster boy for everything bad in manufacturing.

She added, “We realized that if we still want to be the brand of choice in 20 years, we had certain responsibilities to fulfill.”⁴⁵

Oregon Reverses Its Decision. In early 2001, Oregon’s state board of higher education cast doubt on the legality of the University of Oregon’s WRC membership, and the university dissolved its ties with the labor organization.⁴⁶ In September of the same year, Phil Knight renewed his financial support. Although the exact amount of Knight’s donation was kept confidential, it was sufficient enough to ensure that the \$85 million expansion of the university’s football stadium would go through as originally planned. In 2000, the stadium expansion plans suffered a significant setback when Knight withdrew his funding. Many of the proposed additions, such as a 12,000-seat capacity increase and 32 brand-new skyboxes, were made possible largely due to Knight’s pledge of financial support.^{47,48}

Nike released its first corporate social responsibility report in October 2001. According to Phil Knight, “[I]n this report, Nike for the first time has assembled a comprehensive public review of our corporate responsibility practices.”⁴⁹ The report cites several areas in which the firm could do better, such as worker conditions in Indonesia and Mexico. The report, compiled by both internal auditors and outside monitors, also notes that Nike is one of only four companies that has joined a World Wildlife Fund program to reduce greenhouse admissions. Jason Mark, a spokesman for Global Exchange, one of Nike’s chief critics, praised the report and stated that Nike is “obviously responding to consumer concerns.”⁵⁰

KASKY V. NIKE, INC.

Nike’s problems with fair labor issues continued on a related front. Labor activist Mark Kasky had sued Nike in 1998, arguing that Nike had engaged in false advertising when it denied that there was mistreatment of workers in Southeast Asian factories. At issue was the question of whether Nike’s defense of its practices was commercial speech, for

which there are laws against making misleading claims, or political speech, for which free speech protections apply. The California Supreme Court ruled that Nike's statements about labor conditions could be construed as false advertising. Nike appealed this ruling to the U.S. Supreme Court, which sent it back to the California court without making a judgment on the free speech issue. In September 2003, Kasky and Nike settled the case for a \$1.5 million donation to the Fair Labor Association.⁵¹ The settlement, however, left many questions unanswered.⁵² Many feared that the risk of lawsuits would have a chilling effect, causing firms to stop releasing social responsibility reports, which unlike the SEC financial reports, are all voluntary. In 2001, Nike issued a corporate social responsibility report, but the company announced that, due to the California decision, they would not release a corporate social responsibility report in 2002–2003. Nike released a “Community Investment” report detailing its philanthropic efforts instead.⁵³ In 2004, the company did release a sustainability report.⁵⁴

CRITICS QUIET DOWN BUT DON'T GO AWAY

Nike's critics have not gone away, but they have quieted down as the company has taken steps to address many of the criticisms made over the years. Though the critics are less vocal today compared to previous periods, there is still some ongoing opposition to the company. Typical of the continuing opposition is the organization Educating for Justice (EFJ) that runs a continuing Stop Nike Sweatshops campaign. In 2006, EFJ planned a film titled *Sweat*. The film, as described on EFJ's website, is the journey of two young Americans uncovering the story behind the statistics about Nike factory workers. Through the lens of their experiences, they claim viewers will discover the injustices of Nike's labor practices in the developing world, specifically in Indonesia, and how Nike's cutthroat, bottom-line

economic decisions have a profound effect on human lives.⁵⁵

NIKE LATER GETS POSITIVE RECOGNITIONS

In spite of its controversial record on the issue of sweatshops and monitoring labor practices abroad, Nike has been the recipient of a variety of CSR recognitions over the past several years. For example, Nike claimed the only spot in its industry for the 2007 SustainableBusiness.com list of the World's Top Sustainable Stocks. In addition, in the Apparel category, Nike was named to the 2007 World's Most Ethical companies list compiled by *Ethisphere* magazine. Finally, Nike earned the No. 3 ranking on the 2007 “100 Best Corporate Citizens” list published by *CRO* magazine. Nike's ranking rose from No. 13 in 2006 and No. 31 in 2005.⁵⁶

Questions for Discussion

1. What are the ethical and social issues in this case?
2. Why should Nike be held responsible for what happens in factories that it does not own? Does Nike have a responsibility to ensure that factory workers receive a “living wage”? Do the wage guidelines of FLA or WRC seem most appropriate to you? Why?
3. Is it ethical for Nike to pay endorsers millions while its factory employees receive a few dollars a day?
4. Is Nike's responsibility to monitor its subcontracted factories a legal, economic, social, or philanthropic responsibility? What was it 10 years ago? What will it be 10 years from now?
5. What could Nike have done, if anything, to prevent the damage to its corporate reputation? What steps should Nike take in the future? Is it “good business” for Nike to

- acknowledge its past errors and become more socially responsible?
6. What are the goals of the AFL-CIO? Does the campus antisweatshop movement help or hinder the AFL-CIO's goals? Are the students being "used" by the AFL-CIO?
 7. Regarding the *Kasky v. Nike, Inc.* case, is Nike's defense of its practices commercial speech or political speech? What are the long-term implications of your decision, not only for Nike but also for business in general?
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Case 23

Coke and Pepsi in India: Issues, Ethics, and Crisis Management

There is nothing new about multinational corporations (MNCs) facing challenges as they do business around the world, especially in developing nations or emerging markets. Royal Dutch Shell had to reduce its production of oil in Nigeria greatly due to guerrilla attacks on its pipelines. Cargill was forced to shut down its soy processing plant in Brazil because it was claimed that it was contributing to the destruction of the Amazon rainforest. Tribesmen in Botswana accused De Beers of pushing them off their land to make way for diamond mines.¹ Global business today is not for the fainthearted.

It should not come as a surprise, therefore, that MNC giants such as Coca-Cola and Pepsico, highly visible, multibillion-dollar corporations with well-known product brands around the world, would encounter challenges in the creation and distribution of their products. After all, soft drinks are viewed as discretionary and sometimes luxurious products when compared to the staples of life, which are often scarce in developing countries.

Whether it is called an issue, an ethics challenge, or a scandal, the situation confronting both Coke and Pepsi in India, beginning in 2003, richly illustrates the many complex and varied social challenges companies may face once they decide to embark on other countries' shores. Their experiences in India may presage other issues they may eventually face elsewhere or trials other companies might face as well. With a billion-plus people and an expanding economy, and with

markets stagnating in many Western countries, India, along with China and Russia, represents great opportunities for growth for virtually all businesses. Hence, these companies cannot afford to ignore these burgeoning markets.

INITIAL ALLEGATIONS

Coke's and Pepsi's serious problems in India began in 2003. In that year, India's Center for Science and Environment (CSE), an independent public interest group, made allegations that tests they had conducted revealed dangerously high levels of pesticide residue in the soft drinks being sold all over India. The director of CSE, Sunita Narain, stated that such residues can cause cancer and birth defects as well as harm nervous and immune systems if the products were consumed over long periods of time.² Further, CSE stated that the pesticide levels in Coke's and Pepsi's drinks were much higher than that permitted by European Union standards. On one occasion, Narain accused Pepsi and Coke of pushing products that they wouldn't dare sell at home.³

In addition to the alleged pesticides in the soft drinks, another special interest group, India Resource Center (IRC), accused the companies of overconsuming scarce water and polluting water sources due to its operations in India.⁴ IRC dramatically criticized the companies, especially Coca-Cola, by detailing a number of different "water woes" experienced by different cities and regions of the country. IRC's allegations even more broadly accused the companies of water

This case was prepared by Archie B. Carroll, University of Georgia.

exploitation and of controlling natural resources, and thus communities. Examples frequently cited were the impact of Coke's operations in the communities of Kerala and Mehdiganj.⁵

In 2004, IRC continued its "Campaign to Hold Coca-Cola Accountable" by arguing that communities across India were under assault by Coke's practices. Among the continuing allegations were communities experiencing severe water shortages around Coke's bottling plants, significant depletion of the water table, strange water tastes and smells, and pollution of groundwater as well as soil. IRC said that in one community, Coke was distributing its solid waste to farmers as fertilizer and that tests conducted found cadmium and lead in the waste, thus making it toxic waste. The accusation of high levels of pesticides continued. According to IRC, the Parliament of India banned the sale of Coca-Cola in its cafeteria.⁶ Another significant event in February 2004 was the government's joint parliamentary commission's "seconding" of CSE's findings.⁷ In December 2004, India's Supreme Court ordered Coke and Pepsi to put warning labels on their products. This caused a serious slide in sales for the next several years.⁸

Sunita Narain. One major reason that Indian consumers and politicians took the allegations of both CSE and IRC seriously was because of CSE's director, Sunita Narain. Narain was a well-known activist in New Delhi. Narain, now in her mid-40s, was born into a family of freedom fighters whose support of Mahatma Gandhi goes back to the days when Gandhi was pushing for independence in India 60 years ago. She took up environmental causes in high school. One major cause she adopted was to stop developers from cutting down trees. Her quest was to save India from the ravages of industrialization. She became director of CSE in 2002.⁹

According to a *BusinessWeek* writer, Narain strongly holds forth on the topic of MNCs exploiting the natural resources of developing countries, especially India. She manifests an alarmist tone that tends toward the end-is-near

level of fervency. She is skilled at getting media attention. In 2005, she won the Stockholm Water Prize, one of a number of environmental accolades she has received.¹⁰ In addition, she has been very successful in taking advantage of India's general suspicion of huge MNCs, dating back to its tragic Bhopal gas explosion in 1984.¹¹

Sacred Water. Coke's and Pepsi's problems in India have been complicated by the fact that water carries such significance in India. We are often told about cultural knowledge we should have before doing business in other countries. Water is one of those issues in India. In spite of having some of the worst water in the world due to poor sewage, pollution, and pesticide use, according to UN sources, water carries an almost spiritual meaning to Indians. Bathing is viewed by many to be a sacred act, and tradition for some holds that one's death is not properly noted until one's ashes are scattered in the Ganges River. In one major poll, Indians revealed that drinking water was one of their major life activities to improve their well-being.¹² Indians' sensitivity to the subject of water has undoubtedly played a role in the public's reactions to the allegations.

COKE'S AND PEPSI'S EARLY RESPONSES

Initially, the two companies denied the allegations of CSE and IRC, primarily through the media. It was observed that their response was limited at best as they got caught up in the technical details of the tests. Coke conducted its own tests, the conclusion of which was that their drinks met demanding European standards.¹³ Over the next several years, the debate continued as the companies questioned the studies and conducted studies of their own. The companies also pointed out that other beverages and foods in the Indian food supply, and indeed, the water, had trace pesticide levels in it, and they sought to deflect the issue in this manner.

The Indian Resource Center (IRC) also attacked the companies for not taking the crisis seriously. The IRC argued that the companies were “destroying lives, livelihoods, and communities” while viewing the problems in India as “public relations” problems that they could “spin” away. They pointed out that Coca-Cola had hired a new public relations firm to help them build a new image in India, rather than addressing the real issues. According to IRC, the new CEO of Coke, Neville Isdell, immediately made a visit to India, but it was a “stealth” visit designed to avoid the heavy protests that would have met him had the trip been public. IRC also pointed out that Coke had just increased its marketing budget by a sizable amount in India. IRC then laid out the steps it felt Coke should take to address its problems effectively.¹⁴

A NEW STUDY IN 2006

The controversy flared up again in August of 2006 when the Center for Science and Environment (CSE) issued a new study. The new test results showed that 57 samples from 11 Coke and Pepsi brands contained pesticide residue levels 24 times higher than the maximum allowed by the Indian government. Public response was swift. Seven of India’s 28 states imposed partial bans on the two companies, and the state of Kerala banned the drinks completely. Officials there ignored a later court ruling reversing the ban.¹⁵ During 2006, the United Kingdom’s Central Science Laboratory questioned the CSE findings. Coca-Cola sought a meeting with CSE that it denied. Also that year, India’s union health ministry rejected the CSE study as “inconclusive.”¹⁶

THE COMPANIES RATCHET UP THEIR RESPONSES

As a result of the second major flurry of studies and allegations in 2006, both Coke and Pepsi ratcheted up their responses, sometimes acting

together, sometimes taking independent action. They responded almost like different companies than they were before. Perhaps they figured this issue was not going to go away and had to be addressed more forcefully.

Coke’s Response. Coke started with a more aggressive marketing campaign. It ran three rounds of newspaper ads refuting the new study. The ads appeared in the form of a letter from more than 50 of India’s company-owned and franchised Coke bottlers, claiming that their products were safe. Letters with a similar message went out to retailers and stickers were pressed onto drink coolers declaring that Coke was “safety guaranteed.” Coke also hired researchers to talk to consumers and opinion leaders to find out what exactly they believed about the allegations and what the company needed to do to convince them the allegations were false.¹⁷

Based on its research findings, Coke created a TV ad campaign that featured testimonials by well-respected celebrities. One of the ads featured Aamir Khan, a popular movie star, as he toured one of Coke’s plants. He told the people that the product was safe and that if they wanted to see for themselves, they could personally do so. In August and September 2006, more than four thousand people took him up on it and toured the plants. Opening up the plants sent the message that the company had nothing to hide, and this was very persuasive.¹⁸ The TV ads, which were targeted toward the mass audience, were followed by giant posters with a picture of movie star Khan drinking a Coke. These posters appeared in public places such as bus stops. In addition, other ads were targeted toward adult women and housewives, who make the majority of the food-purchasing decisions. One teenager was especially impressed with Khan’s ads, because she knew he was very selective about which movies he appeared in and that he wouldn’t take a position like this if it wasn’t appropriate.¹⁹

In a later interview, Coke’s CEO Isdell said he thought the company’s response during the

second wave of controversy was the key reason the company began turning things around. After the 2003 episode, the company changed management in India to address many of the problems, both real and imagined. The new management team was especially concerned about how it would handle its next public relations crisis. Weeks later, in December 2006, India's Health Ministry said that both Coke's and Pepsi's beverages tested in three different labs contained little or no pesticide residue.

Pepsi's Response. Pepsi's response was similar to Coke's. Pepsi decided to go straight to the Indian media and try to build relationships there. Company representatives met with editorial boards, presented its own data in press conferences, and also ran TV commercials. Pepsi's commercials featured the then-president in India, Rajeev Bakshi, shown walking through a polished Pepsi laboratory.²⁰

In addition, Pepsi increased its efforts to cut down on water usage in its plants. Employees in the plants were organized into teams and used Japanese-inspired *kaizens* to emphasize continuous improvements to bring waste under control. The company also employed local lobbying of government.

Indra Nooyi Becomes CEO. Pepsi had an advantage in rebuilding its relationships in India because in October 2006, an Indian-born woman, Indra Nooyi, was selected to be CEO of the multinational corporation. It is not known whether Pepsi's problems in India were in any way related to her being chosen CEO, but it definitely helped. After graduating from the prestigious Indian Institute of Management, and later, Yale University, Nooyi worked her way up the hierarchy at PepsiCo before being singled out for the top position.²¹ She previously held positions at the Boston Consulting Group, Motorola, and ABB Group.

Prior to becoming CEO, Nooyi had a number of successes in Pepsi and became the company's chief strategist. She was said to have a perceptive

business sense and an irreverent personal style. One of Nooyi's first decisions was to take a trip to India in December 2006. While there, she spoke broadly about Pepsi's programs to improve water and the environment. The Indian media loved her, beaming with pride, and covered her tour positively as she shared her own heartwarming memories of her life growing up in India. She received considerable praise. Not surprisingly, Pepsi's sales started moving upward.²²

While all the criticism of Coke and Pepsi was going on, roughly from 2003 to 2006, both companies were pursuing corporate social responsibility (CSR) initiatives in India, many of them related to improving water resources for communities, at the same time as the conflict was holding center stage.

A COMMENTARY: WHAT'S GOING ON

Because of all the conflicting studies and the stridency of CSE and IRC, one has to wonder what is going on in India to cause this developing country to criticize giant MNCs such as Coke and Pepsi so severely. Many developing countries would be doing all they could to appease these companies. It was speculated by a number of different observers that what was at work was a form of backlash against huge MNCs that come into countries and consume natural resources.²³ Why were these groups so hostile toward the companies? Was it really pesticides in the water and abuse of natural resources? Or was it environmental interest groups using every opportunity to bash large corporations on issues sensitive to the people? Was it CSE and IRC strategically making an example of these two, hugely successful companies, and trying to put them in their place?

Late in 2006, an interesting commentary appeared in *BusinessWeek*, exploring the topic of what has been going on in India with respect to Coke and Pepsi.²⁴ This commentary argued that the companies may have been singled out because they are foreign owned. It appears that no Indian soft drink companies were singled out for pesti-

cide testing, though many people believe pesticide levels are even higher in Indian milk and bottled tea. It was pointed out that pesticide residues are present in most of India's groundwater, and the government has ignored or been slow to move on the problem. The commentary went on to observe that Coke and Pepsi have together invested \$2 billion in India over the years and have generated twelve thousand five hundred jobs and support more than two hundred thousand indirectly through their purchases of Indian-made products, including sugar, packing materials, and shipping services.²⁵

PROTESTS AND ACTIVITIES CONTINUE IN 2007

At this writing, the open conflict has settled down and sales have taken an upturn for both companies, but the issue lingers. In June 2007, the Indian Resource Center continued its attacks on Coca-Cola. It accused the company of "greenwashing" its image in India.²⁶ The IRC staged a major protest at the new Coke Museum in Atlanta on June 30, 2007, questioning the company's human rights and environmental abuses. They erected a 20-foot banner that read "Coca-Cola Destroys Lives, Livelihoods, Communities" in front of the New World of Coke that just opened in May 2007. Amit Srivastava of the IRC was quoted as saying, "This World of Coke museum is a fairy tale land and the real side of Coke is littered with abuses." A representative of the National Alliance of People's Movements, a large coalition of grassroots movements in India, said, "The museum is a shameful attempt by the Coca-Cola Company to hide its crimes."²⁷

Piling On. The protestations by these groups have apparently motivated other groups to take action against Coke. It was reported that United Students Against Sweatshops also staged a "die-in" around one of Coke's bottling facilities in India. In addition, more than 20 colleges and universities in the United States, Canada, and the

United Kingdom have removed Coca-Cola from campuses because of student-led initiatives to put pressure on the company. In addition, the protests in Atlanta were endorsed by a host of groups that participate in the U.S. Social Forum.²⁸

Renewed Priorities. Undaunted, Coca-Cola continues its initiatives to improve the situation in India and around the world. Coke faces water problems around the world because water is the key natural resource that goes into its products. The company now has 70 clean-water projects in 40 countries aimed at boosting local economies. It has been observed that these efforts are part of a broader strategy on the part of CEO Neville Isdell to build Coke's image as a local benefactor and a global diplomat.²⁹

The criticism of Coke has been most severe in India. CEO Isdell admits that the company's experience in India has taught some humbling lessons. Isdell, who took over the company after the crisis had begun, told the *Wall Street Journal*, "It was very clear that we had not connected with the communities in the way we needed to." He indicated that the company has now made "water stewardship" a strategic priority and, in a recent 10-K securities filing, has listed a shortage of clean water as a strategic risk.³⁰ In August 2007, Coca-Cola India unveiled its "5-Pillar" growth strategy to strengthen its bonds with India. Coke's new strategy focuses on the pillars of People, Planet, Portfolio, Partners, and Performance. The company also announced a series of initiatives under each of the five pillars and also announced its "Little Drops of Joy" proposal, which tries to reinforce the company's connection with stakeholders in India.³¹

Though most of the attention recently has been on Coca-Cola, it should also be noted that Pepsi has continued on a number of projects as well. One new initiative is that the company now gathers rainwater in excavated lakes and ponds and on the rooftops of its bottling plants in India. The company also sponsors other community water projects as well.³²

Questions for Discussion

1. Identify the issues that are going on in this case with respect to issues management, crisis management, global business ethics, and stakeholder management. Rank these in terms of their order of priorities for Coca-Cola and for PepsiCo.
2. Evaluate the corporate social responsibility (CSR) of Coke and Pepsi in India.
3. Are these companies ignoring their responsibilities in India or is something else at work?
4. Why does it seem that Coke has become a larger and more frequent target than Pepsi in India? Did having an Indian-born CEO help Pepsi's case?
5. How do companies protect themselves against the nonstop allegations of special interest groups that have made them a target? Is stakeholder management an answer?
6. What should the companies have done differently in 2003 to address the water allegations? What should the company now do as it moves forward?
7. What lessons does this case present for MNCs doing business in the global marketplace?

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Case 24

Chiquita: An Excruciating Dilemma between Life and Law

AN ETHICAL DILEMMA

Assume that you are the top executive for a firm doing business in Colombia, South America. If a known terrorist group threatens to kill your employees unless you pay extortion money, should the company pay it?

If you answer “no”, how would you respond to the family of an employee who is later killed by the terrorist group?

If you answer “yes”, how would you respond to the family of an innocent citizen who is killed by a bomb your money funded?¹

BACKGROUND

In many parts of the world, doing business is a dangerous proposition. Such has been the case in the country of Colombia in South America. The danger has been described in the following way: “In Colombia’s notoriously lawless countryside, narco-terrorists ran roughshod over the forces of law and order—or collaborated with them in a mutual game of shakedowns, kidnappings, and murders.”² Foreign companies that chose to do business in many parts of the world are easy targets. These companies have resources, they care about their employees, and many of them have been willing to negotiate with terrorists and just consider it one of the costs of doing business. Security in many of these countries can only be had at a price.³

Formerly known as United Fruit Company and then as United Brands, Chiquita Brands Interna-

tional, based in Cincinnati, Ohio, is the type of company that faces the kind of situation described above. Today, Chiquita is a global food company that employs more than twenty-six thousand employees on six continents around the world. According to its website, Chiquita owns approximately ninety thousand acres (thirty-six thousand four hundred hectares) and leases about fifty thousand acres (twenty thousand hectares) of improved land, primarily in Panama, Costa Rica, Colombia, Guatemala, and Honduras. The company also grows bananas on the Ivory Coast and through joint ventures in the Philippines and Australia. For the most part, the company uses this land for growing, packing, and shipping bananas.⁴

IT ALL STARTED IN 1997

According to CEO Fernando Aguirre, Chiquita began making payments to paramilitary groups in Columbia beginning in 1997 and extending into 2004. The payments came to a total of about \$1.7 million. The company felt it was forced to make these payments because the lives of its employees were at stake.⁵ During the period 2001–2004, the company was making payments to the terrorist group United Self-Defense Forces of Columbia (AUC). AUC was the group’s Spanish acronym, and it is the name by which the group was primarily known. A major complication during this period was that the U.S. government had declared AUC to be a specially designated terrorist organization, making it illegal to provide funds for them, and the Bush administration had vowed to

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go after any company that funded terrorist groups.⁶

CHIQUITA TURNS ITSELF IN

Chiquita turned itself in and reported to the government that it had made the payments to AUC during the years indicated.

In April 2007, CEO Fernando Aguirre released a public statement outlining what he called “an excruciating dilemma between life and law.”⁷ Following are some excerpts from his statement:

- In February 2003, senior management of Chiquita Brands International learned that protection payments the company had been making to paramilitary groups in Colombia to keep our workers safe from the violence committed by those groups were illegal under U.S. law.
- The company had operated in Colombia for nearly a century, generating fifty-four hundred direct and an additional eight thousand indirect jobs. We contributed almost \$70 million annually to the Colombian economy in the form of capital expenditures, payroll, taxes, social security, pensions and local purchases of goods and services.
- But during the 1990s, it became increasingly difficult to protect our workforce. Among the hundreds of documented attacks by left- and right-wing paramilitaries were the 1995 massacre of 28 innocent Chiquita employees who were ambushed on a bus on their way to work, and the 1998 assassination of two more of our workers on a farm while their colleagues were forced to watch.
- Despite the harsh realities on the ground, the discovery that our payments were violating U.S. law created a dilemma of more than theoretical proportions for us: the company could stop making the payments, complying with the law but putting the lives of our workers in immediate jeopardy; or we could keep our workers out of harm's way while violating American law.⁸

- Each alternative was unpalatable and unacceptable. So the company decided to do what we believe any responsible citizen should do under the circumstances: We went to the U.S. Department of Justice and voluntarily disclosed the facts and the predicament. The U.S. government had no knowledge of the payments and, had we not come forward ourselves, it is entirely possible that the payments would have remained unknown to American authorities to this day.⁹

In a plea deal, the company was fined \$25 million, and in September 2007 it made its first installment payment of \$5 million. Chiquita's general counsel said that “this was a difficult situation for the company” and that the company had to do it to protect the well-being of our employees and their families.” The Department of Justice prosecutor called the payments “morally repugnant” and said that the protection payments “fueled violence everywhere else.”¹⁰

BOARD KNOWLEDGE REVEALED

During the investigation of this incident, it came out that the board of directors of the company had received knowledge the questionable payments were going on. A prosecution document, according to the *Miami Herald*, presented the following timeline of events:

- 2000—Chiquita's audit committee, composed of board members, heard about the payments and took no action.
- 2002—Soon after AUC had been designated a terrorist organization, a Chiquita employee learned about the designation and alerted the company.
- 2003—Chiquita consulted with a Washington attorney, who told the company, “Bottom line: cannot make the payment.”
- 2003—Two months later, Chiquita executives reported to the full board of directors that the company was still making payments. One

board member objected and the directors agreed to make the payments known to the Justice Department.

CHIQUITA'S SOCIAL RESPONSIBILITY INITIATIVES

An interesting description of the company's track record in the area of corporate social responsibility (CSR) makes this case particularly out of the ordinary. Jon Entine's account of Chiquita's turnaround as a company is instructive. Apparently, Chiquita spent at least 15 years living down its long-standing reputation as a "ruthless puppeteer manipulating corrupt Latin American banana republics."¹¹ Once operating as United Fruit, the company began turning itself around in 1990 and remade itself into a model food distributor, complete with high environmental and ethical standards.

