Society and Business Anthology

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Mesa Community College Edition

VARIOUS AUTHORS

Contents

Reading Your Anthology Textbook

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> Anthologies are the bridge we build: the most direct bridge between writer and reader, and a bridge to new concepts. In the introduction, you get the condensed version of the topic. In the ensuing essays, you get the unfiltered perspective of people who actually live the experiences they are writing about: something of a rarity in traditional academic writing.[1]

In book publishing, an anthology is a collection of literary works chosen by the compiler. It may be a collection of poems, short stories, plays, songs, or excerpts by different authors.[2]

For this textbook, your compiler is a subject matter expert and Mesa Community College faculty member, who selected chapter readings from various open educational resources (OER) to ensure alignment to your course competencies and prepare you for real-world application. As a result of this search, your textbook does not have the traditional introduction, body, conclusion, or summary which you may have become accustomed. Each chapter was selected to provide you with content knowledge and may have different authors and a different voice. Additionally, your textbook is an ebook which you can access now and after class, and from any device with an internet connection.

To prepare for reading your textbook review your Module Overview and make note of the objectives and checklist tasks so that you can focus your reading and note-taking.

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What is OER?

Wouldn't it have been nice if a resource you found and wanted to use – like an image you found through a Google search – and the creator of that image somehow said to you, "I'm free to use, no strings attached, you don't need to ask for my permission because it is already granted"?

Open Educational Resources (OER) are an answer to that need. OER is a subset of FREE and openly licensed works that are educational in nature. OER is all about SHARING.

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OER explained in less than 2 minutes

Here's a video produced in Washington state that explains the concept of OER in less than 2 minutes:

A YouTube element has been excluded from this version of the text. You can view it online here: https://open.maricopa.edu/societyandbusiness/?p=21

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[1] Girl w/Pen

[2]Wikipedia

1. Adopting a Stakeholder Orientation

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Identify key types of business-stakeholder relationships**
- **Explain why laws do not dictate every ethical responsibility a company may owe key stakeholders**
- **Discuss why stakeholders' welfare must be at the heart of ethical business decisions**

Have you ever had a stake in a decision someone else was making? Depending on your relationship with that person and your level of interest in the decision, you may have tried to ensure that the choice made was in your best interests. Understanding your somewhat analogous role as a stakeholder in businesses large and small, local and global, will help you realize the value of prioritizing stakeholders in your own professional life and business decisions.

Stakeholder Relationships

Many individuals and groups inside and outside a business have an interest in the way it brings products or services to market to turn a profit. These stakeholders include customers, clients, employees, shareholders, communities, the environment, the government, and the media (traditional and social), among others. All stakeholders should be considered essential to a business, but not all have equal priority. Different groups of stakeholders carry different weights with decision makers in companies and assert varying levels of interest and influence. As we examine their roles, consider how an organization benefits by working with its stakeholders and how it may benefit from encouraging stakeholders to work together to promote their mutual interests.

What are the roles of an organization's many stakeholders? We begin with the internal stakeholders. The board of directors—in a company large enough to have one—is responsible for defining and evaluating the ongoing mission of a business after its founding. It broadly oversees decisions about the mission and direction of the business, the products or services offered, the markets in which the business will operate, and salary and benefits for the senior officers of the organization. The board also sets goals for income and profitability. Its most important function is to select and hire the chief executive officer (CEO) or president. The CEO is usually the only employee who reports directly to the board of directors, and he or she is charged with implementing the policies the board sets and consulting with them on significant issues pertaining to the company, such as a dramatic shift in products or services offered or discussions to acquire—or be acquired by—another firm.

In turn, the CEO hires executives to lead initiatives and carry out procedures in the various functional areas of the business, such as finance, sales and marketing, public relations, manufacturing, quality control, human resources (sometimes called human capital), accounting, and legal compliance. Employees in these areas are internal stakeholders in the success of both their division and the larger corporation. Some interact with the outside environment in which the business operates and serve as contact points for external stakeholders, such as media and government, as well.

In terms of external stakeholders for a business, customers certainly are an essential group. They need to be able to trust that products and services are backed by the integrity of the company. They also provide reviews, positive or negative, and referrals. Customers' perceptions of the business matter, too. Those who learn that a business is not treating employees fairly, for instance, may reconsider their loyalty or even boycott the business to try to influence change in the organization. Stakeholder relationships, good and bad, can have compound effects, particularly when social media can spread word of unethical behavior quickly and widely.

Key external stakeholders are usually those outside of the organization who most directly influence a business's bottom line and hold power over the business. Besides customers and clients, suppliers have a great deal of influence and command a great deal of attention from businesses of all sizes. Governments hold power through regulatory bodies, from federal agencies such as the Environmental Protection Agency to the local planning and zoning boards of the communities in which businesses exist. These latter groups often exercise influence over the physical spaces where businesses work and try to grow (Figure 1.1).

Figure 1.1 *Maryland's former Lieutenant Governor, Anthony Brown, hosts a 2014 small-business stakeholder roundtable discussion. Governments consider local businesses to be stakeholders in economic decision-making. Small businesses have their own local and regional stakeholders, who are influenced by the products and services they offer and the decisions they make in building their businesses. (credit: modification of "Lt. Governor Host MBE_Small Business Stakeholders Roundtable Discussion" by "Maryland GovPics"/Flickr, CC BY 2.0)*

Businesses are responsible to their stakeholders. Every purchase of a product or a service carries with it a sort of promise. Buyers promise that their money or credit is good, and businesses promise a level of quality that will deliver what is advertised. The relationship can quickly get more complex, though. Stakeholders also may demand that the businesses they patronize give back to the local community or protect the global environment while developing their products or providing services. Employees may demand a certain level of remuneration for their work. Governments demand that companies comply with laws, and buyers in business-to-business exchanges (B2B, in business jargon) demand not only high-quality products and services but on-time delivery and responsive maintenance and service should something go wrong. Meeting core obligations to stakeholders is primarily about delivering good products and services, but it is also about communicating and preparing for potential problems, whether from within the company or from external circumstances like a natural disaster.

Ethical Responsibilities Often Extend Beyond Legal Requirements

We have seen that stakeholders include the people and entities invested in and influential in the success of an organization. It is also true that stakeholders can have multiple, and simultaneous, roles. For example, an employee can also be a customer and a stockholder.

Any transaction between a stakeholder and a business organization may appear finite. For instance, after you purchase something from a store you leave and go home. But your relationship with the store probably continues. You might want to repurchase the item or ask a question about a warranty. The store may have collected future marketing data about you and your purchases through its customer loyalty program or your use of a credit card.

Samsung, based in South Korea, is a large, multinational corporation that makes a variety of products, including household appliances such as washers and dryers. When Samsung's washers developed a problem with the spin cycle in 2017, the company warned customers that the machines could become unbalanced and tip over, and that children should be kept away. The problem persisted, however, and Samsung's responsibility and legal exposure increased. The eventual fix was to offer all owners of the particular washer model a full refund even if the customer did not have a complaint, and to offer free pick up of the machine as well. The recall covered almost three million washers, which ranged in price from $450 to $1500. By choosing to spend billions to rectify the problem, Samsung limited its legal exposure to potential lawsuits, settlement of which would likely have far exceeded the refunds it paid. This example demonstrates the weight of the implicit social contract between a company and its stakeholders and the potential impact on the bottom line if that contract is broken.

When a product does not live up to its maker's claims for whatever reason, the manufacturer needs to correct the problem to retain or regain customers' trust. Without this trust, the interdependence between the company and its stakeholders can fail. By choosing to recognize and repay its customer stakeholders, Samsung acted at an **ethical maximum**, taking the strongest possible action to behave ethically in a given situation. An **ethical minimum**, or the least a company might do that complies with the law, would have been to offer the warning and nothing more. This may have been a defensible position in court, but the warning might not have reached all purchasers of the defective machine and many children could have been hurt.

Each case of a faulty product or poorly delivered service is different. If laws reach above a minimum standard, they can grow cumbersome and impede business growth. If businesses adhere only to laws and ethical minimums, however, they can develop poor reputations and people can be harmed. The ethically minimal course of action is not illegal or necessarily unethical, but the company choosing it will have failed to recognize the value of its customers.

CASES FROM THE REAL WORLD

Amazon Sets a Demanding Pace on the Job

In a visit to an Amazon distribution center, a group of business students and their professors met with the general manager.[3] After taking them on an extensive tour of the five-acre facility, the general manager commented on the slowness of the visitors' walking pace. He described the Amazon Pace, a fast, aggressive walk, and confirmed that the average employee walks eight or nine miles during a shift. These employees are called "pickers," and their task is to fill an order and deliver it to the processing and packing center as quickly as possible. The design of the center is a trade secret that results in a random distribution of products. Therefore, the picker has to cover a number of directions and distances while filling an order. Those who cannot keep up the pace are usually let go, just as would be those who steal.

Critical Thinking

- **Does the requirement to walk an average of eight or nine miles at a fast pace every day strike you as a reasonable expectation for employees at Amazon, or any other workplace? Why or why not? Should a company that wants to impose this requirement tell job applicants beforehand?**
- **Is it ethical for customers to patronize a company that imposes this kind of requirement on its employees? And if not, what other choices do customers have and what can they do about it?**
- **The center's general manager may have been exaggerating about the Amazon Pace to impress upon his visitors how quickly and nimbly pickers**

fill customer orders for the company. If not, however, is such a pace sustainable without the risk of physiological and psychological stress?

The law only partly captures the ethical obligations firms owe their stakeholders. One way many companies go beyond the legally required minimum as employers is to offer lavish **amenities**—that is, resources made available to employees in addition to wages, salary, and other standard benefits. They include such offerings as on-site exercise rooms and other services, company discounts, complimentary or subsidized snacks or meals, and the opportunity to buy stock in the company at a discounted price. Astute business leaders see the increased costs of amenities as an investment in retaining employees as long-term stakeholders. Stakeholder loyalty within and outside the firm is essential in sustaining any business venture, no matter how small or large.

WHAT WOULD YOU DO?

The Social Responsibility of Business

There are two opposing views about how businesses, and large publicly held corporations in particular, should approach ethics and social responsibility. One view holds that businesses should behave ethically within the marketplace but concern themselves only with serving shareholders and other investors. This view places economic considerations above all others. The other view is that stakeholders are not the means to the end (profit) but are ends in and of themselves as human beings (see our earlier discussion of deontological ethics in Ethics from Antiquity to the Present). Thus, the social responsibility of business view is that being responsible to customers, employees, and a host of other stakeholders should be not only a corporate concern but central to a business's mission. In essence, this view places a premium on the careful consideration of stakeholders. Consider what approach you might take if you were the CEO of a multinational corporation.

Critical Thinking

- **Would your business be driven primarily by a particular social mission or simply by economics?**
- **How do you think stakeholder relationships would influence your approach to business? Why?**

LINK TO LEARNING

Read a detailed consideration of the social responsibility of business in the form of polite but fiercely oppositional correspondence between economist Milton Friedman and John Mackey, founder and CEO of Whole Foods to learn more.

One challenge for any organization's managers is that not all stakeholders agree on where the company should strive to land when it chooses between ethical minimums and maximums. Take stockholders, for example. Logically, most stockholders are interested in maximizing the return on their investment in the firm, which earns profit for them in the form of dividends. Lynn Stout, late Professor of Law at Cornell Law School, described the role of shareholders in this way:

"Shareholders as a class want companies to be able to treat their stakeholders well, because this encourages employee and customer loyalty . . . Yet individual shareholders can profit from pushing boards to exploit committed stakeholders—say, by threatening to outsource jobs unless employees agree to lower wages, or refusing to support products customers have come to rely on unless they buy expensive new products as well. In the long run, such corporate opportunism makes it difficult for companies to attract employee and customer loyalty in the first place."[1]

Essential to Stout's point is that shareholders do not necessarily behave as a class. Some will want to maximize their investment even at a cost to other stakeholders. Some may want to extend beyond the legal minimum and seek a long-term perspective on profit maximization, demanding better treatment of stakeholders to maximize future potential value and to do more good than harm.

In the long run, stakeholder welfare must be kept at the heart of each company's business operations for these significant, twin reasons: It is the right thing to do and it is good for business. Still, if managers need additional incentive to act on the basis of policies that benefit stakeholders, it is useful to recall that stakeholders who believe their interests have been ignored will readily make their displeasure known, both to company management and to the much wider community of social media.

2. Weighing Stakeholder Claims

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Explain why stakeholders' claims vary in importance**
- **Categorize stakeholders to better understand their claims**

As we saw earlier in this chapter and in Why Ethics Matter, the law only partially captures the ethical obligations firms owe their stakeholders. A particular **stakeholder claim**, that is, any given stakeholder's interest in a business decision, may therefore challenge the ethical stance even of an organization that complies with the law. For example, some community members may oppose the opening of a "big box" chain store that threatens the livelihoods of small-business owners in the area, while shareholders, creditors, employees, and consumers within the nearby neighborhoods support it as an additional opportunity for profit and quality goods at competitive prices. Conflicts like this illustrate how complicated prioritizing stakeholder claims can be, particularly when there are ethical pros and cons on both sides. A big box store may offer a wider selection of goods at lower prices, for example, and create jobs for teens and part-time workers.

A related theme to recall is that even though all stakeholder claims are important for a company to acknowledge, not all claims are of equal importance. Most business leaders appreciate that a company's key stakeholders are essential to its efficient operation and growth, and that its overall mission, goals, and limited resources will force its managers to make choices by prioritizing stakeholders' needs. In this section, we look at ethical ways in which business managers can begin to make those decisions.

The Ethical Basis of Stakeholders' Claims

Stakeholder claims vary in their significance for a firm. According to Donaldson and Preston,[1] there are three theoretical approaches to considering stakeholder claims: a descriptive approach, an instrumental approach, and a normative approach. The descriptive approach sees the company as composed of various stakeholder groups, each with its own interests. These interests impinge on the company to a greater or lesser degree; thus, the main point of the descriptive approach is to develop the most accurate model and act on it in ways that weigh and balance these interests as fairly as possible. The instrumental approach connects stakeholder management and financial outcomes, proposing that appropriate management of stakeholder interests is important and useful because it contributes to a positive bottom line.

The normative approach considers stakeholders as ends in themselves rather than simply as means to achieve better financial results. According to Donaldson and Preston, in the normative approach "the interests of all stakeholders are of intrinsic value. That is, each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group, such as the share-owners."[2] This approach is the one that most appropriately represents ethical stakeholder theory, according to Donaldson and Preston, and it places an objective consideration of all stakeholders' interests ahead of fiscal considerations alone.

We can also view these three approaches to stakeholders as occupying levels of increasing comprehensiveness. At the lowest level is the descriptive approach, which merely sets the stage for consideration of stakeholder claims and concerns. The instrumental aspect combines a consideration for profit along with other stakeholder concerns and attempts to balance these interests with particular attention to the way the company and its shareholders might be affected. The normative approach takes the most comprehensive view of the organization and its stakeholders, putting the focus squarely on stakeholders. Although Donaldson and Preston stress that the descriptive and instrumental approaches are integral to stakeholder theory, they contend that the fundamental basis of stakeholder theory is normative.[3]

Of course, these are theoretical approaches, and the extent to which any of them is implemented in a given company will vary. But unfortunately, the decision to disconnect from stakeholders is both real and expensive for a corporation. A 2005 survey of customers of 362 companies is demonstrative: "Only 8% of customers described their experience as 'superior.' However, 80% of the companies surveyed believe that the experience they have been providing is indeed superior."[4] Another study found significant links between levels of customer satisfaction and a firm's performance, including rates of retention, overall revenue, and stock price.[5] Enlightened companies spend time and resources testing their stakeholders' concerns and eliciting their feedback while there is time to incorporate it into management decisions.

LINK TO LEARNING

This article discusses a recent video showing United Airlines removing ticketed, seated passengers from a plane to make room for four of its employees who needed to fly to another airport igniting debate over company policies and how they are implemented. This related article about the United Airlines overbooking situation provides some more information.

Upon being asked to deplane and take a later flight, should a customer who has booked the fare for the earlier flight have the right to refuse? Which stakeholder(s) do you think United valued more in this incident? Why?

Airlines overbook to ensure that despite any no-shows or cancellations, any given flight will have as many occupied seats as possible, because an unoccupied seat represents lost revenue. In terms of valuing stakeholders, does this strategy make sense to you? Why or why not?

A classic example of negative consumer reaction is the response that met Ford Motor Company's 1958 introduction of the Edsel (Figure 2.1). Ford had done extensive research to create a luxury family sedan aimed at an upper-income segment of the market then dominated by Buick, Oldsmobile, and Chrysler. However, the market did not identify Ford products with high status, and the Edsel did not last three years in the marketplace. Ford failed to serve the investors, suppliers, and employees who depended on the company for their livelihoods. Of course, the corporation survived that failure, perhaps because it learned the lessons of stakeholder management the hard way.

Figure 2.1 *This Edsel Pacer was manufactured in 1958, the first year of production of the ill-fated Ford model, which ceased production in November 1959. (credit: modification of "Edsel Pacer 2-door Hardtop 1958 front" by "Redsimon"/Wikimedia Commons, CC BY 2.5)*

Entertainers too (as well as their clubs, venues, and studios) are sensitive to the views of their stakeholders—that is, fans and the consuming public as a whole. Scarlett Johansson recently signed on to play the role of Dante "Tex" Gill in a biographical film (or "biopic"). Gill had been identified as female at birth but spent much of his professional career self-identifying as male. When the casting was announced in July 2018, it provoked a controversy among transgender rights groups, and within a few days, Johansson announced she had withdrawn from the role.[6] “In light of recent ethical questions raised surrounding my casting as Dante Tex Gill, I have decided to respectfully withdraw my participation in the project. . . . While I would have loved the opportunity to bring Dante’s story and transition to life, I understand why many feel he should be portrayed by a transgender person, and I am thankful that this casting debate, albeit controversial, has sparked a larger conversation about diversity and representation in film,” she said.[7]

Defining Stakeholder Categories

To better understand stakeholder theory and, ultimately, manage stakeholder claims and expectations, it may be helpful to take a closer look at categories of stakeholders. One way to categorize stakeholders is by defining their impact. For example, regulatory stakeholders including stockholders, legislatures, government regulators, and boards of directors are enabling stakeholders because they permit the firm to function. Normative stakeholders such as competitors and peers influence the norms or informal rules of the industry; functional stakeholders are those who influence inputs, such as suppliers, employees, and unions, and those influencing outputs such as customers, distributors, and retailers. Finally, diffused stakeholders include other organizations such as nongovernmental organizations (NGOs), voters, and mass media organizations with less direct relationships but potential for meaningful impacts on firms (Figure 2.2).[8]

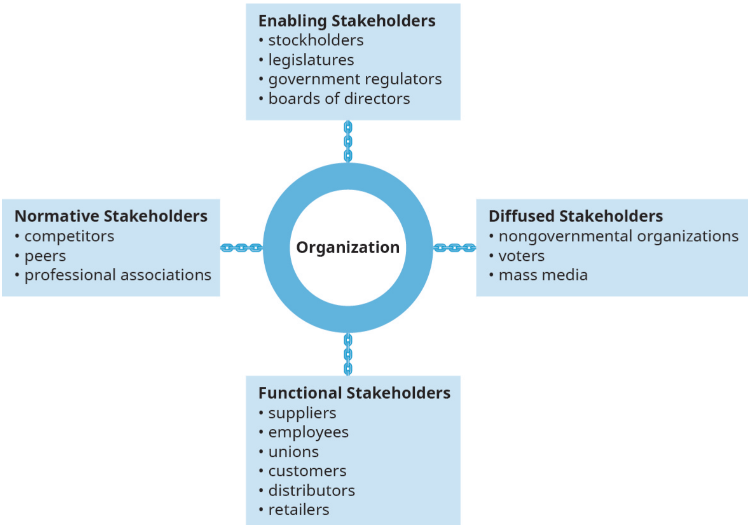

Figure 2.2 *Grouping stakeholders into meaningful categories according to relationship types allows an organization to prioritize stakeholders' claims. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)*

As the Figure 2.2 shows, enabling and functional stakeholders are those active in design, production, and marketing. They provide input for the products or services the organization distributes in the form of output. Companies should identify all the stakeholders shown in the figure and consider how they are linked to the firm. Although the diffused linkage stakeholders will vary according to place and time, the enabling, functional, and normative linkage stakeholders are constant, because they are integral to the operation of the firm. Stakeholders, in turn, can exert some control and authority by serving on the board of directors, by exercising their power as purchasers, by being elected to public office, or by joining employees' unions.

In many cases, if one stakeholder effects a change in the firm, other stakeholders will be affected. For example, if an NGO raises concerns about unequal pay of laborers on a rubber plantation that provides raw materials for gasket makers, the supplier may be forced to equalize pay, incurring additional expense. The supplier has taken the ethical action, but ultimately the cost is likely passed through the supply chain to the end user, the retail purchaser at the local car dealer. The supplier could also have absorbed the additional cost, diminishing the bottom line and reducing returns for stockholders, who may withdraw their investment from the company. Although this model of stakeholder relationships is complex, it is useful in understanding the impact of each individual group on the organization as a whole.