Better Banana Project. In the early 1990s, the company separated itself from its competitors by teaming up with the Rainforest Alliance on sustainability and labor standards. This became known as the Better Banana Project.¹²

The Rainforest Alliance had the following to say about Chiquita's adoption of the Better Banana Project:

*Chiquita Brands International, Inc.—a global leader in banana production—today announced that it has transformed its farming practices and led the way for the banana industry. The Rainforest Alliance monitors and verifies that Chiquita's farms abide by strong environmental and social standards, which have positive impacts on rural communities and tropical landscapes. By meeting the Rainforest Alliance's standards, Chiquita has improved water quality, instituted programs for recycling and safe waste disposal, dramatically decreased agrichemical use, and improved the quality of life of workers on all its company-owned farms in Latin America.*¹³

Chiquita also became well known through its publications of its corporate responsibility reports. The company issued public reports on its corporate responsibility efforts each year starting in 2000. In addition, beginning in 2003, the company issued interim updates on its corporate responsibility progress as part of its annual reports to shareholders.

Regarding its CSR initiatives and payments to terrorist groups, CEO Fernando Aguirre had the following to say:

Chiquita is completely committed to corporate responsibility and compliance. The fact that we voluntarily came forward and disclosed the payments to the paramilitaries did not simply acknowledge an illegal act, it proved our willingness to take responsibility for our actions, even when such a step comes at considerable cost.

*Legal scholars, business ethicists and governmental leaders can, and should, consider the implications of the situation we faced. There are a number of questions that deserve serious discussion and debate, among them: What should a company do when faced with the excruciating conflict between a possible violation of law and protecting the lives of its workers? What is the proper public policy toward, and punishment of, companies that voluntarily reveal potentially illegal behavior to the government?*¹⁴

In June 2004, Chiquita sold its Colombian farms at a loss of \$9 million, in order to extricate itself from this difficult situation.¹⁵

A TALE OF TWO COMPANIES

The Chiquita payment controversy has been called a "tale of two companies." One Chiquita comes across as a defiant, secretive multinational, with lots of resources, determined to break the law to keep its employees safe and its businesses running. The other Chiquita builds partnerships with groups such as the Rainforest Alliance to support

the Better Banana Project and issues frequent corporate social responsibility reports to keep its stakeholders happy and informed, eventually extricating itself by turning itself in, paying a huge fine, suffering tremendous embarrassment and loss of reputational capital, and finally selling its farms to help reach closure. Which is the real Chiquita?

Questions for Discussion

1. Go back to the ethical dilemma at the beginning of the case. Which position did you take and why? Did your position change after you read the case?
2. Was Chiquita justified in making the extortion payments to protect its employees? Was the company really between a rock and a hard place? What should it have done?
3. Using your knowledge of business ethics and global practices, what concepts, principles, or ideas from your study have a bearing on this case? Explain how some of them might have guided Chiquita toward better decisions.
4. What is your assessment of CEO Aguirre's statements? Is he sincere or just making excuses?
5. What is your analysis of the Chiquita board of directors' handling of this case? Do you think selling the farms at a loss in Colombia was the right thing to do? Why?
6. In the "tale of two companies," which do you think is the real Chiquita and why?

Case Endnotes

1. Denis Collins, Edgewood College, Madison, Wisconsin, posed these questions in a post-

ing to an International Association for Business and Society (IABS) Listserv discussion list discussing the Chiquita Banana situation, on June 18, 2007. Used with permission.

2. Rushworth M. Kidder, "Ethical Bananas," *Ethics Newslines* (March 19, 2007), a publication of the Institute for Global Ethics, <http://www.globalethics.org/newslines/>, retrieved September 7, 2007.
3. *Ibid.*
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7. The Corporate Citizen, April 2007, http://www.uschamber.com/bclc/resources/newsletter/2007/chiquita_newsletter_april2007.htm, retrieved September 19, 2007.
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12. *Ibid.*
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Case 25

Astroturf Lobbying

“Save Our Species Alliance,” “Americans for Job Security,” and “Citizens for Asbestos Reform”—the names of these organizations would lead one to believe they are composed of individual people who have organized at the grassroots level to solve a problem about which they feel deeply. However, according to a 2007 Public Citizen report, these organizations “are bankrolled by large corporations, industry trade associations, or ultra-wealthy individuals who have little in common with the regular Americans they are pretending to represent.”¹ The purpose of the “Save Our Species Alliance” was to make land management more industry-friendly by gutting the Endangered Species Act. “Americans for Job Security” advocated for repeal of the estate tax in order to protect inherited wealth, and the “Citizens for Asbestos Reform” bases its operations in the offices of the American Insurance Association.²

Many other examples of this practice exist. According to the *Washington Post*, groups such as “Citizens for a Sound Economy” provide analyses that add an air of authority to corporate arguments—while often maintaining the corporate donors’ anonymity.³ Public Interest has also cited “Citizens for a Better Medicare” as being created and funded by the pharmaceutical industry.⁴ Organizations that falsely portray themselves to be grassroots entities are engaging in what many people call astroturf or stealth lobbying. Although astroturf lobbying occurs in a variety of arenas, the campaign for tort reform has been a key proponent of this tactic.

THE CALA STUDY

According to a report prepared by Public Citizen and the Center for Justice and Democracy, Citizens Against Lawsuit Abuse (CALA) organizations are part of a “national corporate-backed network of front groups that receive substantial financial and strategic assistance from some of America’s biggest corporations.”⁵ In “The CALA Files: The Secret Campaign by Big Tobacco and Other Major Industries to Take Away Your Rights,” Public Citizen and the Center for Justice and Democracy argue that the goal of astroturf lobbying is to insulate corporations from having to pay a price for their reckless behavior.⁶ They studied dozens of CALA groups in 18 states and found among other things that:

1. Although they claim to be supported by individual donations, they are funded mostly by large corporate donors and representatives of industries that want to be shielded from lawsuits. Central to this effort is the American Tort Reform Association, a coalition of major corporations and trade associations.
2. They hide their pro-business agenda behind friendly consumer-oriented names. The intent to deceive is shown in a memo from the Tobacco Institute: “In order to be totally effective, the grassroots effort must appear to be spontaneous rather than a coordinated effort.”⁷
3. According to documents made public during the tobacco litigations, tobacco companies spend millions each year to weaken tort laws through forming and funding groups such as these.
4. The CALA efforts have been successful. They have achieved passage of legislation designed

This case was written by Ann K. Buchholtz, University of Georgia.

to limit consumer rights to sue manufacturers, and they have conducted successful “voter education” campaigns to unseat judges who favor expanded consumer rights and elect judges who favor limits on liability.

NOT IN MY BACKYARD

According to a report prepared by Public Citizen and Citizen Action, another leading consumer group, corporations only seek tort reform when they are the defendants. “The National Association of Manufacturers: A Study in Hypocrisy,” documents a variety of cases where corporations are the plaintiffs and charges, “the same companies lobbying to restrict the legal rights of people injured or killed by defective products have unfettered access to our nation’s courts as their own private playground.”⁸ Examples of frivolous corporate cases include the time when Exxon sued the Georgia minor league baseball team Columbus Redstixx for violating their trademark by having two *x*’s in their name and the time when Gillette sued Norelco for ads depicting nonelectric razors as “ferocious creatures.”

The View from CALA. For their part, CALA groups say that they are not against the legal system but that tort reform is needed to corral an out-of-control civil justice system. They don’t oppose needed lawsuits, simply the frivolous excesses that abuse the system. They argue that tort litigation is costing the United States nearly 2 percent of its gross domestic product, which is twice as much as litigation costs in Europe.⁹

ESTABLISHING GRASSROOTS LOBBYING DISCLOSURE REQUIREMENTS

Efforts to require corporations and industry groups to disclose their astroturf lobbying campaigns were derailed in 2007. The U.S. House of

Representatives passed the Honest Leadership and Open Government Act of 2007 (H.R. 2316) in May 2007.¹⁰ At this writing, it is on the Senate Legislative calendar.¹¹ Although it addresses many other important concerns, the bill does not contain a provision to address the issue of astroturf lobbying. Rep. Martin Meehan (D-MA) offered a grassroots lobbying amendment early in the process, but it faced strong bipartisan opposition. At this point, the likelihood of grassroots lobbying disclosure requirements making their way into legislation is very small.

Questions for Discussion

1. By searching on “CALA and lawsuit,” you can find the websites of a variety of CALA organizations. Search their websites and decide whether you agree with the assessments of the CALA report. Do you find their practices to be deceptive or defensible? Do the various CALAs differ in that regard?
2. Where do you draw the line? What limits should be placed on corporate lobbying under shell grassroots organizations? Does your attitude toward “shell” lobbying groups vary with the extent to which you agree with the causes they are promoting?
3. What, if any, public policy recommendations would you make?

Case Endnotes

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4. <http://www.citizen.org>.

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7. Robert Weissman, "The 'Lawsuit Abuse' Scam," *Multinational Monitor* ((September 2000)), 7.
8. *Ibid.*
9. "Putting Brakes on the Litigation Machine," *BusinessWeek* ((January 29, 2001)), 144.
10. <http://www.ombwatch.org/article/articleview/3853/1/422?TopicID=1>.
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Case 26

The Ethics of Earmarks

According to the Congressional Research Service (CRS), there is no formal definition of earmarks. In fact, there is no informal definition upon which people generally agree. The CRS defines *earmarks* broadly as “provisions associated with legislation (appropriations or general legislation) that specify certain congressional spending priorities or in revenue bills that apply to a very limited number of individuals or entities. Earmarks may appear in either the legislative text or report language (committee reports accompanying reported bills and joint explanatory statement accompanying a conference report.”¹ A key aspect of the definitions of earmarks in the Senate Reform proposals reviewed by CRS is the specification of the identity of the recipient of the assistance.²

Why do firms invest so much time, energy, and money in lobbying for earmarks? According to a 2007 *BusinessWeek* investigation, the average firm generates \$28 in earmark revenue for each dollar invested in lobbying. Although some firms get no earmarks in spite of heavy lobbying, the most successful firms can generate \$100 or more in earmark revenue from each dollar spent in their lobbying efforts.³

THE BUSINESSWEEK INVESTIGATION

For years, no one ever really knew how much money firms made from their lobbying expenditures. However, recent scandals over U.S. congressional earmarks prompted requirements for the disclosure of those spending measures that

target money to go to legislators’ favorite companies. In “Inside the Hidden World of Earmarks,” *BusinessWeek* reports on the results of an investigation they conducted with Columbia Books. The team analyzed the earmarks that firms received in 2005, the first full year of data available. They compared the earmark revenue to the amount spent on lobbying in the previous year. Determining the value of lobbying by assessing earmark revenue is inexact because it is impossible to know how much firms spent on general lobbying rather than seeking earmarks. Nevertheless, the findings are instructive. In a nutshell, they found that lobbying is a highly lucrative activity:⁴

1. As already mentioned, firms average about \$28 in earmark revenue for each dollar spent in lobbying. That is especially impressive when compared to the \$17.52 brought in by S&P 500 firms for every dollar of capital expenditures in 2006.
 - a. The most successful firms did far better than the average. In terms of “bang for the buck,” Scientific Research, a small maker of classified intelligence technology, was the winner with \$21 million earned from \$60,000 spent on lobbying. That represented a return of \$344 for each dollar spent on lobbying.
 - b. In terms of overall earmark revenue, the winner by far was Boeing. They received about \$456 million in combined earmarks for purchases as varied as missile technology and helicopters.
2. Firms often received earmark revenue from different spending bills. For example, Boeing

This case was written by Ann K. Buchholtz, University of Georgia.

received its \$456 million in revenue from 29 different earmarks.

3. In terms of dollar value from lobbying, the clear winner is the defense industry. In addition to Boeing, Northrop Grumman, General Dynamics, Lockheed Martin, and Raytheon comprised the top five in earmark revenue generated. Even Raytheon, at fifth on the list, made an impressive \$158 million from lobbying.
4. Hiring the right lobbyist is clearly a key to success in obtaining earmarks. The most successful firms hired lobby firms with not only former members of Congress but also former congressional aides with appropriations committee experience. The number of firms using lobbyists has swelled in recent years. The number of firms that hired lobbyists for help with budget and appropriations issues grew from 1,447 in 1998 to 4,516 in 2006. Not surprisingly, given the increase in demand, the number of lobbying firms specializing in obtaining earmarks also grew from nearly none in 1997 to about a dozen in 2007.

EFFORTS TO END EARMARKS

The history of earmarks is replete with scandals that include using earmark funds for buying votes on other bills, gifts to political donors, and blatant bribery. Unfortunately, the scandals are part of the present as well as the past. In July 2007, the FBI raided the home of Senator Ted Stevens (R-AK) to determine whether he used diverted earmark funds to benefit his son and his business partners. Senator Stevens became the butt of “pork barrel” jokes when he championed \$223 million in funds to build a bridge to an island with fifty people on it. The bridge became known as the “Bridge to Nowhere.”⁵ Former Representative Randy “Duke” Cunningham (R-CA) is serving eight years in prison for directing earmarks to defense contractors in return for more than \$2.4 million in bribes.⁶

Because of these and other scandals, both President George W. Bush and House Speaker Nancy Pelosi have called for a cut in earmark appropriations. The U.S. Congress passed new disclosure requirements, and Internet databases will make it easier for the public and the press to be aware of earmark activity. Early evidence suggests that the disclosure requirements may be having an impact. Fiscal 2008 earmarks are down significantly from the 2005 defense spending peak of 2,657 earmarks worth \$11.6 billion. Many observers believe, however, that earmark activity will bounce back when the attention on it diminishes.⁷

ARE EARMARKS BENEFICIAL?

In a 2007 *New York Times* editorial, Representative Rahm Emanuel (D-IL) argues that the government should not get rid of earmarks entirely. He supported the action Congress took in 2007 to reform earmarks but explained that the purpose was never to get rid of them because they have a useful purpose to serve. According to Emanuel, putting all earmarks in one boat does a disservice to the public by distorting the debate.⁸ As Emanuel explains:

In my own district, I obtained an earmark to rebuild a bridge that not only was rated as deficient but also was identified by the Department of Homeland Security as a major evacuation route in case of a terrorist attack on Chicago. Does that make me an “earmark thug” or a congressman who took care of a critical need in his district? Other earmarks I’ve championed include money for after-school programs, computers for police patrol cars, master teacher training programs and a children’s hospital research facility.

I make no apologies for these earmarks, which serve important public purposes—and might even save a life. I’m happy to defend them in the well of the House or against attacks from campaign opponents. In fact, I’ve voluntarily

*gone beyond the requirements of our reforms by posting on my Congressional Web site all the earmarks I've requested, not just those that have been approved. I'm gratified that a number of colleagues from both parties have followed that example.*⁹

Emanuel explains that he knows the needs of the people he represents better than a Washington bureaucratic or White House occupant. From Emanuel's perspective, getting rid of earmarks would make it more difficult for him to meet those needs. Subsequent letters to the editor took issue with his stand. They argued that if earmarks really do take care of an important need, then they should have their own bills and attendant debate. Finally, letters to the editor questioned whether there were other bridges with even greater needs for repair that might get overlooked because they were in a district with a less powerful congressman.¹⁰

Questions for Discussion

1. Visit the website that is designed to provide more transparency to the earmark process (<http://earmarks.omb.gov/>). Does it give you the information you need to understand current earmarks?
2. Where do you draw the line? What limits should be placed on earmarks? Does your attitude toward earmarks vary with the extent to which you agree with the causes the earmark is promoting?
3. Do you agree with Representative Emanuel? What, if any, public policy recommendations would you make?
4. From an ethics perspective, how do earmarks compare with general lobbying? What, if any, differences do you see? Is it ethical for businesses to lobby in a quest to get earmarks?

Case Endnotes

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8. Rahm Emanuel, "Op-Ed Contributor: Don't Get Rid of Earmarks," *New York Times* (August 14, 2007), A19.
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Case 27

DTC: The Pill-Pushing Debate

What do Nexium, Lunesta, Vytarin, Crestor, and Advair have in common? They are the five drugs with the highest direct-to-consumer advertising in the United States.¹ Although their brand-name recognition does not rival that of Coca-Cola, their names are familiar to consumers across the nation. As the flag bearers of the direct-to-consumer (DTC) advertising efforts of the pharmaceutical industry, they are at the forefront of the DTC debate. A recent AC Nielsen study found that 17 percent of new prescriptions filled were the result of DTC advertising.² Furthermore, patients were significantly more likely to refill a prescription that arose from DTC advertising.³

THE PROBLEM

Why debate DTC advertising? In his testimony before the Senate Commerce Subcommittee on Consumer Affairs, Dr. Sidney Wolfe, director of Public Citizen's Health Research Group, expressed the following concern: "There is little doubt that false and misleading advertising to patients and physicians can result in prescriptions being written for drugs that are more dangerous and/or less effective than perceived by either the doctor or the patient. This can then lead to a subsequent toll of deaths and injuries that would not have occurred had safer, more effective drugs been prescribed."⁴ Dr. Wolfe cites the following findings from medical studies as cause for concern:

1. Consumers rate drugs significantly more positively when ads have incomplete risk statements.

2. Consumers believe that there is prior scrutiny of DTC ads by the FTC and that DTC ads are held to a higher standard than other ads. Both of those beliefs are wrong.
3. DTC ads provide only a minimal amount of educational information.
4. When a study asked what patients would do if a doctor refused to prescribe a drug that a patient wanted because of a DTC ad, 25 percent said they would seek a prescription elsewhere; 15 percent said they would terminate their relationship with the physician.⁵

Another concern relates to opportunity costs and the danger that DTC advertising will siphon funds from other more important purposes. A 2006 report from the United States Government Accountability Office (GAO) found that money spent on DTC advertising "increased twice as fast from 1997 through 2005 as spending on promotion to physicians or on research and development."⁶ As of 2007, the United States and New Zealand remained the only two developed countries to allow the practice of DTC advertising.⁷

THE DEBATE

Consumer groups claim that one cause of the increase in health care costs is the explosion of DTC ads and the unnecessary medication that results. The advertising seems to work. The sales of the heavily advertised drugs increased by 32 percent compared to 14 percent for other drugs. However, proponents of DTC ads argue that they help patients. Dr. Richard Dolinar, an endocrinologist, says that the ads empower consumers:

This case was written by Ann K. Buchholtz, University of Georgia.

“Direct-to-consumer advertising is getting patients with diabetes into my office sooner so they can be treated.”⁸

Most physicians disagree with Dr. Dolinar: 64 percent believe there should be some sort of moratorium on DTC advertising in the United States, 44 percent would approve a moratorium of two years or more, and 27 percent believe that DTC ads should be banned completely.⁹ Doctors claim it makes it very difficult to prescribe the appropriate medication when a patient comes to the office already committed to the drug he or she wants the doctor to prescribe. This takes much of the diagnosis and prescribing freedom and authority out of the hands of the professionals who should be making these judgments. Dr. Kurt Stange, editor of the *Annals of Family Medicine*, described the effect of DTC ads on the patient-doctor relationship in an editorial calling for a ban of DTC ads:¹⁰

DTC ads manipulate the patient's agenda and steal precious time away from an evidence-based primary care clinician agenda that is attempting to promote healthy behavior, screen for early-stage treatable disease, and address mental health. The negative consequences of this manipulation of the public, the patient, the clinician, and their relationship are subtle but pervasive. An insidious adverse effect occurs in what is not done during the limited time of a visit. Discussing why the advertised drug is not the best option for a particular patient may mean that a mammogram is not ordered, an important health behavior is not discussed, a family matter is not brought up, a deeper patient concern is never articulated, a diagnosis for which there is no drug ad is not made. The clinician is put in the role of gatekeeper for the advertised commodity rather than a gateway for prioritizing health care based on the concerns of

patients and the science-based recommendations for preventive, chronic disease, mental health, and family care.

Questions for Discussion

1. What are the ethical issues in this case?
2. Should DTC advertising be judged by the same criteria as other advertising? If not, how should it be judged differently?
3. What public policy changes would you advocate regarding DTC? Should the United States and/or New Zealand ban them?

Case Endnotes

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5. *Ibid.*
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Case 28

Easy Credit Hard Future

The “Freshman 15” once referred to the 15 pounds that college freshmen often gain from too much late-night pizza. Now the “Freshman 15” is taking on a new meaning—the \$15,000 of debt some students acquire before they reach the age of 21.¹ Representative Louise Slaughter (D-NY) comments, “It’s astonishing to me to see college students coming out of school with staggering amounts of debt and credit scores so abominable that they couldn’t rent a car.”²

UNIVERSITY PARTNERSHIPS

In April 2007, the University of Wisconsin-Oshkosh sent letters to incoming freshmen to inform them that their student IDs could double as debit and ATM cards for students who open an account with U.S. Bank. A bank application was attached to the letter. Administrators replied to critics that the offer provides students with convenience because they can use one card instead of two. However, the *Milwaukee Journal Sentinel* found that U.S. Bank charged the highest overdraft fee in the Oshkosh area. In addition, the card that U.S. Bank promotes through the university website has what the newspaper termed “notably higher” interest rates.³

Universities have partnered with financial institutions before. Recent scandals uncovered financial-aid officers who allegedly owned stock in the parent company of a lender they had been recommending to students. Other financial-aid directors have been accused of receiving consulting fees and other payments from lenders they had been recommending to their students. In addition, dozens of universities have deals with various

lenders in which the school receives a percentage of the proceeds from student loans, with the funds often funneled to financial aid.⁴ The credit card partnerships are different for two reasons. First, in the wake of the scandals, many schools have now ended the practice of having “preferred lenders.”⁵ Second, credit card promotions can target almost every student, not just those who need loans.⁶

Campus card partnerships began about twenty years ago. They involve mostly large national banks and include more than 100 colleges and universities. The university receives signing bonuses, as well as ongoing revenues based on the number of accounts opened and the level of debit activity. In return, the university typically promotes the bank to students and parents and also allows the bank to both put ATMs on campus and offer checking accounts through student IDs. According to the *Journal Sentinel*, U.S. Bank has more partnerships than any other bank. For the previously mentioned credit cards, the bank paid UW-Oshkosh a one-time signing bonus of \$30,000 and ongoing “soft money” based on the number of students and faculty who open checking accounts. In 2006, the soft money royalty payments were about \$15,000, but the contract indicates that royalties can go as high as \$130,000.⁷

PROMOTIONAL CAMPAIGNS

When students come to campus, they are inundated with credit card offers. Companies offer free T-shirts, Frisbees, water bottles, and even iPods in hopes of attracting new customers.⁸ The enticements seem to work. Very few students had credit

This case was written by Ann K. Buchholtz, University of Georgia.

cards a generation ago, but now 75 percent of college students carry plastic.⁹

Students often serve as the salespeople for credit card companies. Ryan Rhoades was a college freshman when he heard that he could make money by signing up his fellow students for credit cards. He received \$5 to \$10 for each filled-out application, depending on the type of card. He was given suggested sales lines like, “Even if you apply, you can always cut up the card” and “It’s easy to pay off your balance once you graduate and get a great job.”

Rhodes signed up 29 students in one morning—none of whom even glanced at the credit card application terms and conditions.¹⁰ At the end of the morning, he needed only one more filled-out application to receive a cash bonus, so he filled out the application himself. Five years later, he found himself struggling with the \$13,000 he had racked up in credit card debt. According to Rhoades, “They should put warnings on credit cards like they do on cigarettes, to make sure people know how dangerous the cards are.”¹¹

WHY STUDENTS?

Many people question how students with little or no income can qualify for credit cards. In most cases, an unemployed person would find it very difficult to get a card; however, students do not have the same difficulty. When he applied for his card, Ryan Rhoades was told not to worry about being unemployed. Typically, an applicant without a job would have difficulty obtaining a card—particularly one with a five-figure credit line. Consumer advocates argue that banks treat students differently for two reasons: (1) they are a more vulnerable group, and (2) their parents will typically bail them out. In a series on students and credit card debt, *BusinessWeek* profiled Seth Woodworth, who racked up \$3,000 in credit card debt by his sophomore year. He received an American Express card with a limit of \$6,000 in spite of the fact that he had no job. In three months, his credit limit increased to \$10,000.¹²

Students are vulnerable for a variety of reasons. They can have difficulty understanding the complex fees and charges that credit cards employ but, of course, they are not alone in that.¹³ A U.S. Government Accountability Office (GAO) report concluded, “Contrary to usability and readability best practices, the disclosures buried important information in text, failed to group and label related material, and used small typefaces. Perhaps as a result, cardholders that the expert tested often had difficulty using the disclosures to find and understand key rates or terms applicable to the cards.”¹⁴ Credit card contracts average about thirty pages of small type. According to Elizabeth Warren, a Harvard law professor, “It’s like selling toasters and handing a consumer a wiring diagram.”¹⁵

Students also are new to the world of credit, and so many do not realize that the use of a credit card to fund the purchase of necessities can lead to a downward spiral of debt. They also live in what *BusinessWeek* calls “a culture of debt.” When you already owe tens of thousands for your education, an additional \$50 for dinner might not seem like a big deal. Furthermore, students are anticipating an increase in future earnings and may be inclined to overestimate its impact on their ability to pay down debt.¹⁶

Universal default is another aspect of students’ increased vulnerability. Many people do not realize that banks often change the rates they charge cardholders when their credit scores change. Because they have short credit histories, students’ credit scores can drop precipitously with a single missed payment. This results in higher rates not only on the card for which the student missed a payment but also on all that student’s cards. The U.S. Senate has held hearings on this practice, but no action has been taken at this writing.¹⁷

In their defense, banks argue that they are providing a valuable service to students and that they work hard to make certain students use their credit cards sensibly. They distribute a wealth of materials on handling debt and make information

available online. They say the goal of this is to enable students to develop good financial habits and a strong credit history. Consumer advocates counter that the emphasis on credit education simply shifts burden of responsibility to students.¹⁸

That responsibility can be a heavy burden. Woodworth didn't realize that a \$500 balance can take three years to pay off if only making minimum payments. The minimum payments became unmanageable, and the thought of the downward spiral of debt debilitated him. He got some help from his parents but still had to drop out of school to pay down his debts. "If I could do it over again," says Woodworth, "I never would have gotten a credit card."¹⁹

Questions for Discussion

1. What are the ethical issues in this case?
2. Who are the stakeholders impacted by this situation? How would you rank their claims?
3. Alcohol and tobacco companies are not permitted to market on campus. Should credit card companies be banned as well (as some universities have already done)? Why or why not?
4. What, if any, public policy recommendations would you make?

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Case 29

Big Pharma's Marketing Tactics

“Big Pharma” is the name the business press uses for the gargantuan pharmaceutical industry. Most of us are familiar with Big Business and Big Government. Now, Big Pharma is in the news and has been for several years regarding its marketing, advertising, and sales tactics. As *Time* magazine recently stated, it’s hard to empathize with the drug industry these days because of the high cost of our prescriptions. We either just emptied our wallets in paying for our latest prescription or just returned on a Greyhound bus from Canada where we bought our prescriptions for less.¹ Public perceptions of the pharmaceutical industry add to its problems. In a 2007 poll, Big Pharma has been called greedy as well as shifty, and it was found that most people do not trust the industry to disclose bad news about its products.²

Big Pharma has been aware that it is in for challenges to its marketing and sales tactics. Not too long ago, a major conference was held in Boston where industry representatives discussed the sale and illegal marketing of drugs for “off label” uses that were not approved by the Food and Drug Administration. A lawyer from one of the law firms that sponsored the conference said, “Rarely has a conference been more timely.”³ Since that conference, it is uncertain how much progress has been made.

It is hard to visualize Big Pharma cowering before FDA regulators, because the industry has built up an army of lobbyists in Washington, DC, to protect its interests. Public Citizen recently reported that the industry had 526 lobbyists—almost one for every member of Congress.

THE INDUSTRY

The pharmaceutical industry is one of the healthiest in America. According to 2006 financial data, the pharmaceutical industry was the second most profitable industry, behind only mining/crude oil production. Among the top 10 companies, their profits as a percent of revenues were 19.6.⁴ Global sales of pharmaceutical products, both prescribed and over-the-counter, exceed \$600 billion annually.⁵

The top ten U.S. pharmaceutical companies, according to the 2007 *Fortune* magazine annual rankings, include the familiar names, with the most profitable at the top of the list:⁶

1. Johnson & Johnson
2. Pfizer
3. Merck
4. Abbott Laboratories
5. Wyeth
6. Bristol-Myers Squibb
7. Eli Lilly
8. Amgen
9. Schering-Plough
10. Genzyme

Among this group, only Johnson & Johnson ranked (#4) among *Fortune's* “most admired companies in 2007.”⁷

The pharmaceutical industry spends more than \$20 billion a year on promotional spending. This includes both professional and direct-to-consumer (DTC) spending by the drug makers.⁸ In spite of its size and success, Big Pharma has been called into question for a number of years now for its

This case was written and revised by Archie B. Carroll, University of Georgia.

questionable marketing, advertising, or sales techniques. The charges have included questionable advertising to consumers (DTC) and charges of dubious ethics, and a number of them have resulted in lawsuits. It seems quite amazing, actually, that the pharmaceutical industry has not been more in the spotlight.

FROM SCIENCE TO SALESMANSHIP

An overall criticism of Big Pharma is that the industry has abandoned science for salesmanship.⁹ That is, the industry has become more concerned with pushing pills for whatever problem than for developing new and important drugs. An example of this is provided in the aggressive marketing by Novartis of its fourth-biggest-selling drug. Is this drug a lifesaver? No, it's Lamisil, a pill for toenail fungus. Yes, toenail fungus can turn a nail yellow, but apparently no one has died of this illness. On the other hand, a few people may have died taking the drug, as regulators have linked the drug to 16 cases of liver failure, including 11 deaths. Novartis claims most of these patients had preexisting illnesses or were on other drugs.¹⁰

Many patients taking Lamisil have been enticed to the drug by a grotesque cartoon creature named Digger the Dermatophyte, who is a squat, yellowish character with a dumb-guy big city accent. In the TV ads, Digger lifts a toenail, creeps beneath it, and declares, "I'm not leavin'!"¹¹ One group calculated that Novartis spent \$236 million on Lamisil ads over three years, but Novartis denies this figure. In the first run of the commercial, Digger is crushed by a giant Lamisil tablet. Regulators thought the ad so overstated the drug's benefits that the company had to pull that particular version of the ad. It has been reported that the drug only cures the problem in 38 percent of patients, but Lamisil's sales increased 19 percent after it.¹² In short, it is alleged that the industry spends a fortune on remedies to cure trivial maladies while, at the same time, its drug research pipelines run dry. This has been dubbed "salesmanship over science."¹³ Others have called it

marketing and profits coming before consumer safety and wellness.¹⁴

PROMOTION TO MED STUDENTS

Big Pharma starts its promotional techniques while the doctors are still students in medical school. There, the med students have in the past received free lunches, pens, notepads, and other gifts that are given by the companies. The companies start early trying to persuade the young doctors to prescribe their products by inundating them with logo-infested products and other gifts. A number of medical students have become fed up with the practice and have resisted the free gifts and have started movements to stop the practice from occurring in the first place.

One med student, Jaya Agrawal, launched a national campaign calling on students to sign a pledge saying they would not accept drug-industry gifts. Medical students on other campuses have organized seminars and lectures on the issue. Ms. Agrawal was reminded of how difficult it would be to get everyone to think like her when she moved into an apartment she was planning to share with two other med students and noticed a Big Pharma logo on a clock in three rooms of the apartment.¹⁵

LAWSUITS

An examination of some of the lawsuits against companies in the pharmaceutical industry reveals some of the legal problems the industry has had in recent years. This listing is by no means comprehensive.

Pricing. The attorneys general in Ohio and Pennsylvania filed lawsuits charging fraud or deceptive sales practices against a number of companies. The State of Ohio claimed five companies provided false wholesale pricing data that led their Medicaid program to pay more than it should have for drugs. The State of Pennsylvania filed suits against Pfizer and 12 other drug makers, claiming problems with pricing. They also questioned the free samples and free trips for doctors

that the companies allegedly have been providing.¹⁶ The Justice Department spends a lot of time monitoring companies that may be collecting more from Medicare and Medicaid than they should. In 2007, Justice had 150 cases of alleged fraud by pharmaceutical companies on its docket.¹⁷

Off-Label Offenses. Companies have been reportedly illegally promoting drugs for uses for which they were not approved. The result of this is that doctors may be prescribing, and patients may be using, drugs for conditions for which those medicines are not needed, are not appropriate, or might hurt them.¹⁸ A consideration of specific cases and specific companies reveals some of the details.

Prescribing of Neurontin. Pfizer Inc.'s Warner-Lambert unit agreed to pay \$430 million to settle civil and criminal charges that it illegally marketed the prescription drug Neurontin, an anti-seizure drug. It is legal for doctors to prescribe FDA-approved drugs for whatever uses they see fit. However, according to the law, the drug companies are not permitted to encourage or promote their drugs for uses for which they have not been approved.¹⁹

Government officials claimed that Warner-Lambert pushed doctors to prescribe Neurontin for maladies ranging from migraines to social disorders, even though it was not approved for such uses. The company's tactics, it was claimed, involved sending doctors on lavish trips to Florida or to the Olympics, where they received presentations on unapproved uses of the drug. Among the one-on-one sales tactics later used were sales pitches to doctors, the dispatching of "medical liaisons" who falsely presented themselves to be experts, and teleconferences in which the sales reps would recruit physicians to talks about off-label uses.²⁰

Sales of Neurontin were \$2.4 billion in the U.S. during 2003, and off-label sales were estimated to be 90 percent of overall Neurontin sales. This information came from a lawyer who was representing David Franklin, the whistle-blower who brought this information to light. According to Franklin,

"Patients every day are still taking this drug hoping it's effective, and there's really no evidence for that. That, to this day, keeps me up at night."²¹

Promoting Paxil. When Eliot Spitzer was the attorney general of New York, he filed a lawsuit alleging that GlaxoSmithKline (GSK), the world's second-largest drug firm, had covered up results from clinical trials of its drug Paxil, an antidepressant. Spitzer alleged that the drug was at best ineffective in children and at worst could increase suicidal thoughts. GSK has denied the charges. Spitzer charged the company with "repeated and persistent fraud" in promoting the drug.²²

Other Companies. The U.S. Food and Drug Administration (FDA) and state attorneys general have been up in arms about drug companies marketing their products for "off-label" uses. Recently, cases have been pursued against a Johnson & Johnson subsidiary, Janssen, Eli Lilly & Co., and Brisbane.²³

IMPROPER PAYMENTS

Sometimes the questionable marketing of drugs entails improper payments or bribes. The Securities and Exchange Commission announced that the drug maker Schering-Plough Corporation would pay a \$500,000 penalty to settle claims that one of its subsidiaries made improper payments to a Polish charity in a quest to get a Polish government health official to buy the company's products.²⁴

The SEC claimed that Schering-Plough Poland donated about \$76,000 to a Polish charity over a three-year period. Chudnow Castle Foundation, the charity, was headed up by a health official in the Polish government. Apparently, this information came to light while regulators were investigating several pharmaceutical companies for compliance with the U.S. Foreign Corrupt Practices Act. The SEC charged that the payments were not accurately shown on the company's books and that the company's internal controls failed to prevent or detect them. The SEC said that the charity was legitimate but that the company made

the contributions with the expectation of boosting drug sales. In addition to paying the fine, the company also agreed to hire an independent consultant to review the company's internal control system and to ensure the firm's compliance with the Foreign Corrupt Practices Act.²⁵

Johnson & Johnson is another company that has been pursued for improper payments. In J&J's case, the improper payments were in connection with the sale of medical devices in two foreign countries. J&J turned itself in, and the worldwide chairman of medical devices and diagnostics took responsibility and retired.²⁶

PAYMENTS TO DOCTORS

Few cases more vividly illustrate the questionable marketing tactics of Big Pharma than that of the allegations against Schering-Plough. According to an investigation by the *New York Times*, Schering-Plough used the marketing tactic of making payments to doctors in exchange for their commitment to prescribe the company's medications exclusively. One doctor reported receiving an unsolicited check for \$10,000 in the mail. He said it had been made out to him personally in exchange for an enclosed "consulting" agreement in which all he had to do was prescribe the company's medicines.²⁷

Financial Lures. Interviews with 20 doctors, industry executives, and observers close to the investigation of Schering-Plough and other drug companies revealed a "shadowy system of financial lures" that the companies had been using to convince the physicians to favor their drugs. In the case of Schering-Plough, the tactics included paying doctors large sums of money to prescribe its drug for hepatitis C and to participate in the company's clinical trials that turned out to be thinly disguised marketing ploys that required very little on the part of the doctors. The company even barred doctors from participating in the program if they did not exhibit loyalty to the company's drugs.²⁸

One doctor, a liver specialist, and eight others who were interviewed, said that the company paid

them \$1,000 to \$1,500 per patient for prescribing Intron A, the company's hepatitis C medicine. The doctors were supposed to gather data, in exchange for the fees, and pass it on to the company. Apparently, many doctors were not diligent in recordkeeping, but the company did little. Another liver disease specialist said that the trials were "merely marketing gimmicks."²⁹ According to some doctors, the company would even shut off the money if one of the doctors wrote prescriptions for competing drugs, or even spoke favorably about other competing drugs. Other doctors reported being signed up for consulting services and being paid \$10,000, and the only purpose was to keep them loyal to the company's products.³⁰ In another case, Schering-Plough had been charged with and was expected to plead guilty to federal charges that it had not provided Medicaid with the lowest drug prices and would pay a fine.³¹

In response to the allegations against it, Schering-Plough CEO Fred Hassan reported that the violations took place before he took office. He went on to outline steps he was taking to get the company on track. This included instituting an "integrity hotline" for employees to report wrongdoing and the creation of a chief compliance officer to report directly to the CEO and the board. Hassan said that compliance has to become "part of the DNA" of a drug company.³² Another company official said that the company has been "undergoing a company-wide transformation since the arrival of new leadership in mid 2003," which is a "commitment to quality compliance and business integrity."³³

Questionable Doctors. Some Big Pharma companies continue to pay doctors with questionable credentials to oversee their drug trials and contribute to marketing. One recent case is a doctor whose medical license was suspended in 1997 by the Minnesota Board of Medical Practice. The *New York Times* recently reported that from 1997 to 2005, this same doctor was hired by several drug firms to conduct multiple drug trials, and he was paid for speaking and consulting fees as well.³⁴ The *New York Times'* investigation found

that 103 doctors in Minnesota who had been disciplined by the Minnesota Board of Medical Practice received a total of \$1.7 million in payments for research and marketing services rendered.³⁵ Though Minnesota was the only state willing to make its records available for inspection, experts say this is a national problem.

GIFTS TO DOCTORS

In total, Big Pharma gives an estimated \$19 billion worth of gifts to physicians every year. This is a practice that has a number of attorneys general of the states worried. Attorney General Anne Milgram of New Jersey summoned a task force to consider putting limits on the gratuities given to doctors and their staffs. Milgram asserts, "Patients should be getting prescription and device recommendations based on what's best for them, not based on financial incentives doctors receive from companies."³⁶

In September 2007, Bristol-Myers Squibb Co. agreed to pay more than \$515 million to settle fraud allegations involving kickbacks to doctors and inflated drug prices, according to the U.S. Justice Department. The U.S. Attorney in Boston said that Bristol agreed to settle the charges that doctors were illegally paid to motivate them to prescribe Bristol drugs. Part of this was the company participating in various programs, which included trips to luxurious resorts.³⁷

Pharmaceutical companies have given meals, tickets to shows and sporting events, ski and beach vacations disguised as medical education seminars, consulting "jobs" for which the doctors do no work, and other gifts as part of their marketing strategies for decades. The companies expect something in return. They expect the doctors to prescribe their medicines. It is estimated that there is an army of eighty-eight thousand or more pharmaceutical reps, many of them young and beautiful, supplying the doctors and their staffs with gifts and freebies. It is argued that these gifts damage the doctors' integrity.³⁸

An article published in the *New England Journal of Medicine* reported on a recent survey of doctors

and found that 94 percent of them reported some type of relationship with the drug industry. The most frequent drug industry ties were food and drinks in the workplace (83 percent), drug samples (78 percent), payments for consulting (18 percent), payments for speaking (16 percent), reimbursement for meeting expenses (15 percent), and tickets to cultural or sporting events (7 percent).³⁹ The Pharmaceutical Research and Manufacturers of America (PhRMA), the main trade association of Big Pharma, did adopt a voluntary Code on Interactions with Healthcare Professionals in 2002.⁴⁰ It is widely believed, however, that the questionable marketing tactics of the industry continue. Certainly, its excessive advertising and sales-force spending leads consumers to believe that Big Pharma cares more about profits than protecting health.⁴¹

BIG BUCKS, BIG PHARMA

In 2007, the Media Education Foundation, a non-profit corporation that produces and distributes educational material observing the impact and ethics of the media industry, released a new film, *Big Bucks, Big Pharma: Marketing Disease & Pushing Drugs*.⁴²

According to the Media Education Foundation, *Big Bucks, Big Pharma* pulls back the curtain on the multibillion dollar pharmaceutical industry to expose the insidious ways that illness is used, manipulated, and in some instances created, for capital gain. Focusing on the industry's marketing practices, media scholars and health professionals help viewers understand the ways in which direct-to-consumer (DTC) pharmaceutical advertising glamorizes and normalizes the use of prescription medication, and works in tandem with promotion to doctors. Combined, these industry practices shape how both patients and doctors understand and relate to disease and treatment.

Lobbying. Big Pharma is able to ward off most government regulations through the power of its huge lobbying force. The pharmaceutical lobby has defeated most attempts to restrain drug marketing.

In September 2007, Congress passed a sweeping drug-safety bill, but before it was passed, it was stripped of provisions that were intended to limit the ability of the industry to market directly to consumers. In addition, in 11 states that considered legislation to expose pharmaceutical gift-giving, the bills were either defeated or stalled.⁴³

Questions for Discussion

1. What are the ethical issues in this case?
2. Who are the primary stakeholders in these incidents?
3. Is there any justification for the marketing tactics described in the case? Which are acceptable and which are questionable?
4. What is your evaluation of giving free promotional items to med students? What are the arguments for and against such practices?
5. What ethical principles may be violated by the marketing tactics described? Do any of these ethical principles *support* the companies' actions?
6. Big Pharma needs enormous sums of money to conduct R&D and to advance its industry. Do the ends justify the means because our health is at stake?
7. What response do you think physicians should take when approached regarding some of the schemes presented in this case?
8. What does your personal research indicate is the status of the above cases or that of Big Pharma?

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Case 30

Firestone and Ford: The Tire Tread Separation Tragedy

It is often tricky to know when an ethical or social issue really begins. Does it begin before it is “recognized” or “identified” as an issue? Does it begin when an isolated manager recognizes an incident or a trend and reports it via a memo to his superiors? Does it begin once the media get hold of information and the frenzy begins? Such questions arise in the case of the Firestone–Ford tire tread separation debacle that began dominating business news in the fall of 2000, with implications for passenger safety that continue today.

Ask any consumer about the two most critical features of safety on their automobiles, and most will quickly respond—brakes and tires. It is not surprising, then, that the tire tread separations that began appearing on certain categories of Firestone tires, especially those associated with the Ford Explorer, caught the public’s attention like few other recent product safety issues.

Was this a tire problem or an SUV problem? Was this Firestone’s problem or Ford’s problem? Were both companies responsible for what happened? Were government regulations administered through the National Highway Traffic Safety Administration (NHTSA) adequate to protect the public? These questions are simple to ask but difficult to answer because they are complex.

Let’s start where the “public” knowledge of the product dangers began to surface—with a couple of accidents reported since 1998.

TWO KEY ACCIDENTS

Jessica LeAnn Taylor was a 14-year-old junior high school cheerleader on the way to a homecoming football game near her hometown of Mexia, Texas, on October 16, 1998. She was in a Ford Explorer SUV, driven by a friend of her mother’s, when the tread on the left-rear Firestone ATX tire allegedly “peeled off like a banana,” leading the Explorer to veer left and roll over. Jessica died in this accident.¹ In another incident, two years later, Victor Rodriguez and his family piled into the family’s Ford Explorer over Labor Day weekend and prepared to visit a sick aunt at a hospital in Laredo, Texas. As Rodriguez started down Interstate 35, he was startled by a thumping sound and looked in his rearview mirror to see the tread shredding off one of his Firestone Wilderness AT tires. Rodriguez was unable to control his vehicle. It flipped, ejecting five of its passengers. Among the passengers was his 10-year-old son, Mark Anthony, who died instantly.²

Jessica LeAnn Taylor and Mark Anthony Rodriguez were just two of many victims in a far-reaching safety crisis that, according to some accounts, had taken the lives of close to 90 Americans by fall 2000 and had “driven fear into the hearts of motorists” who had begun to think of the sport utility vehicle as the ideal family car.

A KEY COURT VICTORY

A number of different people brought the tire safety/SUV tragedy to the public’s attention. One account gives the credit to Jessica Taylor’s family

This case was written/updated by Archie B. Carroll, University of Georgia.

lawyer, Randy Roberts, because of his tenacity. Roberts was a small-town lawyer, and when he took the case, he realized there was not much hope of taking on a corporate giant such as Firestone, a unit of Japan's Bridgestone Corporation. As many other tire companies have successfully done in the past, Firestone ruled out a tire problem at the very outset. It and other companies have been successful in keeping lawsuits and consumer complaint data confidential, or private, saying the Taylor accident was similar to only one other with which they were familiar. Randy Roberts did not buy this argument, and in November 1999, he won a crucial victory from state judge Sam Bournias, who ordered Firestone to turn over any information on complaints or other lawsuits, as well as employee depositions associated with these lawsuits concerning its ATX and Wilderness tires. The judge also permitted Roberts to share this information with other lawyers who were involved in similar lawsuits.³

Other Lawsuits. Roberts discovered that other attorneys, for example, Bruce Kaster of Ocala, Florida, and Tab Turner of Little Rock, Arkansas, had been suing Firestone for much of the decade over the same type of issue. Though a trial date for his case had not been set, Roberts was one of the first to sense the broad scope of potential tire defects. At that time, he reported that there had been more than 1,100 incident reports and 57 lawsuits by February 2000.⁴

NHTSA GETS INVOLVED

By February 2000, the National Highway Traffic Safety Administration (NHTSA) had received fewer than 50 complaints over the better part of the previous decade about the suspect tires. It began to receive tips from State Farm Insurance that it was experiencing an unusually high number of insurance claims in which these tires were associated. After a report on tread separation accidents by Houston's TV station KHOU, 30 to 40 more complaints came in. At this point, NHTSA got interested. They contacted Randy Roberts, and

Roberts was quite willing to help them do their work. He reported his findings about widespread complaints, and it is believed to have been a significant factor leading up to Firestone's voluntary recall of 6.5 million possibly defective tires. The voluntary recall began August 9, 2000, and it included the Radial ATX, Radial ATXII, and certain Wilderness AT tires.⁵

By September 2000, the recall had only replaced about 2 million tires. One reason was due to a shortage of replacement tires. At about the same time, the NHTSA reported that possibly 1.4 million more tires, especially those manufactured at the Decatur, Illinois, plant, may be susceptible to the same type of tread separations.⁶

THE FINGER-POINTING BEGINS

As the bad news spread and in the absence of any good news, the finger-pointing between Bridgestone/Firestone and Ford began and continued unabated. Ford's position was best articulated by then-CEO Jacques Nasser, who stated that "this is a tire issue, not a vehicle issue." Nasser was trying to distance Ford from responsibility for the tire failures. For its part, Firestone argued that Ford's recommended lower air pressure for the tires may have contributed to the problem. Firestone said it recommended 30 psi for the tires, whereas Ford was recommending 26 psi for the tires.⁷ It would later come out that Firestone believed the lower air pressure may have been an important contributory factor in the tire separations.

Investigations. The finger-pointing and squabbling between Firestone and Ford created a very murky picture of what was going on and why. The result was that both companies began to be investigated by the media and government, and the situation got worse for them both. The confusion caused Congress to begin hearings in September 2000 as top executives of both companies were summoned to Washington for testimony. At about the same time, it got worse for both as Venezuelan consumer protection officials were expected to recommend that both Ford and Firestone be

charged with criminal negligence after investigating more than 60 deaths in that country that had been linked to accidents involving Ford Explorers equipped with Firestone tires.⁸

CONGRESSIONAL HEARINGS AND THE UNFOLDING STORY

In congressional hearings beginning in September 2000, Congress started grilling Bridgestone/Firestone and Ford executives about problems with their tires in the United States and abroad.⁹ Congressional investigators reported on internal documents from both Firestone and Ford that the two companies were aware of the tread separation problem. The documents revealed that the companies knew something was amiss. In the unfolding paper trail, it was suggested that Firestone should have understood it had glitches at its Decatur, Illinois, plant, where some of the damaged tires had been identified as having been manufactured. A chart circulated inside the company by Firestone analysts earlier in the year had shown that nearly 60 percent of claims against the company in 1999 were for tires made during a strike that was taking place at the Decatur plant. Also, Firestone knew that two-thirds of the dollar payments it had made to settle claims involving tire separations came from the Decatur plant. On top of this, a March 12, 1999, Ford memo was disclosed that suggested that Firestone was reluctant to recall suspect tires in Saudi Arabia because doing so would require the company to notify the U.S. Department of Transportation.¹⁰ So, evidence that there was trouble was available to both the companies.

Another Accident Victim. After another accident victim, Lori Lazarus, heard about the big Firestone tire recall, she was very upset but not surprised. Back on Labor Day 1996, while driving home from Disney World, a Firestone tire on her Ford Explorer had shredded. Her SUV flipped into a drainage ditch, leaving her trapped. She was finally saved by passing motorists, who pulled her from the submerged vehicle. She still suffers from headaches and balance problems. The 31-year-old teacher was

bitter that Ford and Firestone were just beginning to own up to their problems. She said, "They've known something was wrong for years."¹¹

DAMAGE CONTROL CONTINUED

With the allegations spinning out of control, Ford and Firestone began full-blown damage control. Pressure was mounting to widen the recall. Critics wanted to know if the companies were guilty of a cover-up or just dragging their feet. Evidence continued to unfold that both companies had known about the problem for years. Lawsuits first started occurring in 1991. Documents from those lawsuits showed that Firestone had begun reimbursing some consumers for faulty ATX tires as early as 1989. By 1997, insurance adjustors at State Farm began noticing a pattern of problems with ATX and Wilderness tires. In a few cases, they sought and received reimbursements from Firestone. State Farm said it shared its data with federal safety regulators in 1998, but an investigation into the tires was not opened up until two years later. In 1998, Ford also noticed Firestone treads unraveling on Explorers in Saudi Arabia, Asia, and South America, and in 1999 began replacing tires on nearly fifty thousand foreign vehicles. Ford did not reveal to U.S. regulators its foreign recall until May 2000.¹²

Previous Lawsuits Concealed. Through the judicious use of its lawyers, Firestone was able to conceal the fact that it had been sued many times before due to tire problems. How was this possible? An investigation by *U.S. News and World Report* found that Bridgestone/Firestone routinely used legal protective orders to conceal crucial data that was generated when consumers filed warranty claims with the company. The head of Trial Lawyers for Public Justice, Arthur Bryant, observed, "Deaths and serious injuries could have been prevented with these tires if manufacturers had not been able to use protective orders and court secrecy to hide the dangers." It took months for federal investigators to get access to the warranty data from

Firestone. It finally became public only after Congress demanded it at the hearings in early September 2000.¹³

Reporting Not Required. Apparently, tire makers are not legally required to share potentially damaging reports with the government as other industries must do when public safety issues arise. For example, manufacturers and hospitals are required to notify the Food and Drug Administration every time a medical device such as a pacemaker is involved in an injury or death. The NHTSA has no such clout with the tire makers. The companies are required to report on themselves only if they discover a defect. Clarence Ditlow of the Center for Auto Safety, a consumer advocacy organization, says the federal government requires manufacturers to surrender adjustment data “only in the aftermath of a tragedy.” Lawmakers have been angry about this. Transportation Secretary Rodney Slater wanted this loophole closed. He admitted the NHTSA does not have the authority to get the critical safety numbers, but it appears Congress is now getting ready to do something about this.¹⁴ The NHTSA also claims that it has not received adequate funding from Congress to do its work effectively.