James E. Grunig, now professor emeritus at University of Maryland, and Todd Hunt, who together developed the organizational linkage model in Figure 2.2, looked at these relationships through the lens of four "publics" or cohorts: the nonpublic, the latent, the aware, and the active. These publics are distinguished by their degree of awareness of a problem and ability to do something about it. In the nonpublic cohort, no problem is recognized or exists. For the latent public, a problem is there but the public does not recognize it. The aware public recognizes that a problem exists. The active public is aware of the problem and organizes to respond to it. These categories help the organization design its message about a problem and decide how to communicate. Herein lies the ethical significance. If an organization is aware of a problem and the public is not, the organization has an opportunity to communicate and guide the public in recognizing and dealing with it, as the example of Johnson & Johnson's Tylenol product in the following box illustrates.

CASES FROM THE REAL WORLD

The Chicago Tylenol Murders

In the fall of 1982, Johnson & Johnson faced a public relations nightmare when customers in Cook County, Illinois, began dying—eventually, a total of seven people died—after taking over-the-counter, Tylenol-branded acetaminophen capsules. Analysis showed the presence of potassium cyanide, a fatal poison in no way connected with the production of the pill. Johnson & Johnson voluntarily removed all Tylenol products from the U.S. marketplace and offered to pay full retail price for any pills returned to the company. This represented about thirty million bottles of capsules worth more than $100 million. (Significantly, too, Johnson & Johnson decided on this wide-ranging action despite the fact that it and law enforcement realized the cyanide poisoning was limited to Cook County, Illinois.)

Because Tylenol was a flagship product bringing in significant revenue, this was an extreme action but one based on the company's ethics, rooted in its corporate credo. Investigation showed that someone had tinkered with the bottles and injected cyanide into the product in stores. Although no one was ever apprehended, the entire drug industry responded, following Johnson & Johnson's lead, by introducing tamper-proof containers that warned consumers not to use the product if the packaging appeared in any way compromised.

The strong ethical stance taken by Johnson & Johnson executives resulted in immediate action that reassured the public. When the company eventually returned Tylenol to the market, it introduced it first to clinics, hospitals, and physicians' offices, promoting medicine's professional trust in the product. The strategy was successful. Before the poisonings, Tylenol had 37 percent of the market of over-the-counter analgesics. That plunged to 7 percent in fall 1982 but was resurrected to 30 percent by fall 1983.

Critical Thinking

- **In its corporate credo, Johnson & Johnson identifies multiple stakeholders: users of its products (output), employees (input), employees' families (diffused linkage), and the government (enabling linkage). Applying Grunig and Hunt's theory, do you believe Johnson & Johnson acted as an enlightened company that includes and communicates with a variety of publics?**
- **U.S. business leaders are often accused of acting on a short-term obsession with profitability at the expense of the long-term interests of their corporation. Which aspects of the Tylenol crisis demonstrate a short-term perspective? Which show the value of a longer-term perspective?**

LINK TO LEARNING

With the adoption of its credo, Johnson & Johnson became one of the first corporations to create something like a mission statement. Read the Johnson & Johnson credo to learn more.

On the other hand, a company might try to manage a problem by covering it up or denying it. For example, Volkswagen had data that showed its diesel engine's emissions exceeded U.S. pollution standards. Rather than redesign the engine, Volkswagen engineers installed a unit in each car to interpret the emissions as if they met Environmental Protection Agency standards. When the fraud was discovered, Volkswagen was required to buy back millions of cars. As of September 2017, the company had incurred fines and expenses in excess of $30 billion, and some employees had gone to jail. Such damage is bad enough, but loss of reputation and the trust of consumers and stockholders has hurt the company's value and share price.[9] Volkswagen's management of stakeholder relationships was poor and extremely expensive. Once-loyal stakeholders became part of an aware and active public—a group of people united by a common problem and organized for satisfaction, sometimes demanding compensation.[10]

A challenge for business leaders is to assign appropriate weights to stakeholder claims on their companies in an ethical manner. This task is even more difficult because a claim is not necessarily a formal process. "Essentially, stakeholders 'want something' from an organization. Some want . . . to influence what the organization does

. . . and others are, or potentially could be, concerned with the way they are affected by the organization."[11]

If a stakeholder has its own identity or voice, or if members of a stakeholder group are many, the claim can be clear and direct, such as in the case of a union negotiating for better pay and benefits, or a community trying to lure a corporation to open operations there. Think of the enormous effort communities around the world make to try to get the Olympics or World Cup organizers to bring the competition to their locale. In spite of significant investment and debt, these communities see a real advantage to their local economy.

Many stakeholder claims are indirect, or "voiceless," due perhaps to their representing relatively few individuals relative to the size and power of the organization and the time required to evoke a response from a large, bureaucratic company. If you have ever had a problem with a cable television or satellite company, you can immediately understand this stakeholder relationship, because it is so difficult to find someone with enough authority to make a decision on behalf of the company. Some companies count on individuals' growing frustrated and giving up on the claim. An indirect stakeholder claim might also be one that affects future generations, such as concerns about air and water pollution. For example, University of Southern California law professor Christopher D. Stone introduced in 1972 what was then a radical concept for the law in the United States, that the environment itself is entitled to legal standing in the courts. If this were so, then the environment might also be eligible for certain protections under the law. Appearing at the dawn of increasing social awareness of ecologic concerns, Stone's influential law review article "Should Trees Have Standing?" gave many environmentalists a new legal philosophy to harness in defense of the natural world.[12]

LINK TO LEARNING

Try playing a game of stakeholder identification, mapping, and analysis, such as this one from the "Gamestorming" website to learn more.

3. Corporate Social Responsibility

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Define corporate social responsibility and the triple bottom line approach**
- **Compare the sincere application of CSR and its use as merely a public relations tool**
- **Explain why CSR ultimately benefits both companies and their stakeholders**

Thus far, we have discussed stakeholders mostly as individuals and groups outside the organization. This section focuses on the business firm as a stakeholder in its environment and examines the concept of a corporation as a socially responsible entity conscious of the influence it has on society. That is, we look at the role companies, and large corporations in particular, play as active stakeholders in communities. Corporations, by their sheer size, affect their local, regional, national, and global communities. Creating a positive impact in these communities may mean providing jobs, strengthening economies, or driving innovation. Negative impacts may include doing damage to the environment, forcing the exit of smaller competitors, and offering poor customer service, to name a few. This section examines the concept of a corporation as a socially responsible entity conscious of the influence it has on society.

Corporate Social Responsibility Defined

In recent years, many organizations have embraced corporate social responsibility (CSR), a philosophy (introduced in Why Ethics Matter,) in which the company's expected actions include not only producing a reliable product, charging a fair price with fair profit margins, and paying a fair wage to employees, but also caring for the environment and acting on other social concerns. Many corporations work on pro-social endeavors and share that information with their customers and the communities where they do business. CSR, when conducted in good faith, is beneficial to corporations and their stakeholders. This is especially true for stakeholders that have typically been given low priority and little voice, such as the natural environment and community members who live near corporate sites and manufacturing facilities.

CSR in its ideal form focuses managers on demonstrating the social good of their new products and endeavors. It can be framed as a response to the backlash corporations face for a long track record of harming environments and communities in their efforts to be more efficient and profitable. Pushback is not new. Charles Dickens wrote about the effects of the coal economy on nineteenth-century England and shaped the way we think about the early industrial revolution. The twentieth-century writer Chinua Achebe, among many others, wrote about colonization and its transformative and often painful effect on African cultures. Rachel Carson first brought public attention to corporation's chemical poisoning of U.S. waterways in her 1962 book Silent Spring.

Betty Friedan's The Feminine Mystique (1963) critiqued the way twentieth-century industrialization boxed women into traditional roles and limited their agency. Kate Chopin's novel The Awakening (1899) and the nineteenth-century novels of Jane Austen had already outlined how limited options were for women despite massive social and economic shifts in the industrializing West. Stakeholder communities left out of or directly harmed by the economic revolution have demanded that they be able to influence corporate and governmental economic practices to benefit more directly from corporate growth as well as entrepreneurship opportunities. The trend to adopt CSR may represent an opportunity for greater engagement and involvement by groups mostly ignored until now by the wave of corporate economic growth reshaping the industrialized world.

CSR and the Environment

Corporations have responded to stakeholder concerns about the environment and sustainability. In 1999, Dow Jones began publishing an annual list of companies for which sustainability was important. Sustainability is the practice of preserving resources and operating in a way that is ecologically responsible in the long term.[24] The Dow Jones Sustainability Indices "serve as benchmarks for investors who integrate sustainability considerations into their portfolios."[25] There is a growing awareness that human actions can, and do, harm the environment. Destruction of the environment can ultimately lead to reduction of resources, declining business opportunities, and lowered quality of life. Enlightened business stakeholders realize that profit is only one positive effect of business operations. In addition to safeguarding the environment, other ethical contributions that stakeholders could lobby corporate management to make include establishing schools and health clinics in impoverished neighborhoods and endowing worthwhile philanthropies in the communities where companies have a presence.

Other stakeholders, such as state governments, NGOs, citizen groups, and political action committees in the United States apply social and legal pressure on businesses to improve their environmental practices. For example, the state of California in 2015 enacted a set of laws, referred to as the California Transparency in Supply Chains Act, which requires firms to report on the working conditions of the employees of their suppliers. The law requires only disclosures, but the added transparency is a step toward holding U.S. and other multinational corporations responsible for what goes on before their products appear in shiny packages in stores. The legislators who wrote California's Supply Chains Act recognize that consumer stakeholders are likely to bring pressure to bear on companies found to use slave labor in their supply chains, so forcing disclosure can bring about change because corporations would rather adjust their relationships with supply-chain stakeholders than risk alienating massive numbers of customers.[26]

As instances of this type of pressure on corporations increase around the world, stakeholder groups become simultaneously less isolated and more powerful. Firms need customers. Customers need employment, and the state needs taxes just as firms need resources. All stakeholders exist in an interdependent network of relationships, and what is most needed is a sustainable system that enables all types of key stakeholders to establish and apply influence.

People, Planet, Profit: The Triple Bottom Line

How can corporations and their stakeholders measure some of the effects of CSR programs? The triple bottom line (TBL) offers a way.

TBL is a measure described in 1994 by John Elkington, a British business consultant (Figure 3.6), and it forces us to reconsider the very concept of the "bottom line." Most businesses, and most consumers for that matter, think of the bottom line as a shorthand expression of their financial well-being. Are they making a profit, staying solvent, or falling into debt? That is the customary bottom line, but Elkington suggests that businesses need to consider not just one but rather three measures of their true bottom line: the economic and also the social and environmental results of their actions. The social and environmental impacts of doing business, called people and planet in the TBL, are the externalities of their operations that companies must take into account.

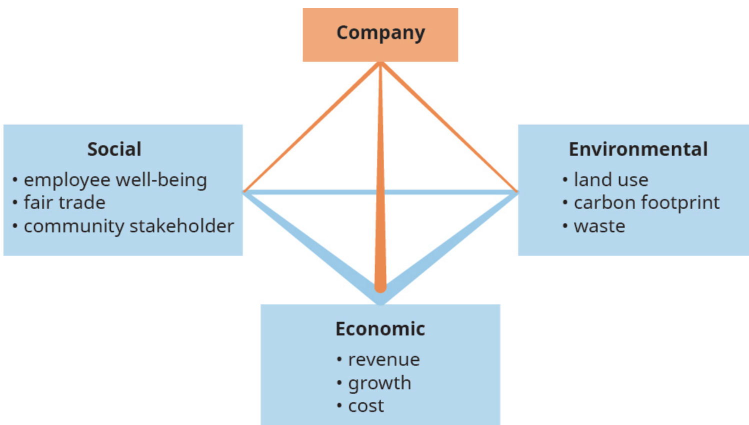

***Figure 3.6** The three components of the triple bottom line are interrelated. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)*

The TBL concept recognizes that external stakeholders consider it a corporation's responsibility to go beyond making money. If increasing wealth damages the environment or makes people sick, society demands that the corporation revise its methods or leave the community. Society, businesses, and governments have realized that all stakeholders have to work for the common good. When they are successful at acting in a socially responsible way, corporations will and should claim credit. In acting according to the TBL model and promoting such acts, many corporations have reinvested their efforts and their profits in ways that can ultimately lead to the development of a sustainable economic system.

CSR as Public Relations Tool

On the other hand, for some, CSR is nothing more than an opportunity for publicity as a firm tries to look good through various environmentally or socially friendly initiatives without making systemic changes that will have long-term positive effects. Carrying out superficial CSR efforts that merely cover up systemic ethics problems in this inauthentic way (especially as it applies to the environment), and acting simply for the sake of public relations is called **greenwashing**. To truly understand a company's approach toward the environment, we need to do more than blindly accept the words on its website or its advertising.

CASES FROM THE REAL WORLD

When an Image of Social Responsibility May Be Greenwashing

Ben and Jerry's Ice Cream started as a small ice cream stand in Vermont and based its products on pure, locally supplied dairy and agricultural products. The company grew quickly and is now a global brand owned by Unilever, an international consumer goods company co-headquartered in Rotterdam, The Netherlands, and London, United Kingdom.

According to its statement of values, Ben and Jerry's mission is threefold: "Our Product Mission drives us to make fantastic ice cream—for its own sake. Our Economic Mission asks us to manage our Company for sustainable financial growth. Our Social Mission compels us to use our Company in innovative ways to make the world a better place."

With its expansion, however, Ben and Jerry's had to get its milk—the main raw ingredient of ice cream—from larger suppliers, most of which use confined-animal feeding operations (CAFOs). CAFOs have been condemned by animal-rights activists as harmful to the well-being of the animals. Consumer activists also claim that CAFOs contribute significantly to pollution because they release heavy concentrations of animal waste into the ground, water sources, and air.

Critical Thinking

- **Does the use of CAFOs compromise Ben and Jerry's mission? Why or why not?**
- **Has the growth of Ben and Jerry's contributed to any form of greenwashing by the parent company, Unilever? If so, how?**

LINK TO LEARNING

Read Ben and Jerry's Statement of Mission for more on the company's values and mission.

Coca-Cola provides another example of practices some would identify as greenwashing. The company states the following on its website:

"Engaging our diverse stakeholders in long-term dialogue provides important input that informs our decision making, and helps us continuously improve and make progress toward our 2020 sustainability goals . . . We are committed to ongoing stakeholder engagement as a core component of our business and sustainability strategies, our annual reporting process, and our activities around the world. As active members of the communities where we live and work, we want to strengthen the fabric of our communities so that we can prosper together." 27

Let us take a close look at this statement. "Engaging stakeholders in long-term dialogue" appears to describe an ongoing and reciprocal relationship that helps improvement be continuous. Commitment to "stakeholder engagement as a core component of business and sustainability strategies" appears to focus the company on the requirement to conduct clear, honest, transparent reporting.

Currently 20 percent of the people on Earth consume a Coca-Cola product each day, meaning a very large portion of the global population belongs to the company's consumer stakeholder group. Depending on the process and location, it is estimated that it takes more than three liters of water to produce a liter of Coke. Each day, therefore, millions of liters of water are removed from the Earth to make Coke products, so the company's water footprint can endanger the water supplies of both employee and neighbor stakeholders. For example, in Chiapas, Mexico, the Coca-Cola bottling plant consumes more than one billion liters of water daily, but only about half the population has running water.[28] Mexico leads the world in per capita consumption of Coke products.

If consumers are aware only of Coca-Cola's advertising campaigns and corporate public relations writings online, they will miss the very real concerns about water security associated with it and other corporations producing beverages in similar fashion. Thus it requires interest on the part of stakeholders to continue to drive real CSR practices and to differentiate true CSR efforts from greenwashing.

The Ultimate Stakeholder Benefit

CSR used in good faith has the potential to reshape the orientation of multinational corporations to their stakeholders. By positioning themselves as stakeholders in a broader global community, conscientious corporations can be exemplary organizations. They can demonstrate interest and influence on a global scale and improve the way the manufacture of goods and delivery of services serve the local and global environment. They can return to communities as much as they extract and foster automatic financial reinvestment so that people willing and able to work for them can afford not only the necessities but a chance to pursue happiness.

In return, global corporations will have sustainable business models that look beyond short-term growth forecasts. They will have a method of operating and a framework for thinking about sustained growth with stakeholders and as stakeholders. Ethical stakeholder relationships systematically grow wealth and opportunity in dynamic fashion. Without them, the global consumer economy may fail. On an alternate and ethical path of prosperity, today's supplier is a consumer in the next generation and Earth is still inhabitable after many generations of dynamic change and continued global growth.

Demands for Corporate Social Responsibility

The emergence of CSR as a more prominent item on a corporation board's agenda reflects a shift in popular opinion about the role of business in society and the convergence of environmental forces, such as the following:

- **Globalization.** There are now more than 60,000 multinational corporations estimated to be in the world. [1] Perceptions about the growing reach and influence of global companies has drawn attention to the impact of business on society. This has led to heightened demands for corporations to take responsibility for the social, environmental, and economic effects of their actions. It has also spawned more aggressive demands for corporations to set their sights on limiting harm and actively seeking to improve social, economic, and environmental circumstances.
- **Loss of trust.** High-profile cases of corporate financial misdeeds (Enron, WorldCom, and others) and of social and environmental irresponsibility (e.g., Shell's alleged complicity in political repression in Nigeria; Exxon's oil spill in Prince William Sound in Alaska; Nike's and other apparel makers' links with "sweatshop" labor in developing countries; questions about Nestlé's practices in marketing baby formula in the developing world) have contributed to a broad-based decline in trust in corporations and corporate leaders. The public's growing reluctance to give corporations the benefit of the doubt has led to intensified scrutiny of corporate impact on

society, the economy, and the environment, and a greater readiness to assume–rightly or wrongly–immoral corporate intent.

- **Civil society activism.** The growing activity and sophistication of "civil society" organizations, many of which are oriented to social and environmental causes, has generated pressure on corporations to take CSR seriously. [2] Well-known international nongovernmental organizations (NGOs), such as Oxfam, Amnesty International, Greenpeace, the Rainforest Action Network, and the Fair Labor Association, have influenced corporate decision making in areas, such as access to essential medicines, labor standards, environmental protection, and human rights. The advent of the Internet has increased the capacity of these organizations–as well as a plethora of national and local civic associations–to monitor corporate behavior and mobilize public opinion. [3]
- **Institutional investor interest in CSR.** The growth in "socially responsible investing" has created institutional demand for equity in corporations that demonstrate a commitment to CSR. Recent growth in assets involved in socially responsible investing has outpaced growth in all professionally managed investment assets in the United States, even though the mainstream financial community has been slow to incorporate nonfinancial factors into its analyses of corporate value. [4]

These trends indicate that there is both a growing perception that corporations must be more accountable to society for their actions, and a growing willingness and capacity within society to impose accountability on corporations. This has profound implications for the future of corporate governance. It suggests that boards will soon have to deal with a growing pressure to give stakeholders a role in corporate governance; a growing pressure on corporations to disclose more and better information about their management of social, environmental, and economic issues; an increasing level of regulatory compulsion related to elements of corporate activity that are currently regarded as voluntary forms of social responsibility; a growing interest by the mainstream financial community in the link between shareholder value and nonfinancial corporate performance.

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[1] World Investment Report (2004).

[2] The International Chamber of Commerce, a global advocacy group for the private sector, observed in 2000 that "non-governmental organizations have gained an enormous influence" over corporate decision making, as quoted in Barrington (2000, January–June).

[3] "Civil society" is sometimes described as the part of society that exists between the state and the market. A more formal definition is "the voluntary association of citizens, promoting their values and interests in the public domain," according to Saxby and Schacter (2003, p. 4). Kaldor, Anheier, and Glasius (2003, p. 2) estimate that there are approximately 48,000 international nongovernmental organizations (NGOs), and that total membership in international NGOs grew by about 70% between 1990 and 2000.

[4] "Big investors want SRI research: European institutions to allocate part of brokers' fees to 'nontraditional' information," Financial Times (UK), October 18, 2004.

4. Carroll's Pyramid of CSR

Corporate social responsibility (CSR) in its modern formulation has been an important and progressing topic since the 1950s. To be sure, evidences of businesses seeking to improve society, the community, or particular stakeholder groups may be traced back hundreds of years (Carroll et al. 2012). In this discussion, however, the emphasis will be placed on concepts and practices that have characterized the post-World War II era. Much of the literature addressing CSR and what it means began in the United States; however, evidences of its applications, often under different names, traditions, and rationales, has been appearing around the world. Today, Europe, Asia, Australia, Africa, South America, and many developing countries are increasingly embracing the idea in one form or another. Clearly, CSR is a concept that has endured and continues to grow in importance and impact.

To be fair, it must be acknowledged that some writers early on have been critical of the CSR concept. In an important Harvard Business Review article in 1958, for example, Theodore Levitt spoke of "The Dangers of Social Responsibility." His position was best summarized when he stated that business has only two responsibilities – (1) to engage in face-to-face civility such as honesty and good faith and (2) to seek material gain. Levitt argued that long-run profit maximization is the one dominant objective of business, in practice as well as theory (Levitt 1958, p. 49). The most well-known adversary of social responsibility, however, is economist Milton Friedman who argued that social issues are not the concern of business people and that these problems should be resolved by the unfettered workings of the free market system (Friedman 1962).

Introduction

The modern era of CSR, or social responsibility as it was often called, is most appropriately marked by the publication by Howard R. Bowen of his landmark book Social Responsibilities of the Businessman in 1953. Bowen's work proceeded from the belief that the several hundred largest businesses in the United States were vital centers of power and decision making and that the actions of these firms touched the lives of citizens in many ways. The key question that Bowen asked that continues to be asked today was "what responsibilities to society may businessmen reasonably be expected to assume?" (Bowen 1953, p. xi) As the title of Bowen's book suggests, this was a period during which business women did not exist, or were minimal in number, and thus they were not acknowledged in formal writings. Things have changed significantly since then. Today there are countless business women and many of them are actively involved in CSR.

Much of the early emphasis on developing the CSR concept began in scholarly or academic circles. From a scholarly perspective, most of the early definitions of CSR and initial conceptual work about what it means in theory and in practice was begun in the 1960s by such writers as Keith Davis, Joseph McGuire, Adolph Berle, William Frederick, and Clarence Walton (Carroll 1999). Its' evolving refinements and applications came later, especially after the important social movements of the 1960s, particularly the civil rights movement, consumer movement, environmental movement and women's movements.

Dozens of definitions of corporate social responsibility have arisen since then. In one study published in 2006, Dahlsrud identified and analyzed 37 different definitions of CSR and his study did not capture all of them (Dahlsrud 2006).

In this article, however, the goal is to revisit one of the more popular constructs of CSR that has been used in the literature and practice for several decades. Based on his four-part framework or definition of corporate social responsibility, Carroll created a graphic depiction of CSR in the form of a pyramid. CSR expert Dr. Wayne Visser has said that "Carroll's CSR Pyramid is probably the most well-known model of CSR…" (Visser 2006). If one goes online to Google Images and searches for "Carroll's Pyramid of CSR," well over 100 variations and reproductions of the pyramidal model are presented there (Google Images) and over 5200 citations of the original article are indicated there (Google Scholar).

The purpose of the current commentary is to summarize the Pyramid of CSR, elaborate on it, and to discuss some aspects of the model that were not clarified when it was initially published in 1991. Twenty five years have passed since the initial publication of the CSR pyramid, but in early 2016 it still ranks as one of the most frequently downloaded articles during the previous 90 days in the journal in which it was published – (Elsevier Journals), Business Horizons (Friedman 1962) – sponsored by the Kelley School of Business at Indiana University. Carroll's four categories or domains of CSR, upon which the pyramid was established, have been utilized by a number of different theorists (Swanson 1995; Wartick and Cochran 1985; Wood 1991, and others) and empirical researchers (Aupperle 1984; Aupperle et al. 1985; Burton and Hegarty 1999; Clarkson 1995; Smith et al. 2001, and many others). According to Wood and Jones, Carroll's four domains have "enjoyed wide popularity among SIM (Social Issues in Management) scholars (Wood and Jones 1996). Lee has said that the article in which the four part model of CSR was published has become "one of the most widely cited articles in the field of business and society" (Lee 2008). Thus, it is easy to see why a re-visitation of the pyramid based on the four category definition might make some sense and be useful.

Many of the early definitions of CSR were rather general. For example, in the 1960s it was defined as "seriously considering the impact of the company's actions on society." Another early definition of CSR read as follows: "Social responsibility is the obligation of decision makers to take actions which protect and improve the welfare of society along with their own interests" (Davis 1975). In general, CSR has typically been understood as policies and practices that business people employ to be sure that society, or stakeholders, other than business owners, are considered and protected in their strategies and operations. Some definitions of CSR have argued that an action must be purely voluntary to be considered socially responsible; others have argued that it embraces legal compliance as well; still others have argued that ethics is a part of CSR; virtually all definitions incorporate business giving or corporate philanthropy as a part of CSR and many observers equate CSR with philanthropy only and do not factor in these other categories of responsibility.

The ensuing discussion explains briefly each of the four categories that comprise Carroll's four-part definitional framework upon which the pyramidal model is constructed.

The four-part definitional framework for CSR

Carroll's four part definition of CSR was originally stated as follows: "Corporate social responsibility encompasses the economic, legal, ethical, and discretionary (philanthropic) expectations that society has of organizations at a given point in time" (Carroll 1979, 1991). This set of four responsibilities creates a foundation or infrastructure that helps to delineate in some detail and to frame or characterize the nature of businesses' responsibilities to the society of which it is a part. In the first research study using the four categories it was found that the construct's content validity and the instrument assessing it were valid (Aupperle et al. 1985). The study found that experts were capable of distinguishing among the four components. Further, the factor analysis conducted concluded that there are four empirically interrelated, but conceptually independent components of corporate social responsibility. This study also found that the relative values or weights of each of the components as implicitly depicted by Carroll approximated the relative degree of importance the 241 executives surveyed placed on the four components—economic = 3.5; legal = 2.54; ethical = 2.22; and discretionary/philanthropic = 1.30. Later research supported that Aupperle's instrument measuring CSR using Carroll's four categories (Aupperle 1984) was valid and useful (Edmondson and Carroll 1999; Pinkston and Carroll 1996 and others). In short, the distinctiveness and usefulness in research of the four categories have been established through a number of empirical research projects. A brief review of each of the four categories of CSR follows.

Economic responsibilities

As a fundamental condition or requirement of existence, businesses have an economic responsibility to the society that permitted them to be created and sustained. At first, it may seem unusual to think about an economic expectation as a social responsibility, but this is what it is because society expects, indeed requires, business organizations to be able to sustain themselves and the only way this is possible is by being profitable and able to incentivize owners or shareholders to invest and have enough resources to continue in operation. In its origins, society views business organizations as institutions that will produce and sell the goods and services it needs and desires. As an inducement, society allows businesses to take profits. Businesses create profits when they add value, and in doing this they benefit all the stakeholders of the business.

Profits are necessary both to reward investor/owners and also for business growth when profits are reinvested back into the business. CEOs, managers, and entrepreneurs will attest to the vital foundational importance of profitability and return on investment as motivators for business success. Virtually all economic systems of the world recognize the vital importance to the societies of businesses making profits. While thinking about its' economic responsibilities, businesses employ many business concepts that are directed towards financial effectiveness – attention to revenues, cost-effectiveness, investments, marketing, strategies, operations, and a host of professional concepts focused on augmenting the long-term financial success of the organization. In today's hypercompetitive global business environment, economic performance and sustainability have become urgent topics. Those firms that are not successful in their economic or financial sphere go out of business and any other responsibilities that may be incumbent upon them become moot considerations. Therefore, the economic responsibility is a baseline requirement that must be met in a competitive business world.

Legal responsibilities

Society has not only sanctioned businesses as economic entities, but it has also established the minimal ground rules under which businesses are expected to operate and function. These ground rules include laws and regulations and in effect reflect society's view of "codified ethics" in that they articulate fundamental notions of fair business practices as established by lawmakers at federal, state and local levels. Businesses are expected and required to comply with these laws and regulations as a condition of operating. It is not an accident that compliance officers now occupy an important and high level position in company organization charts. While meeting these legal responsibilities, important expectations of business include their

- Performing in a manner consistent with expectations of government and law
- Complying with various federal, state, and local regulations
- Conducting themselves as law-abiding corporate citizens
- Fulfilling all their legal obligations to societal stakeholders
- Providing goods and services that at least meet minimal legal

- requirements

Ethical responsibilities

The normative expectations of most societies hold that laws are essential but not sufficient. In addition to what is required by laws and regulations, society expects businesses to operate and conduct their affairs in an ethical fashion. Taking on ethical responsibilities implies that organizations will embrace those activities, norms, standards and practices that even though they are not codified into law, are expected nonetheless. Part of the ethical expectation is that businesses will be responsive to the "spirit" of the law, not just the letter of the law. Another aspect of the ethical expectation is that businesses will conduct their affairs in a fair and objective fashion even in those cases when laws do not provide guidance or dictate courses of action. Thus, ethical responsibilities embrace those activities, standards, policies, and practices that are expected or prohibited by society even though they are not codified into law. The goal of these expectations is that businesses will be responsible for and responsive to the full range of norms, standards, values, principles, and expectations that reflect and honor what consumers, employees, owners and the community regard as consistent with respect to the protection of stakeholders' moral rights. The distinction between legal and ethical expectations can often be tricky. Legal expectations certainly are based on ethical premises. But, ethical expectations carry these further. In essence, then, both contain a strong ethical dimension or character and the difference hinges upon the mandate society has given business through legal codification.

While meeting these ethical responsibilities, important expectations of business include their

- Performing in a manner consistent with expectations of

societal mores and ethical norms
- Recognizing and respecting new or evolving ethical/moral norms adopted by society
- Preventing ethical norms from being compromised in order to achieve business goals
- Being good corporate citizens by doing what is expected morally or ethically
- Recognizing that business integrity and ethical behavior go beyond mere compliance with laws and regulations (Carroll 1991)

As an overlay to all that has been said about ethical responsibilities, it also should be clearly stated that in addition to society's expectations regarding ethical performance, there are also the great, universal principles of moral philosophy such as rights, justice, and utilitarianism that also should inform and guide company decisions and practices.

Philanthropic responsibilities

Corporate philanthropy includes all forms of business giving. Corporate philanthropy embraces business's voluntary or discretionary activities. Philanthropy or business giving may not be a responsibility in a literal sense, but it is normally expected by businesses today and is a part of the everyday expectations of the public. Certainly, the quantity and nature of these activities are voluntary or discretionary. They are guided by business's desire to participate in social activities that are not mandated, not required by law, and not generally expected of business in an ethical sense. Having said that, some businesses do give partially out of an ethical motivation. That is, they want to do what is right for society. The public does have a sense that businesses will "give back," and this constitutes the "expectation" aspect of the responsibility. When one examines the social contract between business and society today, it typically is found that the citizenry expects businesses to be good corporate citizens just as individuals are. To fulfill its perceived philanthropic responsibilities, companies engage in a variety of giving forms – gifts of monetary resources, product and service donations, volunteerism by employees and management, community development and any other discretionary contribution to the community or stakeholder groups that make up the community.

Although there is sometimes an altruistic motivation for business giving, most companies engage in philanthropy as a practical way to demonstrate their good citizenship. This is done to enhance or augment the company's reputation and not necessarily for noble or self-sacrificing reasons. The primary difference between the ethical and philanthropic categories in the four part model is that business giving is not necessarily expected in a moral or ethical sense. Society expects such gifts, but it does not label companies as "unethical" based on their giving patterns or whether the companies are giving at the desired level. As a consequence, the philanthropic responsibility is more discretionary or voluntary on business's part. Hence, this category is often thought of as good "corporate citizenship." Having said all this, philanthropy historically has been one of the most important elements of CSR definitions and this continues today.

In summary, the four part CSR definition forms a conceptual framework that includes the economic, legal, ethical, and philanthropic or discretionary expectations that society places on businesses at a given point in time. And, in terms of understanding each type of responsibility, it could be said that the economic responsibility is "required" of business by society; the legal responsibility also is "required" of business by society; the ethical responsibility is "expected" of business by society; and the philanthropic responsibility is "expected/desired" of business by society (Carroll 1979, 1991). Also, as time passes what exactly each of these four categories means may change or evolve as well.

The Pyramid of CSR

The four-part definition of CSR was originally published in 1979. In 1991, Carroll extracted the four-part definition and recast it in the form of a CSR pyramid. The purpose of the pyramid was to single out the definitional aspect of CSR and to illustrate the building block nature of the four part framework. The pyramid was selected as a geometric design because it is simple, intuitive, and built to withstand the test of time. Consequently, the economic responsibility was placed as the base of the pyramid because it is a foundational requirement in business. Just as the footings of a building must be strong to support the entire edifice, sustained profitability must be strong to support society's other expectations of enterprises. The point here is that the infrastructure of CSR is built upon the premise of an economically sound and sustainable business.

At the same time, society is conveying the message to business that it is expected to obey the law and comply with regulations because law and regulations are society's codification of the basic ground rules upon which business is to operate in a civil society. If one looks at CSR in developing countries, for example, whether a legal and regulatory framework exists or not significantly affects whether multinationals invest there or not because such a legal infrastructure is imperative to provide a foundation for legitimate business growth.

In addition, business is expected to operate in an ethical fashion. This means that business has the expectation, and obligation, that it will do what is right, just, and fair and to avoid or minimize harm to all the stakeholders with whom it interacts. Finally, business is expected to be a good corporate citizen, that is, to give back and to contribute financial, physical, and human resources to the communities of which it is a part. In short, the pyramid is built in a fashion that reflects the fundamental roles played and expected by business in society. Figure 1 presents a graphical depiction of Carroll's Pyramid of CSR.

Fig. 1 *Carroll's pyramid of CSR*

Ethics permeates the pyramid

Though the ethical responsibility is depicted in the pyramid as a separate category of CSR, it should also be seen as a factor which cuts through and saturates the entire pyramid. Ethical considerations are present in each of the other responsibility categories as well. In the Economic Responsibility category, for example, the pyramid implicitly assumes a capitalistic society wherein the quest for profits is viewed as a legitimate, just expectation. Capitalism, in other words, is an economic system which thinks of it as being ethically appropriate that owners or shareholders merit a return on their investments. In the Legal

Responsibility category, it should be acknowledged that most laws and regulations were created based upon some ethical reasoning that they were appropriate. Most laws grew out of ethical issues, e.g., a concern for consumer safety, employee safety, the natural environment, etc., and thus once formalized they represented "codified ethics" for that society. And, of course, the Ethical Responsibility stands on its own in the four part model as a category that embraces policies and practices that many see as residing at a higher level of expectation than the minimums required by law. Minimally speaking, law might be seen as passive compliance. Ethics, by contrast, suggests a level of conduct that might anticipate future laws and in any event strive to do that which is considered above most laws, that which is driven by rectitude. Finally, Philanthropic Responsibilities are sometimes ethically motivated by companies striving to do the right thing. Though some companies pursue philanthropic activities as a utilitarian decision (e.g., strategic philanthropy) just to be seen as "good corporate citizens," some do pursue philanthropy because they consider it to be the virtuous thing to do. In this latter interpretation, philanthropy is seen to be ethically motivated or altruistic in nature (Schwartz and Carroll 2003). In summary, ethical motivations and issues cut through and permeate all four of the CSR categories and thus assume a vital role in the totality of CSR.

Tensions and trade-offs

As companies seek to adequately perform with respect to their economic, legal, ethical and philanthropic responsibilities, tensions and trade-offs inevitably arise. How companies decide to balance these various responsibilities goes a long way towards defining their CSR orientation and reputation. The economic responsibility to owners or shareholders requires a careful trade-off between short term and long term profitability. In the short run, companies' expenditures on legal, ethical and philanthropic obligations invariably will “appear” to conflict with their responsibilities to their shareholders. As companies expend resources on these responsibilities that appear to be in the primary interests of other stakeholders, a challenge to cut corners or seek out best long range advantages arises. This is when tensions and trade-offs arise. The traditional thought is that resources spent for legal, ethical and philanthropic purposes might necessarily detract from profitability. But, according to the “business case” for CSR, this is not a valid assumption or conclusion. For some time it has been the emerging view that social activity can and does lead to economic rewards and that business should attempt to create such a favorable situation (Chrisman and Carroll 1984).

The business case for CSR refers to the underlying arguments supporting or documenting why the business community should accept and advance the CSR cause. The business case is concerned with the primary question – What does the business community and commercial enterprises get out of CSR? That is, how do they benefit tangibly and directly from engaging in CSR policies, activities and practices (Carroll and Shabana 2010). There are many business case arguments that have been made in the literature, but four effective arguments have been made by Kurucz, et al., and these include cost and risk reductions, positive effects on competitive advantage, company legitimacy and reputation, and the role of CSR in creating win-win situations for the company and society (Kurucz et al. 2008). Other studies have enumerated the reasons for business to embrace CSR to include innovation, brand differentiation, employee engagement, and customer engagement. The purpose for business case thinking with respect to the Pyramid of CSR is to ameliorate the believed conflicts and tensions between and among the four categories of responsibilities. In short, the tensions and tradeoffs will continue to be important decision points, but they are not in complete opposition to one another as is often perceived.

The pyramid is an integrated, unified whole

The Pyramid of CSR is intended to be seen from a stakeholder perspective wherein the focus is on the whole not the different parts. The CSR pyramid holds that firms should engage in decisions, actions, policies and practices that simultaneously fulfill the four component parts. The pyramid should not be interpreted to mean that business is expected to fulfill its social responsibilities in some sequential, hierarchical, fashion, starting at the base. Rather, business is expected to fulfill all responsibilities simultaneously. The positioning or ordering of the four categories of responsibility strives to portray the fundamental or basic nature of these four categories to business's existence in society. As said before, economic and legal responsibilities are required; ethical and philanthropic responsibilities are expected and desired. The representation being portrayed, therefore, is that the total social responsibility of business entails the concurrent fulfillment of the firm's economic, legal, ethical, and philanthropic responsibilities. Stated in the form of an equation, it would read as follows: Economic Responsibilities + Legal responsibilities + Ethical Responsibilities + Philanthropic Responsibilities = Total Corporate Social Responsibility. Stated in more practical and managerial terms, the CSR driven firm should strive to make a profit, obey the law, engage in ethical practices and be a good corporate citizen. When seen in this way, the pyramid is viewed as a unified or integrated whole (Carroll and Buchholtz 2015).

The pyramid is a sustainable stakeholder framework

Each of the four components of responsibility addresses different stakeholders in terms of the varying priorities in which the stakeholders might be affected. Economic responsibilities most dramatically impact shareholders and employees because if the business is not financially viable both of these groups will be significantly affected. Legal responsibilities are certainly important with respect to owners, but in today's litigious society, the threat of litigation against businesses arise most often from employees and consumer stakeholders. Ethical responsibilities affect all stakeholder groups. Shareholder lawsuits are an expanding category. When an examination of the ethical issues business faces today is considered, they typically involve employees, customers, and the environment most frequently. Finally, philanthropic responsibilities most affect the community and nonprofit organizations, but also employees because some research has concluded that a company's philanthropic involvement is significantly related to its employees' morale and engagement.

The pyramid should be seen as sustainable in that these responsibilities represent long term obligations that overarch into future generations of stakeholders as well. Though the pyramid could be perceived to be a static snapshot of responsibilities, it is intended to be seen as a dynamic, adaptable framework the content of which focuses both on the present and the future. A consideration of stakeholders and sustainability, today, is inseparable from CSR. Indeed, there have been some appeals in the literature for CSR to be redefined as Corporate Stakeholder Responsibility and others have advocated Corporate Sustainability Responsibilities. These appeals highlight the intimate nature of these interrelated topics (Carroll and Buchholtz 2015). Furthermore, Ethical Corporation Magazine which emphasizes CSR in its Responsible Summit conferences integrates these two topics – CSR and Sustainability—as if they were one and, in fact, many business organizations today perceive them in this way; that is, to be socially responsible is to invest in the importance of sustainability which implicitly is concerned with the future. Annual corporate social performance reports frequently go by the titles of CSR and/or Sustainability Reports but their contents are undifferentiated from one another; in other words, the concepts are being used interchangeably by many.

Global applicability and different contexts

When Carroll developed his original four-part construct of CSR (1979) and then his pyramidal depiction of CSR (1991), it was clearly done with American-type capitalistic societies in mind. At that time, CSR was most prevalent in these more free enterprise societies. Since that time, several writers have proposed that the pyramid needs to be reordered to meet the conditions of other countries or smaller businesses. In 2007, Crane and Matten observed that all the levels of CSR depicted in Carroll's pyramid play a role in Europe but they have a dissimilar significance and are interlinked in a somewhat different manner (Crane and Matten 2007). Likewise, Visser revisited Carroll's pyramid in developing countries/ continents, in particular, Africa, and argued that the order of the CSR layers there differ from the classic pyramid. He goes on to say that in developing countries, economic responsibility continues to get the most emphasis, but philanthropy is given second highest priority followed by legal and then ethical responsibilities (Visser 2011). Visser continues to contend that there are myths about CSR in developing countries and that one of them is that "CSR is the same the world over." Following this, he maintains that each region, country or community has a different set of drivers of CSR. Among the "glocal" (global + local) drivers of CSR, he suggests that cultural tradition, political reform, socio-economic priorities, governance gaps, and crisis response are among the most important (Visser 2011, p. 269). Crane, Matten and Spence do a nice job discussing CSR in a global context when they elaborate on CSR in different regions of the globe, CSR in developed countries, CSR in developing countries, and CSR in emerging/transitional economies (Crane et al. 2008).

In addition to issues being raised about the applicability of CSR and, therefore, the CSR pyramid in different localities, the same may be said for its applicability in different organizational contexts. Contexts of interest here might include private sector (large vs. small firms), public sector, and civil society organizations (Crane et al. 2008). In one particular theoretical article, Laura Spence sought to reframe Carroll's CSR pyramid, enhancing its relevance for small business. Spence employed the ethic of care and feminist perspectives to redraw the four CSR domains by indicating that Carroll's categories represented a masculinist perspective but that the ethic of care perspective would focus on different concerns. In this manner, she argued that the economic responsibility would be seen as "survival" in the ethic of care perspective; legal would be seen as "survival;" ethical would be recast as ethic of care; and philanthropy would continue to be philanthropy. It might be observed that these are not completely incompatible with Carroll's categories. She then added a new category and that would be identified as "personal integrity." She proposed that there could be at least four small business social responsibility pyramids – to self and family; to employees; to the local community; and to business partners (Spence 2016). Doubtless other researchers will continue to explore the applicability of the Pyramid of CSR to different global, situational, and organizational contexts. This is how theory and practice develops.