THE CRISIS WOULD NOT GO AWAY

Throughout the fall of 2000 and early 2001, both Ford and Firestone scrambled to contain the crisis that would not go away. It was not clear which company was catching the greatest amount of heat. *Fortune* magazine called it Jacques Nasser’s, then Ford’s CEO, “biggest test”—a crisis that jolts customers, suppliers, and employees and sends the company’s stock reeling as it threatens the company’s good name.¹⁵ *BusinessWeek* referred to it as “a crisis of confidence” for Ford, as Nasser scrambled to contain the problem at Ford.¹⁶ Throughout most of this time, Ford was able to deflect the blame and pin most of the responsibility on the tire maker, but as investigations continued, Bridgestone/Firestone fired back. John Lampe, who was Firestone’s executive vice pres-

ident at that time, said the problem is that Ford Explorers have a tendency to roll over. He pointed out that Explorers had been involved in sixteen thousand rollovers since the model was introduced a decade earlier and that less than 10 percent of those accidents involved tread separations of Firestone tires. Critics had been concerned about the stability of the Explorer well before Firestone announced its tire recall.¹⁷

FIRESTONE’S HANDLING OF THE CRISIS

For Bridgestone/Firestone, its apparent lack of savvy in handling the tire crisis seemed to make matters worse. Bridgestone president Yoichiro Kaizaki was a star in Japan. He was credited with globalizing operations and doubling profits during an earlier period. His performance in the tire crisis left a lot to be desired. His strategy was to lie low and not make public appearances. One consultant said, “This is a huge crisis, but Bridgestone and Kaizaki are handling it terribly.” A former company executive said, “They just don’t have a clue how to handle this.” Bridgestone’s apparent strategy had been to hunker down and wait for this thing to blow over. This seems to be the normal approach used in Japan. There, few managers are comfortable dealing with the press and investors. The former company executive said, “The Japanese don’t understand the value of PR.” Masatoshi Ono, CEO of Firestone in the United States, apparently did not perform any better than Kaizaki.¹⁸

OTHER FACTORS

In late 2000, representatives from Bridgestone/Firestone went into action and engaged in a lot of finger-pointing. Much of their action was to blame Ford and other factors for many of the tire problems. Some of these “other factors” included the weight of the Ford Explorer, the SUV that had figured into so many of the reported accidents and deaths. Other factors mentioned by Firestone executives were the “uneven weight distribution” on the Explorer’s back axle. Firestone officials said

that more weight is distributed on the left side of the Explorer, making the vehicle potentially unstable and more susceptible to a serious accident when the tires fail. Related to the weight issue, Firestone claimed that Ford recommended a tire inflation level of 26 psi when Firestone was calling for an inflation level of 30 psi.¹⁹ Ford disputed that the weight of the Explorer contributed to the tire failures.²⁰

Three Other Factors. Firestone identified three other factors it said contributed to the deadly accidents. These included unspecified “manufacturing problems” at their Decatur, Illinois, plant, the design of the tire in the shoulder area, and “customer usage.” This last factor referred to the company’s belief that motorists driving their vehicles at high speeds and the great amount of use to which they put the tires were contributing factors.²¹

THE LITIGATION PACKET

By early 2001, the tread separation controversy had assumed its rightful place in the long history of product litigation. In a featured article titled “The Litigation Machine,” published in *BusinessWeek*, lawyers could read about the “Firestone Tire Tread Separation” litigation packet that could be purchased from the Association of Trial Lawyers of America (ATLA). The ATLA is the powerful Washington trade group that serves as the tort bar’s central brain trust. The litigation packet, all 689 pages of it, was distributed only to plaintiffs’ lawyers. It provided a step-by-step guide to suing Bridgestone/Firestone and Ford Motor Company. After a breezy synopsis of the tire debacle, the manual proceeded to offer its lawyer-readers everything they needed to get a lawsuit started.²²

Included in the manual were 59 complaints from previously filed tread separation cases that, with a few minor changes to reflect local laws, could be recycled to be used anywhere in the country. Also included were a list of documents to request from Firestone, a package of useful National Highway Traffic Safety Administration documents, and a directory of informative websites.²³

FIRESTONE GETS A NEW CEO

By April 2001, Firestone had a new face at the helm—John Lampe, its new CEO. The company’s reputation had been badly damaged, and the company continued to fight lawsuits, but the new CEO was determined to restore credibility to the embattled company. Over the previous nine months, Firestone had recalled 6.5 million tires from Ford Explorers after some tires shredded on the highway, leading to rollovers that the NHTSA said had killed 174 people and injured 700 more. Lampe ordered Firestone’s Decatur plant to change its manufacturing process and spent \$50 million to upgrade several different facilities.²⁴

Lampe Defends His Company. Lampe also went on the attack to defend his company against Ford Motor Company. Since the recall had begun, Ford placed all the blame for the Explorer rollovers on Firestone. Lampe had testified earlier that Ford had made its new Explorers too heavy to drive safely at the tire air pressure it recommended. Questions continued to be raised as to whether the design of the Explorer could have contributed to the crashes. According to Joan Claybrook, executive director of Public Citizen, a public advocacy group, Lampe went after Ford relentlessly. She said, “That took some guts. Very few suppliers go after the auto companies.” At that time, Ford was still buying one-third of its tires from Firestone and was its biggest customer, though business between the two companies was diminishing.²⁵

THE CORPORATE DIVORCE

Criticism and escalating mistrust of each other led to a corporate “divorce” between Firestone and Ford in May 2001. In a May 21 meeting, it was clear the two companies were continuing to point fingers at one another and blame each other for the tire separation problems. At that emotional meeting, Lampe dropped a bombshell. He severed all ties with Ford, its largest customer. He handed Ford executives a prepared letter that said, in essence, that they would no longer do business

with Ford, and then they asked to be excused from the meeting. The letter caught Ford by surprise. Jacques Nasser recalled: "I've been around for a long time, and that's the first time I've heard anyone say they didn't want to do business with the Ford Motor Company."²⁶ The next day, Ford announced that it would replace 13 million Firestone tires, at a cost of \$3 billion.

Magnitude of Divorce. To appreciate the magnitude of this corporate divorce, it should be noted that the two companies had had a 100-year relationship. It was one of the oldest partnerships in U.S. business history, initially forged through the personal friendships of Harvey S. Firestone and Henry Ford. Further, it was cemented by the marriage of their grandchildren, William Clay Ford and Martha Parke Firestone. Lampe later stated, "The decision I had to make to terminate our relationship with Ford was the most difficult, the most painful, decision I've ever made. But it was the only decision we could take." Ford's Nasser remained resolute. "This is a tire issue and only a tire issue," Nasser said before a congressional subcommittee. "We do not get any satisfaction from this dispute with Firestone. But we cannot and will not let them dictate when Ford Motor Company can and will act to protect our customer's safety."²⁷

CLOSING OF THE DECATUR PLANT

In late June 2001, Bridgestone/Firestone announced plans to close its troubled factory in Decatur, Illinois. In terms of capacity, it was the company's third-largest plant. The company decided to close the plant, as it faced almost a 50 percent plunge in sales of its flagship Firestone-brand tires. The company also hoped the closure would help the company regain its financial footing and help put the tire-recall crisis behind it. Firestone also said that the Decatur plant was operating at half its capacity and was targeted because of its age and the expected cost of modernization. The Decatur facility had been originally built as a tank factory in World War II

and was converted to tire manufacturing when the company bought it in 1963.²⁸

LAWSUITS CONTINUED

On the lawsuit front, in August 2001, Firestone settled the first trial to come out of the Firestone tire debacle. The company agreed to pay \$7.5 million to the family of a 40-year-old woman who was paralyzed and suffered brain damage in the rollover crash of a Ford Explorer. In making this settlement, the company wrapped up the first of hundreds of defective-tire lawsuits to go to trial since the recall of 6.5 million tires in August 2000. The plaintiff in this case, Dr. Joel Rodriguez, whose wife, Marisa, had suffered the injuries during a rollover crash in a Ford Explorer SUV, initially had named the Ford Motor Company as a defendant. However, Ford settled out of court before the trial for \$6 million.²⁹ Bridgestone/Firestone had blamed the accident on the Explorer, saying that design flaws made it prone to rolling over. In settling the case, Bridgestone/Firestone admitted no liability.³⁰

NASSER'S DOWNFALL

By fall 2001, Ford was continuing to flounder and the tire-SUV controversy was only part of the problem. The company's brand name had been sullied by the Firestone scandal, its vehicle quality ranking had plummeted, and dealers and employees had become fed up with Jacques Nasser. Though Nasser had great visions for the company, he and the company got ensnarled in events that brought them both down. In early November 2001, chairman William Clay Ford, Jr., great-grandson of the founder and part-time chairman for the previous three years, fired Nasser. Bill Ford himself took over as CEO. This was a turnabout for Nasser. Just 15 months earlier, he had been the auto industry's rising star. Some observers had compared him to a young Jack Welch. Some of his bold management innovations, however, did not endear him to his workers. One of his management initiatives was that 10 percent of all workers

would receive a “C” grade on their performance evaluations; that could lead to their termination. This Darwinian HR initiative resulted in employee lawsuits. The new CEO was seen to be a healer.³¹

According to Brock Yates, editor-at-large of *Car and Driver* magazine, Mr. Nasser was a hero until the Ford Explorer/Firestone rollover squabble. From that moment on, Nasser and the company began a downward spiral that resulted in his dismissal. When you added in the severed relationship with Firestone, slipped Ford quality, and the recession, Nasser was finished.³²

ANOTHER RECALL AND CLASS-ACTION STATUS

In October 2001, Firestone recalled an additional 3.5 million tires. It had fought the NHTSA over this additional recall for a year but finally capitulated and agreed not to fight the recall. These tires were the Wilderness AT tires mounted on SUVs. Most of these tires were manufactured prior to 1998 and placed as original equipment on vehicles. According to Firestone, there were only about seven hundred sixty-eight thousand of these tires still on the market.³³

In late November 2001, Ford and Firestone suffered another crushing blow when U.S. District judge Sarah Evans Barker ruled in Indianapolis that more than 500 individual lawsuits related to Explorers and Firestone and its private brand tires would be combined into a single, massive class-action lawsuit. Class-action status opens the door for millions more to join those already suing. This came as disturbing news for the automaker and tire company, both financially strapped by problems to date. According to this ruling, anyone who ever owned or leased a Ford Explorer or had Firestone-made tires during the past 12 years could qualify for reimbursement for economic losses from Ford or Bridgestone/Firestone. Both companies said they planned to appeal the decision.³⁴

By December 2001, federal highway regulators had connected 271 deaths and hundreds of additional injuries to Firestone–Explorer accidents.³⁵

EVENTS CONTINUED

In 2004, a Texas judge approved a \$149 million settlement of class-action lawsuits stemming from the huge recall.³⁶ This settlement was only for those who were not injured or suffered property damage from the tires. The unfriendly relationship between Ford and Firestone warmed somewhat in the ensuing three years. However, Firestone did not think Ford was likely to become a customer in its U.S. market again soon. John Lampe, the CEO, said he believed that eventually Firestone would return as one of Ford’s major tire suppliers at some point in time, but he wouldn’t specify when.³⁷

Who Owes What? In 2001, Ford spent nearly \$3 billion of its own money replacing almost 13 million Firestone tires that it said could not be trusted. To this day, some are saying that a reasonable argument could be made that Firestone owes that money to Ford. It has been argued that, at a minimum, Bridgestone/Firestone owes Ford \$600 million, which represents the 2.7 million Ford-replaced tires that the NHTSA formally ruled were unsafe.³⁸ John Lampe, in an interview in January 2004, said, “Ford’s decision to do their replacement program in 2001 was their decision. They did it on their own. We were not in favor of it. Everybody knows that. We took the responsibility in 2000. They took the responsibility in 2001.”³⁹

Dispute Settled. In late 2006, it was reported that Bridgestone’s financial results had only recently recovered from the losses related to the massive tire-recall scandal at its U.S. subsidiary, Bridgestone Firestone North America, six years earlier.⁴⁰ Bridgestone paid \$240 million to Ford Motor Co. in 2005 to settle its dispute in lawsuits related to the 2000–2001 recalls. The payment was intended to help cover the costs of Ford’s 2001 tire replacement program. The settlement is said to have ended the dispute between the two companies.⁴¹

A Movie on the Tragedy. It was announced that a feature film was being made showing the many sides of the Ford–Firestone tire calamity. It was reported that Michael Douglas would pro-

duce and star in the film based on Adam Penenberg's book *Tragic Indifference*.⁴² The courtroom thriller has been pitched as a David v. Goliath story of the lawsuit brought on by attorney Tab Turner against the Ford and Firestone corporations for negligence in connection with the SUV rollovers and defective tires. The story focuses on the case of Donna Bailey, who became a quadriplegic as a result of a near-fatal accident in a Ford SUV and sought only an admission of guilt and an apology from the companies.⁴³ By September 2007, the film was being promoted but had not been yet released.

Questions for Discussion

1. What are the major and minor ethical issues involved in this case?
2. Who are the stakeholders and what are their stakes? How do legitimacy, power, and urgency factor in? Do these companies care about consumers? Discuss.
3. Conduct a CSR analysis of both Firestone and Ford. How do they measure up in fulfilling their various social responsibilities?
4. Who is at fault in the tire separation controversy? Bridgestone/Firestone? Ford Motor Company? The NHSTA?
5. Do you think Firestone has an ethical responsibility to pay Ford \$3 billion (or \$600 million) for the tires it replaced on its own because the company did not think they were safe?
6. Research the current status of both Bridgestone/Firestone and Ford. What has happened since the end of the case?
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Case 31

McDonald's—The Coffee Spill Heard 'Round the World

This case is about the most famous consumer lawsuit in the world. Everyone knows about this case, and the details involved in it are presented and debated in many different venues—classrooms, websites, blogs, law schools, and business schools. Regardless, it serves as one of the best platforms in the world for discussing what companies owe their consumer stakeholders and what responsibilities consumers have for their own well-being.

STELLA LIEBECK

Stella Liebeck and her grandson, Chris Tiano, drove her son Jim to the airport 60 miles away in Albuquerque, New Mexico, on the morning of February 27, 1992. Because she had to leave home early, she and Chris missed having breakfast. Upon dropping Jim off at the airport, they proceeded to a McDonald's drive-through for breakfast. Stella, a spry, 79-year-old, retired department-store clerk, ordered a McBreakfast, and Chris parked the car so she could add cream and sugar to her coffee.¹

What occurred next was the coffee spill that has been heard 'round the world. A coffee spill, serious burns, a lawsuit, and an eventual settlement made Stella Liebeck the "poster lady" for the bitter tort reform discussions that have dominated the news for more than 15 years. To this day, the case is the subject of continuing debate.

THIRD-DEGREE BURNS

According to Liebeck's testimony, she tried to get the coffee lid off. She could not find any flat surface in the car, so she put the cup between her knees and tried to get it off that way. As she tugged at the lid, scalding coffee spilled into her lap. Chris jumped from the car and tried to help her. She pulled at her sweat suit, squirming as the 170-degree coffee burned her groin, inner thigh, and buttocks. Third-degree burns were evident as she reached an emergency room.

Hospitalization. Following the spill, Liebeck spent a week in the hospital and about three weeks at home recuperating with her daughter, Nancy Tiano. She was then hospitalized again for skin grafts. Liebeck lost 20 pounds during the ordeal and at times was practically immobilized. Another daughter, Judy Allen, recalled that her mother was in tremendous pain both after the accident and during the skin grafts.²

According to a *Newsweek* report, Liebeck wrote to McDonald's in August 1994, asking them to turn down the coffee temperature. Though she was not planning to sue, her family thought she was due about \$2,000 for out-of-pocket expenses, plus the lost wages of her daughter who stayed at home with her. The family reported that McDonald's offered her \$800.³

STELLA FILES A LAWSUIT

After this, the family went looking for a lawyer and retained Reed Morgan, a Houston attorney, who had won a \$30,000 settlement against

This case was written and updated by Archie B. Carroll, University of Georgia.

McDonald's in 1988 for a woman whose spilled coffee had caused her third-degree burns. Morgan filed a lawsuit on behalf of Liebeck, charging McDonald's with "gross negligence" for selling coffee that was "unreasonably dangerous" and "defectively manufactured." Morgan asked for no less than \$100,000 in compensatory damages, including pain and suffering, and triple that amount in punitive damages.

McDonald's Motion Rejected. McDonald's moved for summary dismissal of the case, defending the coffee's heat and blaming Liebeck for spilling it. According to the company, she was the "proximate cause" of the injury. With McDonald's motion rejected, a trial date was set for August 1994.

As the trial date approached, no out-of-court settlement occurred. Morgan, the attorney, said that at one point he offered to drop the case for \$300,000 and was willing to settle for half that amount, but McDonald's would not budge. Days before the trial, the judge ordered the two parties to attend a mediation session. The mediator, a retired judge, recommended McDonald's settle for \$225,000 using the argument that a jury would likely award that amount. Again, McDonald's resisted settlement.⁴

THE TRIAL

The trial lasted seven days, with expert witnesses dueling over technical issues, such as the temperature at which coffee causes burns. Initially, the jury was annoyed at having to hear a case about spilled coffee, but the evidence presented by the prosecution grabbed its attention. Photos of Liebeck's charred skin were introduced. A renowned burn expert testified that coffee at 170 degrees would cause second-degree burns within 3.5 seconds of hitting the skin.

The Defense Helped Liebeck. Defense witnesses inadvertently helped the prosecution. A quality-assurance supervisor at McDonald's

testified that the company did not lower its coffee heat despite 700 burn complaints over 10 years. A safety consultant argued that 700 complaints—about one in every 24 million cups sold—was basically trivial. This comment was apparently interpreted that McDonald's cared more about statistics than people. An executive for McDonald's testified that the company knew its coffee sometimes caused serious burns, but it was not planning to go beyond the tiny print warning on the cup that said, "Caution: Contents Hot!" The executive went on to say that McDonald's did not intend to change any of its coffee policies or procedures, saying, "There are more serious dangers in restaurants."

In the closing arguments, one of the defense attorneys acknowledged that the coffee was hot and that that is how customers wanted it. She went on to insist that Liebeck had only herself to blame as she was unwise to put the cup between her knees. She also noted that Liebeck failed to leap out of the bucket seat in the car after the spill, thus preventing the hot coffee from falling off her. The attorney concluded by saying that the real question in the case is how far society should go to restrict what most of us enjoy and accept.⁵

THE JURY DECIDES

The jury deliberated about four hours and reached a verdict for Liebeck. The jury decided on compensatory damages of \$200,000, which it reduced to \$160,000 after judging that 20 percent of the fault belonged to Mrs. Liebeck for spilling the coffee. The jury concluded that McDonald's had engaged in willful, reckless, malicious, or wanton conduct, which is the basis for punitive damages. The jury decided upon a figure of \$2.7 million in punitive damages.

Company Was Neglecting Customers.

One juror later said that the facts were overwhelmingly against the company and that the company just was not taking care of its customers. Another juror felt the huge punitive damages were

intended to be a stern warning for McDonald's to wake up and realize its customers were getting burned. Another juror said he began to realize that the case was really about the callous disregard for the safety of customers.

Public opinion polls after the jury verdict were squarely on the side of McDonald's. Polls showed that a large majority of Americans—including many who usually support the little guy—were outraged at the verdict.⁶

JUDGE REDUCES AWARD

The judge later slashed the jury award by more than 75 percent to \$640,000. Liebeck appealed the reduction, and McDonald's continued fighting the award as excessive. In December 1994, it was announced that McDonald's had reached an out-of-court settlement with Liebeck, but the terms of the settlement were not disclosed due to a confidentiality provision. The settlement was reached to end appeals in the case.

Debate over Temperature. Coffee temperature suddenly became a hot topic in the industry. The Specialty Coffee Association of America put coffee safety on its agenda for discussion. A spokesperson for the National Coffee Association said that McDonald's coffee conforms to industry temperature standards. A spokesman for Mr. Coffee, the coffee-machine maker, said that if customer complaints are any indication, industry settings may be too low. Some customers like it hotter. A coffee connoisseur who imported and wholesaled coffee said that 175 degrees is probably the optimum temperature for coffee because that's when aromatics are being released. McDonald's continues to say that it is serving its coffee the way customers like it. As one writer noted, the temperature of McDonald's coffee helps to explain why it sells a billion cups a year.⁷

LATER INCIDENTS

In August 2000, a Vallejo, California, woman sued McDonald's, saying she suffered second-degree

burns when a handicapped employee at a drive-through window dropped a large cup of coffee in her lap. The suit charged that the handicapped employee could not grip the cardboard tray and was instead trying to balance it on top of her hands and forearms when the accident occurred in August 1999. The victim, Karen Muth, said she wanted at least \$10,000 for her medical bills, pain and suffering, and "humiliation." But, her lawyer, Dan Ryan, told the local newspaper that she was entitled to between \$400,000 and \$500,000. Attorney Ryan went on to say, "We recognize that there's an Americans with Disabilities Act, but that doesn't give them (McDonald's) the right to sacrifice the safety of their customers." It is not known how this lawsuit was settled.

Suits Go Global. It was also announced in August 2000 that British solicitors have organized 26 spill complainants into a group suit against McDonald's over the piping hot nature of its beverages. One London lawyer said, "Hot coffee, hot tea, and hot water are at the center of this case. We are alleging they are too hot." Since that time other lawsuits have been filed around the world.

From Coffee to Pickles. In a related turn of events, a Knoxville, Tennessee, woman, Veronica Martin, filed a lawsuit in 2000 claiming that she was permanently scarred when a hot pickle from a McDonald's hamburger fell on her chin. She claimed the burn caused her physical and mental harm. Martin sued for \$110,000. Martin's husband, Darrin, also sought \$15,000 because he "has been deprived of the services and consortium of his wife." According to Veronica Martin's lawsuit, the hamburger "was in a defective condition or unreasonably dangerous to the general consumer and, in particular, to her." The lawsuit went on to say "while attempting to eat the hamburger, the pickle dropped from the hamburger onto her chin. The pickle was extremely hot and burned the chin of Veronica Martin." Martin had second-degree burns and was permanently scarred, according to the lawsuit. One report was that the McDonald's owner settled this case out of court.⁸

ISSUE WON'T GO AWAY

The Stella Awards. For more than fifteen years now, the coffee spill heard 'round the world continues to be a subject of heated debate. The coffee spill and subsequent trial, publicity, and resolution "prompted a tort reform storm that has barely abated."⁹ One school of thought held that it represents the most frivolous lawsuit of all time. In fact, a program called the "Stella Awards" was begun to recognize each year's most outrageous lawsuit. The awards were the creation of humorist Randy Cassingham, and his summaries of award-winning cases may be found at <http://www.stellaawards.com>.¹⁰ In actuality, most of the lawsuits he chronicles are far more outrageous than the coffee spill in which an elderly lady did get seriously injured. On the other hand, consumer groups are still concerned about victims of what they see as dangerous products and they continue to assail McDonald's callous unconcern for Stella Liebeck.

In the ensuing decade-and-a-half, lawsuits over spilt beverages have continued to come and go, but most of them have been resolved with less fanfare than Stella's case. As for S. Reed Morgan, the lawyer who successfully represented Stella Liebeck, he has handled only three cases involving beverages since Liebeck's suit. Morgan has turned down many plaintiffs, but said he is only interested in such cases if they involve third-degree burns.

Another Scalded-Granny Case. It was reported in summer 2004 that Morgan has a new McDonald's coffee case that resembles the Liebeck case. This case involves Maxine Villegas, a grandmother in her seventies, who was a passenger in a car stopped at a drive-through, where coffee splashed on her legs and resulted in third-degree burns. In a deposition, Villegas testified coffee spilled on her legs when her sister was passing her the cup of coffee.¹¹

Whether the Villegas case will turn out to be another Liebeck case or not remains to be seen.

Matt Fleischer-Black, writing in the *American Lawyer*, perhaps summarized its potential well:

*Villegas' complaint against McDonald's may generate nothing more than jokes for Jay Leno and David Letterman. Yet in light of the influence of the earlier suit, this scalded-granny case may keep a 90-million-cup-a-day industry on alert for another decade to come.*¹²

The outcome of the Villegas case has not yet been in the news. Lawsuits of this type are often stretched out over years or get dropped with no public announcement.

A Lawsuit in Moscow. These types of lawsuits may never end. They have even gone global. In fact, a long-running case against McDonald's in Moscow was closed in 2006 by a Moscow court after the claimant withdrew her \$34,000 lawsuit. Olga Kuznetsova filed a lawsuit against the company after hot coffee was spilled on her in a Russian McDonald's. Kuznetsova claimed that a swinging door hit her while she was walking out onto the restaurant's terrace with a full tray. She demanded 900,000 rubles (about \$34,000) in damages. McDonald's lawyers said she had nobody to blame but herself because the paper cup carried a warning that the coffee was hot, which prompted her to go to court.¹³

Questions for Discussion

1. What are the major issues in the Liebeck case and in the following incidents?
2. What are McDonald's social (economic, legal, and ethical) responsibilities toward consumers in the Liebeck case and the other cases? What are consumers' responsibilities when they buy a product such as hot coffee or hot hamburgers? How does a company give consumers what they want and yet protect them at the same time?
3. What are the arguments supporting McDonald's position in the Liebeck case? What

- are the arguments supporting Liebeck's position?
4. If you had been a juror in the Liebeck case, which position would you most likely have supported? Why? What if you had been a juror in the pickle burn case?
 5. What are the similarities and differences between the coffee burn cases and the pickle burn case? Does one represent a more serious threat to consumer harm? What should McDonald's, and other fast food restaurants, do about hot food, such as hamburgers?
 6. What is your assessment of the "Stella Awards"? Is this making light of a too-serious problem?
 7. What are the implications of these cases for future product-related lawsuits? Do we now live in a society where businesses are responsible for customers' accidents or carelessness in using products?
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Case 32

Is the Customer Always Right?

When we discuss the social contract between a business and its customers, our focus tends to be on the responsibilities of business and how well or how badly a business treats its customers. Social contracts, however, are two-way relationships in which the customer also plays an active part. In this case, we focus on how well or how badly customers treat the businesses they patronize. We will examine situations in which customers are able to determine the prices they will pay and even whether they will pay at all.