Conclusions

CSR has had a robust past and present. The future of CSR, whether it be viewed in the four part definitional construct, the Pyramid of CSR, or in some other format or nomenclature such as Corporate Citizenship, Sustainability, Stakeholder Management, Business Ethics, Creating Shared Value, Conscious Capitalism, or some other socially conscious semantics, seems to be on a sustainable and optimistic future. Though these other terminologies will sometimes be preferred by different supporters, CSR will continue to be the centerpiece of these competing and complementary frameworks (Carroll 2015). Though its enthusiasts would like to think of an optimistic or hopeful scenario wherein CSR would be adopted the world over and would be transformational everywhere it is practiced, the more probable scenario is that CSR will be consistent and stable and will continue to grow on a steady to slightly increasing trajectory. Four strong drivers of CSR taking hold in the 1990s and continuing forward have solidified its primacy. These include globalization, institutionalization, reconciliation with profitability, and academic proliferation (Carroll 2015b). Globally, countries have been quickly adopting CSR practices in both developed and developing regions. CSR as a management strategy has become commonplace, formalized, integrated, and deeply assimilated into organizational structures, policies and practices. Primarily via "business case" reasoning, CSR has been more quickly adopted as a beneficial practice both to companies and society. The fourth factor driving CSR's growth trajectory has been academic acceptance, enthusiasm, and proliferation. There has been an explosion of rigorous theory building and research on the topic across many disciplines and this is expected to continue and grow. In short, CSR, the Pyramid of CSR, and related models and concepts face an upbeat and optimistic future. Those seeking to refine these concepts will continue to do so.

5. Legitimacy and Corporate Governance

BY CARY COGLIANESE

Introduction

In recent years, the institutional structures of public corporations appear to be converging in notable ways with the institutional structures of public government. Changes to corporate governance may well be crucial for enhancing trust in corporations and capital markets, but they may also come at some cost to other important values. Because corporate governance is a major issue for society and the economy, we ought to take note of the direction corporate governance reforms are heading, if for no other reason than to assess the consequences of such efforts to increase corporate legitimacy.

POWER AND LEGITIMACY

I shall begin with a key linkage between power and legitimacy. For most of us, the concept of legitimacy is deeply and persistently linked with the power of government—not of business. A government, like that in the United States or other developed countries, possesses enormous powers—powers of violence, powers of compulsion, and powers of conscription. And government possesses its powers in a unified, monopolistic manner. Of course, generally this is a good thing, for no matter what many of us may think about competition in the marketplace, free competition in the kind of police powers possessed by government would not be a happy state of affairs. Indeed, creating a monopoly in such powers is precisely the solution to the core problem of a Hobbesian world.[1]

Yet the monopoly of legislative and police power in the government brings with it the potential for its own abuse—and also gives rise to the challenge of legitimacy. Legitimacy is what is needed to justify, in moral terms, the wielding of such enormous, monopolistic power. Of course, compared with the Hobbesian world, any old monopolist might be thought to be better than the brutish state of nature; however, life under an oppressive government monopolist can also be quite nasty, brutish, and short. Moreover, because the government wields power monopolistically, people do not have any realistic choice about whether they must submit to it. So, it is proper to demand more of a government than simply that it amounts to being the biggest thug around. We can and should ask whether government possesses legitimacy in addition to whether it has secured de facto monopolistic power.

All of this should be rather familiar. But what about corporations and their managers? They too exert significant power affecting people's lives in important ways.[2] Their power over employees is easiest to see. But business decisions also have major ramifications for investors, for customers, for those who inhabit the communities where corporations do business, and for the economy overall in cities and regions around the world. Even though corporations are unlike government in that they are voluntary associations, and also unlike government in that they have competitors, we still can and should ask whether corporate power is legitimate. Just as with governmental power, corporate power—more precisely, corporate managerial power—can be abused.[3] It can be used to satiate the self-interested thirst of greedy CEOs at the expense of shareholders. It can be used to exploit workers, treating them inhumanely and failing to provide safe working conditions or suitable wages. It can be used to make profits at the expense of environmental quality, even putting innocent lives at risk from accidents or toxic pollution.

The existence of power wielded by corporations means that the question of legitimacy can be applied to the private sector. And in our post-Enron,[4] post-WorldCom,[5] post-Tyco,[6] post-Parmalat [7] environment, it is precisely this kind of question that has been raised increasingly in board rooms, stock exchanges, the Securities and Exchange Commission, the media, and in the academy. How can integrity and trust—that is, legitimacy—be maintained in the corporate world?

My thesis—and it is simply a positive or descriptive thesis—is that the prevailing responses to the question of corporate legitimacy have followed certain of the forms of political or governmental legitimacy. Perhaps more than ever before, corporate governance reforms bear a much closer resemblance to institutional mechanisms typically found in government. With government, legitimacy is usually conceptualized in two main ways: procedural legitimacy and substantive legitimacy. Procedural legitimacy is defined in terms of democratic accountability, with elections being the principal defining characteristic, and also in terms of institutional arrangements like separation of powers, transparency, and rule of law principles intended to combat abuses of power.

Substantive legitimacy, in contrast, is usually defined in terms of rights, typically rights enshrined within a constitution that makes certain actions off limits even to an otherwise procedurally legitimate legislature.[8] When the U.S. Constitution states that Congress shall make no law abridging freedom of religion,[9] for example, it is saying that even laws that might meet all the tests of procedural legitimacy will still be illegitimate if they restrict citizens' ability to worship freely.

There is a clear parallel with corporate institutions. What is called corporate governance is akin to procedural legitimacy. Corporate governance refers to, among other things, the assignment of separate powers to management, shareholders, and boards of directors, the procedures for selecting and removing members of boards of directors, and so forth.

What is the substantive legitimacy parallel? It is corporate regulation. Regulation imposed by government says that even properly constituted corporations with fully functioning boards of directors (a test of procedural legitimacy) cannot take actions that will pollute the environment, treat their workers badly, or take money from investors. Regulation places side constraints on corporate managers in a way conceptually parallel to the side constraints that constitutions place on legislatures.

A SHIFT IN CORPORATE GOVERNANCE

For the past thirty years or so, government regulation has placed many stringent and costly side constraints on how corporations can act. [10] These side constraints are much more extensive and detailed than the side constraints the Constitution places on legislatures. But if the substantive constraints on corporations have been strong, until recently at least the requirements for procedural legitimacy imposed on corporations have generally been much weaker than those found in government. It is here that I think the potentially most profound changes are taking place.

Some of the most important changes in recent years in response to Enron, WorldCom and other corporate scandals have been decidedly procedural in nature. Corporate governance reforms imposed on companies by the Sarbanes-Oxley law of 2002,[11] and various rules issued either by the stock exchanges or regulators such as the SEC, have together moved companies closer in the direction of government in terms of at least some of their institutional structures.[12] Corporate management has become more procedurally constrained, using institutional features not too dissimilar to those procedural devices imposed on government. Consider the following four institutional features: separation of powers, transparency, codes of ethics, and elections.

Separation of Powers. Since at least the time of the Federalist Papers, a key structural feature of government has been the separation of powers, with ambition designed to counteract ambition, and a system of checks and balances between different branches of government.[13] In principle, corporations have also long had their own checks and balances, with boards of directors responsible both for hiring the CEOs who actually run companies and then overseeing their work, and with shareholders retaining the theoretical ability to challenge the slate of directors. While boards in theory provide a check on managerial power, they have functioned for many years quite deferentially to the CEO. Indeed, a common cause of corporate scandals and skyrocketing executive compensation has been said to be weaknesses in boards' oversight.[14] Remarkably, unlike the kind of strict separation of powers observed in government, boards of directors have never been entirely independent of corporate management. Indeed, corporate managers (in particular, CEOs) have sat and voted themselves on boards; in some cases the CEO has also served as the chair of the board or on the nominating committee that selects new board members. Furthermore, even so-called independent board members, that is, those not employed by the company, would still sometimes conduct extensive business with the company.

Such conflicts of interest no doubt can cloud board members' judgment and reduce their incentives to look carefully at how management is running a company with the interests of the shareholders in mind. The thrust of recent changes to the rules of corporate governance has been to make boards more independent than they have been, strengthening them by moving them a bit closer to the kind of strict separation of powers exhibited in national and state government.[15] For example, Sarbanes-Oxley imposed a requirement that the audit committees of the boards of public companies be comprised solely of independent board members, that is, those that neither manage the company nor accept consulting fees or other compensation from the company.[16] New listing standards adopted by the stock exchanges seek to strengthen the independence of boards of publicly traded companies.[17] And in the mutual fund industry, the SEC has made dramatic changes to boards of directors, requiring that they have independent chairs (something that previously only about 20% of the companies in the industry had)[18] and that 75% of the members of the board be independent.[19]

Transparency. A key feature of procedural legitimacy for government has been openness. Laws need to be made in the open, and information about most government functions must be made available to the public under laws such as the Freedom of Information Act.[20] In the business context, publicly traded companies have been, ever since the stock market crash in the early part of the last century, subject to a variety of disclosure requirements that similarly aim to create transparency.[21] But SarbanesOxley has taken a series of steps designed to improve the accuracy of financial disclosures and increase transparency in corporations. CEOs and CFOs must now certify the accuracy of key financial statements,[22] and companies now have a duty to update their financials and report material changes in the financial status of the company.[23] New requirements that restrict auditors from performing non-audit services, limit conflicts of interest with auditing companies, and strengthen the regulation of the auditing industry all aim to make investors better aware of the true financial conditions of companies.[24]

Codes of Ethics. The federal government's code of ethics[25] instructs public officials and public managers to "Put loyalty to the highest moral principles . . . above loyalty to persons, party, or Government department,"[26] to "Uphold the Constitution, laws, and legal regulations of the United States and of all governments therein and never be a party to their evasion,"[27] and to "Expose corruption wherever discovered."[28] A governmental code of ethics is premised on the belief that inculcating norms of public-regarding behavior can help prevent governmental corruption.

The Sarbanes-Oxley law similarly adopts measures to expand the adoption of codes of ethics within companies.[29] It also calls for the SEC to impose new obligations on corporate lawyers, requiring them to report to the corporate counsel or CEO any evidence of material violations of securities laws or serious breaches of the company's managers' fiduciary duties.[30] Even in business, some protection against abuse may lie in efforts to create a culture of integrity.[31] Elections.

Elections are a major feature of procedural legitimacy for governments, and we are seeing some movement in the field of corporate governance that may eventually make corporate management more electorally accountable to shareholders. Formally speaking, shareholders do vote on members of the board of directors, but they typically only vote on one slate of candidates—those nominated by the existing board.[32] Rarely are board elections real contests.[33] Indeed, Professor Lucian Bebchuk has documented that for major companies—those with a market cap of over $200 million—meaningful electoral contests occurred in fewer than two companies a year on average during the period 1996-2002.34 This really is not too surprising, since the board, after all, effectively controls the ballot for itself.[35]

In response to this state of affairs, the SEC in recent years has proposed a relatively modest change in securities rules that would make it somewhat easier under certain conditions for candidates for a few board seats to be placed on the ballot by shareholders themselves.[36] The rule has not been adopted, as it has engendered a firestorm of controversy given its symbolic importance.[37] It is not clear where a modest proposal like this will eventually end up in the years ahead. But suffice it to say, the fact that such a proposal has been seriously put forward by the SEC indicates yet another possible direction that corporate governance may head in the coming years, taking corporations a small step closer to the kind of electoral legitimacy exhibited by governments.

CONCLUSION

In these four ways, and in others, we see what appears to be movement in corporate America toward considering or adopting institutional features that have typically been characteristic of governments. This is not to say that corporate governance has become or ever will become fully identical to the kind of politics exhibited by democratic governments; far from it.[38] Corporations are still much more hierarchical and unitary than government is, and corporate managers still possess a lot of power. But the kinds of responses and proposals adopted in the last few years clearly move corporations and their governance in a direction closer to the kinds of institutional arrangements that we have seen exhibited by liberal, democratic governments.

Recognizing as a descriptive matter that such a movement may be afoot is but the first step in posing the question of whether such a shift would be a good one. In conclusion, I simply raise—though do not answer—the most important policy or normative question that lies ahead in corporate governance: how much procedural legitimacy should society demand of corporations? The procedural mechanisms that characterize governments often reflect a high level of risk aversion to the worst abuses governments can exhibit. They are conservative in that they make it harder for government to move with a unitary voice in a direction dictated by a single individual or a single faction. One result is that government is often criticized for its sluggishness and for its "gridlock."[39]

Maybe sluggishness and gridlock are not necessarily such bad things for governments. How much gridlock and division, though, is tolerable in the corporate setting? Answering this question will depend in part on an assessment of the dangers of corporate power; the greater they loom, the more ambition should be designed to counteract ambition in the corporate world. But we must also consider the benefits that come from giving business managers the discretion they need to innovate and respond quickly to changing economic circumstances, and consider what will be lost if we make corporate governance too constraining. I suspect that few proponents of current corporate governance reforms would advocate making corporations fully as rule-bound and democratically open as government is. But exactly how far should we move in that direction? That is the key policy question that must be confronted. It is squarely on the table if, as I have suggested here, corporate governance is increasingly assuming more of the institutional indicia of the governance of nations and states.

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6. Corporate Governance and Sarbanes-Oxley Act and Other Recent Reforms

What Is Corporate Governance?

The tug of war between individual freedom and institutional power is a continuing theme of history. Early on, the focus was on the church; more recently, it is on the civil state. Today, the debate is about making corporate power compatible with the needs of a democratic society. The modern corporation has not only created untold wealth and given individuals the opportunity to express their genius and develop their talents but also has imposed costs on individuals and society. How to encourage the liberation of individual energy without inflicting unacceptable costs on individuals and society, therefore, has emerged as a key challenge.

Corporate governance lies at the heart of this challenge. It deals with the systems, rules, and processes by which corporate activity is directed. Narrow definitions focus on the relationships between corporate managers, a company's board of directors, and its shareholders. Broader descriptions encompass the relationship of the corporation to all of its stakeholders and society, and cover the sets of laws, regulations, listing rules, and voluntary private-sector practices that enable corporations to attract capital, perform efficiently, generate profit, and meet both legal obligations and general societal expectations. The wide variety of definitions and descriptions that have been advanced over the years also reflect their origin: lawyers tend to focus on the contractual and fiduciary aspects of the governance function; finance scholars and economists think about decision-making objectives, the potential for conflict of interest, and the alignment of incentives, while management consultants tend to adopt a more task-oriented or behavioral perspective.

Complicating matters, different definitions also reflect two fundamentally different views about a corporation's purpose and responsibilities. Often referred to as the "shareholder versus stakeholder" perspectives, they define a debate about whether managers should run a corporation primarily or solely in the interests of its legal owners—the shareholders (the shareholder perspective)—or whether they should actively concern themselves with the needs of other constituencies (the stakeholder perspective).

This question is answered differently in different parts of the world. In Continental Europe and Asia, for example, managers and boards are expected to concern themselves with the interests of employees and the other stakeholders, such as suppliers, creditors, tax authorities, and the communities in which they operate. Reflecting this perspective, the Centre of European Policy Studies (CEPS) defines corporate governance as "the whole system of rights, processes and controls established internally and externally over the management of a business entity with the objective of protecting the interests of all stakeholders."[1] In contrast, the Anglo-American approach to corporate governance emphasizes the primacy of ownership and property rights and is primarily focused on creating "shareholder" value. In this view, employees, suppliers, and other creditors have rights in the form of contractual claims on the company, but as owners with property rights, shareholders come first:

Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.[2]

Perhaps the broadest, and most neutral, definition is provided by the Organization for Economic Cooperation and Development (OECD), an international organization that brings together the governments of countries committed to democracy and the market economy to support sustainable economic growth, boost employment, raise living standards, maintain financial stability, assist other countries' economic development, and contribute to growth in world trade:

Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.[3]

Corporate Governance: Linking Corporations and Society

The U.S. Corporate Governance System

Today's U.S. corporate governance system is best understood as the set of fiduciary and managerial responsibilities that binds a company's management, shareholders, and the board within a larger, societal context defined by legal, regulatory, competitive, economic, democratic, ethical, and other societal forces.

Shareholders

Although shareholders own corporations, they usually do not run them. Shareholders elect directors, who appoint managers who, in turn, run corporations. Since managers and directors have a fiduciary obligation to act in the best interests of shareholders, this structure implies that shareholders face two separate so-called principal-agent problems—with management whose behavior will likely be concerned with its own welfare, and with the board, which may be beholden to particular interest groups, including management.[1] Many of the mechanisms that define today's corporate governance system are designed to mitigate these potential problems and align the behavior of all parties with the best interests of shareholders broadly construed.

The notion that the welfare of shareholders should be the primary goal of the corporation stems from shareholders' legal status as residual claimants. Other stakeholders in the corporation, such as creditors and employees, have specific claims on the cash flows of the corporation. In contrast, shareholders get their return on investment from the residual only after all other stakeholders have been paid. Theoretically, making shareholders residual claimants creates the strongest incentive to maximize the company's value and generates the greatest benefits for society at large.

Not all shareholders are alike and share the same goals. The interests of small (minority) investors, on the one hand, and large shareholders, including those holding a controlling block of shares and institutional investors, on the other, are often different. Small investors, holding only a small portion of the corporation's outstanding shares, have little power to influence the board of the corporation. Moreover, with only a small share of their personal portfolios invested in the corporation, these investors have little motivation to exercise control over the corporation. As a consequence, small investors are usually passive and interested only in favorable returns. They often do not even bother to vote; they simply sell their shares if they are not satisfied.

In contrast, large shareholders often have a sufficiently large stake in the corporation to justify the time and expense necessary to monitor management actively. They may hold a controlling block of shares or be institutional investors, such as mutual funds, pension plans, employee stock ownership plans, or—outside the United States—banks whose stake in the corporation may not qualify as majority ownership but is large enough to motivate active engagement with management.

It should be noted that the term "institutional investor" covers a wide variety of managed investment funds, including banks, trust funds, pension funds, mutual funds, and similar "delegated investors." All have different investment objectives, portfolio management disciplines, and investment horizons. As a consequence, institutional investors both represent another layer of agency problems and opportunity for oversight. To identify the potential for an additional layer of agency problems, ask why we should expect that a bank or pension fund will look out for minority shareholder interests any better than corporate management. On the one hand, institutional investors may have "purer" motives than management— principally a favorable investment return. On the other hand, they often make for passive, indifferent monitors, partly out of preference and partly because active monitoring may be prohibited by regulations or by their own internal investment rules. Indeed, a major tenet of the recent governance debate is focused on the question of whether it is useful and desirable to create ways for institutional investors to take a more active role in monitoring and disciplining corporate behavior. In theory, as large owners, institutional investors have a greater incentive to monitor corporations. Yet, the reality is that institutions failed to protect their own investors from managerial misconduct in firms like Enron, Tyco, Global Crossing, and WorldCom, even though they held large positions in these firms.

The latest development in the capital markets is the rise of private equity. Private equity funds differ from other types of investment funds mainly in the larger size of their holdings in individual investee companies, their longer investment horizons, and the relatively fewer number of companies in individual fund portfolios. Private equity managers typically have a greater degree of involvement in their investee companies compared to other investment professionals, such as mutual fund or hedge fund managers, and play a greater role in influencing the corporate governance practices of their investee companies. By virtue of their longer investment horizon, direct participation on the board, and continuous engagement with management, private equity managers play an important role in shaping governance practices. That role is even stronger in a buyout or majority stake acquisition, where a private equity manager exercises substantial control—not just influence as in minority stake investments—over a company's governance. Not surprisingly, scholars and regulators are keeping a close watch on the impact of private equity on corporate performance and governance.

State and Federal Law

Until recently, the U.S. government relied on the states to be the primary legislators for corporations. Corporate law primarily deals with the relationship between the officers, board of directors, and shareholders, and therefore traditionally is considered part of private law. It rests on four key premises that define the modern corporation: (a) indefinite life, (b) legal personhood, (c) limited liability, and (d) freely transferable shares. A corporation is a legal entity consisting of a group of persons—its shareholders—created under the authority of the laws of a state. The entity's existence is considered separate and distinct from that of its members. Like a real person, a corporation can enter into contracts, sue and be sued, and must pay tax separately from its owners. As an entity in its own right, it is liable for its own debts and obligations. Providing it complies with applicable laws, the corporation's owners (shareholders) typically enjoy limited liability and are legally shielded from the corporation's liabilities and debts. [2]

The existence of a corporation is not dependent upon whom the owners or investors are at any one time. Once formed, a corporation continues to exist as a separate entity, even when shareholders die or sell their shares. A corporation continues to exist until the shareholders decide to dissolve it or merge it with another business. Corporations are subject to the laws of the state of incorporation and to the laws of any other state in which the corporation conducts business. Corporations may therefore be subject to the laws of more than one state. All states have corporation statutes that set forth the ground rules as to how corporations are formed and maintained.

A key question that has helped shape today's patchwork of corporate laws asks, "What is or should be the role of law in regulating what is essentially a private relationship?" Legal scholars typically adopt either a "contract-based" or "public interest" approach to this question. Free-market advocates tend to see the corporation as a contract, a voluntary economic relationship between shareholders and management, and see little need for government regulation other than the necessity of providing a judicial forum for civil suits alleging breach of contract. Public interest advocates, on the other hand, concerned by the growing impact of large corporations on society, tend to have little faith in market solutions and argue that government must force firms to behave in a manner that advances the public interest. Proponents of this point of view focus on how corporate behavior affects multiple stakeholders, including customers, employees, creditors, the local community, and protectors of the environment.

The stock market crash of 1929 brought the federal government into the regulation of corporate governance for the first time. President Franklin Roosevelt believed that public confidence in the equity market needed to be restored. Fearing that individual investors would shy away from stocks and, by doing so, reduce the pool of capital available to fuel economic growth in the private sector, Congress enacted the Securities Act in 1933 and the Securities Exchange Act in the following year, which established the Securities and Exchange Commission (SEC). This landmark legislation shifted the balance between the roles of federal and state law in governing corporate behavior in America and sparked the growth of federal regulation of corporations at the expense of the states and, for the first time, exposed corporate officers to federal criminal penalties. More recently, in 2002, as a result of the revelations of accounting and financial misconduct in the Enron and WorldCom scandals, Congress enacted the Accounting Reform and Investor Protection Act, better known as the Sarbanes-Oxley Act.

Most of the major state court decisions involving corporate governance are issued by the Delaware Chancery Court, due to the large number of major corporations incorporated in Delaware. In the 21st century, federal securities law, however, has supplanted state law as the most visible means of regulating corporations. The federalization of corporate governance law is perhaps best illustrated by the provision of the Sarbanes-Oxley law that bans corporate loans to directors and executive officers, a matter long dominated by state law.

The Securities and Exchange Commission

The SEC—created to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation—is charged with implementing and enforcing the legal framework that governs security transactions in the United States. This framework is based on a simple and straightforward concept: All investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This promotes efficiency and transparency in the capital market, which, in turn, stimulates capital formation. To ensure efficiency and transparency, the SEC monitors the key participants in the securities trade, including securities exchanges, securities brokers and dealers, investment advisers, and mutual funds. [3]

Crucial to the SEC's effectiveness in each of these areas is its enforcement authority. Each year the SEC brings hundreds of civil enforcement actions against individuals and companies for violation of the securities laws. Typical infractions include insider trading, accounting fraud, and providing false or misleading information about securities and the companies that issue them. Although it is the primary overseer and regulator of the U.S. securities markets, the SEC works closely with many other institutions, including Congress, other federal departments and agencies, self-regulatory organizations (e.g., the stock exchanges), state securities regulators, and various private sector organizations. Specific responsibilities of the SEC include (a) interpret federal securities laws; (b) issue new rules and amend existing rules; (c) oversee the inspection of securities firms, brokers, investment advisers, and ratings agencies; (d) oversee private regulatory organizations in the securities, accounting, and auditing fields; and (e) coordinate U.S. securities regulation with federal, state, and foreign authorities.

The Exchanges

The NYSE Euronext and NASDAQ account for the trading of a major portion of equities in North America and the world. While similar in mission, they are different in the ways they operate and in the types of equities that are traded on them. [4]

The NYSE Euronext and its predecessor, the NYSE, trace their origins to 1792. Their listing standards are among the highest of any market in the world. Meeting these requirements signifies that a company has achieved leadership in its industry in terms of business and investor interest and acceptance. The Corporate Governance Listing Standards set out in Section 303A of the NYSE Listed Company Manual were initially approved by the SEC on November 4, 2003, and amended in the following year. Today, NYSE Euronext's nearly 4,000 listed companies represent almost $30 trillion in total global market capitalization.

The NASDAQ, the other major U.S. stock exchange, is the largest U.S. electronic stock market. With approximately 3,200 companies, it lists more companies and, on average, trades more shares per day than any other U.S. market. It is home to companies that are leaders across all areas of business, including technology, retail, communications, financial services, transportation, media, and biotechnology. The NASDAQ is typically known as a high-tech market, attracting many of the firms dealing with the Internet or electronics. Accordingly, the stocks on this exchange are considered to be more volatile and growth-oriented.

While all trades on the NYSE occur in a physical place, on the trading floor of the NYSE, the NASDAQ is defined by a telecommunications network. The fundamental difference between the NYSE and NASDAQ, therefore, is in the way securities on the exchanges are transacted between buyers and sellers. The NASDAQ is a dealer's market in which market participants buy and sell from a dealer (the market maker). The NYSE is an auction market, in which individuals typically buy from and sell to one another based on an auction price.

Prior to March 8, 2006, a major difference between these two exchanges was their type of ownership: the NASDAQ exchange was listed as a publicly traded corporation, while the NYSE was private. In March of 2006, however, the NYSE went public after being a not-for-profit exchange for nearly 214 years. In the following year, NYSE Euronext—a holding company—was created as part of the merger of the NYSE Group Inc. and Euronext N.V. Now, NYSE Euronext operates the world's largest and most liquid exchange group and offers the most diverse array of financial products and services (see

NYSE Web site at http://www.nyse.com). It brings together six cash equities exchanges in five countries and six derivatives exchanges and is a world leader for listings, trading in cash equities, equity and interest rate derivatives, bonds, and the distribution of market data. As publicly traded companies, the NASDAQ and the NYSE must follow the standard filing requirements set out by the SEC and maintain a body of rules to regulate their member organizations and their associated persons. Such rules are designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and provide a means by which they can take appropriate disciplinary actions against their membership when rule violations occur.

The Gatekeepers: Auditors, Security Analysts, Bankers, and Credit Rating Agencies

The integrity of our financial markets greatly depends on the role played by a number of "gatekeepers"– external auditors, analysts, and credit rating agencies–in detecting and exposing the kinds of questionable financial and accounting decisions that led to the collapse of Enron, WorldCom, and other "misreporting" or accounting frauds. [5] A key question is whether we can (or should) rely on these gatekeepers to perform their roles diligently. It can be argued that we can and should because their business success depends on their credibility and reputation with the ultimate users of their information– investors and creditors–and if they provide fraudulent or reckless opinions, they are subject to private damage suits. The problem with this view is that the interests of gatekeepers are often more closely aligned with those of corporate managers than with investors and shareholders. Gatekeepers, after all, are typically hired and paid (and fired) by the very firms that they evaluate or rate, and not by creditors or investors. Auditors are hired and paid by the firms they audit; credit rating agencies are typically retained and paid by the firms they rate; lawyers are paid by the firms that retain them; and, as we learned in the aftermath of the 2001 governance scandals, until recently the compensation of security analysts (who work primarily for investment banks) was closely tied to the amount of related investments banking business that their employers (the investment banks) do with the firms that their analysts evaluate. [6] A contrasting view, therefore, holds that most gatekeepers are inherently conflicted and cannot be expected to act in the interests of investors and shareholders. Advocates of this perspective also argue that gatekeeper conflict of interest worsened during the 1990s because of the increased cross-selling of consulting services by auditors and credit rating agencies and by the cross-selling of investment banking services. [7] Both issues are addressed by recent regulatory reforms; new rules address the restoration of the “Chinese Wall” between investment banks and security analysts, and mandate the separation of audit and consulting services for accounting firms.

[1] Agency theory explains the relationship between principals, such as shareholders and agents, like a company’s executives. In this relationship, the principal delegates or hires an agent to perform work. The theory attempts to deal with two specific problems: first, that the goals of the principal and agent are not in conflict (agency problem) and second, that the principal and agent reconcile different tolerances for risk.

[2] This section is based on Kenneth Holland’s May 2005 review of the book Corporate Governance: Law, Theory and Policy.

[3] http://www.sec.gov/about/whatwedo.shtml

[4] http://www.investopedia.com

[5] This section draws on Edwards (2003).

[6] Citigroup paid $400 million to settle government charges that it issued fraudulent research reports; and Merrill Lynch agreed to pay $200 million for issuing fraudulent research in a settlement with securities regulators and also agreed that, in the future, its securities analysts would no longer be paid on the basis of the firm’s related investment-banking work.

[7] Coffee (2002, 2003a, 2003b).

Corporate Governance in America: A Brief History Entrepreneurial, Managerial, and Fiduciary Capitalism

In the first part of the twentieth century, large U.S. corporations were controlled by a small number of wealthy entrepreneurs—Morgan, Rockefeller, Carnegie, Ford, and Du Pont, to name a few. These "captains of industry" not only owned the majority of the stock in companies, such as Standard Oil and U.S. Steel, but they also exercised their rights to run these companies. By the 1930s, however, the ownership of U.S. corporations had become much more widespread. Capitalism in the United States had made a transition from entrepreneurial capitalism, the model in which ownership and control had been synonymous, to managerial capitalism, a model in which ownership and control were effectively separated—that is, in which effective control of the corporation was no longer exercised by the legal owners of equity (the shareholders) but by hired, professional managers. With the rise of institutional investing in the 1970s, primarily through private and public pension funds, the responsibility of ownership became once again concentrated in the hands of a relatively small number of institutional investors who act as fiduciaries on behalf of individuals. This large-scale institutionalization of equity brought further changes to the corporate governance landscape. Because of their size, institutional investors effectively own a major fraction of many large companies. And because this can restrict their liquidity, they de facto may have to rely on active monitoring (usually by other, smaller activist investors) than trading. This model of corporate governance, in which monitoring has become as or more important than trading, is sometimes referred to as fiduciary capitalism. [1]

The 1980s: Takeovers and Restructuring

As the ownership of American companies changed, so did the board-management relationship. For the greater part of the 20th century, when managerial capitalism prevailed, executives had a relatively free rein in interpreting their responsibilities toward the various corporate stakeholders and, as long as the corporation made money and its operations were conducted within the confines of the law, they enjoyed great autonomy. Boards of directors, mostly selected and controlled by management, intervened only infrequently, if at all. Indeed, for the first half of the last century, corporate executives of many publicly held companies managed with little or no outside control. Saylor URL: http://www.saylor.org/books Saylor.org 22

In the 1970s and 1980s, however, serious problems began to surface, such as exorbitant executive payouts, disappointing corporate earnings, and ill-considered acquisitions that amounted to little more than empire building and depressed shareholder value. Led by a small number of wealthy, activist shareholders seeking to take advantage of the opportunity to capture underutilized assets, takeovers surged in popularity. Terms, such as leveraged buyout, dawn raids, poison pills, and junk bonds, became household words, and individual corporate raiders, including Carl Icahn, Irwin Jacobs, and T. Boone Pickens, became well known. The resulting takeover boom exposed under performing companies and demonstrated the power of unlocking shareholder value.

The initial response of U.S. corporate managers was to fight takeovers with legal maneuvers and to attempt to enlist political and popular support against corporate raiders. These efforts met with some legislative, regulatory, and judicial success and made hostile takeovers far more costly. As a result, capital became scarce and junk-bond-financed, highly leveraged, hostile takeovers faded from the stage. [2] Of lasting importance from this era was the emergence of institutional investors who knew the value of ownership rights, had fiduciary responsibilities to use them, and were big enough to make a difference. [3] And with the implicit assent of institutional investors, boards substantially increased the use of stock option plans that allowed managers to share in the value created by restructuring their own companies. Shareholder value, therefore, became an ally rather than a threat. [4] [1] This section is based on the essay by Hawley and Williams (2001). [2] Thornton (2002, January 14). Hostile takeovers made a dramatic comeback after the 2001 to 2002 economic recession. In 2001, the value of hostile takeovers climbed to $94 billion, more than twice the value in 2000 and almost $15 billion more than in 1988, the previous peak year. [3] Romano (1994). [4] Holmstrom and Kaplan (2003). Saylor URL: http://www.saylor.org/books Saylor.org 23

The Meltdown of 2001

The year 2001 will be remembered as the year of corporate scandals. The most dramatic of these occurred in the United States—in companies such as Enron, WorldCom, Tyco, and others—but Europe also had its share, with debacles at France's Vivendi, the Netherlands' Ahold, Italy's Parmalat, and ABB, a Swiss-Swedish multinational company. Even before these events fully unfolded, a rising number of complaints about executive pay, concerns about the displacement of private-sector jobs to other countries through off-shoring, and issues of corporate social responsibility had begun to fuel emotional and political reactions to corporate news in the United States and abroad.

Most of these scandals involved deliberately inflating financial results, either by overstating revenues or understating costs, or diverting company funds to the private pockets of managers. Two of the most prominent examples of fraudulent "earnings management" include Enron's creation of off– balance sheet partnerships to hide the company's deteriorating financial position and to enrich Enron executives and WorldCom's intentional misclassification of as much as $11 billion in expenses as capital investments—perhaps the largest accounting fraud in history.

The Enron scandal came to symbolize the excesses of corporations during the long economic boom of the 1990s. [1] Hailed by Fortune magazine as "America's Most Innovative Company" for 6 straight years from 1996 to 2001, Enron became one of the largest bankruptcies in U.S. history. Its collapse in December 2001 followed the disclosure that it had reported false profits, using accounting methods that failed to follow generally accepted procedures. Both internal and external controls failed to detect the financial losses disguised as profits for a number of years. At first, Enron's senior executives, whose activities brought the company to the brink of ruin, escaped with millions of dollars as they retired or sold their company stock before its price plummeted. Enron employees were not so lucky. Many lost their jobs and a hefty portion of retirement savings invested in Enron stock. Because the company was able to hide its losses for nearly 5 years, the Enron scandal shook the confidence of investors in American governance around the world. Outside agencies, such as accounting firms, credit rating businesses, and stock market analysts had failed to warn the public Saylor URL: http://www.saylor.org/books Saylor.org 24 about Enron's business losses until they were obvious to all. Internal controls had not functioned, either. And Enron's board of directors, especially its audit committee, apparently did not understand the full extent of the financial activities undertaken by the firm and, consequently, had failed in providing adequate oversight. Some experts believed that the federal government also bore some responsibility. Politicians in both the legislative and executive branches received millions of dollars in campaign donations from Enron during the period when the federal government decided to deregulate the energy industry, removing virtually all government controls. Deregulation was the critical act that made Enron's rise as a $100 billion company possible.

In June 2002, shortly after the Enron debacle, WorldCom admitted that it had falsely reported $3.85 billion in expenses over 5 quarterly periods to make the company appear profitable when it had actually lost $1.2 billion during that period. [2] Experts said it was one of the biggest accounting frauds ever. In its aftermath, the company was forced to lay off about 17,000 workers, more than 20% of its workforce. Its stock price plummeted from a high of $64.50 in 1999 to 9 cents in late July 2002 when it filed for bankruptcy protection. In March 2004, in a formal filing with the SEC, the company detailed the full extent of its fraudulent accounting. The new statement showed the actual fraud amounted to $11 billion and was accomplished mainly by artificially reducing expenses to make earnings appear larger. After restructuring its debt and meeting other requirements imposed by a federal court, the company emerged from bankruptcy protection in April 2004 and formally changed its name to MCI Inc. Even as it emerged from bankruptcy, industry observers anticipated that MCI would need to merge with another telecommunications firm to compete against larger companies that offered a broader range of telecommunications services. The merger materialized less than a year later, in February 2005, when Verizon Communications Inc. announced its acquisition of MCI for about $6.7 billion in cash, stocks, and dividend payments. MCI ceased to exist as an independent company under the terms of the merger, which was completed in 2006.

As Edwards (2003) notes, these scandals raised fundamental questions about the motivations and incentives of executives and about the effectiveness of existing corporate governance practices, not only in the United States, but also in other parts of the world, including, What motivated executives to engage in fraud and earnings mismanagement? Why did boards either condone or fail to recognize Saylor URL: http://www.saylor.org/books Saylor.org 25 and stop managerial misconduct and allow managers to deceive shareholders and investors? Why did external gatekeepers, for example, auditors, credit rating agencies, and securities analysts, fail to uncover the financial fraud and earnings manipulation, and alert investors to potential discrepancies and problems? Why were shareholders themselves not more vigilant in protecting their interests, especially large institutional investors? What does this say about the motivations and incentives of money managers?[3]

Because of the significance of these questions and their influence on the welfare of the U.S. economy, the government, regulatory authorities, stock exchanges, investors, ordinary citizens, and the press all started to scrutinize the behavior of corporate boards much more carefully than they had before. The result was a wave of structural and procedural reforms aimed at making boards more responsive, more proactive, and more accountable, and at restoring public confidence in our business institutions. The major stock exchanges adopted new standards to strengthen corporate governance requirements for listed companies; then Congress passed the Sarbanes-Oxley Act of 2002, which imposes significant new disclosure and corporate governance requirements for public companies, and also provides for substantially increased liability under the federal securities laws for public companies and their executives and directors; and the SEC adopted a number of significant reforms. [1] Lindstrom (2008). [2] "MCI, Inc.," Microsoft® Encarta® Online Encyclopedia (2008). [3] Edwards (2003). Saylor URL: http://www.saylor.org/books Saylor.org 26

The Financial Crisis of 2008

Just as investor confidence had (somewhat) been restored and the avalanche of regulatory reform that followed the 2001 meltdown digested, a new, possibly even more damaging crisis, potentially global in scale and scope, emerged. While it has not (yet) been labeled as a "corporate governance" crisis, the "financial crisis of 2008" once again raises important questions about the efficacy of our economic and financial systems, board oversight, and executive behavior. Specifically, as the economic news worsens—rising inflation and unemployment, falling house prices, record bank losses, a ballooning federal deficit culminating in a $10 trillion national debt, millions of Americans losing their homes, a growing number of failures of banks and other financial institutions—CEOs, investors, and creditors are walking away with billions of dollars, while American taxpayers are being asked to pick up the tab (Freddie Mac's chairman earned $14.5 million in 2007; Fannie Mae's CEO earned $14.2 million that same year). Not surprisingly, ordinary citizens who have seen the value of the 401K plans shrink by 40% or more are asking tough questions: How did we get into this mess? Why should we support Wall Street? Where was the government? What has happened to accountability? While the causes of the current crisis will be debated for some time—Did we rely too much on free markets or not enough? Did special interests shape public policy? Did greed rule once again? Where were the boards of Bear Stearns, Lehman Brothers, and AIG? Were regulators asleep at the wheel? Incompetent?—one thing is for sure. Another wave of regulatory reform—this time possibly global in reach—is around the corner. And once again we will be asking the questions that prompted the writing of this book: What will be the impact on investor confidence? On corporate behavior? On boards of directors? On society?

Sarbanes-Oxley Act Overview

The Sarbanes-Oxley Act of 2002 imposes significant new disclosure and corporate governance requirements for public companies and also provides for substantially increased liability under the federal securities laws for public companies and their executives and directors. After it was adopted, the NYSE, NASDAQ, and AMEX adopted more comprehensive reporting requirements for listed companies, and the Securities and Exchange Commission (SEC) issued a host of new regulations aimed at strengthening transparency and accountability through more timely and accurate disclosure of information about corporate performance.

The most important changes concern director independence, the composition and responsibilities of the audit, nominating and compensation committees, shareholder approval of equity compensation plans, codes of ethics or conduct, the certification of financial statements by executives, payments to directors and officers of the corporation, the creation of an independent accounting oversight board, and the disclosure of internal controls.

Director Independence

New stock exchange listing requirements stipulate that the majority of directors of public companies be "independent." [1] The rules further state, "No director will qualify as independent unless the board affirmatively determines that the director has no material relationship with the listed company" and require companies to disclose determinations of independence in its annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10-K filed with the SEC. The rationale for increasing independence was that shareholders, by virtue of their inability to directly monitor management behavior, rely on the board of directors to perform critical monitoring activities and that the board's monitoring potential is reduced, or perhaps eliminated, when management itself effectively controls the actions of the board. Additionally, outside directors may lack independence through various affiliations with the company and may be inclined to support management's decisions in hopes of retaining their relationship with the firm. Requiring a board to have a majority of independent directors therefore increases the quality of board oversight and lessens the possibility of damaging conflicts of interest.

Audit Committees

Rule 10A-3 under the Exchange Act directs the stock exchanges and NASDAQ to require listed companies to have an audit committee composed entirely of independent directors. Subsequent stock exchange and SEC amendments further strengthened this provision by requiring the following, among other things:

- Each member of the audit committee is financially literate, as such qualification is interpreted by the board in its business judgment, or will become financially literate within a reasonable period of time after his or her appointment to the audit committee.
- At least one member of the audit committee is a "financial expert," defined as someone who has
    - an understanding of financial statements and generally accepted accounting principles;
    - an ability to assess the general application of such principles in connection with the accounting for estimates, accruals, and reserves;
    - experience preparing, auditing, analyzing, or evaluating financial statements;
    - an understanding of internal controls and procedures for financial reporting;
    - an understanding of audit committee functions.
- The audit committee has a charter that addresses the committee's purpose and sets forth the duties and responsibilities of the committee.
- The audit committee obtains and reviews an annual report by the independent auditor regarding the firm's internal quality-control procedures, discusses the audited financial statements with the independent auditor and management, and reports regularly to the board of directors.
- The audit committee is directly responsible for the

appointment, compensation, retention, and oversight of the outside auditors. Additionally, the outside auditors must report directly to the audit committee.
- The audit committee has the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.
- The audit committee approves, in advance, any audit or nonaudit services provided by the outside auditors.

The reasons behind these reforms are self-evident. Audit committees are in the best position within the company to identify and act in instances where top management may seek to misrepresent reported financial results. An audit committee composed entirely of outside independent directors can provide independent recommendations to the company's board of directors. The responsibilities of the audit committee include review of the internal audit department, review of the annual audit plan, review of the annual reports and the results of the audit, selection and appointment of external auditors, and review of the internal accounting controls and safeguard of corporate assets.

Compensation Committees

New NYSE and SEC rules require that

- listed companies have a compensation committee composed entirely of independent directors;
- the compensation committee has a written charter that addresses, among other things, the committee's purpose and sets forth the duties and responsibilities of the committee;
- the compensation committee produces—on an annual basis—a compensation committee report on executive compensation, to be included in the company's annual proxy statement or

annual report on Form 10-K filed with the SEC.

These reforms respond to the unprecedented growth in compensation for top executives and a dramatic increase in the ratio between the compensation of executives and their employees over the last 2 decades. A reasonable and fair compensation system for executives and employees is fundamental to the creation of long-term corporate value. The responsibility of the compensation committee is to evaluate and recommend the compensation of the firm's top executive officers, including the CEO. To fulfill this responsibility objectively, it is necessary that the compensation committee be composed entirely of outside independent directors.