THE TERRA BITE LOUNGE

The Terra Bite Lounge has a locked box on the counter. Customers put money into the box to pay for their meals—they determine what, when, and even whether they pay. The café has no prices listed on the wall and employees do not suggest prices to customers. The employee handbooks suggest that employees respond to customer questions by saying something like, “We don’t have set prices, you can pay what you feel is right.” Employees are specifically told never to use the words *free*, *tip*, *donation*, and *contribution*.¹

An average of 200 customers frequent Terra Bite each day, paying about \$2 to \$3 per person. Although the café makes less per food items than typical cafés, they are able to break even by keeping operational costs low. They save money by being able to get by with hiring fewer staff, as well as forgoing the expense of financial transaction services.²

One of the café’s founders, Ervin Peretz, says that the café is able to help people while still turning a profit: “We’re not nearly as selfless as a soup kitchen. We’re able to operate without charity.” It certainly helps that they have customers like Tina Cooper, who says, “I feel like some people might not pay so I pay a little bit more.”³

ISSA

Issa, the Canadian singer–songwriter formerly known as Jane Siberry, uses “self-determined pricing” to sell her music. Fans of her music can download it from her website using one of four options: (1) Free (gift from artist), (2) Self-determined (pay now), (3) Self-determined (pay later, which gives downloaders a chance to hear the music and determine its worth to them), (4) Standard (going rate of \$.99).

The website includes statistics regarding the choices that people make. At this writing, 19 percent chose to make the music a gift from the artist (i.e., they paid nothing so it was free) and 18 percent paid the standard rate. Most people (57 percent) chose to pay later while only 5 percent chose self-determined pay now. This added to an average price per song of \$1.18 (higher than the \$.99 standard rate). The majority of people (80 percent) paid the suggested price: 14 percent paid more than the suggested price while only 6 percent paid less.⁴

The artist gives the following payment advice to her fans:

You decide what feels right to your gut. If you download for free, perhaps you'll buy an extra CD at an indie band's concert. Or if you don't go

This case was written by Ann K. Buchholtz, University of Georgia.

*with your gut feeling, you might sleep poorly, wake up grumpy, put your shoes on backwards and fall over. Whatever. You'll know what to do.*⁵

She goes on to say:

*I am making a choice to work this way and take full responsibility for whatever it may bring to me. You make your own decision and stand by it, too. This is not a guilt trip. Feel no pressure.*⁶

Freakonomics co-author Stephen J. Dubner opines that the posting of downloader statistics indicates Issa has a good sense of the impact of incentives. He suggests that by posting those statistics she reminds people who might want to take the music for free that other people have paid. He also notes that allowing people to opt not to pay until they hear the music takes the variable pricing method, favored by economists, and puts it in the hands of the consumer.⁷

THE BAGEL MAN

As the head of a public research group at a research institute in Washington, DC, Paul began the habit bringing bagels as a Friday treat for his employees. When employees from other departments wanted them as well, he found himself bringing in fifteen dozen bagels each week and so he put out a basket to recoup his costs. After years on the job, Paul ended up well paid but unfulfilled. So he decided to turn his hobby of bringing bagels into the office into a full-time job. A few years after leaving his job to deliver bagels for a living, Paul was delivering 700 dozen bagels a week to 140 different companies and leaving a basket to collect money. He would return before lunch to collect the leftovers and the money. Paul earned as much as he ever did as a research analyst and was much happier.⁸

Paul's economist friends thought Paul would be wasting his talent and economics training with this career move. However, the move to the bagel business created an unexpected benefit—a natural economic experiment that was featured in the

book *Freakonomics*. Paul could compare the money collected to the number of bagels taken and determine how honest his customers had been. The bagel data provided a unique opportunity to study white-collar crime. Admittedly, cheating the bagel man is on a smaller scale than most white-collar crime, but it still is exactly that. “Stiffing” the bagel man is not unlike embezzling or stealing company property. Most statistics on white-collar crime only capture the known criminals (those that get caught), but the bagel data provided information on every bagel user.⁹

After eight years, Paul had delivered 1,375,103 bagels, of which 1,255,483 were eaten. In addition, he had delivered 648,341 doughnuts, of which 608,438 were eaten. His payment rate while he still worked at the research institute, before he began the business, was 95 percent. He found that percentage was artificially high because people knew him at the research institute and his presence deterred some of the stealing. In his bagel business, he came to perceive 90 percent payment as being a high level of honesty and adjusted the price accordingly. He described averages between 80 and 90 percent as “annoying but tolerable” and he had to “grit his teeth” to continue with businesses that averaged less than 80 percent.¹⁰

Paul has observed some interesting trends. From 1992, the payment rates declined slowly but steadily until 2001 when the terrorist attacks precipitated a 2 percent increase from the 87 percent rate to which it had fallen. The rate has remained fairly steady ever since. As *Freakonomics* coauthors Dubner and Levitt point out, a 2 percent increase may not seem like much, but it means the nonpayment fell from 13 percent to 11 percent—a 15 percent decrease in nonpayment. Many of Paul's customers work in national security, so he is not certain if the change reflects an increase in patriotism or simply a general increase in empathy.¹¹

Paul went through several different containers for the cash. In the beginning he put out an open basket, but the money disappeared too often. He then tried coffee cans with a slit in top but that didn't improve matters enough. He finally settled on plywood boxes with a slit for the money in the

top – those have worked well. He loses about one of the 7,000 boxes he puts out each year. Paul is intrigued by the fact that the same people who regularly steal from him by eating more than 10 percent of his wares without paying will rarely go so far as to steal the money boxes.¹²

Paul has kept data on payment rates over the years and this experiment in human nature has yielded some interesting findings—some backed by data and some from years of observation. Office morale is a strong predictor—people who like their bosses and their work have significantly higher payment rates. In addition, smaller offices have higher payment rates. Dubner and Levitt note that this might be surprising because a larger office would have more people around the table and thus more potential witnesses to the theft. They point out, however, that this finding is consistent with the fact that rural communities have less crime than big cities. The employment rate is a factor as well. One might expect a low unemployment rate (i.e., a good economy) would lead to higher payment rates because people have more cash. The opposite was actually true. As unemployment went down, theft went up.

Paul thought that places that required security clearances would have higher payment rates, but they did not. As for industries, telecom companies have been the worst culprits, but law firms aren't much better. Weather plays an important role. On unseasonably pleasant days, payment rates are higher but unseasonably cold weather or heavy rain and wind lead to greater cheating. Holidays have a variable effect—depending on the holiday. Those that lead to higher payment rates are July 4, Labor Day, and Columbus Day. Payment rates drop in the week surrounding April 15 and they also drop for Thanksgiving and Valentine's Day. Surprisingly, the week of Christmas produces a 15 percent increase in theft—as previously mentioned, that is a 2 percent drop in payment rates.¹³

One company's office design enabled Paul to observe how position in the hierarchy might affect behavior—of course, one must be careful in drawing too many conclusions from the results at one firm. In this firm, Paul delivered bagels to three

floors where different levels of employees were on different floors. The executives were on the top floor; sales, service, and administrative employees were on the lower floors. Paul found that the executives cheated more than the lower-level managers. Paul suggests two possible explanations for this finding. Perhaps executives cheat more due to a general sense of entitlement. Alternatively, Paul wonders if cheating is how they attained their positions.

Questions for Discussion

1. Would a place like the Terra Bite Lounge succeed in your community? In what places might that business model work and in what places might it not? What payment would you give as a customer of the café? How do you feel about Tina Cooper's philosophy?
2. Would "self-determined pricing" work for all musical artists or is Issa's situation in some way different? What insights can you gain from the statistics the website presents? If you wanted to download an Issa song, what would you pay?
3. How do you handle baskets that ask for donations for coffee, bagels, and the like? What payment rate do you think your organization would have if Paul delivered his bagels there? Why? How would you interpret Paul's findings from his economic experiment? Do any of his findings surprise you?
4. Taken as a whole, how do the results of these experiments with pricing shape, predict, and/or explain how customers deal with the companies they patronize? What does it tell us about how companies deal with their customers? What general insights can you draw about people's honesty?

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The Hudson River Cleanup and GE

One of the major challenges businesses face with respect to government regulations is that compliance with existing regulations during an earlier period often does not protect them against expensive problems that occur or come to light later. The plight of General Electric (GE) with respect to its dumping of PCBs more than 30 years ago is a classic case in point.

For decades, GE had electrical-equipment-making plants along the Hudson River in New York. During the period prior to 1977, GE discharged more than 1.3 million pounds of PCBs (polychlorinated biphenyls) into a 40-mile stretch of the Hudson before the chemicals were banned in 1977. In 2001, the PCB-contaminated upper Hudson River had become the largest EPA Superfund site in the nation and was becoming the most expensive to clean up.¹ In August 2001, the Environmental Protection Agency (EPA) circulated a draft proposal informing General Electric that it would have to spend hundreds of millions of dollars to clean up the PCBs that were legally dumped over a 30-year period that ended in 1977.²

According to *BusinessWeek*, the Bush administration and the EPA, under fire for their environmental policies, ordered GE to clean up the Hudson in what has been called the biggest environmental dredging project in U.S. history. The decision would reaffirm a plan developed in the waning days of the Clinton administration. A GE representative stated that the company is “disappointed in the EPA’s decision,” which it says “will cause more harm than good.” Environmentalists, predictably, have praised the deci-

sion, and the Sierra Club executive director called the decision a “monumental step toward protecting New Yorkers from cancer-causing PCBs.”³

The cleanup plan became a heated and politically charged debate in fall 2001, as an investigative report detailed how environmentalists (the Greens) claimed that GE and the EPA used the terrorists’ attacks on the World Trade Center and Pentagon as a distraction from the priority of the planned cleanup. The Greens charged that GE and the EPA, under the leadership of EPA administrator Christine Todd Whitman, delayed and were “negotiating in the shadow of September 11.” The executive director of the Clearwater advocacy groups and spokesperson for the coalition said of the meetings between GE and EPA— “It smells really bad.”⁴

USE OF PERFORMANCE STANDARDS

The Greens charged that a modification of the cleanup plan that would favor GE was in the works. This would be the establishment of “performance standards” to measure the effectiveness of dredging to remove the PCBs. In a change from the original Clinton administration plan, the revised goal of the EPA would be to roll out the dredging project in stages with periodic testing for PCBs. EPA stated: “The performance indicators being considered will include measuring PCB levels in the soil and the water column, as well as measuring the percentage of dredged material that gets re-suspended.” The agency added: “Based on these objective scientific indicators, EPA will determine at each stage of the project whether it is scientifically justified to continue the

This case was prepared by Archie B. Carroll, University of Georgia.

cleanup. PCB levels in fish will be monitored throughout the project as well.”⁵

Would GE Be Favored? Environmentalists believed that the performance standards would be weighted in ways that would favor GE’s position and would put an early lid on the project. They communicated to EPA that they did not want any standards built into the project that would offer GE an “out.” Environmentalists who met with the EPA claimed they were talking to a brick wall—that their arguments were brushed off. One stated: “That office (EPA), with all due respect, seems to get its information from G.E. It’s a political process being handled inside the [Washington] beltway; it’s inappropriate and possibly illegal.” The Greens stated they planned to start an advertising blitz hammering on its claim that terrorism was used as a cover while EPA and GE schemed a way to dilute the plan.⁶

THE HUDSON RIVER

Close to 40 miles of the half-mile-wide Hudson River is involved in the planned cleanup. It is a pastoral and wooded stretch of the river that winds in the shadows of the Adirondacks, which serve recreational activities of numerous towns and villages. At one time, these villages were thriving examples of American industrial power. Today, most of the factories, mills, and plants are closed. Like in many other industries, jobs headed south, west, across borders, or across oceans as companies tried to extricate themselves from what they saw as devastating taxes and regulations. Though not obvious to the eye, the hidden problem of hazardous waste pollution has been a significant barrier to redevelopment of the area.⁷

SUPERFUND SITE

In 1983, the upper Hudson was named a Superfund site by the EPA. This meant that GE would be held responsible by law for cleaning up the pollution resulting from years of disposal of pollutants, regardless of whether the disposal

was legal at the time. John Elvin, an investigative reporter, claimed that the Hudson River is just one of 77 alleged sites to be in need of cleanup under the EPA’s Superfund program. Also, it is believed that there are numerous other sites in addition to the upper Hudson River where PCBs were dumped. In addition to the Hudson River area, the chemicals were used at plants throughout the New England area.⁸

PCBs

PCBs are a large family of fire-retardant chemicals that GE once used in the production of electrical products. There are more than 200 variations of the chemical and they were, for the most part, dumped legally in the years before it was determined they posed a possible cancer risk. The PCBs were oily and tarry and were disposed of as fill for roadbeds, housing developments, and other such uses. It was reported that GE often dispensed the material free to residents surrounding its factories. In various forms, the company sold or gave away what is now considered a contaminated waste product to be used as a wood preservative, fertilizer, termite inhibitor, and as a component in house paints. As for directly dumped wastes, the PCBs are now said to be leaking into groundwater from landfills that GE had put caps on.⁹

PCBs Are Dangerous. According to the EPA, PCBs have been found to cause cancer and can also harm the immune, nervous, and reproductive systems of humans, fish, and wildlife. They think the chemicals are especially risky for children.¹⁰ A critic of GE has been David Carpenter of the State University of New York’s School of Public Health. According to Carpenter, all experts except those allied with GE believe PCBs to be a “probable” cause of cancer in humans. Carpenter has lashed out at GE for “deceitful and unscientific” claims that are “preposterous.” Carpenter claims that PCBs are linked to reduced IQs in children, attention deficit disorder, suppressed immune systems, diabetes, and heart disease.¹¹

Controversy. There is controversy over whether PCBs are dangerous or not. Like the EPA, environmental groups believe they are dangerous. A handout from the Friends of a Clean Hudson coalition states strongly: “PCBs are a class of synthetic toxic chemicals universally recognized as among the world’s most potent and persistent threats to human health.” On the other hand, a former GE employee who worked intimately with PCBs for 25 to 30 years states differently. To put it in layman’s terms, he said, “You’re talking about a big, fat, slippery, stable molecule that doesn’t break down. That’s why it was used in lubrication and cooling in the manufacturing process. It’s just plain sludge, that’s all.”¹²

Another hazardous-waste-management expert was reported as saying: “I’ve been in PCBs up to my armpits. So have any number of engineers and scientists working with GE and other firms. I drank a half glass of the stuff accidentally 25 years ago. The fact is there are no reported cases of cancer traced to PCBs. This controversy is 25 percent an environmental concern and 75 percent politics in a state and towns abandoned by GE, left with no industry and a lot of trash.” In spite of his views, the expert does think that GE should clean up the “hot spots” where dumping was most severe and the rest of the river should be left to heal on its own.¹³

GE’S POSITION

GE did not accepted EPA’s cleanup plan as a done deal. The huge, wealthy company, one of the largest in the world, cranked up a barrage of TV infomercials, radio and TV ads, and initiatives by top-tier Washington lobbyists to sway the public, media, and government. The company fielded an imposing cadre of Washington lobbyists. Among these lobbyists were former senator George Mitchell, former House speaker-designate Bob Livingston, and several other prominent people.¹⁴

Jack Welch Chimes In. The retired former chief executive officer of GE, the legendary Jack Welch, was negotiating with regulators over this issue as far back as the 1970s. Welch summarized

the company’s position in a statement he made to GE stockholders while he was CEO: “We simply do not believe that there are any adverse health effects from PCBs.”¹⁵ Today, one estimate is that GE has already spent millions of dollars fighting the proposal to clean up the river. The company contends that the proposed dredging would actually be more destructive because it will stir up PCBs buried in the mud and recontaminate the river. Supporting GE’s position, Rep. John Sweeney (R-NY) said that he would continue to fight the dredging plan because it would have an adverse impact on local residents.¹⁶

One journalist estimated that GE may end up spending as much fighting the EPA plan as it would if they just went ahead with the cleanup. This raises the obvious question as to why GE would fight the plan. According to John Elvin, investigative reporter, it is because the company thinks it is a precedent-setting case that could leave the company open to a tobacco-sized settlement claim. As it turns out, this is only one of the many sites GE used legally to dispose of manufacturing by-products, and PCBs are just one of the many possibly hazardous wastes that the company had to deal with over the years. Apparently, GE used as many as 77 sites alleged to be in need of cleanup under the Superfund program.¹⁷

CITIZENS’ AND ENVIRONMENTAL GROUPS’ VIEWS

Many of the residents of the upstate area that would be most affected by a GE cleanup prefer to just leave the situation alone and let the river heal itself. A poll commissioned by GE and handled by Zogby International found that 59 percent of the residents in the region favored letting the river deal with the pollutants naturally. Another poll done by Siena College Research Institute found that 50 percent of all the residents along the entire length of the Hudson wanted the river left alone. On the other side, polls have shown that a large majority of the citizens want a cleanup.¹⁸ The

survey results seem to depend on which citizens are chosen to be polled.

Grassroots Opposition. There is even some grassroots opposition to EPA's dredging plan. An example is found in Citizen Environmentalists Against Sludge Encapsulation (CEASE) and Farmers Against Irresponsible Remediation (FAIR). CEASE proposed acts of civil disobedience to prevent the government from coming onto private property. According to one CEASE activist, "the downstate enviros are only interested in punishing GE at the expense of agriculture, recreation, and other economic interests in our community."¹⁹ FAIR, for its part, asked a federal district court in Albany, New York, for a preliminary injunction blocking EPA from issuing a final decision until it provided additional information on the impact of the dredging project. But, the U.S. District Court for the Northern District of New York ruled that it did not have jurisdiction over the case because the Superfund Amendments and Reauthorization Act of 1986 prohibits judicial review at this point in the case.²⁰

Supporters of the Cleanup. For their part, environmental groups continued to think that the cleanup is the right thing to do. Advocates of the cleanup said that the project would be a "gift from heaven" to the rustbelt towns along the Hudson River. Friends of a Clean Hudson, a coalition of 11 major environmental groups, commissioned a study in which they concluded that thousands of jobs and hundreds of millions of dollars would come into the area once the project was underway. The coalition claimed benefits that could include the creation of close to nine thousand new jobs with annual payrolls of up to \$346 million. In a reaction to this report, Rep. Maurice Hinchey (D-NY), whose district includes a downstate portion of the river, claimed that as a result of the dredging "tourism will increase, the fishing industry will be revived, thousands of jobs will be created and property values will rise."²¹

According to reporter John Elvin, there are many festering grudges still held against GE. GE

was once the centerpiece of the bustling and prosperous area. He contends that GE eventually left the region because of New York's antibusiness environment and that, in recent years, legislators have felt free to tax the company to their heart's content, but the company expressed its own right to pack up and leave. He maintains that many state and local officials, and some citizens, just wanted a last piece of GE's hide—a last chance to make GE pay.²²

Only time will tell fully what will be the ramifications to GE and the contaminated Hudson River. It is obvious from all the interests involved and opinions expressed, however, that it is less than clear what should take place in the PCB-tainted Hudson River.

PROGRESS TO DATE

Companies may resist, but government agencies do not go away. Such is the case in the continuing saga of the Hudson River cleanup. In 2001, the Bush administration ordered a full-scale dredging of a 40-mile stretch of the river. It was to be the largest environmental dredging project in history. GE has to pay the estimated \$490 million charge for the cleanup and the project is expected to take about a decade, with dredging beginning in 2005. In 2003, it was reported that the Hudson River cleanup was moving on schedule although at the time GE was withholding payments, according to environmental groups. A spokesman for Environmental Advocates, one of 13 concerned groups that formed the Friends of a Clean Hudson coalition, "contrary to dire predictions of two or three years ago, the project is on track." Critics say that GE has not been cooperative but the company denies this evaluation of their efforts. At that time, the environmental groups graded the key players in the cleanup. The U.S. Environmental Protection Agency got a "B" and GE got a "D."²³

Performance Standards Finalized. In May 2004, the EPA finally released its final quality of life performance standards for the Hudson River cleanup.²⁴ By March 2004, an environmental

progress report was released in which it was stated that more than two hundred and ninety thousand pounds of PCBs had been removed from the Hudson Falls plant site. GE installed a comprehensive network of collection and monitoring wells to capture PCBs in the bedrock and prevent them from reaching the river. Also in March 2004, the New York State Department of Environmental Conservation (DEC) had approved GE's plan to build innovative under-the-river tunnels to capture the final few ounces a day of PCBs that are thought to trickle out of the river bottom near the Hudson Falls plant.²⁵

Dredging Delayed, Backroom Deals.

According to environmental groups, GE has been dragging its feet in moving forward with the cleanup. Initially, dredging was to begin in 2005, but due to GE-requested delays the start date was pushed back to 2009. Also, the Natural Resources Defense Council (NRDC), an environmental group, claimed that in 2005 the EPA rewarded GE's foot-dragging by striking a backroom deal that required GE to commit only to completing the Phase 1 of the cleanup—just 10 percent of the total job²⁶.

Settlement Reached. On November 2, 2006, the federal district court signed off on the EPA–GE settlement. This agreement allows for the dredging of the PCB-contaminated river sediments to proceed. GE continues to challenge the EPA over important details and it continues to press a federal lawsuit challenging the EPA's authority to require GE in the future to complete Phase 2 of the cleanup. If GE gets out of the second phase, taxpayers would have to foot the bill to clean up the remaining mess, face protracted legal battles with GE to get it to complete the job, or else be forced to live with a polluted river indefinitely. Much of the upper Hudson River is already closed to fishing. South of Troy, New York, women of childbearing age and children have been advised not to eat fish at all. And, according to the NRDC, the pollution is spreading, continuing to move downriver from Albany.²⁷

Progress on the Hudson River cleanup may be monitored on the EPA's website: <http://www.epa.gov/hudson/>.

Questions for Discussion

1. What are the social and ethical issues in this case? Which are major and which are minor?
2. Who are the stakeholders and what are their stakes? Assess their legitimacy, power, and urgency.
3. Do research on PCBs. Do your findings clarify their status as being so hazardous they must be removed? Or, are they best left where they have settled?
4. Who is responsible for the contaminated Hudson River? GE? EPA? State of New York? Local citizens? What ethical principles help to answer this question?
5. Do research on the EPA Superfund. Does it appear to be fair environmental legislation? Should a company have to pay for something that was legal at the time they did it?
6. Towards the end of the case, does it appear that GE is winning in its negotiations with EPA to complete the cleanup of the Hudson River? Should issues involving human health be negotiable?
7. Do research on this case and update the case facts. Has anything changed since the facts were presented that affects its resolution?

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Case 34

Safety? What Safety?

KIRK'S FIRST YEAR

Kirk was a bright individual who was being groomed for the controller's position in a medium-sized manufacturing firm. After Kirk's first year as assistant controller, the officers of the firm started to include him in major company functions. One day, for instance, he was asked to attend the monthly financial statement summary at a prestigious consulting firm. During the meeting, Kirk was intrigued at how the financial data he had accumulated had been transformed by the consultant into revealing charts and graphs.

NEW MANUFACTURING PLANT

Kirk was generally optimistic about the session and the company's future until the consultant started talking about the new manufacturing plant the company was adding to the current location and the per-unit costs of the chemically plated products it would produce. At that time, Bob, the president, and John, the chemical engineer, started talking about waste treatment and disposal problems. John mentioned that the current waste treatment facilities could not handle the waste products of the "ultramodern" new plant in a manner that would meet the industry's fairly high standards, although the plant would still comply with federal standards.

Cost Increases. Kirk's boss, Henry, noted that the estimated per-unit costs would increase if the waste treatment facilities were upgraded according to recent industry standards. Industry

standards were presently more stringent than federal regulations, and environmentalists were pressuring strongly for stricter regulations at the federal level. Bob mentioned that since their closest competitor did not have the waste treatment facilities that already existed at their firm, he was not in favor of any more expenditures in that area. Most managers at the meeting resoundingly agreed with Bob, and the business of the meeting proceeded to other topics.

Kirk's Dilemma. Kirk did not hear a word during the rest of the meeting. He kept wondering how the company could possibly have such a casual attitude toward the environment. Yet he did not know if, how, when, or with whom he should share his opinion. Soon, he started reflecting on whether this firm was the right one for him.

Questions for Discussion

1. Who are the stakeholders in this case, and what are their stakes?
2. What social responsibility does the firm have for the environment? How would you assess the firm's CSR using the four-part CSR definition presented in Chapter 2?
3. Identify the different competing "standards" at issue in this case. Which standard seems most defensible for this company considering all factors?
4. How should Kirk reconcile his personal thinking with the thinking being presented by the firm's management?
5. What should Kirk do? Why?

This case was written by Donald E. Tidrick, University of Texas at Austin. Permission to reprint granted by Arthur Andersen & Co., SC.

Case 35

Little Enough or Too Much?

BRYAN IS HIRED

Bryan was recently hired by a large chemical company to oversee the construction of production facilities to produce a new product. Gossett Chemical Company developed a new industrial lubricant that it felt it could produce at a price close to those of its competitors. The plant to manufacture the lubricant was built on land adjacent to the East River. Gossett Chemical had already applied for and received the necessary permit to dump waste materials from the process into the river. Several other chemical plants in the near vicinity are also releasing waste materials into the river.

Bryan's Concern. Bryan is concerned because the government agency that oversees the permit process granted Gossett Chemical a permit to release more waste into the river than previously anticipated. An additional stage in the production process that would have reduced the waste and recycled some materials became unnecessary due to the regulatory agency's decision. Because the additional process would have added capital and production costs, it was not built as part of the existing plant. Yet, Gossett Chemical has always stated publicly that it would do all that it could to protect the environment from harmful materials.

THE COMPANY

The company has had mediocre performance for several quarters, and everyone is anxious to see

the new product do well. Tests have shown it to be a top-quality industrial lubricant that can now be produced at a cost significantly less than those of their competitors. Orders have been flowing in, and the plant is selling everything it can produce. Morale in the company has increased significantly because of the success of the new product. Due to the success of the new product, all employees are looking forward to sizable bonuses from the company's profit-sharing plan.