Nominating Committees

New NYSE and SEC rules stipulate that

- a listed company must have a nominating and corporate governance committee composed entirely of independent directors;
- the nominating and corporate governance committee must have a charter that addresses the committee's purpose and sets forth the goals and responsibilities of the committee.

Nominating new board members is one of the board's most important functions. It is the responsibility of the nominating committee to nominate individuals to serve on the company's board of directors. Placing this responsibility in the hands of an independent nominating committee increases the likelihood that chosen individuals will be more willing to act as advocates for the shareholders and other stakeholders and be less beholden to management.

Shareholder Approval for Equity-Compensation Plans

An equity-compensation plan is a plan or other arrangement that provides for the delivery of equity securities (including options) of the listed company to any service provider as compensation for services. Equity-compensation plans can help align shareholder and management interests, and equity-based awards are often very important components of employee compensation. New NYSE and SEC rules require shareholder approval for stock option plans or other equity compensation plans and any material modification of such plans. These rules are subject to a significant number of exemptions, however. Separately, new accounting rules have changed the accounting of stock options. [1]

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[1] For more on this subject, see Chapter 8 “CEO Performance Evaluation and Executive Compensation” in this volume.

Codes of Ethics and Conduct

New rules also require that public companies must adopt and disclose a code of business conduct and ethics for directors, officers, and employees; include its code of business conduct and ethics on its Web site; and each annual report filed with the SEC must state that the code of business conduct and ethics is available on the Web site. The code of conduct must comply with the definition of a “code of ethics” set forth in section 406 of Sarbanes-Oxley and provide for an enforcement mechanism that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations.

Certification of Financial Statements

Sarbanes-Oxley requires the following:

- The principal executive officers and principal financial officers of public companies should provide a written statement with each periodic report that contains financial statements certifying (a) the report complies with the requirements of section 13(a) or 15(d) of the Exchange Act; and (b) the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the company
- The above certifications need to be filed separately with the SEC as exhibits to the periodic reports to which they relate.
- The principal executive officer and principal financial officer of the company must certify in each annual and quarterly report that
    - the certifying officers have reviewed the report;
    - to the certifying officers' knowledge, the report does not contain any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which the statements were made, not misleading;
    - to the certifying officers' knowledge, the financial statements and other financial information included in the report fairly present, in all material respects, the financial condition and results of operations of the company as of the dates of, and for the periods presented in, the reports;

- the certifying officers (a) are responsible for establishing and maintaining effective internal controls, (b) have designed such internal controls to ensure that material information relating to the company is made known to them, (c) have evaluated the effectiveness of the controls as of a date within 90 days prior to the filing of the report, (d) have presented in the report their conclusions about the effectiveness of the controls, (e) have disclosed to their outside auditors and audit committee any significant deficiencies in the internal controls and any fraud involving management or other employees who have a significant role in the company's internal controls, (f) have identified for the outside auditors any material weaknesses in the internal controls, and (g) have indicated in the report whether or not there were significant changes in the internal controls that could affect those controls, including any corrective actions.

Any CEO or CFO who provides the certification knowing that the report does not meet the above listed standards can be fined up to $1 million, imprisoned for up to 10 years, or both.

Payments to Directors and Officers

Sarbanes-Oxley and subsequent SEC directives stipulate that

- no public company may make a personal loan to a director or officer, and existing loans may not be materially modified or renewed;
- the CEO and CFO of a public company that restates its financial statements as a result of misconduct will have to forfeit any bonuses, incentives, equity-based compensation, and profits on sales of company stock realized during the

12-month period following the first public issuance of the financial document or report containing the inaccurate financial statements;
- the SEC has the authority to freeze any extraordinary payments by the company to any of its directors or officers while an investigation is ongoing;
- the SEC can bar a person who has violated section 17(a) of the Securities Act of 1933 or section 10(b) of the Exchange Act from serving as a public company director or officer;
- directors, officers, and 10% of stockholders of public companies are required to report changes in beneficial ownership within 2 business days after the relevant transaction;
- directors and executive officers are prohibited from buying or selling equity securities during a blackout period;
- non-management directors are required to meet in regularly scheduled executive sessions without management present.

Creation of the PCAOB

The Public Company Accounting Oversight Board (PCAOB) is a private-sector, nonprofit corporation created by Sarbanes-Oxley to oversee accounting professionals who provide independent audit reports for publicly traded companies. Its responsibilities include

- registering public accounting firms;
- establishing auditing, quality control, ethics, independence, and other standards relating to public company audits;
- conducting inspections, investigations, and disciplinary proceedings of registered accounting firms;
- enforcing compliance with Sarbanes-Oxley.

When Congress created the PCAOB, it gave the SEC the authority to oversee the PCAOB's operations, to appoint or remove members, to approve the PCAOB's budget and rules, and to entertain appeals of PCAOB inspection reports and disciplinary actions.

Disclosure of Internal Controls

As directed by section 404 of Sarbanes-Oxley, the SEC adopted a rule requiring registered companies to include in their annual reports a report of management on the company's internal control over financial reporting. Theinternal control report must include

- a statement of management's responsibility for establishing and maintaining adequate internal controls;
- a management assessment of the effectiveness of the company's internal controls including disclosure of any material weaknesses;
- a statement identifying the framework used by management to evaluate the effectiveness of internal controls;
- a statement that the independent auditors have issued an attestation report on management's assessment of the company's internal controls over financial reporting. In addition, companies must provide disclosure about off-balance-sheet transactions in registration statements, annual reports, and proxy statements.

7. Red Flags in Management

Analysis of corporations that have experienced major ethical and financial difficulties shows these companies have a great deal in common in terms of their corporate culture and management profiles, as well as their accounting and governance practices. On the basis of this knowledge, we can identify a number of early warning signals, or red flags, boards can use to spot the emergence of a corporate environment and culture susceptible to conflicts of interest and management abuse. Individually, these factors may not be predictive of future problems. In groups, however, they define a heightened risk profile and should be cause for additional scrutiny and objective analysis. For example, the combination of aggressive management practices creating rapid short-term revenue and stock price growth, coupled with weak board oversight, allowing the CEO to rapidly accumulate personal wealth through stock-based incentive compensation, has been present in a significant percentage of recent problem situations. Risk of rapid financial deterioration in such cases is exacerbated when the company also operates with aggressive financial practices and high leverage. Specifically, audit committees would be well advised to monitor the following categories of higher risk characteristics based on their proven usefulness in identifying corporate environments that may be susceptible to rapid stock price and credit deterioration, as well as fraud:

- Business Growth Strategy and Record
    - Aggressive pursuit of growth through acquisitions or through rapid expansion into new business lines, industries, or markets
    - Major or frequent shifts or U-turns in business or operational strategy, including history of restructuring or sale of core business units or assets

- History of setting business growth targets, strategies, and projections that appear aggressive or overly optimistic, especially in comparison to peers
- Growth materially in excess of peers or broader market

- Equity Culture: Stock Price Appreciation Strategy and Management Ownership
  - Aggressive positioning as a "growth stock"
  - Over-preoccupation of management on short-term stock-price appreciation
  - Low or no common dividend policy
  - Rapid accumulation of ownership (stock and options) by senior management, at a rate and to levels materially in excess of peer group
  - Long-established CEO and senior management team with significant ownership interest where structural complexity, leverage, or opaqueness are present
  - Growth in price–earnings ratio, stock price, or market capitalization materially in excess of peers

- Senior Management Character, Compensation, Composition, Tenure, Turnover, and Succession
  - Cult of a CEO (leader) personality or the high media profile of CEO
  - Over-reliance on, excessive power of, or domination by the CEO, including unwillingness to delegate
  - Heavy dependence on the CEO for corporate public, client, and government relations (e.g., when the CEO is the sole or main spokesperson)
  - Weak or "domineered" senior management team below the CEO
  - CEO incentive and/or total compensation materially higher than peer average
  - Link between company financial performance and executive compensation primarily focused on short-term

horizon
    - Special payments or unusual fringe benefits or loans to executives without a clear purpose, or unconnected with any increase in performance (including “guaranteed” bonuses)
    - Compensation plans or provisions that create perverse incentives (i.e., payouts that encourage excessive acquisition activity; payouts on reaching a certain share price trading level).
    - Unclear succession plan and/or failure to name a successor High or unexpected senior management or board of director turnover or departures.
    - Lack of credibility in company explanation of senior departure(s)
    - Lavish CEO and senior executive lifestyle and corporate entertainment

- Corporate Culture and Business Practices
    - Lack of meaningful long-term corporate planning and focus
    - Creation of a “culture of greed” and management self-enrichment: materially more generous compensation pattern for the CEO and senior executives than peers
    - “Make the numbers!” corporate culture: untoward pressure on managers to achieve aggressive budgets o Creation of a “culture of fear,” penalizing internal debate and independent or creative thinking; creation of environment where only “good news” is acceptable to corporate chieftains
    - “Take no prisoners!” corporate culture: questionable or heavy-handed strategies and tactics with competitors, customers, employees, suppliers, accountants, bankers, business partners, and regulators or government authorities
    - History of litigation in pursuit of business strategies and

undue pressure on critics (e.g., lawsuits by company against company customers, employees, suppliers, accountants, bankers, regulators or government entities) o Lack of transparency: history of lack of openness with external and internal constituencies, including independent directors

  - Heavy use of lobbyists and lawyers
  - Aggressive corporate communication and image building; heavy use of "spin"
  - History of aggressive or questionable sales and/or marketing practices
  - Cavalier attitudes toward internal control

- Company's Legal, Business, Financial, Ownership, and Tax Practices
  - Major changes in ownership, managerial, legal, regulatory, and operating structure
  - Over-focus of management time and resources on creating complex corporate legal entity, operating, finance, and tax structures (particularly if this is accompanied by inter-company asset sales, transfers, or fee payments)
  - Existence of seemingly excessive number of corporate legal entity vehicles (particularly those with limited or no clear operational mandates) o Heavy reliance on tax shelters or similar devices to maintain or maximize profitability
  - Management inability or unwillingness to explain reasons behind corporate-, finance-, tax-, or ownership-structure complexities
  - Aggressiveness or complexity in financial leverage and structure, including
    - high degree of leverage versus peers; stability of capital structure susceptible to refinancing risk;
    - over-reliance on short-term debt;

        - management inability to explain rationale for capitalization structure and financing sources and uses;
        - complexity or untoward number of financing subsidiaries or other financing vehicles within the corporate structure;
        - Overly structured financing arrangements

- Financial stability and liquidity sensitive to triggers, contingents, or access to non-operating sources of cash, including
    - existence of material triggers in debt, derivative and operating agreements calling for repayment or collateralization of debt or contingents given certain predefined events;
    - lack of credible contingency funding plan;
    - over-reliance on receivables sales and factoring;
    - danger of tripping covenant thresholds;
    - access or ability to borrow curtailed, increased cost of borrowing;
    - financial viability (debt service or access to capital) dependent on assets sales, extraordinary contingent realizations, or unusually large cash reserves (at borrower or subsidiaries).

- Accounting, Disclosure Practices, and Reported Results
    - Aggressive strategy or history of revenue or income recognition and understating costs or liabilities, including
        - net income growth materially higher than recurring cash flow growth;
        - revenue, income growth, or both, materially higher than peers;
        - aggressive use of "pro-forma" adjustments;
        - litigation or regulatory action charging illicit financial

reporting practices; history of understating costs or liabilities or overstating revenue;
        - history of restatements, accounting errors and irregularities, and nonrecurring and special charges;
        - large percentage of revenues and net income from non-operating, nonrecurring sources, or both;
        - Use of aggressive accounting elections or assumptions.
    - Aggressiveness, problems, frequent changes, and complexity in accounting practices and reporting, including
        - frequent changes in accounting elections and treatments,
        - especially those affecting revenue, cost, and liability reporting;
        - history of changes in, or disputes with, auditors; auditor providing qualified opinion or refusal to sign financials;
        - history of late filing or issuance of financials;
        - weak internal control environment;
        - nontransparent or lacking financial disclosure;
        - weak internal audit function, ineffective audit committee, or both;
        - external constituents' difficulty in understanding reported results or financials because of complexity in operational structure or lack of comparability between reporting periods (e.g., due to impact of successive acquisitions or dispositions), or both.

- Litigation, Regulatory, and Governmental Actions and Track Record
    - High or increasing incidence in litigation, or threat thereof, from customers, vendors, competitors, regulators, shareholders, creditors, or government entities
    - Lawsuits suggesting the development of overly aggressive

or illicit corporate culture in areas including management misrepresentations, product deficiency, excessive executive compensation and benefits or perks, company loans to executives, accounting and reporting irregularities, fraudulent or coercive sales, price fixing and illegal "market cornering" activities, or failure to supervise (management negligence)

- Sizable contingent liabilities exist or have material chance of developing; establishment of material reserves for future litigation costs/liabilities
- Increased incidence of regulatory scrutiny, actions, or penalties (including forced restatement, refiling of various reports or tax audits)

8. Multiple Versus Single Ethical Standards

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Analyze ethical norms and values as they relate to business standards**
- **Explain the doctrine of ethical relativism and why it is problematic**
- **Evaluate the claim that having a single ethical standard makes behaving consistently easier**

Business people sometimes apply different ethical standards in different contexts, especially if they are working in a culture different from the one in which they were raised or with coworkers from other traditions. If we look outside ourselves for ethical guidance, relying on the context in which we find ourselves, we can grow confused about what is ethical business behavior. Stakeholders then observe that the messages we send via our conduct lack a consistent ethical core, which can harm our reputation and that of the business. To avoid falling back on ethical relativism, a philosophy according to which there is no right or wrong and what is ethical depends solely on the context, we must choose a coherent standard we can apply to all our interactions with others.

Some people who adopt multiple ethical standards may choose to exhibit the highest standards with their families, because these are the people they most revere. In a business setting, however, this same person may choose to be an unethical actor whose sole goal is the ruthless accumulation of wealth by any means. Because work and family are not the only two settings in which we live our lives, such a person may behave according to yet another standard to competitors in a sporting event, to strangers on the street, or to those in his or her religious community.

Although the ethical standard we adopt is always a choice, certain life experiences can have more profound effects on our choice than others. Among the most formative experiences are family upbringing and cultural traditions, broadly defined here to include religious and ethnic norms, the standard patterns of behavior within the context in which we live. Culture and family also influence each other because the family exists in and responds to its cultural context, as well as providing us with the bedrock for our deepest values. Regardless of this initial coding, however, we can choose the ethical standards we apply in the business context.

Why should we choose a single ethical code for all the contexts in which we live? The Greek philosophers and later proponents of the normative ethical theories we discussed earlier would say that if you apply your reason to determine how to behave, it makes rational sense to abide by a single ethical code for all interactions with all persons in all contexts. By doing so, you maximize your ethical behavior no matter who the other party is. Furthermore, you have an internally consistent behavior for all family, friends, customers, clients, and anyone else with whom you interact. Thus, we need not choose different values in different contexts, and when people see us in different situations, they are more likely to trust us because they see we uphold the same values regardless of the context.

Indeed, proponents of all the normative ethical theories would insist that the only rational choice is to have a single ethical standard. A deontologist would argue that you should adhere to particular duties in performing your actions, regardless of the parties with whom you interact. A utilitarian would say that any act you take should result in the greatest good for the greatest number. A virtue ethicist would state that you cannot be virtuous if you lack integrity in your behavior toward all.

Adopting a consistent ethical standard is both selfless and in the manager's self-interest. That is, would-be customers and clients are more likely to seek out a business that treats all with whom it interacts with honesty and fairness, believing that they themselves will be treated likewise by that firm. Similarly, business leaders who treat everyone in a trustworthy manner need never worry that they might not have impressed a potential customer, because they always engage in honorable commercial practices. A single standard of business behavior that emphasizes respect and good service appeals to all.

Normative ethics is about discovering right and delineating it from wrong; it is a way to develop the rules and norms we use to guide meaningful decision-making. The ethics in our single code are not relative to the time, person, or place. In this world, we all wear different hats as we go about our daily lives as employees, parents, leaders, students. Being a truly ethical person requires that no matter what hat we wear, we exhibit a single ethical code and that it includes, among others, such universal principles of behavior as honesty, integrity, loyalty, fairness, respect for law, and respect for others.

Yet another reason to adopt a universal ethical standard is the transparent character it nurtures in us. If a company's leadership insists that it stands for honest business transactions at every turn, it cannot prosecute those who defraud the company and look the other way when its own officers do the same. Stakeholders recognize such hypocrisy and rightly hold it against the business's leaders.

Business leaders are not limited to only one of the normative ethical theories we have described, however. Virtue theory, utilitarianism, and deontology all have advantages to recommend them. Still, what should not change is a corporate commitment to not make exceptions in its practices when those favor the company at the expense of customers, clients, or other stakeholders.

Moving from theory to daily life, we can also look at the way our reputation is established by the implicit and explicit messages we send to others. If we adopt ethical relativism, friends, family, and coworkers will notice that we use different standards for different contexts. This lack of consistency and integrity can alter their perception of us and likely damage our reputation.

WHAT WOULD YOU DO?

TAKING ADVANTAGE OF AN EMPLOYEE DISCOUNT

Suppose you work in retail sales for an international clothing company. A perk of the job is an employee discount of 25 percent on all merchandise you purchase for personal use. Your cousin, who is always looking for a bargain, approaches you in the store one day and implores you to give him your employee discount on a $100 purchase of clothes for himself.

Critical Thinking

- **How would you handle this situation and why?**

- **Would it matter if the relative were someone closer to you, perhaps a brother or sister?**

If so, why?

9. Ethical Principles and Responsible Decision-Making

Introduction

What are major ethical principles that can be used by individuals and organizations?

Before turning to organizational and systems levels of ethics, we discuss classical ethical principles that are very relevant now and on which decisions can be and are made by individuals, organizations, and other stakeholders who choose principled, responsible ways of acting toward others. [1]

Ethical principles are different from values in that the former are considered as rules that are more permanent, universal, and unchanging, whereas values are subjective, even personal, and can change with time. Principles help inform and influence values. Some of the principles presented here date back to Plato, Socrates, and even earlier to ancient religious groups. These principles can be, and are, used in combination; different principles are also used in different situations. [2] The principles that we will cover are utilitarianism, universalism, rights/legal, justice, virtue, common good, and ethical relativism approaches. As you read these, ask yourself which principles characterize and underlie your own values, beliefs, behaviors, and actions. It is helpful to ask and if not clear, perhaps identify the principles, you most often use now and those you aspire to use more, and why. Using one or more of these principles and ethical approaches intentionally can also help you examine choices and options before making a decision or solving an ethical dilemma. Becoming familiar with these principles, then, can help inform your moral decision process and help you observe the principles that a team, work-group, or organization that you now participate in or will be joining may be using. Using creativity is also important when examining difficult moral decisions when sometimes it may seem that there are two “right” ways to act in a situation or perhaps no way seems morally right, which may also signal that not taking an action at that time may be needed, unless taking no action produces worse results.

Utilitarianism: A Consequentialist, “Ends Justifies Means” Approach

The utilitarianism principle basically holds that an action is morally right if it produces the greatest good for the greatest number of people. An action is morally right if the net benefits over costs are greatest for all affected compared with the net benefits of all other possible choices. This, as with all these principles and approaches, is broad in nature and seemingly rather abstract. At the same time, each one has a logic. When we present the specifics and facts of a situation, this and the other principles begin to make sense, although judgement is still required.

Some limitations of this principle suggest that it does not consider individuals, and there is no agreement on the definition of “good for all concerned.” In addition, it is difficult to measure “costs and benefits.” This is one of the most widely used principles by corporations, institutions, nations, and individuals, given the limitations that accompany it. Use of this principle generally applies when resources are scarce, there is a conflict in priorities, and no clear choice meets everyone’s needs—that is, a zero-sum decision is imminent

Universalism: A Duty-Based Approach

Universalism is a principle that considers the welfare and risks of all parties when considering policy decisions and outcomes. Also needs of individuals involved in a decision are identified as well as the choices they have and the information they need to protect their welfare. This principle involves taking human beings, their needs, and their values seriously. It is not only a method to make a decision; it is a way of incorporating a humane consideration of and for individuals and groups when deciding a course of action. As some have asked, "What is a human life worth?"

Cooper, Santora, and Sarros wrote, "Universalism is the outward expression of leadership character and is made manifest by respectfulness for others, fairness, cooperativeness, compassion, spiritual respect, and humility." Corporate leaders in the "World's Most Ethical Companies" strive to set a "tone at the top" to exemplify and embody universal principles in their business practices. [3] Howard Schultz, founder of Starbucks; co-founder Jim Sinegal at Costco; Sheryl Sandberg, chief operating officer of Facebook; and Ursula M. Burns, previous chairperson and CEO of Xerox have demonstrated setting effective ethical tones at the top of organizations.

Limitations here also show that using this principle may not always prove realistic or practical in all situations. In addition, using this principle can require sacrifice of human life—that is, giving one's life to help or save others—which may seem contrary to the principle. The film The Post, based on fact, portrays how the daughter of the founder of the famed newspaper, the Washington Post, inherited the role of CEO and was forced to make a decision between publishing a whistle-blowers' classified government documents of then top-level generals and officials or keep silent and protect the newspaper. The classified documents contained information proving that generals and other top-level government administrators were lying to the public about the actual status of the United States in the Vietnam War. Those documents revealed that there were doubts the war could be won while thousands of young Americans continued to die fighting. The dilemma for the Washington Post's then CEO centered on her having to choose between exposing the truth based on freedom of speech—which was the mission and foundation of the newspaper—or staying silent and suppressing the classified information. She chose, with the support of and pressure from her editorial staff, to release the classified documents to the public. The Supreme Court upheld her and her staff's decision. A result was enflamed widespread public protests from American youth and others. President Johnson was pressured to resign, Secretary of State McNamara later apologized, and the war eventually ended with U.S. troops withdrawing. So, universalist ethical principles may present difficulties when used in complex situations, but such principles can also save lives, protect the integrity of a nation, and stop meaningless destruction.

Rights: A Moral and Legal Entitlement–Based Approach

This principle is grounded in both legal and moral rights. Legal rights are entitlements that are limited to a particular legal system and jurisdiction. In the United States, the Constitution and Declaration of Independence are the basis for citizens' legal rights, for example, the right to life, liberty, and the pursuit of happiness and the right to freedom of speech. Moral (and human) rights, on the other hand, are universal and based on norms in every society, for example, the right not to be enslaved and the right to work.

To get a sense of individual rights in the workplace, log on to one of the "Best Companies to Work For" annual lists (http://fortune.com/best-companies/). Profiles of leaders and organizations' policies, practices, perks, diversity, compensation, and other statistics regarding employee welfare and benefits can be reviewed. The "World's Most Ethical Companies" also provides examples of workforce and workplace legal and moral rights. This principle, as with universalism, can always be used when individuals, groups, and nations are involved in decisions that may violate or harm such rights as life, liberty, the pursuit of happiness, and free speech.

Some limitations when using this principle are (1) it can be used to disguise and manipulate selfish and unjust political interests, (2) it is difficult to determine who deserves what when both parties are "right," and (3) individuals can exaggerate certain entitlements at the expense of others. Still, the U.S. Constitution's Bill of Rights, ratified in 1791, was designed as and remains the foundation of, which is based on freedom and justice to protect the basic rights of all.

Justice: Procedures, Compensation, and Retribution

This principle has at least four major components that are based on the tenets that (1) all individuals should be treated equally; (2) justice is served when all persons have equal opportunities and advantages (through their positions and offices) to society's opportunities and burdens; (3) fair decision practices, procedures, and agreements among parties should be practiced; and (4) punishment is served to someone who has inflicted harm on another, and compensation is given to those for a past harm or injustice committed against them.

A simple way of summarizing this principle when examining a moral dilemma is to ask of a proposed action or decision: (1) Is it fair? (2) Is it right? (3) Who gets hurt? (4) Who has to pay for the consequences? (5) Do I/we want to assume responsibility for the consequences? It is interesting to reflect on how many corporate disasters and crises might have been prevented had the leaders and those involved taken such questions seriously before proceeding with decisions. For example, the following precautionary actions might have prevented the disaster: updating the equipment and machinery that failed in the BP and the Exxon Valdez oil crises and investment banks and lending institutions following rules not to sell subprime mortgages that could not and would not be paid, actions that led to the near collapse of the global economy.

Limitations when using this principle involve the question of who decides who is right and wrong and who has been harmed in complex situations. This is especially the case when facts are not available and there is no objective external jurisdiction of the state or federal government. In addition, we are sometimes faced with the question, "Who has the moral authority to punish to pay compensation to whom?" Still, as with the other principles discussed here, justice stands as a necessary and invaluable building block of democracies and freedom.

Virtue Ethics: Character-Based Virtues

Virtue ethics is based on character traits such as being truthful, practical wisdom, happiness, flourishing, and well-being. It focuses on the type of person we ought to be, not on specific actions that should be taken. Grounded in good character, motives, and core values, the principle is best exemplified by those whose examples show the virtues to be emulated.

Basically, the possessor of good character is moral, acts morally, feels good, is happy, and flourishes. Altruism is also part of character-based virtue ethics. Practical wisdom, however, is often required to be virtuous.

This principle is related to universalism. Many leaders' character and actions serve as examples of how character-based virtues work. For example, the famous Warren Buffett stands as an icon of good character who demonstrates trustworthy values and practical wisdom. Applying this principle is related to a "quick test" before acting or making a decision by asking, "What would my 'best self' do in this situation?" Others ask the question inserting someone they know or honor highly.

There are some limitations to this ethic. First, some individuals may disagree about who is virtuous in different situations and therefore would refuse to use that person's character as a principle. Also, the issue arises, "Who defines virtuous, especially when a complex act or incident is involved that requires factual information and objective criteria to resolve?"

The Common Good

The common good is defined as "the sum of those conditions of social life which allow social groups and their individual members relatively thorough and ready access to their own fulfillment." Decision makers must take into consideration the intent as well as the effects of their actions and decisions on the broader society and the common good of the many. [4]

Identifying and basing decisions on the common good requires us to make goals and take actions that take others, beyond ourselves and our self-interest, into account. Applying the common good principle can also be asked by a simple question: "How will this decision or action affect the broader physical, cultural, and social environment in which I, my family, my friends, and others have to live, breathe, and thrive in now, next week, and beyond?"

A major limitation when using this principle is, "Who determines what the common good is in situations where two or more parties differ over whose interests are violated?" In individualistic and capitalist societies, it is difficult in many cases for individuals to give up their interests and tangible goods for what may not benefit them or may even deprive them.

Ethical Relativism: A Self-Interest Approach

Ethical relativism is really not a "principle" to be followed or modeled. It is an orientation that many use quite frequently. Ethical relativism holds that people set their own moral standards for judging their actions. Only the individual's self-interest and values are relevant for judging his or her behavior. Moreover, moral standards, according to this principle, vary from one culture to another. "When in Rome, do as the Romans do."

Obvious limitations of relativism include following one's blind spots or self-interests that can interfere with facts and reality. Followers of this principle can become absolutists and "true believers"—many times believing and following their own ideology and beliefs. Countries and cultures that follow this orientation can result in dictatorships and absolutist regimes that practice different forms of slavery and abuse to large numbers of people. For example, South Africa's all-white National Party and government after 1948 implemented and enforced a policy of apartheid that consisted of racial segregation. That policy lasted until the 1990s, when several parties negotiated its demise—with the help of Nelson Mandela (www.history.com/topics/apartheid). Until that time, international firms doing business in South Africa were expected to abide by the apartheid policy and its underlying values. Many companies in the United States, Europe, and elsewhere were pressured in the 1980s and before by public interest groups whether or not to continue doing business or leave South Africa.

At the individual level, then, principles and values offer a source of stability and self-control while also affecting job satisfaction and performance. At the organizational level, principled and values-based leadership influences cultures that inspire and motivate ethical behavior and performance. The following section discusses how ethical leadership at the top and throughout organizations affects ethical actions and behaviors. [5]

CONCEPT CHECK

1. **What are some ethical guidelines individuals and organizations can use to make ethical choices?**
2. **Can being aware of the actual values you use to guide your actions make a difference in your choices?**

10. A Framework for Making Ethical Decisions

MAKING CHOICES: A FRAMEWORK FOR MAKING ETHICAL DECISIONS

Decisions about right and wrong permeate everyday life. Ethics should concern all levels of life: acting properly as individuals, creating responsible organizations and governments, and making our society as a whole more ethical. This document is designed as an introduction to making ethical decisions. It recognizes that decisions about "right" and "wrong" can be difficult, and may be related to individual context. It first provides a summary of the major sources for ethical thinking, and then presents a framework for decision-making.

1. WHAT IS ETHICS?:

Ethics provides a set of standards for behavior that helps us decide how we ought to act in a range of situations. In a sense, we can say that ethics is all about making choices, and about providing reasons why we should make these choices.

Ethics is sometimes conflated or confused with other ways of making choices, including religion, law or morality. Many religions promote ethical decision-making but do not always address the full range of ethical choices that we face. Religions may also advocate or prohibit certain behaviors which may not be considered the proper domain of ethics, such as dietary restrictions or sexual behaviors.

A good system of law should be ethical, but the law establishes precedent in trying to dictate universal guidelines, and is thus not able to respond to individual contexts. Law may have a difficult time designing or enforcing standards in some important areas, and may be slow to address new problems. Both law and ethics deal with questions of how we should live together with others, but ethics is sometimes also thought to apply to how individuals act even when others are not involved. Finally, many people use the terms morality and ethics interchangeably. Others reserve morality for the state of virtue while seeing ethics as a code that enables morality. Another way to think about the relationship between ethics and morality is to see ethics as providing a rational basis for morality, that is, ethics provides good reasons for why something is moral.

2. TRADITIONAL ARRANGEMENT OF THE FIELD OF ETHICS:

There are many systems of ethics, and numerous ways to think about right and wrong actions or good and bad character. The field of ethics is traditionally divided into three areas: 1.) meta-ethics, which deals with the nature of the right or the good, as well as the nature and justification of ethical claims; 2.) normative ethics, which deals with the standards and principles used to determine whether something is right or good; 3.) applied ethics, which deals with the actual application of ethical principles to a particular situation. While it is helpful to approach the field of ethics in this order, we might keep in mind that this somewhat "top down" approach does not exhaust the study of ethics. Our experience with applying particular ethical standards or principles can inform our understanding of how good these standard or principles are.

Three Broad Types of Ethical Theory:

Ethical theories are often broadly divided into three types: i) Consequentialist theories, which are primarily concerned with the ethical consequences of particular actions; ii) Non-consequentialist theories, which tend to be broadly concerned with the intentions of the person making ethical decisions about particular actions; and iii) Agent-centered theories, which, unlike consequentialist and non-consequentialist theories, are more concerned with the overall ethical status of individuals, or agents, and are less concerned to identify the morality of particular actions. Each of these three broad categories contains varieties of approaches to ethics, some of which share characteristics across the categories. Below is a sample of some of the most important and useful of these ethical approaches.

i.) Consequentialist Theories:

The Utilitarian Approach

Utilitarianism can be traced back to the school of the Ancient Greek philosopher Epicurus of Samos (341-270 BCE), who argued that the best life is one that produces the least pain and distress. The 18th Century British philosopher Jeremy Bentham (1748-1832) applied a similar standard to individual actions, and created a system in which actions could be described as good or bad depending upon the amount and degree of pleasure and/or pain they would produce. Bentham's student, John Stuart Mill (1806-1873) modified this system by making its standard for the good the more subjective concept of "happiness," as opposed to the more materialist idea of "pleasure."

Utilitarianism is one of the most common approaches to making ethical decisions, especially decisions with consequences that concern large groups of people, in part because it instructs us to weigh the different amounts of good and bad that will be produced by our action. This conforms to our feeling that some good and some bad will necessarily be the result of our action and that the best action will be that which provides the most good or does the least harm, or, to put it another way, produces the greatest balance of good over harm. Ethical environmental action, then, is the one that produces the greatest good and does the least harm for all who are affected—government, corporations, the community, and the environment.

The Egoistic Approach

One variation of the utilitarian approach is known as ethical egoism, or the ethics of self- interest. In this approach, an individual often uses utilitarian calculation to produce the greatest amount of good for him or herself. Ancient Greek Sophists like Thrasymacus (c. 459-400 BCE), who famously claimed that might makes right, and early modern thinkers like Thomas Hobbes (1588-1679) may be considered forerunners of this approach. One of the most influential recent proponents of ethical egoism was the Russian-American philosopher Ayn Rand (1905-1982), who, in the book The Virtue of Selfishness (1964), argues that self-interest is a prerequisite to self-respect and to respect for others. There are numerous parallels between ethical egoism and laissez-faire economic theories, in which the pursuit of self-interest is seen as leading to the benefit of society, although the benefit of society is seen only as the fortunate byproduct of following individual self-interest, not its goal.

The Common Good Approach

The ancient Greek philosophers Plato (427-347 BCE) and Aristotle (384-322 BCE) promoted the perspective that our actions should contribute to ethical communal life life. The most influential modern proponent of this approach was the French philosopher Jean-Jacques Rousseau (1712-1778), who argued that the best society should be guided by the "general will" of the people which would then produce what is best for the people as a whole. This approach to ethics underscores the networked aspects of society and emphasizes respect and compassion for others, especially those who are more vulnerable.

ii.) Non-consequentialist Theories:

The Duty-Based Approach

The duty-based approach, sometimes called deontological ethics, is most commonly associated with the philosopher Immanuel Kant (1724-1804), although it had important precursors in earlier non-consquentialist, often explicitly religious, thinking of people like Saint Augustine of Hippo (354-430), who emphasized the importance of the personal will and intention (and of the omnipotent God who sees this interior mental state) to ethical decision making. Kant argued that doing what is right is not about the consequences of our actions (something over which we ultimately have no control) but about having the proper intention in performing the action. The ethical action is one taken from duty, that is, it is done precisely because it is our obligation to perform the action. Ethical obligations are the same for all rational creatures (they are universal), and knowledge of what these obligations entail is arrived at by discovering rules of behavior that are not contradicted by reason.

Kant's famous formula for discovering our ethical duty is known as the "categorical imperative." It has a number of different versions, but Kant believed they all amounted to the same imperative. The most basic form of the imperative is: "Act only according to that maxim by which you can at the same time will that it should become a universal law." So, for example, lying is unethical because we could not universalize a maxim that said "One should always lie." Such a maxim would render all speech meaningless. We can, however, universalize the maxim, "Always speak truthfully," without running into a logical contradiction. (Notice the duty-based approach says nothing about how easy or difficult it would be to carry out these maxims, only that it is our duty as rational creatures to do so.) In acting according to a law that we have discovered to be rational according to our own universal reason, we are acting autonomously (in a self-regulating fashion), and thus are bound by duty, a duty we have given ourselves as rational creatures. We thus freely choose (we will) to bind ourselves to the moral law. For Kant, choosing to obey the universal moral law is the very nature of acting ethically.

The Rights Approach

The Rights approach to ethics is another non-consequentialist approach which derives much of its current force from Kantian duty-based ethics, although it also has a history that dates back at least to the Stoics of Ancient Greece and Rome, and has another influential current which flows from work of the British empiricist philosopher John Locke (1632-1704). This approach stipulates that the best ethical action is that which protects the ethical rights of those who are affected by the action. It emphasizes the belief that all humans have a right to dignity. This is based on a formulation of Kant's categorical imperative that says: "Act in such a way that you treat humanity, whether in your own person or in the person of another, always at the same time as an end and never simply as a means to an end." The list of ethical rights is debated; many now argue that animals and other non-humans such as robots also have rights.

The Fairness or Justice Approach

The Law Code of Hammurabi in Ancient Mesopotamia (c. 1750 BCE) held that all free men should be treated alike, just as all slaves should be treated alike. When combined with the universality of the rights approach, the justice approach can be applied to all human persons. The most influential version of this approach today is found in the work of American philosopher John Rawls (1921-2002), who argued, along Kantian lines, that just ethical principles are those that would be chosen by free and rational people in an initial situation of equality. This hypothetical contract is considered fair or just because it provides a procedure for what counts as a fair action, and does not concern itself with the consequences of those actions. Fairness of starting point is the principle for what is considered just.

The Divine Command Approach

As its name suggests, this approach sees what is right as the same as what God commands, and ethical standards are the creation of

God’s will. Following God’s will is seen as the very definition what is ethical. Because God is seen as omnipotent and possessed of free will, God could change what is now considered ethical, and God is not bound by any standard of right or wrong short of logical contradiction. The Medieval Christian philosopher William of Ockham (1285-1349) was one of the most influential thinkers in this tradition, and his writings served as a guide for Protestant Reformers like Martin Luther (1483-1546) and Jean Calvin (1509-1564). The Danish philosopher Søren Kierkegaard (1813-1855), in praising the biblical Patriarch Abraham’s willingness to kill his son Isaac at God’s command, claimed that truly right action must ultimately go beyond everyday morality to what he called the “teleological suspension of the ethical,” again demonstrating the somewhat tenuous relationship between religion and ethics mentioned earlier.

iii.) Agent-centered Theories:

The Virtue Approach

One long-standing ethical principle argues that ethical actions should be consistent with ideal human virtues. Aristotle, for example, argued that ethics should be concerned with the whole of a person’s life, not with the individual discrete actions a person may perform in any given situation. A person of good character would be one who has attainted certain virtues. This approach is also prominent in non-Western contexts, especially in East Asia, where the tradition of the Chinese sage Confucius (551-479 BCE) emphasizes the importance of acting virtuously (in an appropriate manner) in a variety of situations. Because virtue ethics is concerned with the entirety of a person’s life, it takes the process of education and training seriously, and emphasizes the importance of role models to our understanding of how to engage in ethical deliberation.

The Feminist Approach

In recent decades, the virtue approach to ethics has been supplemented and sometimes significantly revised by thinkers in the feminist tradition, who often emphasize the importance of the experiences of women and other marginalized groups to ethical deliberation. Among the most important contributions of this approach is its foregrounding of the principle of care as a legitimately primary ethical concern, often in opposition to the seemingly cold and impersonal justice approach. Like virtue ethics, feminist ethics concerned with the totality of human life and how this life comes to influence the way we make ethical decisions.

Applied Ethics

Terms Used in Ethical Judgments

Applied ethics deals with issues in private or public life that are matters for ethical judgments. The following are important terms used in making moral judgments about particular actions.

Obligatory: When we say something is ethically "obligatory" we mean that it is not only right to do it, but that it is wrong not to do it. In other words, we have a ethical obligation to perform the action. Sometimes the easiest way to see if an action is ethically obligatory is to look at what it would mean NOT to perform the action. For example, we might say it is ethically obligatory for parents to care for their children, not only because it is right for them to do it, but also because it is wrong for them not to do it. The children would suffer and die if parents did not care for them. The parents are thus ethically "obligated" to care for their children.

Impermissible: The opposite of an ethically obligatory action is an action that is ethically impermissible, meaning that it is wrong to do it and right not to do it. For example, we would say that murder is ethically impermissible.

Permissible: Sometimes actions are referred to as ethically permissible, or ethically “neutral,” because it is neither right nor wrong to do them or not to do them. We might say that having plastic surgery is ethically permissible, because it is not wrong to have the surgery (it is not impermissible), but neither is it ethically necessary (obligatory) to have the surgery. Some argue that suicide is permissible in certain circumstances. That is, a person would not be wrong in committing suicide, nor would they be wrong in not committing suicide. Others would say that suicide is ethically impermissible.

Supererogatory: A fourth type of ethical action is called supererogatory. These types of actions are seen as going “above and beyond the call of duty.” They are right to do, but it is not wrong not to do them. For example, two people are walking down a hallway and see a third person drop their book bag, spilling all of their books and papers onto the floor. If one person stops to help the third person pick up their books, but the other person keeps on walking, we somehow feel that the person who stopped to help has acted in a more ethically appropriate way than the person who did not stop, but we cannot say that the person who did not stop was unethical in not stopping. In other words, the person who did not help was in no way obligated (it was not ethically obligatory) to help. But we nevertheless want to ethically praise the person who did stop, so we call his or her actions supererogatory.

3. FRAMEWORKS FOR ETHICAL DECISION-MAKING:

Making good ethical decisions requires a trained sensitivity to ethical issues and a practiced method for exploring the ethical aspects of a decision and weighing the considerations that should impact our choice of a course of action. Having a method for ethical decision making is essential. When practiced regularly, the method becomes so familiar that we work through it automatically without consulting the specific steps. This is one reason why we can sometimes say that we have a “moral intuition” about a certain situation, even when we have not consciously thought through the issue. We are practiced at making ethical judgments, just as we can be practiced at playing the piano, and can sit and play well “without thinking.” Nevertheless, it is not always advisable to follow our immediate intuitions, especially in particularly complicated or unfamiliar situations. Here our method for ethical decision making should enable us to recognize these new and unfamiliar situations and to act accordingly.

The more novel and difficult the ethical choice we face, the more we need to rely on discussion and dialogue with others about the dilemma. Only by careful exploration of the problem, aided by the insights and different perspectives of others, can we make good ethical choices in such situations.

Three Frameworks

Based upon the three-part division of traditional normative ethical theories discussed above, it makes sense to suggest three broad frameworks to guide ethical decision making: The Consequentialist Framework; The Duty Framework; and the Virtue Framework.

While each of the three frameworks are useful for making ethical decisions, none is perfect—otherwise the perfect theory would have driven the other imperfect theories from the field long ago. Knowing the advantages and disadvantages of the frameworks will be helpful in deciding which is most useful in approach the particular situation with which we are presented.

The Consequentialist Framework

In the Consequentialist framework, we focus on the future effects of the possible courses of action, considering the people who will be directly or indirectly affected. We ask about what outcomes are desirable in a given situation, and consider ethical conduct to be whatever will achieve the best consequences. The person using the Consequences framework desires to produce the most good.

Among the advantages of this ethical framework is that focusing on the results of an action is a pragmatic approach. It helps in situations involving many people, some of whom may benefit from the action, while others may not. On the other hand, it is not always possible to predict the consequences of an action, so some actions that are expected to produce good consequences might actually end up harming people. Additionally, people sometimes react negatively to the use of compromise which is an inherent part of this approach, and they recoil from the implication that the end justifies the means. It also does not include a pronouncement that certain things are always wrong, as even the most heinous actions may result in a good outcome for some people, and this framework allows for these actions to then be ethical.

The Duty Framework

In the Duty framework, we focus on the duties and obligations that we have in a given situation, and consider what ethical obligations we have and what things we should never do. Ethical conduct is defined by doing one's duties and doing the right thing, and the goal is performing the correct action.

This framework has the advantage of creating a system of rules that has consistent expectations of all people; if an action is ethically correct or a duty is required, it would apply to every person in a given situation. This even-handedness encourages treating everyone with equal dignity and respect.