BRYAN'S DECISION

Bryan is upset that the company failed to build the additional stage on the plant and fears that the excess waste released today will cause problems for the company tomorrow. Bryan approaches Bill Gates, the plant supervisor, with his concerns. Bill replies, "It's up to the government agency to protect the river from excess waste, and the company only had to meet the agency's standards. The amount of waste being released poses no threat to the environment, according to the agency. The engineers and chemists who originally designed the production process must have been too conservative in their estimates. Even if the agency made a mistake, the additional recycling and waste reduction process can be added later when it becomes necessary."

Implications. Bill continues, "At this point, building the additional process would require costly interruptions in the production process and might cause customers to switch to our competitors. Heck, environmental groups might become suspicious if production was stopped to build in the additional process—they might see it

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as an admission of wrongdoing. No one in the company wants to attract any unwarranted attention from the environmental groups. They give us enough trouble as it is. The best thing we can do is make money while the company can and deal with issues as they come up. Don't go trying to cause trouble without any proof. The company doesn't like troublemakers, so watch your step. You're new here, and you wouldn't want to have to find a new job."

Bryan Is Unsure. Bryan is frustrated and upset. He can see all the benefits of the new product, but inside he is sure the company is making a short-sighted decision that will hurt them in the long run. The vice president of operations will tour the plant next week, and Bryan is considering approaching the officer with

his concerns. It might also be possible to contact the government agency and request that the permit be reviewed. Bryan is unsure what to do, but he feels he should do something.

Questions for Discussion

1. What are the social or ethical issues in this case?
2. Are the ethical issues in this case those of the firm or of Bryan? Discuss.
3. Assess the corporate social responsibility of the firm based on the comments of Bill Gates, the plant supervisor.
4. What ethical responsibility, if any, does Bryan have in this case? What should he do? Why?

Case 36

The Betaseron Decision (A)

The United States Food and Drug Administration's (FDA) approval of interferon beta-1b (brand name Betaseron), made it the first multiple sclerosis (MS) treatment to get FDA approval in 25 years. Betaseron was developed by Berlex Laboratories, a U.S. unit of Schering AG, the German pharmaceutical company. Berlex handled the clinical development, trials, and marketing of the drug, while Chiron Corporation, a biotechnology firm based in California, manufactured it. The groundbreaking approval of Betaseron represented not only a great opportunity for Berlex but a dilemma. Supplies were insufficient to meet initial demand, and shortages were forecast for three years. With insufficient supplies and staggering development costs, how would Berlex allocate and price the drug?

THE CHALLENGE OF MULTIPLE SCLEROSIS

MS is a disease of the central nervous system that interferes with the brain's ability to control such functions as seeing, walking, and talking. The nerve fibers in the brain and spinal cord are surrounded by myelin, a fatty substance that protects the nerve fibers in the same way that insulation protects electrical wires. When the myelin insulation becomes damaged, the ability of the central nervous

system to transmit nerve impulses to and from the brain becomes impaired. With MS, there are sclerotic (i.e., scarred or hardened) areas in multiple parts of the brain and spinal cord when the immune system mistakenly attacks the myelin sheath.

The Impact of MS. The symptoms of MS depend to some extent on the location and size of the sclerosis. Symptoms may include numbness, slurred speech, blurred vision, poor coordination, muscle weakness, bladder dysfunction, extreme fatigue, and paralysis. There is no way to know how the disease will progress for any individual, because the nature of the disease can change. Some people will have a relatively benign course of MS with only one or two mild attacks, nearly complete remission, and no permanent disability. Others will have a chronic progressive course resulting in severe disability. A third group displays the most typical pattern, which is periods of exacerbations, when the disease is active, and periods of remission, when the symptoms recede yet generally leave some damage. People with MS live with an exceptionally high degree of uncertainty, because their disease can change from one day to the next. Dramatic downturns as well as dramatic recoveries are not uncommon.

THE PROMISE OF BETASERON

Interferon beta is a naturally occurring protein that regulates the body's immune system. Betaseron is composed of interferon beta-1b that has been genetically engineered and laboratory manufactured as a recombinant product. Although other interferons (i.e., alpha and gamma) had been tested, only beta interferon had been shown,

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through large-scale trials, to affect MS. Because it is an immunoregulatory agent, Betaseron was believed to combat the immune problems that make MS worse. However, the exact way in which it works was yet to be determined.

Research. In clinical studies, Betaseron was shown to reduce the frequency and severity of exacerbations in ambulatory MS patients with a relapsing–remitting form of the disease. It did not reverse damage nor did it completely prevent exacerbations. However, Betaseron could dramatically improve the quality of life for the person with MS. For example, people taking Betaseron were shown to have fewer and shorter hospitalizations. Betaseron represented the first and only drug to have an effect on the frequency of exacerbations.

Administration. Betaseron is administered subcutaneously (under the skin) every other day by self-injection. To derive the most benefits from the therapy, it was important that the MS patient maintain a regular schedule of the injections. Some flu-like side effects, as well as swelling and irritation around the injection, had been noted. However, these side effects tended to decrease with time on treatment. In addition, one person who received Betaseron committed suicide while three others attempted it. Because MS often leads to depression, there was no way to know whether the administration of Betaseron was a factor. Last, Betaseron was not recommended for use during pregnancy.

THE BETASERON DILEMMA

FDA approval for Betaseron allowed physicians to prescribe the drug to MS patients who were ambulatory and had a relapsing–remitting course of MS. An estimated one-third of the 300,000 people with MS in the United States fell into that category, resulting in a potential client base of 100,000. The expedited FDA approval process for Betaseron took only one year instead of the customary three. As a result, Berlex was unprepared to manufacture and distribute the treatment. Chiron Corporation had been making the drug in small quantities for

experimental use and did not have the manufacturing facilities to handle the expected explosion in demand. Chiron estimated that it would have enough of the drug for about twelve thousand to twenty thousand people by the end of the year. By the end of the second year, Chiron expected to be able to provide the drug to forty thousand patients. Depending on demand, it might take about three years to provide the drug to all patients who requested it. Chiron's expanded manufacturing represented the only option for Berlex, because the process required for another company to get FDA approval to manufacture the drug would take even longer.

Pricing. In addition to availability, price was a concern, because successes must fund the failures that precede them. Betaseron represented years of expensive, risky research by highly trained scientists in modern research facilities. Furthermore, genetically engineered drugs were extremely expensive to manufacture. In the case of Betaseron, a human interferon gene is inserted into bacteria, resulting in a genetically engineered molecule. The stringent quality controls on the procedure take time and are expensive. As a result, the price of Betaseron was expected to be about \$10,000 per year for each patient.

Betaseron brought great hope to people with MS and a great quandary to Berlex. How should Berlex handle the supply limitations, the distribution, and the pricing of this drug?

Questions for Discussion

1. What are the ethical issues in this situation? Which issues must Berlex consider first when determining how to distribute Betaseron?
2. Given the shortage of the drug, how should Berlex decide who receives it and who waits? Give a specific plan.
3. How should Berlex handle the logistics of distribution?
4. How should Berlex determine the drug's relative pricing (assume the drug costs about \$12,000 per year)?
5. Who, if anyone, should be involved in the decision making?

Case 37

A Moral Dilemma: Head versus Heart

SITUATION

A 42-year-old male suddenly and unexpectedly died of a brain tumor, leaving behind a wife and small child. During a review of his employee benefits, it was noted that although he was eligible for an additional company-sponsored life insurance plan used for plant decommissioning purposes, his name was not identified on the insurance rolls.

Evaluation. It was determined that when the employee was promoted to supervisor three years before his death, his paperwork had been submitted to the corporate office for inclusion in the program. Coincidentally, the program was under review at the time, and the employee was not entered into the program due to administrative oversight.

Legal Review. A legal department review determined that the program was offered to certain supervisory employees at the discretion of the company. Therefore, there was no legal obligation to pay.

DILEMMA

The death benefit was twice the employee's salary. Because the employee was not enrolled in the life

insurance program, if the company were to pay any benefit, it would have to come from the general fund (paid from the business unit's annual operating budget).

To Pay or Not to Pay? The company could argue that it must start acting like a business and use its head, not its heart. Existing company programs adequately compensate the individual's family; no additional dollars should be paid. On the other hand, it was an administrative oversight that failed to enter the employee into the program. What would you want the company to do for your family if you were the one who suddenly died?

Questions for Discussion

1. As a manager, you are steward of the company's funds. Are you willing to forgo departmental improvements and potential salary increases to honor this claim? Remember, there is no legal obligation to pay.
2. Would you feel an ethical obligation to pay? Would you be perceived as a weak manager if you did?
3. What are the ethical issues in this case?
4. What would you do? Why?

Case 38

Wal-Mart and Its Associates: Efficient Operator or Neglectful Employer?

In the past decade, the primary criticism of Wal-Mart, one of the world's largest companies, has been its impact on communities and small merchants. Antisprawl activists and small-town merchants in particular have taken issue with the company moving into their communities.¹ In *Case 1—Wal-Mart: The Main Street Merchant of Doom*, these issues, along with Wal-Mart's international growth and impact, were presented in some detail.

In the past few years, however, other issues concerning the company have become important as well and have begun dominating the news. In particular, Wal-Mart's treatment of its employees has raised many issues in public and business discussions. Paradoxically, Wal-Mart refers to its employees as "associates," a term intended to bestow a more lofty status than the term *employees*.

Many people do view Wal-Mart as an excellent provider of jobs in communities, and in spite of criticisms that have been raised by many, people continue to seek out employment with Wal-Mart. Though it has high turnover, it is viewed by many as a stable place to work, and some individuals have sought to establish careers at the company. In 2004, Wal-Mart was named America's Most Admired Company for the second time in a row in the annual *Fortune* magazine rankings.² In spite of this, *Fortune* writer Jerry Useem asked, "Should we admire Wal-Mart?" He goes on to say: "Some say it's evil. Others insist it's a model of all that's

right with America. Who are we to believe?"³ By 2007, Wal-Mart had fallen to nineteenth in *Fortune's* "most admired" rankings, still placing it in the top 20.⁴

Employee Allegations and Issues. Many different employee-related issues with respect to Wal-Mart have been the focus of much news coverage in the past few years. The company has been accused of hiring too many part-time workers; offering jobs that are actually dead-end jobs; paying low wages and poor benefits; forcing workers to work "off the clock," that is, to work overtime without overtime pay; and taking advantage of illegal immigrants. Over the years, the company has also been accused of gender discrimination against women, who occupy most jobs at the company. Coupled with these allegations of employee mistreatment, the company, which currently is not unionized, has fought unions and unionization everywhere it locates.

LOW PAY, HARD WORK, QUESTIONABLE TREATMENT

Wal-Mart is the nation's largest employer. As such, it is not surprising that it has a large number of interactions with employees, and these interactions will be both positive and negative. Wal-Mart claims to offer "good jobs, (and) good careers," but a growing number of employees have become vocal in recent years about their working conditions at the company. As with many retailers and service industries, Wal-Mart is accused of offering low pay and few benefits. Many of these employees

This case was prepared and updated by Archie B. Carroll, University of Georgia.

have been angered by the disparity between their low wages and the company's high profits.⁵

One Person's Experience. Journalist Barbara Ehrenreich, author of the best-seller *Nickel and Dimed: On (Not) Getting By in America*,⁶ spent three weeks working at a Wal-Mart to get insights into whether many of the claims she had heard about Wal-Mart's treatment of employees were true. Ehrenreich had claimed she'd heard stories about Wal-Mart workers being locked in stores overnight and being asked to work extra hours without overtime pay. During her three weeks there, she said she saw a side of the mega-retailer that most people who shop there never get to see. She remembered workers having to crouch behind racks of clothing to chat with coworkers because her department head forbade talking among workers during work hours.⁶ Ehrenreich complained that it was undignified for women in their fifties to have to resort to such behavior on the job.

Further, she observed that many of the store's cheapest items were often unaffordable to the workers who sold them because of their low pay. She observed, "When you work for a company who you can't afford to buy their product, you're in trouble." She went on, "Here is this store that's oriented toward the lower end of the economic spectrum, but not low enough [for its own workers]." She said on one occasion she had to go to the local food bank, and she was mistaken for another Wal-Mart worker who had just been there.⁷

Of course, some people would say that there is nothing wrong with low pay and few benefits if a business can still find workers willing to work there. After all, in a free market, this is the way the economic system works. And, indeed, one reason Wal-Mart has been so efficient and has contributed to nationwide productivity increases is precisely because of its tight controls on labor costs. The McKinsey consulting group has said that Wal-Mart was responsible for roughly 25 percent of the nation's productivity gains in the 1990s. Their low prices have also contributed significantly to low inflation. Financial guru Warren Buffett has

expressed the opinion that Wal-Mart has contributed more than any other company to the economic vigor that is found in America.⁸

Working Off the Clock and without Breaks. One of the most serious allegations of unfair treatment reported by some Wal-Mart employees is that of being asked to "work off the clock." This means that employees are pressured to do overtime work for which they do not get paid. One employee reported that he was asked to work off the clock by both the store manager and the assistant manager. The allegation is that managers would wait until an employee has clocked out and then say something like, "Do me a favor. I don't have anyone coming in—could you stay here?" Before you knew it, four to five hours passed before you got away.⁹ According to Wal-Mart's 2007 *Annual Report*, the company is, indeed, the defendant in several cases containing allegations the company forced employees to work "off the clock" or failed to provide work breaks.¹⁰

In October 2006, a jury in Philadelphia ruled that Wal-Mart had to pay \$78 million to its current and former employees in Pennsylvania for not paying them when they worked off the clock or worked through rest breaks. The company argued that these charges were from years ago but that now its systems have been improved to help ensure that all associates receive their scheduled breaks. The plaintiffs accused the company of failing to pay for missed breaks from 1998 through 2006. The plaintiff's lawyers also claimed that Wal-Mart's managers pushed unpaid work because their budgets were inadequate to hire needed workers. The company was also charged for not having a good-faith reason for not paying the associates properly.¹¹

In June 2007, the New Jersey Supreme Court certified a class-action lawsuit against Wal-Mart by employees there who claimed they were denied meal and rest breaks and forced to work off the clock. It was estimated that each worker lost an average of \$500 in wages due to the company's conduct.¹² Wal-Mart is appealing all charges against it.

The Pressure Is On. The company has blamed individual store and department managers for any unpaid overtime. They claim it is against company policy to not pay for overtime. However, there is evidence that managers are under significant pressure from corporate headquarters to get more work done than can be done with the number of employees allowed. One attorney for an employee said that headquarters collects reams of data on every store and every employee and uses sales figures to determine how many hours of labor it wants to allocate to each store. Then, the store managers are required to schedule fewer hours than allotted and their store performance is closely monitored on a daily basis. The store managers, in turn, put pressure on lower managers, and employees start feeling the pressure to work hours without pay. In another case, a former Wal-Mart manager claimed that supervisors had been known to regularly delete hours from time records and even to reprimand employees who claimed overtime hours so the store could keep its labor costs under control.¹³

LABOR UNION RESISTANCE

Because of employee complaints and desires to have higher wages and more generous benefits, Wal-Mart employees have been targeted by union organizers for decades, especially recently. Wal-Mart's huge size and number of employees increasingly allows the firm to "set the standard for wages and benefits throughout the U.S. economy."¹⁴

A Typical "Associate." The experience of Jennifer McLaughlin, age 22, an employee at the Paris, Texas, Wal-Mart is typical of many of the company's employees. Jennifer lives in a modest apartment complex with her one-year-old son and drives to the store five days a week and slips on her blue vest with "How May I Help You?" inscribed on the back. She works at a frenzied pace, often feeling there aren't enough workers to do all that has to be done. She feels stressed out as she says, "They push you to the limit. They just

want to see how much they can get away with without having to hire someone else." According to McLaughlin, she has been three years with the firm, earns less than \$20,000 a year, and says, "I'm considered high paid." She continues, "The way they pay you, you cannot make it by yourself without having a second job or someone helping you, unless you've been there for 20 years or you're a manager."¹⁵ Jennifer is the type of worker the union organizers try to get to sign a card indicating their willingness to vote for a union should a representation vote be held.

Unionization Attempts. Across the country, workers in many states have tried to get unions organized, but so far they have not had very much success. According to one report, employees at more than 100 stores in 25 states, including the store in Paris, Texas, have been trying to get union representation. Wal-Mart has tried various ways to fight the union organizing efforts. The company has engaged in actions that some have judged to be in violation of federal labor laws. Wal-Mart has been held to be in violation of the law in 10 separate cases in which the National Labor Relations Board has ruled that it has engaged in illegal activities such as confiscating union literature, interrogating workers, and discharging union sympathizers.¹⁶ According to one management consultant, Wal-Mart will go to great lengths to keep unions out.

At the time of writing, there are no unions in any part of Wal-Mart. Back in 2000, the meat-cutting department at a Wal-Mart in Jacksonville, Texas, voted to join the United Food and Commercial Workers (UFCW) union, becoming the only Wal-Mart store that had successfully unionized. The company responded quickly. Within two weeks, Wal-Mart totally eliminated its meat-cutting departments throughout the company nationwide.¹⁷ The company claimed it took this action as part of a strategy to have meat cut by outside vendors and supplied differently, rather than as a decision to eliminate the union.

The UFCW is the union that has been most aggressively trying to unionize Wal-Mart across

the country. Several full-time union organizers have traveled the country, trying to convince employees to agree to a union vote in their store. The UFCW, which represents 1.4 million workers in the grocery and retail industry, has representatives in many different cities attempting to convince workers to sign a card indicating they want a union vote held at their store. According to the National Labor Relations Board, a workplace needs 30 percent of its workers to sign cards calling for a union election to have one held. Unions often try to get 50 percent of the employees to sign a card, because they want to increase their chances of winning.¹⁸

Success in Union Resistance. There are several reasons the unions have not been successful in unionizing Wal-Mart. First, many employees feel intimidated by the company and fear signing on with a union. They fear retaliation of some kind, and many of the employees cannot afford to lose their jobs. Second, Wal-Mart has mastered the art and science of fighting unionization. At one point, the company had a “union avoidance program.” In this program, the company, with its vast resources, will wear people down and even destroy their spirit.

One consultant said that each Wal-Mart manager is taught to take attempts at union organizing personally and to consider that supporting a union is like slapping the supervisor in the face.¹⁹ Wal-Mart is considered to be a very sophisticated adversary when it comes to fighting unionization. Managers are asked to call a 24-hour hotline if they ever see a hint of unionization taking place, and a labor team can be dispatched to a store under threat at a moment’s notice.²⁰ Third, many Wal-Marts are located in southern states that do not have a history and tradition of unionization.²¹

For its part, a Wal-Mart spokesman says that the company is not anti-union, it is “pro-associate.”²² According to writer Karen Olsson, “Wal-Mart has made it clear that keeping its stores union-free is as much a part of the culture as door greeters and blue aprons.”²³

USE OF ILLEGAL IMMIGRANTS

Several years ago, a series of predawn raids by federal agents were conducted in which they rounded up 250 illegal immigrants working as cleaning crews in 61 Wal-Marts across 21 states. Though not technically employees of the company, the company was accused by federal officials of knowing that its contractors were using the illegal immigrants as employees. The Immigration and Customs Enforcement program claimed it has wiretaps revealing that Wal-Mart knew contractors were using illegals in their cleaning crews.²⁴

Wal-Mart continues to fight against the charges, because it reports that the company was cooperating with the government for as long as three years in federal investigations in Chicago and Pennsylvania. Wal-Mart reports that it was led to believe that it was not a target of the investigation and that it did not sever its ties with the contractors because federal officials had asked them to leave the relationships in place during their investigations. Wal-Mart claimed that it was told it would be given a heads-up before any arrests were made in its stores, but that did not happen.²⁵

Wal-Mart claims that it did what it could to ensure that its contractors were hiring legal workers, both before and after the raid. Antidiscrimination provisions of the immigration code limit an employer’s ability to investigate an employee’s legal status, the company claimed. The company claimed that as far back as in 1996, the Immigration and Naturalization Service (INS) filed a complaint against Wal-Mart for requiring prospective hires who were not U.S. citizens to show more verification than that required by law. The company paid a \$60,000 fine and became very hesitant to ask for more assurances about the status of its contractors’ employees, the company claims.²⁶

Ending Relationships. Wal-Mart claimed it began to end its relationships with outside cleaning contractors beginning in 2002. The company concluded it could typically save money by having its own crews cleaning and polishing

the floors. By October 2003, when the raid occurred, fewer than 700 stores (18 percent) were still using contractors. This was down to half of the stores that were using outside contractors in 2000. The company said it adopted a new written contract in 2002 that included stronger contractual commitment by the outside contractors that they were complying with all federal, state, and local employment laws. The company admitted it unwittingly may have still been doing business with some of the contractors that were in violation and that their own investigations revealed that they were dealing with companies with different corporate identities and names that made it difficult to eliminate suspected violators.²⁷

SEX DISCRIMINATION

The most serious legal issues Wal-Mart continues to face are accusations of gender discrimination against women. In 2001, six women filed a gender bias lawsuit against Wal-Mart, claiming they were discriminated against. The case, *Dukes v. Wal-Mart*, started as an EEOC complaint by Betty Dukes, the lead plaintiff, who claimed she had been trying to get promoted from the cashier ranks for nine years.²⁸ In a landmark decision in June of 2004, a federal judge in San Francisco ruled that the sex discrimination lawsuit could proceed as a class-action lawsuit, affecting as many as 1.6 million current and former female employees who had worked for the company since December 26, 1998.²⁹ In February 2007, a federal appeals court upheld the 2004 decision that Wal-Mart must face the class-action bias claim. Again, Wal-Mart said it would appeal the decision. It has been said that the company stands to lose billions of dollars should it be found guilty of sex discrimination.³⁰ The lawsuit, which has been called the “largest private civil rights case ever,”³¹ has the potential to go on for years and doubtless will have significant repercussions for Wal-Mart and other companies in the retail and other industries.

The Allegations. Lawyers for the plaintiffs presented various statistical analyses supporting

their allegations of sex discrimination. They presented detailed statistical models documenting that Wal-Mart paid their full-time female workers 5–15 percent less than full-time males doing the same jobs. The lawyers also contended that the disparities between females and males increased as employees moved up in the management ranks.³² Plaintiffs also claimed that Wal-Mart’s 2001 payroll statistics, the year the lawsuit was filed, also revealed discriminatory patterns such as the following:

- Female workers in hourly jobs earned \$1,100 less than men.
- Women managers earned \$14,500 less than their male counterparts.
- 65 percent of Wal-Mart’s hourly employees were female, but two-thirds of the company’s managers were men.
- On average, it took men just 2.86 years to get promoted to assistant manager, but it took women 4.38 years, despite better performance ratings.³³

Individual cases also documented allegations of sex discrimination against the company. The case of Gretchen Adams is illustrative. Adams, the mother of four, took an hourly job at the Wal-Mart in Stillwater, Oklahoma, in 1993. Adams was quickly promoted to manager of the deli department, where she supervised 60 workers and flew around the country training hundreds of other workers. She learned that a man she had trained was now making \$3,500 more than she was, and she was told it was “a fluke.” She witnessed other men leapfrog past her, and she never landed the job of store manager she says she was promised. Adams claimed she complained and “they told me where to go.” She quit the company at the end of 2001.³⁴

Figure 1 presents a summary of the major lawsuits that are under way against the company as presented in the “Litigation” section of its 2007 *Annual Report*. Many of these lawsuits are reported over and over each year, as they extend many years before being resolved.

Figure

1

Major Lawsuits Under Way Against Wal-Mart

Wal-Mart is defendant in a number of legal proceedings. Wal-Mart has been charged with:

- Forcing employees to “work off the clock”
- Forcing workers to work while not being provided meal and rest breaks in accordance with California law
- Not using proper methodology in making payments under various associate incentive bonus plans
- Sex discrimination in *Dukes v. Wal-Mart*. The suit alleges that the company engaged in a pattern and prac-

tice of discriminating against women in promotions, pay, training, and job assignments. The suit seeks injunctive relief, compensatory damages, punitive damages, and attorney’s fees.

- Failure to hire or make transfer requests to women who were not hired or transferred into positions for which they applied. The class seeks back pay and injunctive relief.

Source: Summarized from “Litigation” section of Wal-Mart’s 2007 Annual Report, 54–55.

Other women made sworn statements that Wal-Mart had denied their requests to be placed in a management training position leading to a salaried position, denied them jobs as support managers in favor of men who had less seniority or qualifications, gave promotions to men with less experience, and were fired for not going along with alleged acts of sexual harassment.³⁵

A summary of the major allegations against Wal-Mart includes three major areas. First, women claim they have been denied equal promotions. Second, women claim they have been paid less for the same jobs, even when they have more experience. Third, women claim they are subjected to sexist actions and gender stereotyping.³⁶

Did Top Management Know? Lawyers for the plaintiffs are developing the argument that top managers at Wal-Mart knew about the sex bias that was taking place in the company. The lawyers are preparing to argue that women complained to corporate executives, including CEO Lee Scott, about pay disparities or sexism and received very little response. They are also arguing that informa-

tion was shared with board members and that outsiders complained and got little or no response from corporate offices.³⁷

The Company’s Defense. Wal-Mart has long argued that it treats its female employees fairly. The company has said that women do not apply for promotion as often as men, and this accounts for the underrepresentation of women.³⁸ The main argument by the company has been its opposition to the lawsuit being ruled a class-action lawsuit. The company argues that decisions about employees are made at the individual store level and that a class-action lawsuit is too unwieldy, because it thinks it should be able to present evidence defending itself against each individual plaintiff’s claims and that this would not be possible in a class-action trial. Wal-Mart claims that in a class-action lawsuit of this size, it means that store managers will not be given the opportunity to explain how they made individual compensation and promotion decisions.

The company has argued in its appeal of the class-action judgment that the class was certified

under laws intended to provide injunctive relief; that is, to stop a particular practice, but that the judge ruled that the class can also seek monetary damages, which the company does not think applies to the case. Part of the monetary relief could be punitive damages, but for these to apply, it has to be proven that Wal-Mart management “fostered or recklessly ignored discriminatory practices.” The judge concluded that whereas the individual decisions were made at specific store locations, there was some evidence of a corporate culture of gender stereotyping that may have affected the decisions made at the store level.³⁹ Judge Martin Jenkins was not ruling on the merits of the case but was simply saying there was some evidence of a corporate culture permeating the organization that may be related to the discrimination, and thus he allowed the case to move forward as a class action.

Lawyers who are not a part of the case have said that Wal-Mart should continue to appeal that, because employment decisions are not made centrally but at individual stores, so the class-action suit is based on an erroneous concept. The company should argue that each plaintiff would have to sue the individual store in which the alleged practice took place, and the company would then be able to defend itself against each claim.⁴⁰ Of course, in 2007 the class action held up under appeal, so the company may continue this line of argumentation in future appeals, which are certain to come.

Dragging on for Years. Based on other huge class-action discrimination lawsuits, the lawsuit against Wal-Mart for sex discrimination could drag on for years and could have ramifications for the retail industry in which the company is the dominant leader. The retail industry is ranked among the top 20 occupations for women in the United States, according to the Department of Labor, and about 42 percent of retail sales staffs are women, according to annual averages. The lawsuit, which is the largest private civil rights case ever, will surely be watched by many for years to come.⁴¹

CHANGES IN LABOR PRACTICES AT WAL-MART

Partially as a result of criticism and bad publicity Wal-Mart has been receiving in recent years, the company announced some changes that were planned to improve conditions for its workers. CEO Lee Scott outlined the changes at one of its annual shareholders’ meetings in Fayetteville, Arkansas, but it may take several years before the true impact of the changes take place and are felt throughout the company.⁴²

One change will include the creation of a compliance group to oversee workers’ pay, hours, and their breaks. The company is also testing a new program that will alert cashiers when it is time for them to take a meal break. Another change is the implementation of a new system that will require employees to sign off on any changes that are made to their time cards. The company also plans to implement software that will force managers to adhere to state employment rules regarding areas such as how late teenagers can work. While announcing these new policies, Scott mentioned several times that he was tired of the adverse publicity that the company was getting.⁴³

New Pay Scheme. One of the most sweeping changes that the company announced was a new pay scheme for its employees. Though the details and ramifications of the new pay plan have been sketchy, it was apparent they were partially in response to the bad publicity the company has gotten over its pay policies. As a part of the new pay plan, workers would be divided into pay classes with clearly defined starting and ceiling rates, and workers below a certain minimum would be given a raise. Changes would also take place in how annual pay is calculated, changing from a percentage of salary to a flat dollar amount. In addition, merit raises would be limited to about 5 percent of the store’s employees. As one writer observed, “Wal-Mart seems to be shaking up its pay structure. But like nearly everything this giant does, that’s sure to spark new firestorms.”⁴⁴

Following the annual meeting, one Wal-Mart director, John Opie, indicated that the company was very concerned about its image and that it was “working very hard” to improve it. He added, “you’ll continue to see excellent progress on it.”⁴⁵

JULIE ROEHM LAWSUIT AND COUNTER-LAWSUIT

In December 2006, Wal-Mart fired its top advertising executive, Julie Roehm, charging that she broke company rules by accepting meals and gifts, tried to steer Wal-Mart’s \$580 million account to an agency with which she had discussed taking a job, and most dramatically, had an affair with a subordinate.⁴⁶ Roehm had been with the firm for less than a year. Before the ink was dry on this story, Roehm struck back by filing a counter-lawsuit against Wal-Mart, claiming that the company had a double standard and that some of what she had been accused of doing was done by other top executives in the company.⁴⁷

Roehm claimed that several top executives, including CEO Lee Scott, had accepted gifts like concert tickets and had bought expensive products, such as a boat, at discounted prices from a supplier who does business with the company.⁴⁸ Roehm’s suit alleges breach of contract, fraud, and misrepresentation.⁴⁹ Soon afterward, Irwin Jacobs, the Minnesota businessman accused of offering the special deals to Lee Scott, filed a defamation lawsuit against Julie Roehm, claiming the charges were not true.⁵⁰ Jacobs’ attorney said, “Irwin Jacobs is an ethical, upstanding businessman who has many business constituencies, and the purpose of the lawsuit is to clear his name of these allegations that tarnish his reputation.”⁵¹

Short of a quick settlement, these cases have the potential to go on for years. The actual facts have yet to come out, so it is difficult to say what the final outcome will be.

WAL-MART’S CHARM OFFENSIVE

Wal-Mart has been battered by adverse publicity in recent years. Some of the articles aimed at the

company have included the following titles: “Attack of the Wal-Martys,”⁵² “Bruised in Bentonville,”⁵³ and “The Unending Woes of Lee Scott (CEO).”⁵⁴ Its economic woes have been chronicled as “Wal-Mart’s Midlife Crisis.”⁵⁵ But, beginning in about 2005, the company ratcheted up its charm offensive by trying to enhance its public image. CEO Lee Scott admitted the company was trying to improve its image by being more open to its critics and trying to take specific steps to improve the way the world perceives the company. He admitted that when growth was easier, they could ignore their critics, but as the share price slowed its growth, the company had to start reaching out and being more responsive to the concerns raised.⁵⁶

Specific Actions. Wal-Mart has sought to improve its image with stakeholders on four fronts. First, in the area of outreach, the company opened offices in eight major cities in an attempt to improve community relations and be responsive to local critics. Second, the company met with several activist groups seeking to improve its environmental impact. Third, the company hired Business for Social Responsibility (BSR), the nonprofit organization, to help it establish better relations with antisweatshop advocates and to strengthen its global labor monitoring program. Fourth, the company set up quick-response teams in Washington and at its Arkansas headquarters, with the help of a public relations firm, so that it could be more responsive to public criticism.⁵⁷ It appears that Wal-Mart has finally realized the legitimacy of the “stakeholder effect” as commented upon by R. Edward Freeman: “As companies grow and develop, some stakeholders become more important than others, and new stakeholders sometimes emerge.”⁵⁸

www.walmartfacts.com. Another initiative to be responsive to critics was the creation by the company of a special website. The purpose of this website was to present one place that critics could go to for information about topics upon which the company has been criticized. The walmartfacts.com

website provides updates on such topics as health care, economic opportunities, associates benefits, merchandising, employment and diversity, charitable giving, and sustainability.⁵⁹

Questions for Discussion

1. Identify and describe the major ethical issues facing Wal-Mart and the stakeholders likely to be affected.
2. Wal-Mart has been said to have excessive power in its relationship with communities. How is its manifestation of power with employees similar to or different than with communities? Which is the most serious issue? Why?
3. Are many of the allegations by employees at Wal-Mart just reflections of the changing social contract between companies and their workers? Are many of the so-called problems just the free-enterprise system at work? Discuss.
4. Regarding the various labor practices discussed in this case, do they reflect immoral or just amoral management actions?
5. Is the practice of being required to “work off the clock” an unethical practice or just “to be expected” in the modern world of work? After all, many salaried employees are expected to work “until the job is done,” no matter how many hours it takes.
6. Is it wrong for Wal-Mart to fight unionization? Sam Walton always felt the company should function as one big happy family and that unions were to be resisted. What is your evaluation of the union opposition?
7. Regarding the allegations of sex discrimination, does it sound like the company has been guilty of systemic discrimination? Do you think it is right that *Dukes v. Wal-Mart* will proceed as a class-action suit, or should Wal-Mart be permitted to defend itself against each charge at the store level?
8. If Wal-Mart can effectively argue that women are contributors to their plight by not applying

for promotions or for seeking fewer responsibilities to accommodate family priorities, should the company be held to be in violation of sex discrimination laws because the statistics reveal differences between women and men?

9. Do you think the changes in labor practices and “charm offensive” at Wal-Mart will effectively address the issues that have been raised concerning the company?
10. Conduct Web-based research on Wal-Mart and update allegations and lawsuits against the company.

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Case 39

Dead Peasant Life Insurance

Caroline Murray was mourning the death of her husband, Mike, when she received a call from the employee benefits division of his company requesting a copy of the death certificate.¹ After asking why they needed the certificate, Caroline was surprised to learn that her husband's company had purchased a life insurance policy on her husband. Especially surprising was the fact that Caroline had no record of the policy, and apparently, neither did her husband. This particular policy listed only the company as beneficiary and allowed the company to borrow against Mike's policy, write off the loan's interest on its taxes, and receive a tax-free payout upon Mike's death. Mike's position at the company was not an executive one; he was the security guard at a local manufacturing company, and his company received \$80,000, tax free, upon his death. His family received nothing. How did this happen? Through the company's purchase of a life insurance policy nicknamed "dead peasant" life insurance.

CORPORATE-OWNED LIFE INSURANCE POLICIES

The Prevalence of COLIs. Corporate-owned life insurance policies (COLI) have been around for years. They are used as funding mechanisms for protecting businesses against the loss of its "human capital." Additionally, until the 1990s, these policies provided financial gains for companies as a form of "tax arbitrage" where they could deduct the interest on leveraged insurance transactions while simultaneously avoiding tax payments on the interest credited to

the policies' cash values. In the mid-1990s, the federal government closed most of the tax loopholes and opportunity for arbitrage; however, the tax-free benefits and tax deferrals on the policies still exist as financial incentives for many companies. It is estimated that about a quarter of the *Fortune* 500 either have or had "broad-based" COLI policies covering about 5 million employees.²

The pseudonym "broad-based" refers to the policies' coverage of both executive and lower-level employees. Until the mid-1980s, most states required that an employer have an "insurable interest" in the lives of the employees that they insured, so these plans were limited to executives. As a result of federal tax law changes that limited the amount that companies might deduct per insured employee, many states relaxed the "insurable interest" requirement, and businesses began taking life insurance policies out on rank-and-file workers to retain profitability on their policies. Articles in the *Wall Street Journal* in early 2002 drew newfound attention to the large corporations who purchased a considerable number of these policies, including AT&T, Dow Chemical, Nestlé, Pitney Bowes, Procter & Gamble, Enron, and others.³ A 2002 *San Francisco Chronicle* article cited the fact that Wal-Mart took out COLI policies on more than three hundred and fifty thousand of its workers in the 1990s.⁴

The Laws Regarding COLIs. How is it that companies are able to take out life insurance on employees without their knowledge? Part of the confusion lies with the different state laws. Some state laws, like those in Texas, require that employees "consent" to having their lives insured while other states, like Georgia, do not require consent. Additionally, some employees "consent" without

This case was written by Jill A. Brown, Lehigh University.

knowing it. In one Texas lawsuit, Wal-Mart employees alleged that they consented without knowing it when they were offered a special \$5,000 death benefit when Wal-Mart launched the program from 1994–1996. Wal-Mart disputed the claim by stating that the policies were signed in Georgia with an insurance management company located in Georgia, and therefore the more lenient Georgia law applied, regardless of the consent issue.⁵ Wal-Mart ended up settling the suit after the Fifth U.S. Circuit Court of Appeals upheld a ruling that Wal-Mart lacked sufficient financial interest in the lives of its rank-and-file employees.⁶ While only five states required employee consent for COLI in 2003, many states have recently prohibited the sale and/or purchase of such policies without consent, and to anybody other than executives. However, the term “consent” is nebulous when some states consider consent granted if an employee does not object to a notice of the employer’s intent to purchase a policy.⁷

Perhaps as a result of contradictory state laws and litigation, the federal government has recently initiated “best practices” for COLI insurers, albeit under tax law. In August 2006, President Bush signed the Pension Protection Act, which among other things, amended the Internal Revenue Code 101(j) to institute a “COLI Best Practices Act” promoting consent of each insured employee and reinforcing that the policies should be sold and purchased for “highly compensated” employees. If an employer does not comply with section 101(j), all policy proceeds in excess of total premiums paid by the employer would be included in the employer’s taxable income, thereby limiting the financial benefit of the policy.

CRITICS

The COLI Debate. Critics of dead peasant insurance policies point to the disincentives for employee safety; after all, if a company is going to collect money on an employee’s death, what incentives does it really have to protect that employee? Additionally, critics point to the com-

parison to slaveholders’ policies, the loss of tax revenues, and the use of these policies to fund exorbitant executive compensation programs. Supporters of these insurance policies cite the fact that it is no different than insuring a business asset and it is perfectly legal. For years, companies have protected their interests with life insurance policies on their CEOs, top management team members, and executives whose deaths could seriously impact a company’s bottom line. Finally, many supporters point out that these insurance policies provide a nice vehicle for funding the growing costs of retiree benefits, so there is financial soundness to these policies that offer benefit to all employees of the companies.

The Current Situation. While different states continue to set the parameters for the legalities of these policies, some companies have decided to cancel these COLI policies to avoid the risk of lawsuits from family members of the deceased who say that they are the rightful owners of the policies. In January 2002, Wal-Mart canceled most of these policies after several lawsuits with similar companies resulted in stiff penalties and settlements. Wal-Mart continues to settle claims from the estates of deceased Wal-Mart employees.

In December 2006, Wal-Mart agreed to pay nearly \$5.1 million to settle a class-action lawsuit on COLI policies it took out on former employees in Oklahoma. In 2005, Camelot Music, Inc., lost its case to retain COLI policy proceeds when the Tenth Circuit Court of Appeals in Denver held that employers cannot collect the proceeds of COLI policies they write on rank-and-file employees. However, despite the risk, COLI policies still exist as an investment tool for businesses. By the beginning of 2007, COLI policies still accounted for at least 30 percent of the life insurance market, with many falling under old guidelines.⁸

In 2007, a new effort began to limit the dead peasant life insurance practice. Rep. Gene Green (D-TX) introduced HR 150 “to prevent the non-disclosure of employer-owned life insurance coverage of employees as an unfair trade practice under the Federal Trade Commission Act, and for other

purposes.” It is too early to know what will happen to this proposed legislation. At this writing, it has been referred to the House Subcommittee on Health, Employment, Labor, and Pensions. Although this legislation would not outlaw the practice, it would require that employees be informed when insurance is taken out in their names. The goal is for widows and widowers of the employees to be able to mourn the death of their loved ones without surprise calls from benefits divisions.

Questions for Discussion

1. What are the major ethical issues involved in this case? Is it ethical for an employer to benefit from the death of an employee if they took out and paid for the policy?
2. How does the idea that these policies fund executive compensation and/or retiree benefits affect your answer to #1?
3. Should Congress create more stringent guidelines beyond “best practices” for the administration and use of these types of COLI policies? Should states be pressured to conform to a “consent” policy? Should the proposed legislation be passed?
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Case 40

The Case of the Fired Waitress

Ruth Hatton, a waitress for a Red Lobster restaurant in Pleasant Hills, Pennsylvania, was fired from her job because she was accused of stealing a guest-comment card that had been deposited in the customer comment box by a disgruntled couple.¹ The couple, who happened to be black, had been served by Ms. Hatton and were unhappy with the treatment they perceived they got from her. At the time of her firing, Ms. Hatton, age 53, had been a 19-year veteran employee. She said, “It felt like a knife going through me.”

THE INCIDENT

The couple had gone to the Red Lobster restaurant for dinner. According to Hatton, the woman had requested a well-done piece of prime rib. After she was served, she complained that the meat was fatty and undercooked. Hatton then said she politely suggested to the woman that “prime rib always has fat on it.” Hatton later explained that, based on her experience with black customers in the working-class area in which the restaurant was located, the customer might have gotten prime rib confused with spare rib.

Upset Customer Leaves. Upon receiving the complaint, Hatton explained that she returned the meat to the kitchen to be cooked further. When the customer continued to be displeased, Hatton offered the couple a free dessert. The customer continued to be unhappy, doused the prime rib with steak sauce, then pushed it away from her plate. The customer then filled out a restaurant comment card, deposited it in the

customer comment box, paid her bill, and left with her husband.

Card Inadvertently Thrown Out. Ms. Hatton explained that she was very curious as to what the woman had written on the comment card, so she went to the hostess and asked for the key to the comment box. She said she then read the card and put it in her pocket with the intention of showing it to her supervisor, Diane Canant, later. Hatton said that Canant, the restaurant’s general manager, had commented earlier that the prime rib was overcooked, not undercooked. Apparently, the restaurant had had a problem that day with the cooking equipment and was serving meat that had been cooked the previous day and then was being reheated before being served. Later, Ms. Hatton said that she had forgotten about the comment card and had inadvertently thrown it out. It also came out that it is against Red Lobster’s policy to serve reheated meat, and the chain no longer serves prime rib.²

HATTON’S FIRING

Canant said that she fired Ms. Hatton after the angry customer complained to her and to her supervisor. Somehow, the customer had learned later that Ms. Hatton had removed the comment card from the box. Ms. Canant recalled, “The customer felt violated because her card was taken from the box and she felt that her complaint about the food had been ignored.” Referring to the company’s policy manual, Canant said Ms. Hatton was fired because she violated the restau-

This case was prepared by Archie B. Carroll, University of Georgia.

rant's rule forbidding the removal of company property.

Not a Big Deal. Another person to comment on the incident was the hostess, Dawn Brown, then a 17-year-old student, who had been employed by the restaurant for the summer. Dawn stated, "I didn't think it was a big deal to give her the key [to the comment box]. A lot of people would come and get the key from [me]."³

THE PEER REVIEW PROCESS

Ms. Hatton felt she had been unjustly fired for this incident. Rather than filing suit against the restaurant, however, she decided to take advantage of the store's peer review process. The parent company of Red Lobster, Darden Restaurants, had adopted a peer review program four years earlier as an alternative dispute-resolution mechanism. Many companies across the country have adopted the peer review method as an alternative to lengthy lawsuits and as a way of easing workplace tensions.

Success of Peer Review Program. Executives at Red Lobster observed that the peer review program had been "tremendously successful." It helped to protect valuable employees from unfair dismissals, and it had reduced the company's legal bills for employee disputes by \$1 million annually. Close to 100 cases had been heard through the peer review process, with only 10 resulting in lawsuits. Executives at the company also said that the process had reduced racial tensions. In some cases, the peer review panels have reversed decisions made by managers who had overreacted to complaints from minority customers and employees.⁴

HATTON'S PEER REVIEW PANEL

The peer review panel chosen to handle Ruth Hatton's case was a small group of Red Lobster employees from the surrounding area. The panel

included a general manager, an assistant manager, a hostess, a server, and a bartender, all of whom had volunteered to serve on the panel. The peer review panel members had undergone special peer review training and were being paid their regular wages and travel expenses. The peer review panel was convened about three weeks after Hatton's firing. According to Red Lobster policy, the panel was empowered to hear testimony and even to overturn management decisions and award damages.

Testimony Heard. The panel met in a conference room at a hotel near Pittsburgh and proceeded to hear testimony from Ruth Hatton, store manager Diane Canant, and hostess Dawn Brown. The three testified as to what had happened in the incident.

Through careful deliberations, the panelists tried to balance the customer's hurt feelings with what Hatton had done and why, and with the fact that a company policy may have been violated. Initially, the panel was split along job category lines, with the hourly workers supporting Ms. Hatton and the managers supporting store management. After an hour and a half of deliberations, however, everyone was finally moving in the same direction, and the panel finally came to a unanimous opinion as to what should be done.⁵

Questions for Discussion

1. What are the ethical issues in this case from an employee's point of view? From management's point of view? From a consumer's point of view?
2. Who are the stakeholders, and what are their stakes?
3. As a peer review panel member, how would you judge this case? Do you think Ms. Hatton stole company property? Do you think the discharge should be upheld?
4. Do you think the peer review method of resolving work complaints is a desirable

substitute for lawsuits? What are its strengths and weaknesses?

5. If you had been Ms. Hatton, would you be willing to turn your case over to a peer review panel like this and then be willing to live with the results?

Case Endnotes

1. Margaret A. Jacobs, "Red Lobster Tale: Peers Decide Fired Waitress's Fate," *Wall Street Journal* (January 20, 1998), B1, B4.
2. *Ibid.*
3. *Ibid.*
4. *Ibid.*
5. *Ibid.*

Case 41

Pizza Redlining: Employee Safety or Discrimination?

The issue came to a head when William Fobbs, father of three, wanted to order a pepperoni and mushroom pizza for his family one night. Much to his surprise, Domino's refused to deliver to his home. Mr. Fobbs then called Mr. Pizza Man, a local restaurant. It also refused to deliver.

Mr. Fobbs, a security guard, lives in a tough, predominantly black neighborhood near Candlestick Park in San Francisco. He was outraged and ended up feeding his kids tuna fish sandwiches that night instead of the pizza they wanted.

GRANDMOTHER GETS INVOLVED

Exasperated, Mr. Fobbs called his grandmother, Willie Kennedy, then a 72-year-old champion of minority rights who also happened to be a member of San Francisco's Board of Supervisors. Ms. Kennedy's reaction was that her grandson had experienced racism. She said, "It can only be because we are black people." Ms. Kennedy got her friends at city hall involved, and the result was that San Francisco passed the first law that makes it illegal for a pizza restaurant, or any business, to refuse to deliver to a particular neighborhood that is within its normal delivery area.

Some observers think that a law on pizza redlining is just one more example of the city's propensity for excess. Mr. Fobbs, however, takes the issue seriously. He said, "I felt like I was in Vietnam, somewhere in the far-off jungle."¹

ACLU SPEAKS OUT

Dorothy Ehrlich, executive director of the American Civil Liberties Union (ACLU) in Northern California, supports the law.² She says that it is a blow against discrimination and ought to serve as a model for other communities. Pizza-chain owners and others in the restaurant delivery business say the issue is about crime and safety, not discrimination or race. They point to the fact that several pizza deliverers have been murdered on the job in the past few years. They say that obeying this law puts their employees' safety and lives at risk. Someone pointed out that two years earlier, a Domino's pizza deliveryman was murdered in San Francisco in an area designated safe, a so-called green zone.³

OWNER DEFENDS HIMSELF

Wally Wilcox owns the Domino's restaurant that refused to deliver to Mr. Fobbs. Wilcox owns three restaurants that, like most Domino's restaurants across the country, use a computer system that categorizes neighborhoods as green, yellow, or red. Customers in "green" neighborhoods get delivery without questions. In "yellow" areas, customers must come out to the delivery car to pick up their pizzas. Customers in "red" zones do not get delivery. They are considered dangerous.

No Discrimination. Wilcox, who is white, declares that he is not racist and does not discriminate. He pointed out that the Fobbs incident was ironic because it occurred due to error. Mr. Fobbs's street had not been entered into

This case was written by Archie B. Carroll, University of Georgia.

the computer, and restaurant workers did not know his address was in their territory. Despite the mistake, Wilcox defends his restaurant's policy of not delivering to dangerous areas, like public housing projects. Wilcox pointed out that the person ordering the pizza could be a good person but that when the deliverer arrives at the address, he or she could be attacked by others in the area. Wilcox also pointed out that it was one of his drivers who was shot and killed two years earlier in San Francisco's Excelsior district, which is not far from where Mr. Fobbs lives. Wilcox said that street toughs "own the area."

THE POSITION OF HEADQUARTERS

Tom McIntyre, spokesman for Domino's Pizza, Inc., which is headquartered in Ann Arbor, Michigan, said that his company has hundreds of outlets with bulletproof glass because of the threat and the experience of being robbed. The headquarters office distributes the area classification software the restaurants use to categorize areas as green, yellow, or red. However, the categorization is up to the store owner's discretion.⁴

Other national pizza chains, like Little Caesar Enterprises, Inc., and Pizza Hut, say they have policies similar to Domino's. Pizza Hut, the nation's largest chain, says it uses local crime statistics in each delivery area to determine which areas are safe and which are off-limits.

DANGEROUS JOBS

Crime statistics support the conclusion that pizza deliverers are frequently assaulted, robbed, and sometimes killed on the job. The National Institute for Occupational Safety and Health released a study that showed that the riskiest jobs are those in which workers deal with the public, exchange money, and deliver goods and services. In San Francisco, where the Fobbs incident occurred, it had been reported that many pizza drivers, some of them minorities themselves, have been known to carry guns to protect themselves from assaults.

Law Denounced. The California Restaurant Association denounced the law in a letter to the Board of Supervisors, pointing out that the requirement violates federal occupational safety and health laws. These laws bar employers from forcing workers into hazardous situations. The association also pointed out that workers' compensation premiums may escalate due to the new law.

Defenders of the law said it lacks real authority. According to the law, violation is a civil offense that imposes no fines. However, it does make it easier for those who are snubbed to sue for damages.

THE KANSAS CITY EPISODE

A year later, an episode occurred in Kansas City, Missouri, that was related to the San Francisco case. In this case, Pizza Hut was involved. Paseo Academy in Kansas City phoned in a \$450 pizza order four days in advance. The pizza was to be for a midday party for honor-roll students. Much to the school's surprise, the Pizza Hut in the area refused to take the order, saying the area was unsafe. A local chain, Westport Pizza, was more than happy to fill the order.

A few days later, Dorothy Shepherd, principal of Paseo Academy, learned that Pizza Hut had recently won a \$170,000 contract to deliver pizzas twice a week to 21 Kansas City high schools and junior high schools, including Paseo, a \$34 million state-of-the-art school that serves a 70 percent minority student body. Shepherd was outraged. She said, "I respect their wanting to protect their drivers. But how could it be unsafe one day but safe enough for them when it came to that contract? We didn't move the school."

Pizza Hut Asserts Safety Is Issue. Rob Doughty, a spokesman at Pizza Hut's Dallas headquarters, accused school officials of "reacting to emotion" when they talked about canceling the contract with Pizza Hut. Doughty said, "The sole issue is the safety of our employees." He said that the company works out its "trade area restric-

tions” based on crime statistics. He pointed out that two Pizza Hut drivers had been killed in the preceding six weeks, both in presumably safe areas. One murder occurred in Sacramento, California, and the other in Salt Lake City, Utah.

Is a Boycott Appropriate? Doughty claimed that regularly scheduled deliveries, like those called for in the school system contract in Kansas City, can be done safely with more than one driver but that the firm does not and cannot afford to do that with spot orders in which one driver is involved, like the order at Paseo Academy. The company may not get a chance to make any deliveries to Paseo on the contract, however, because students were agitating for a Pizza Hut boycott, and the school board was tempted to spruce up menus with pizza from local firms.⁵

DOMINO’S CHANGES POLICY

Several years later, it was announced that Domino’s Pizza, Inc., would no longer limit delivery service in minority neighborhoods without hard evidence that its drivers are at risk. The company reached an agreement with the Justice Department that its managers will consult crime reports and talk to community groups and local businesses before shutting off an area. The decision came following an incident in Washington, DC, wherein several residents of a black neighborhood sued Domino’s for refusing to deliver to customers’ doors. The plaintiffs pointed out that their neighborhood actually had a lower crime rate than other areas where Domino’s not only delivers, but also actually has stores.⁶

Is Pizza a New Entitlement? Not everyone agreed with Domino’s being forced to change. Sarah McCarthy, a writer, asked: Is pizza the newest entitlement?⁷ According to McCarthy, the Justice Department bullied Domino’s into compliance even though the company could point to 24 of its drivers who had been killed on the job. Apparently, the Justice Department stated that all

people, regardless of race or creed, had a right to pizza and that Domino’s was essentially guilty of racial profiling because of its policies. In response, *Investor’s Business Daily* said, “What about the right of all people,” regardless of race or creed, “to avoid getting killed? Call us crazy, but that right would seem to trump the Justice Department’s newly pronounced right to pizza.”⁸

EPILOGUE

Incidents, debates, and differences of opinion continue between those who think pizza must be delivered to dangerous neighborhoods and some pizza companies that continue to maintain that it is an issue of employee safety and that they have a responsibility not to place their employees where they may get injured or killed.⁹ In 2006, the first labor union for pizza drivers was created—American Union of Pizza Delivery Drivers.¹⁰ The issue of driver safety is one of their concerns. Is pizza redlining discrimination or employee safety?

Questions for Discussion

1. What are the ethical issues involved in pizza deliveries to dangerous neighborhoods that are often predominantly inhabited by minorities? What tensions exist between economic and ethical issues? Whose interests are dominant—consumer stakeholders or employee stakeholders?
2. Are pizza companies genuinely protecting their employees, for which they should be applauded, or discriminating against minorities because they “redline” and are unwilling to deliver to areas they consider dangerous?
3. Should San Francisco law, which makes it illegal for a pizza restaurant or any other business to refuse to deliver to a neighborhood that is within its normal service range, be rescinded? What are the ethical as well as the legal issues?
4. Is Pizza Hut in Kansas City engaging in an unethical practice by refusing spot deliveries

- but agreeing to large-dollar contract deliveries in areas it considers dangerous to its drivers? Is its two-driver versus one-driver explanation reasonable?
5. Are customers entitled to pizza regardless of the risk that a pizza driver might face in delivery?
 6. "Domino's Delivers," *USA Today* (June 7, 2000), 14A.
 7. Sarah J. McCarthy, "Pizza, the Newest Entitlement," *WorldNet Daily* (June 24, 2000), <http://www.worldnetdaily.com>.
 8. Quoted in *ibid.*
 9. These incidents have repeated themselves in many places, including Tarpon Springs, Florida. For more information, read "Redlined Residents Say Racism Is Behind Delivery Denial," August 19, 2002, <http://www.pizza-marketplace.com/news/>; "Florida Operator Ends 7-year Redlining Policy," September 3, 2002, <http://www.pizzamarketplace.com/news/>; "Pizza Hut to Cease Redlining in Tarpon Springs on Nov. 1," October 7, 2002, <http://www.pizzamarketplace.com/news/>.
 10. "Pizza Delivery Drivers Form First Union," *USA Today* (September 22, 2006), http://www.usatoday.com/money/industries/food/2006-09-22-pizza-union_x.htm?csp=34, retrieved October 3, 2007.

Case Endnotes

1. Sewell Chan, "Pizza Redlining: Hot Issue Becomes Law in San Francisco," *Wall Street Journal* (July 10, 1996), A1.
2. American Civil Liberties Union, "With Liberty and Pizza for All," July 10, 1996, <http://archive.aclu.org/news/w071096c.html>.
3. "The Politics of Pizza Delivery," *Time* (July 22, 1996), 38.
4. Chan, A1.
5. James L. Graff, "The Perils of Pizza Hut," *Time* (January 27, 1997).

Case 42

After-Effects of After-Hours Activities: The Case of Peter Oiler

Few people question an employer's right to control an employee's behavior on the job. However, when an employer takes action based on an employee's off-duty conduct, questions of ethics arise. More than half of all states prohibit firing based on various types of after-hours conduct.¹ Federal law prohibits firing that is discriminatory. Some cases, however, fall through those cracks. If you were the judge in the Peter Oiler lawsuit, how would you rule?

Work History. By all accounts, Peter Oiler was a good worker. Hired in 1979 to drive a truck for Winn-Dixie, his responsibilities included driving a 50-foot truck, loading supplies from the company warehouse, driving them to Winn-Dixie stores throughout southeastern Louisiana, and unloading them. Oiler received above-average performance ratings and was promoted three times during his tenure at Winn-Dixie. He adhered to company policies in all ways, including his attire and his presentation.² In his private time, Oiler liked to take on the persona of "Donna" at home, donning women's clothing, accessories, makeup, wigs, and fake breasts. Though he usually stayed home, Oiler would sometimes go out as Donna with his wife and friends to restaurants, the shopping mall, or church.³

The Situation Arises. In 1999, Oiler had a meeting with his supervisor, Greg Miles. A year earlier, Oiler had been bothered by a rumor that had been circulating that Oiler was gay, and so he asked Miles to take action against it. At the

meeting, Miles asked if the rumors had subsided, and Oiler said that they had. Miles asked Oiler why the rumors bothered him, and Oiler said it was because he is transgender instead of gay. When Miles asked what transgender was, Oiler explained that it refers to people who have feelings about their gender that are sometimes inconsistent with their anatomical sex. Oiler added that he had no intention of ever changing his sex or living as a woman full-time.⁴ He was a happily married, heterosexual man, about to celebrate his 25th wedding anniversary.

Winn-Dixie Responds. Miles said he would have to check the company policy about transgender employees. On November 1, 1999, Miles informed Oiler that a supervisor had seen Oiler dressed as a woman off duty. Oiler said that he did sometimes dress as a woman but never on duty. Miles responded that Oiler's activities could harm Winn-Dixie's image, and so the company was asking him to resign. He recommended that Oiler look for another job. Oiler said he did not want another job, because he was happy at Winn-Dixie. He continued to work in his position. From November 4, 1999, to January 5, 2000, Winn-Dixie managers had five meetings with Oiler. They told him to find another job, because he was about to be terminated. They said they had no problem with his work performance, but his off-duty dressing as a woman could hurt Winn-Dixie's public image. Oiler reiterated that he would not wear women's clothing at work. At the January 5, 2000, meeting, Oiler was terminated.⁵

This case was prepared by Ann K. Buchholtz, University of Georgia.

The Aftermath. Oiler sued Winn-Dixie for gender discrimination. He argued that the company fired him because he did not fit the company's gender stereotype of a man. Ken Choe, an American Civil Liberties Union attorney who represented Oiler, said, "Everyone agrees he was not terminated for anything related to his job performance. All of the cross-dressing behavior occurred off the job." In September 2002, a federal judge in New Orleans ruled that transgender people are not a protected class, and so laws against sex discrimination do not apply to them.⁶

Although Oiler lost in court, he may have won the battle for public opinion. According to Oiler, "Quite a few people told me, 'You're not hurting anybody. You do your job extremely well. How can they do this?'" Oiler adds that Winn-Dixie's reaction has made other workers feel less secure. "The common theme (among former coworkers) was, 'If they can get away with this, what can they do to me?' It's got a lot of people saying, 'Where's the limit?'"⁷

Addendum. In 2007, Representative Barney Frank (D-MA) sponsored HR 2015, the Employment Nondiscrimination Act (ENDA). The purpose of this legislation is to prohibit employment discrimination on the basis of actual or perceived sexual orientation or gender identity.⁸ The proposed legislation does not apply to religious institutions or the armed services. It prohibits preferential treatment or quotas and allows only disparate treatment claims. At this writing, it has been referred to committee.

Questions for Discussion

1. What are the ethical issues in this case?
2. Who are the stakeholders, and how are they impacted by this situation?
3. Do you agree with the federal judge's decision? If you were the judge, what would you do?
4. A recently passed ordinance in New Orleans prohibits discrimination against off-the-job cross-dressing. However, the Winn-Dixie branch that fired Oiler is located just outside that jurisdiction. Does this affect your answer to #2?
5. For what after-hours behavior do you feel it is appropriate to terminate an employee? For what after-hours behavior is it not appropriate? Where do you draw the line, and how would you describe that line if you were developing a policy to put into an employee manual?

Case Endnotes

1. Carolyn Hirschman, "Off Duty, Out of Work," *HR Magazine* (February 2003), 50–56.
2. <http://www.aclu.org>.
3. Hirschman, 50–56.
4. <http://www.aclu.org>.
5. *Ibid.*
6. Hirschman, 52.
7. *Ibid.*, 52.
8. <http://thomas.loc.gov>.

Tattoos and Body Jewelry: Employer and Employee Rights

A CFO at a major firm recently stated: “Do whatever you want to your body, but I don’t want to be subjected to it in the workplace.” He went on to say, “It’s a distraction and it’s especially important to hide when investors visit the office.”¹

According to a 2006 study, almost half of Americans between the ages of 21 and 32 have at least one tattoo or a body piercing other than in an ear. An earlier poll found that men and women both say their tattoos make them feel sexy and rebellious, while men and women who don’t have tattoos say body art is unsightly and they think those who have them are less intelligent and less attractive.²

Though many young people are unaware of this history, tattoos were once the noticeable mark of bikers, sailors, and felons. All that seems to be changing as new demographic groups, especially young people, have begun to have tattoos and display body jewelry more than ever before.³

It’s My Body. The idea of employees displaying body art or body jewelry remains somewhat controversial, and it does raise the question of what rights employers have vis-à-vis employees. Many young people continue to argue that their bodies are their own, and they can do with them whatever they please. They argue that it is a matter of individuality, and no one has a right to restrict that. Furthermore, some say, who does it hurt? One authority argued that the issue of tattoos and body piercings reflects the tension between the individ-

ual and the institution that is inherent in the American psyche. What is at stake is a nonverbal form of self-expression.⁴

Appearance and Safety Are Factors.

Employers, on the other hand, argue that they do have the right to be protected against certain types of employee appearance, and restricting tattoos and body jewelry certainly falls into that category. Certain types of professions, such as the police and the military, have been adopting stricter policies on how much and what kinds of body art may be shown.⁵ In 2006, the U.S. Marine Corps began prohibiting sleeve tattoos that would be visible when Marines wear their exercise uniforms. Some police agencies find any visible tattoo excessive. Some agencies seem to be tightening up following a 2006 U.S. appeals court ruling that found that Hartford, Connecticut, police officers’ tattoos do not enjoy First Amendment protection and can be subject to departmental uniform rules.⁶

In traditional suit-and-tie industries, employers continue to argue that it is all a matter of professionalism, and they have a right to regulate appearance standards, especially when contact with the public is involved. According to a professor of communications, “the bottom line matters. If customers are going to be put off by tattoos, then businesses have the right to say, ‘We don’t want that here.’”⁷ In some industries, piercings raise concerns about health and safety issues. For example, many restaurants, cafes, and grocers disapprove of pierced employees handling food, which may be a risk to customers. Also, some

This case was prepared by Archie B. Carroll, University of Georgia.

manufacturing firms are concerned about jewelry getting caught in machines and equipment.

No Problem in Some Businesses. By contrast, some businesses apparently have no problem with body jewelry and tattoos and say that tolerating them helps them recruit young workers who may not feel as welcome in more conservative environments. For example, at workplaces like design firms, salons, and retailers targeting youth, the presence of body art and tattoos is not uncommon. It all depends on the industry and management's preferences.⁸

Dress and Appearance Codes. Some experts say it all comes down to the employer's dress code. Dress codes also cover appearance factors. Sometimes companies call their guidelines "Appearance Codes" so that they are interpreted to include all aspects of individual appearance.⁹ The key seems to be that the dress code can limit visible tattoos and body jewelry just so long as the company's policy is enforced consistently across all employee groups. In other words, companies do believe they have the right to restrict these items as long as they have a clearly enforced and consistently applied policy.

But What About My Rights? Many employees still maintain that they have a right to have their tattoos and body jewelry even if it means their tattoos, tongue studs, and rows of rings ringing their ears or eyebrows are visible. Some claim they have freedom of speech rights under the Constitution that gives them the right to appear as they wish. A rare employee claims his or her religion as justification for visible decorations.¹⁰ With tattoos and body jewelry becoming so common and accepted, is it ethical for an employer to control and suppress an employee's individuality and appearance in the name of profits?

Questions for Discussion

1. What are the economic, legal, and ethical issues in this case?
2. Who are the stakeholders and what are their stakes?
3. Do individual employees have the final right to their individuality? To their appearance?
4. Can employers legally restrict tattoos and body jewelry in the workplace through dress and appearance codes?
5. Could an employer refuse to hire a person who has body art or body piercings even though he or she agrees to keep them hidden?
6. Where will this issue be in 10 years?

Case Endnotes

1. Quoted in Madlen Read, "Tattoos, Piercings Slip into Dress Codes," October 18, 2006, http://www.breitbart.com/article.php?id=2006-10-18_D8KR5GDO0&show_article=1&cat=biz, retrieved September 26, 2007.
2. Michael Felton-O'Brien, "Inked at Work," July 16, 2007, <http://www.hreonline.com/HRE/story.jsp?storyId=20189555>, retrieved July 23, 2007.
3. *Ibid.*
4. *Ibid.*
5. Matt Reed, "Tattoos: Official Blots on Reputations?" *USA Today* (July 23, 2007), 3A.
6. *Ibid.*
7. Felton-O'Brien, *ibid.*
8. Madlen Read, *ibid.*
9. "But It's My Body Art, and I Like It!" <http://hr.blr.com/whitepapers.aspx?id=75704>, retrieved September 26, 2007.
10. *Ibid.*

Case 44

Is Hiring on the Basis of “Looks” Unfair or Discriminatory?

According to an attractive young woman, a student at Northwestern University, the same thing happens to her every time she goes shopping at Abercrombie & Fitch. On at least three occasions, store managers have approached her and offered her a job. This young woman, Elizabeth, measures in at five feet six inches tall and has long blond hair. She has an attractive, stylish appearance. Elizabeth looks like she belongs in an A&F catalog.¹

Does this happen to her by coincidence? Apparently not. A former assistant manager for A&F said that it has been, in fact, company policy that managers approach attractive people and ask them if they wanted a job. The store philosophy has been that if you have the best-looking college kids working for you, everyone would want to shop there.²

Nothing New? Hiring on the basis of “looks,” appearance, or physical attractiveness is nothing new. Certain industries have been doing it for years. In recent years, however, it has become part of a growing trend on the part of merchants who want to project a particular image. A&F is not the only store to engage in this practice. Retail chains, such as the Gap and Benetton, take pleasure in employing attractive people, often from different backgrounds and races. Allegations against A&F, however, have been that their classic American look is narrowly defined by such traits as blond, blue-eyed, and preppy. A&F finds these workers by recruiting on certain college campuses, sororities, and fraternities.³

This case was written by Archie B. Carroll, University of Georgia.

Provocative Strategy. According to a CBS News report, the image of A&F is “party-loving jocks and bare-naked ladies living fantasy lives.” A&F wants its sales reps to reflect what is up on its walls—cool and seductive. Elizabeth, mentioned before, says that “the skirts are getting shorter. The tops are getting smaller. That seems to be the trend and Abercrombie is going with that.”⁴ A&F once had a reputation for the clean-cut, classic look, but that is apparently gone now. In its place is a provocative new strategy targeted toward teens and twenties. Apparently, the more parents get outraged by their approach, the larger their sales. With more than 600 stores and annual sales in excess of \$1 billion, the company has become the leading teen retailer.⁵

LAWSUITS ALLEGE DISCRIMINATION

In recent years, some discrimination experts, as well as individuals who believe they have been excluded because of looks, have been raising the question of whether hiring employees on the basis of their “looks” is discrimination of some kind. In fact, a coalition of four organizations filed an employment discrimination lawsuit against A&F. The coalition filing the lawsuit included the Mexican American Legal Defense Fund, the Asian Pacific American Legal Center, the NAACP Legal Defense and Educational Fund, and the law firm of Lief Cabraser Heimann & Bernstein, LLP. The nine Hispanic and Asian plaintiffs to the lawsuit claimed that A&F discriminates against people of

color, including Latinos, Asian Americans, and African Americans, in its hiring practices, job assignments once hired, compensation, termination, and conditions of employment.⁶

Allegations. The young adults who comprised the plaintiff group have alleged that they were qualified to work at A&F but were either not hired or terminated because of their race, color, and/or national origin. The lawsuit asserted that A&F enforces a national, corporate policy of showing preference to white people for sales positions, desirable assignments, and favorable work schedules. The lawsuit details some of the practices claimed to be illegal, including recruiting, hiring, and maintaining a disproportionately white workforce, systematically discouraging minority applicants, and refusing to hire qualified minorities for positions working on the sales floor. The lawsuit alleges that when minorities are hired, they are channeled into less prominent positions—the stockroom, overnight shift positions—and out of the public eye.⁷

The “A&F Look.” The grievance goes on to claim that the company implements its discrimination in part through a detailed and meticulous “Appearance Policy” that requires all brand representatives to exhibit the “A&F Look.” The lawsuit maintains that the company rigorously maintains the “A&F Look” by vigilant scrutiny and monitoring of its stores by managers from the region, district, and national office. In addition, as part of the monitoring policy, stores have to submit a picture of their brand representatives who fit the “look” to the corporate office each quarter. Then, the corporate office selects about 15 stores’ pictures and holds them up as exemplary models and distributes them throughout their national network of stores. The pictures, it alleges, are almost invariably of white, young people.⁸

Specific Complaints. A representative for the Mexican American Legal Defense and Educational Fund said, “If you look at the material they put out, they are cultivating an all-white look.” He went on: “It is difficult to understand why, given

that their target age demographic is even more heavily minority than the rest of the population.”⁹ One recent graduate of Stanford University, a Filipino American, said he applied for a position at a store at which he previously worked but was told, “We’re sorry, but we can’t rehire you because there’s already too many Filipinos working here.”¹⁰

Second Lawsuit. A&F was then named in a second lawsuit alleging discriminatory practices. This lawsuit, which was seeking class-action status, was filed on behalf of a woman who alleged that her application was denied because she is an African American. This suit was filed by Jesse Jackson’s Rainbow/Push Coalition and three Philadelphia-area law firms.¹¹ According to AbercrombieLawsuit.com, a new consolidated class-action lawsuit was formed bringing the previous two lawsuits into one consolidated suit.¹²

THE A&F POSITION HAS SUPPORTERS

Representatives from A&F say that the company does not discriminate. A&F’s director of communications said that the company likes hiring sales assistants, who they call “brand representatives,” who look great. He said that the brand representatives are ambassadors to the brand, and the company wants them to look great, project individuality, project enthusiasm, and make the store a warm and inviting place to shop.¹³

Related Opinions. Some retailers defend the approach to hiring used by A&F insofar as it attempts to identify and use brand enhancers. For example, one senior industry analyst said, “Being able to find a brand enhancer, or what I call a walking billboard, is critical. It’s really important to create an environment that’s enticing to the community, particularly with the younger, fashionable market. A guy wants to go hang out in a store where he can see good-looking gals.”¹⁴ A New Orleans lawyer who represents many hotels and restaurants said: “Hiring someone who is attractive isn’t illegal per se. But people’s views on what’s attractive may be influenced by their race,

their religion, their age.”¹⁵ One former sales manager for L’Oréal said that she had perceived intense pressure to hire attractive saleswomen, even if they were not competent. She said that company managers tried to force her out when she ignored a directive to fire a woman that her top manager believed was not “hot” enough.¹⁶

RELEVANT LAWS AND SETTLEMENT

There are no federal laws that say you cannot discriminate on the basis of appearance. It is also acceptable for employers to have certain “grooming” (appearance) guidelines. However, it is against the law to discriminate based on a number of different personal characteristics, such as gender, race, age, color, disability, and other legally protected personal features. The debate arises when someone suspects they were discriminated against because of a “protected characteristic,” such as color, age, national origin, and so on, but the employer claims that this was not the case. Therefore, a plaintiff wishing to challenge the legality of “appearance” discrimination somehow has to link or associate appearance to discrimination on the basis of gender, race, age, disability, or some other legally protected characteristic.¹⁷

The two most likely laws someone might find relevant to “appearance” discrimination would be Title VII of the Civil Rights Act and the Americans with Disabilities Act. It should be added, however, that at least one state law (District of Columbia Human Rights Act) does make it unlawful to hire on the basis of personal appearance.¹⁸ Therefore, a careful study of federal, state, and local laws is necessary to help judge these cases.

Settlement. The class-action lawsuit described earlier was finally settled, but A&F did not admit any guilt. A federal judge in San Francisco approved the class-action settlement, and the two sides announced an agreement that calls for the company to pay \$40 million to several thousand minority and female plaintiffs. A&F also agreed to hire 25 diversity recruiters and a vice president for diversity and to pursue benchmarks so that its

hiring and promotion of minorities and women reflect its applicant pool.¹⁹ The agreement also stipulates that A&F is to increase diversity, not just in hiring and promotions, but also in its advertisements and catalogs, which have for many years highlighted models who were predominantly white and who seemed to have just stepped off the football field or out of fraternities or sororities.²⁰

Issue Never Goes Away. After considering the practices of A&F and other employers, we are left with several questions: Is it legal to make employment decisions based on “looks” or appearance? If so, under what circumstances? Is it ethical to take such actions? If so, under what circumstances? Is it unethical to deny a person a job because of his or her appearance? A&F decided to settle its case rather than to reach conclusive answers on these questions.

Questions for Discussion

1. What are the legal and ethical issues in this case?
2. What is your evaluation of the concept of the “A&F look”? Have you personally observed this concept in practice?
3. Are the employment practices of A&F discriminatory? Are they unfair? What ethical principles or precepts guide your analysis? Given that Abercrombie did not admit guilt, does the settlement bring closure to this issue of “looks” discrimination?
4. What could A&F and other retailers be doing that they are not doing now that would make its hiring practices less controversial?
5. Carefully read up on relevant laws and other cases to decide how you think a judge or jury would decide in the A&F case.

Case Endnotes

1. Steven Greenhouse, “Going for the Look, but Risking Discrimination,” *New York Times* (July 13, 2003), 10YT.

2. *Ibid.*
3. *Ibid.*
4. “The Look of Abercrombie & Fitch,” *CBSNews.com* (December 5, 2003).
5. *Ibid.*
6. “Discrimination Lawsuit Filed against Abercrombie & Fitch Co.,” *AFjustice.com*, 2003–2004.
7. *Ibid.*
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9. “Abercrombie & Fitch Faces Discrimination Lawsuit,” *USA Today* (July 14, 2004).
10. *Ibid.*
11. “Business Brief—Abercrombie & Fitch Co: Discriminatory Hiring Practices Are Alleged in a Second Lawsuit,” *Wall Street Journal* (November 20, 2003), 1.
12. *AbercrombieLawsuit.com*, January 6, 2004.
13. Greenhouse, 10YT.
14. *Ibid.*
15. *Ibid.*
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17. Gerard Panaro, “Is Hiring on the Basis of Appearance Illegal?” *BankersOnline.com* (July 8, 2004).
18. *Ibid.*
19. Steven Greenhouse, “Abercrombie & Fitch Bias Case Is Settled,” *New York Times* (November 17, 2004), <http://www.nytimes.com/2004/11/17/national/17settle.html>, retrieved October 3, 2007.
20. *Ibid.*

Case 45

When Management Crosses the Line

While working at a very popular corporate restaurant as a server, questionable practices often occur between managers and employees. It is a well-known fact that restaurants are hot beds for sexual harassment among coworkers. Sexual harassment is problematic enough among peers, but even more disturbing when the abuse comes from management. One of my managers has had a tendency to single out several female servers, including me, for his sick humor and cruelty.

On a number of occasions, he has made disparaging remarks to my friends and me. Unfortunately, he does it when no one else is within earshot. Once he told me that my only way to advance in life was to “work” my assets. He never touches us. He just makes comments that make us feel uncomfortable. Many of us are tempted to mention our grievances to him but fear retribution. Intimidation is his method of managing.

This particular manager is in charge of our schedule and has a history of firing employees for

the slightest infractions. He is not a dumb man; he knows that what he is doing is against the law, but he does it in such a way that his victims have no witnesses. My fellow coworkers and I have talked at length about what to do and feel that we have no recourse without evidence. We desire to work in an environment free of abuse, but we also need to work. Our manager knows this and uses it to his advantage.

Questions for Discussion

1. What are the legal and ethical issues raised in this case?
2. Has sexual harassment occurred in this case, or just typical, flirtatious talk among fellow workers?
3. What should people like me do in situations like this?
4. What steps should be taken to prevent problems like this in the future?

Case 46

The Case of Judy

Judy was paralyzed from the neck down. She must have help getting out of bed, getting dressed, and getting into a motorized wheelchair. Judy says that she still has the greatest ability of all: her mind, which is as sound as ever. She says if she can find a way to attend the university, she will get a degree in public administration, and she wants to have a career in that field.

JUDY COMES TO YOU

She has come to you, a vocational counselor at the state Department of Rehabilitation, as the first step in getting the funding she needs from the state in order to pursue this educational and career goal. Your responsibilities are:

- *Regarding education:* to predict the possibility and probability that an applicant will actually

complete the educational program he or she enters

- *Regarding occupation:* to predict the possibility and probability that an applicant will actually get and retain a job in the proposed field
- *Regarding funds:* to allocate scarce state funds for rehabilitation in a manner that produces the best results for persons with disabilities and for society

Questions for Discussion

1. Considering Judy's situation and your responsibilities, what will your decisions be? What are the potential ethical challenges in this situation?
2. What will you say to Judy?

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Ethics in Practice Case Matrix

This case matrix provides a listing of “Ethics in Practice” cases throughout the book and shows how they can accompany the text chapters. A given case may be appropriate for multiple chapters.

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