This framework also focuses on following moral rules or duty regardless of outcome, so it allows for the possibility that one might have acted ethically, even if there is a bad result. Therefore, this framework works best in situations where there is a sense of obligation or in those in which we need to consider why duty or obligation mandates or forbids certain courses of action.

However, this framework also has its limitations. First, it can appear cold and impersonal, in that it might require actions which are known to produce harms, even though they are strictly in keeping with a particular moral rule. It also does not provide a way to determine which duty we should follow if we are presented with a situation in which two or more duties conflict. It can also be rigid in applying the notion of duty to everyone regardless of personal situation.

The Virtue Framework

In the Virtue framework, we try to identify the character traits (either positive or negative) that might motivate us in a given situation. We are concerned with what kind of person we should be and what our actions indicate about our character. We define ethical behavior as whatever a virtuous person would do in the situation, and we seek to develop similar virtues.

Obviously, this framework is useful in situations that ask what sort of person one should be. As a way of making sense of the world, it allows for a wide range of behaviors to be called ethical, as there might be many different types of good character and many paths to developing it. Consequently, it takes into account all parts of human experience and their role in ethical deliberation, as it believes that all of one's experiences, emotions, and thoughts can influence the development of one's character.

Although this framework takes into account a variety of human experience, it also makes it more difficult to resolve disputes, as there can often be more disagreement about virtuous traits than ethical actions. Also, because the framework looks at character, it is not particularly good at helping someone to decide what actions to take in a given situation or determine the rules that would guide one's actions. Also, because it emphasizes the importance of role models and education to ethical behavior, it can sometimes merely reinforce current cultural norms as the standard of ethical behavior.

Putting the Frameworks Together

By framing the situation or choice you are facing in one of the ways presented above, specific features will be brought into focus more clearly. However, it should be noted that each framework has its limits: by focusing our attention on one set of features, other important features may be obscured. Hence it is important to be familiar with all three frameworks and to understand how they relate to each other—where they may overlap, and where they may differ.

The chart below is designed to highlight the main contrasts between the three frameworks:

[Image/Caption]

Because the answers to the three main types of ethical questions asked by each framework are not mutually exclusive, each framework can be used to make at least some progress in answering the questions posed by the other two.

In many situations, all three frameworks will result in the same—or at least very similar—conclusions about what you should do, **although they will typically give different reasons for reaching those conclusions.**

However, because they focus on different ethical features, **the conclusions reached through one framework will occasionally differ from the conclusions reached through one (or both) of the others.**

4. APPLYING THE FRAMEWORKS TO CASES:

When using the frameworks to make ethical judgments about specific cases, it will be useful to follow the process below.

Recognizing an Ethical Issue

One of the most important things to do at the beginning of ethical deliberation is to locate, to the extent possible, the specifically ethical aspects of the issue at hand. Sometimes what appears to be an ethical dispute is really a dispute about facts or concepts. For example, some Utilitarians might argue that the death penalty is ethical because it deters crime and thus produces the greatest amount of good with the least harm. Other Utilitarians, however, might argue that the death penalty does not deter crime, and thus produces more harm than good. The argument here is over which facts argue for the morality of a particular action, not simply over the morality of particular principles. All Utilitarians would abide by the principle of producing the most good with the least harm.

Consider the Parties Involved

Another important aspect to reflect upon are the various individuals and groups who may be affected by your decision. Consider who might be harmed or who might benefit.

Gather all of the Relevant Information

Before taking action, it is a good idea to make sure that you have gathered all of the pertinent information, and that all potential sources of information have been consulted.

Formulate Actions and Consider Alternatives

Evaluate your decision-making options by asking the following questions:

- Which action will produce the most good and do the least harm? (The Utilitarian Approach)
- Which action respects the rights of all who have a stake in the decision? (The Rights Approach)
- Which action treats people equally or proportionately? (The Justice Approach)
- Which action serves the community as a whole, not just some members? (The Common Good Approach)
- Which action leads me to act as the sort of person I should be? (The Virtue Approach)
- Make a Decision and Consider It
- After examining all of the potential actions, which best addresses the situation? How do I feel about my choice?

Act

Many ethical situations are uncomfortable because we can never have all of the information. Even so, we must often take action.

Reflect on the Outcome

- What were the results of my decision?
- What were the intended and unintended consequences?

- Would I change anything now that I have seen the consequences?

5. CONCLUSIONS:

Making ethical decisions requires sensitivity to the ethical implications of problems and situations. It also requires practice. Having a framework for ethical decision making is essential. We hope that the information above is helpful in developing your own experience in making choices.

Acknowledgements:

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11. Recent Governance Reforms: An Executive Summary

In the aftermath of the governance scandals around the turn of the century, the government, regulatory authorities, stock exchanges, investors, ordinary citizens, and the press all began to scrutinize the behavior of corporate boards much more carefully than they had at anytime before. The result was an avalanche of structural and procedural reforms aimed at making boards more responsive, more proactive, and more accountable, and at restoring public confidence in U.S. business institutions.[1]

The congress passed the Sarbanes-Oxley Act of 2002, which imposes significant new disclosure and corporate governance requirements for public companies and also provides for substantially increased liability under the federal securities laws for public companies and their executives and directors. Subsequently, the NYSE, NASDAQ, and AMEX adopted more comprehensive reporting requirements for listed companies, and the Securities and Exchange Commission (SEC) issued a host of new regulations aimed at strengthening transparency and accountability through more timely and accurate disclosure of information about corporate performance.

The most important changes concern director independence and the composition and responsibilities of the audit, nominating, and compensation committees. Additional reforms address shareholder approval of equity compensation plans, codes of ethics and conduct, the certification of financial statements by executives, payments to directors and officers of the corporation, the creation of an independent accounting oversight board, and the disclosure of internal controls. They are described in some detail in Chapter 12

"Appendix A: Sarbanes-Oxley and Other Recent Reforms" of this book.

It is important to understand the rationale behind some of the most far-reaching reforms. The rationale for increasing **director independence** was that shareholders, by virtue of their inability to directly monitor management behavior, rely on the board of directors to perform critical monitoring activities and that the board's monitoring potential is reduced or perhaps eliminated when management itself effectively controls the actions of the board. Additionally, outside directors may lack independence through various affiliations with the company and may be inclined to support management's decisions in hopes of retaining their relationship with the firm. Requiring a board to have a majority of independent directors, therefore, increases the quality of board oversight and lessens the possibility of damaging conflicts of interest.

Audit committee reforms are among the most important changes mandated by Sarbanes-Oxley. The reasons behind these reforms are self-evident. Audit committees are in the best position within the company to identify and act in instances where top management may seek to misrepresent reported financial results. An audit committee composed entirely of outside independent directors can provide independent recommendations to the company's board of directors. The responsibilities of the audit committee include review of the internal audit department, review of the annual audit plan, review of the annual reports and the results of the audit, selection and appointment of external auditors, and review of the internal accounting controls and safeguard of corporate assets.

Compensation committee reforms respond to the unprecedented growth in compensation for top executives and a dramatic increase in the ratio between the compensation of executives and their employees over the last 2 decades. A reasonable and fair compensation system for executives and employees is fundamental to the creation of long-term corporate value. The responsibility of the compensation committee is to evaluate and recommend the compensation of the firm’s top executive officers, including the CEO. To fulfill this responsibility objectively, it is necessary that the compensation committee be composed entirely of outside independent directors.

Nominating new board members is one of the board’s most important functions. It is the responsibility of the **nominating committee** to nominate individuals to serve on the company’s board of directors. Placing this responsibility in the hands of an independent nominating committee increases the likelihood that chosen individuals will be more willing to act as advocates for the shareholders and other stakeholders and be less beholden to management.

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[1]For a more detailed summary of these and related governance reforms, see, for example, Morgan Lewis,

Counselors at Law, “Corporate Governance: An Overview of Recently Adopted Reforms” (2004); or Petra,

“Corporate Governance Reforms: Fact or Fiction, Corporate Governance” (2006), pp. 107–115

12. Debating CSR: Methods and Strategies

Source: U.S. Navy (CC-BY 2012) Figure 2.1 Deployed U.S. sailors watching the U.S. Presidential debate between candidates Barack Obama and Mitt Romney in 2012.

Why Debate CSR?

In this chapter, we help you prepare for productive debates on CSR. Our first question is: why debate CSR? Why not just study texts on CSR, and then write essays or take tests on the topic? Why do we need to debate?

The position of this textbook is that CSR is not only an important social phenomenon, but a complex and controversial one. As we will see in this book, there are often two sides to CSR issues. As future voters and future employees of corporations, schools, governments, and civil society organizations, you will get a chance to have a real impact on the future of CSR. But what should the future of CSR be?

It is not the role of teachers or textbooks to tell you what to think when it comes to such a new and politically divisive topic. Like your fellow citizens, you are entitled to develop your own opinion, but we hope that it will be an informed and logical opinion, rather than one that emerges reflexively from political partisanship or cultural tradition.

In short, we want you to practice thinking for yourself about CSR, and we think the best way to practice is that is to debate crucial issues relating to CSR. At times you will be asked to come up with the strongest arguments in favor of a position that you do not initially support. As the saying goes, to understand another person you have to walk a mile in their shoes. If you want to understand why many of your fellow citizens take social and political positions that are different from yours, the best thing to do is to consider the strongest arguments on their side—and the best way to do that is to become their advocate, even if only for the length of a class session.

Questioning the Value of CSR Itself

As an example of the importance and complexity of CSR-related public debates, consider the following controversies related to CSR:

CSR: Sincere ethics or hypocritical public relations?

- Facts: CSR is a rapidly growing field of study in universities and business schools, and most large corporations have adopted CSR programs.
- The controversial aspect: Is CSR a good thing or is it just corporate window-dressing?
- In favor of CSR: CSR motivates corporations to address social problems, it energizes and rewards workers, it strengthens ties to the community, and it improves the image of the corporation.
- Against CSR: Surveys show that citizens are more concerned

about corporations treating their workers well and obeying laws than about engaging in philanthropic activities, and CSR may allow corporations to distract consumers and legislators from the need to tightly regulate corporations.

Climate change and CSR

- Facts: There is a scientific consensus that global warming and climate change represent an enormous threat facing mankind.
- The controversial aspect: Can corporate CSR really have a significant impact on climate change, or is it just a public relations vehicle for companies and a distraction from the need for stronger government action, such as through a carbon tax?
- In favor of global warming–related CSR: Corporations can have a major impact in the battle against global warming by reducing their large carbon footprints, by encouraging other corporations to follow suit, and by helping discover and develop alternative sources of energy.
- Against global warming–related CSR: Companies spend a lot of advertising money to boast about small measures against global warming, but many of these companies are in industries—such as fossil fuels or automobiles—that produce the most greenhouse gases to begin with; self-serving claims of climate-change concern are often simply corporate public relations campaigns intended to distract us from the need for society to take more effective measures through taxation and regulation.

Corporate Lobbying and Government Influence

- Facts: Most large corporations spend money on lobbying and on seeking to influence legislators and regulators. In the Citizens United decision, the Supreme Court ruled that, as “corporate persons,” corporations enjoy the same freedom of

speech protections as ordinary citizens and are entitled to relief from strict government control of their rights to political speech.
- The controversial aspect: Many citizens are outraged to find that the justice system accords multinational corporations the same rights as ordinary people on the grounds that corporations are "persons." However, others point out that The New York Times and CNN are also corporations, and that it could have a chilling effect on freedom of speech if all corporations were legally-constrained from speaking out freely.
- In favor of corporate lobbying: As major employers and technological innovators, corporations benefit society. They should be free to oppose inefficient and cumbersome government regulations and taxation that can limit the benefits they provide. In this way, freedom of political speech is so important that we should be cautious about limiting it in any way.
- Against corporate lobbying: Corporations are not "persons" in the same sense that humans are, and therefore, they should not enjoy the same freedom of speech protection. Since corporations can become vastly wealthier than ordinary citizens, allowing them to participate in politics will enable them to bend laws and regulations to their will.

In each of the debates outlined above, there are intelligent and well-informed people on both sides of the issue. However, if our society is going to progress in its handling of these issues, we will need to reach consensus on the best approach, or at least on the best compromise. It is therefore vital that citizens learn to discuss these issues in an informed, respectful and productive manner.

How to Debate CSR: Rules of Civility and Logic

Civility

This chapter introduces you to the techniques of logical debate. We hope to improve your ability to craft a forceful, persuasive argument and to detect faulty logic and weak evidence put forward by your adversaries. It is equally important, however, to practice engaging in social and political debates in a way that is respectful and tolerant of differing viewpoints.

Although we will base our approach to some extent on the rules and methods of formal debate, the reality of life is that most of our disagreements, and much public debate, are not carried out according to formal rules or any previously agreed structure. Indeed, the average political debate with our schoolmates, work colleagues, and family is often quite freewheeling and sometimes extremely illogical. It is an accepted truism of American life that political campaigns are filled with name-calling, mud-slinging, finger-pointing, and scurrilous attack ads. That is one reason that so many people say that you should never discuss politics or religion among friends or family—because doing so can compromise friendships and spoil family gatherings with angry and unproductive arguments.

In this course and in this textbook, we want to lean toward the other extreme. We believe that there are sincere, intelligent people on both sides of most social debates. As educated people, we should not engage in political discussion in order to flaunt our superior intelligence or backgrounds, or to browbeat or insult our interlocutors. Unfortunately, since people sometimes resort to bullying and offensive tactics when discussing sensitive topics, and since many of us are unable to control our wounded, emotional responses to such aggression, it can become difficult to discuss important social issues in a productive way.

We suggest certain ground rules to promote fair and respectful debate.

1. **Do not try to "win" the debate.**

In formal debate contests, each side is trying to defeat the other. Similarly, in political debates each candidate is trying to come out on top so as to win the election. However, in the classroom or in informal discussions around the dinner table or at the workplace, such tactics can be unproductive and can backfire.

Therefore, we recommend that (at least part of the time) instructors randomly assign students to each side of an argument. In this fashion, you will sometimes find that you are arguing on behalf of a position that you would not ordinarily support. This may seem paradoxical to you, so why do we insist on its value?

By obliging you to consider and advocate on behalf of the strongest points of each side of the argument, we want you to appreciate that there are valuable, sincere motivations on both sides of most social debates. We are not asking you to be insincere and pretend to believe in something that you do not support. Rather, we are simply asking you to look for the strongest arguments the other side could make.

So, in this course, the goal is not to try to win the debate by making the other side look bad. The objective here is to obtain greater knowledge and greater depth of understanding. Everyone in the class should consider it a win anytime fellow students make a new or interesting point, express themselves eloquently, or show a willingness to listen and learn from the other side. The ultimate win in this course is to learn more about an important social topic, and to learn to engage in debates in a respectful way.

2. **Admit discomfort or emotionality.**

Discussions of important social or political topics often touch upon values that each of us holds dear. They may be values we have imbibed from the teachings of our parents, trusted elders, respected teachers, and admired thinkers. As a result, when someone strongly challenges those values, especially in a way that we find disrespectful, it is understandable that we feel negative emotions or anger. The challenge is to control those emotions without being tempted to retaliate.

So if you ever feel uncomfortable or embarrassed in a class debate, whether online or in person, do not hesitate to let your interlocutor, the class, and the instructor know of your feelings. You can simply say, for example, “I think that last remark was bit personal,” or “I find that the tone you are using is somewhat aggressive.” However, try to avoid responding in an equally offensive fashion because that usually leads to a breakdown in the conversation.

It is not only up to the instructor; it is up to each class member to monitor class discussions for inappropriate levels of aggression or condescension.

3. **Listen respectfully and show that you have heard the other side.**

It is very easy for debates to degenerate into emotional contests if neither side makes a sincere attempt to listen to the other side’s arguments. Therefore, it is always a good strategy to show that you have heard the other side and have understood their point. For example, you can say, “So it seems that you feel the strongest argument in favor of freedom of corporate lobbying is that if we restrict such lobbying, then we will create a precedent that could eventually lead to restrictions on the freedom of speech of individuals. However, we would like to argue that…”

On political talk shows and at the dinner table, it is quite common for debaters to cut each other off, interrupt rudely, or talk over each other. In the classroom, however, we want to hold ourselves to a higher standard. Let people finish talking before you make your point. If you feel someone is going on too long, you can alert the instructor and request that you be given an equivalent amount of time for your rebuttal.

Logic: The Techniques of Persuasive Argumentation

The Structure of a Debate

Although this is not a course in logical debate, you will get more out of it if you proceed in a systematic manner. Although there are many systems and theories for debate, we present a simplified version here so that your class can have a common framework to follow. The elements of a logical debate are the topic, the argument, and the rebuttal or counter-argument.

The Topic

Sometimes also called the "proposition," "claim," or "thesis," this is the concise statement of what the argument will address. In formal debating, the topic is usually called a proposition and may be presented in the form of a motion that is going to be submitted to a body for a vote, for example:

Resolved, that American corporations should refrain from outsourcing to factories in countries where child labor under the age of 15 is permitted.

Thereafter, one side (sometimes an individual but often a team consisting of up to three people) takes the affirmative position (meaning that it supports the proposition), while the other takes the negative position (meaning that it opposes the proposition). The party taking the affirmative side then opens with a clear formulation of its position and begins the debate by presenting the "main line," or strongest point on its side. The negative side is allowed to question the manner in which the affirmative side has defined the proposition, and may choose to present an alternative formulation before presenting the main line of its argument. In team debating, the second and third members will then present the second and third lines of their team's argument. Opportunities for rebuttal may be provided after each speaker or at the end of each team's main presentation. When the debate is concluded, a vote may be taken (for example, by the audience or by a group of judges) to determine which team has been more persuasive.

In this course, we encourage a more informal approach in order to suit the preferences and prior experience of the instructor and students. You may prefer to present different topics for debate, or provide for a range of alternatives for action. Regardless of the approach you choose, each class and each student should have some freedom to frame the debate in the perspective that he or she finds the most relevant while ensuring that both sides are still engaging the same question. Consequently, it is always a good practice to begin a debate or discussion (or a written assignment) with a clear statement of your topic or proposition, even if it seems implied by the assignment.

The Argument

Once you have clearly stated the debate topic and your opening proposition, you must go on to provide logical support or evidence in support of your argument. In order to persuade an audience, you must support your main thesis with compelling reasoning and/or factual evidence. You may choose to focus on either logic or evidence, or you may use both. For example, if you wanted to base your argument on moral reasoning, you might say,

In the United States, we do not permit full-time factory work for children under the age of 15, so we should not participate in the exploitation of children abroad in a manner we would not accept at home.

Note that this argument, like many other arguments based on logic or reasoning, is itself based on further unstated assumptions, which we may call the logical basis or moral basis of the argument. Thus, the person making the above argument is assuming that

1. it is self-evident that we should not participate in behavior abroad that we do not accept at home (which may or may not be true depending on circumstances); and/or
2. behavior that is not legally accepted in the United States is necessarily exploitative when practiced abroad (which, again, may or may not be the case).

If you wanted to base your argument on factual evidence or statistics, you might say, for example:

Statistics show that countries that permit full-time employment for children have lower levels of literacy.

Or :

Studies show that underage female factory workers are subjected to high levels of sexual harassment and are at greater risk to become victims of rape or violence.

As with arguments based on reasoning, arguments based on evidence also depend on implicit assumptions about the evidence. For example the evidence must be

1. accurate and recent (thus, the statistics should not be derived from unreliably small samples, and they should not be obtained from studies conducted so long ago that they are no longer valid),
2. relevant and logically connected to the argument (thus, the statistics on literacy might show that children raised in the countryside have even lower rates of literacy than urban children who work in factories), and
3. available to be examined (it is very easy to say, "Studies show that . . ." but if you cannot produce any published report of the study, or the study itself, then your argument cannot be considered valid; you might even be misstating the results of the survey).

Rebuttal and Counter-argument

A good debate allows opportunities for each side to respond to the other side's arguments, and this may be called a rebuttal or a counter-argument.

To develop an effective rebuttal, you should listen carefully to the other side's argument and try to detect flaws or gaps in their claims, reasoning, or evidence. In classical rhetoric, debaters were trained to detect a number of logical fallacies, common types of arguments which on further examination are unconvincing. Here are some of the key fallacies, or flaws, you may encounter:

Arguing Off-topic

Failure to stick to the main argument is perhaps the most common of all logical fallacies encountered in everyday discussions. In informal discussions, this is sometimes acceptable, but in a serious intellectual discussion, it wastes time and energy because you cannot seriously argue about two different topics at the same time. For example, in the debate described above, one of the parties might say something like,

"Everyone knows that American corporations don't really care about people; all they care about is profits."

Not only is that point arguable in itself (though it might make for an interesting argument), it is not directly relevant to a discussion of child labor in overseas factories. In such a case, it is appropriate simply to say, "The point you are making is not relevant to the topic of this discussion."

Drawing Excessive or Illogical Conclusions from Evidence

In debates over the value of evidence, it is frequently said that "correlation does not prove causation." In other words, if statistics show a correlation between two sets of facts, they do not necessarily prove a causal connection between them. For example, in one nineteenth century study of tuberculosis in Paris, the researcher noted that tuberculosis most frequently struck people living on the fifth floor of apartment buildings (the highest floor in apartment buildings of the day). He concluded that there was a causal relation between tuberculosis and altitude, and theorized that it was unhealthy to live too high above the ground. In fact, the highest floor was reserved for the small, drafty attic chambers of the poor servants who served the bourgeois families on the lower floors, so the true correlation was between poverty and tuberculosis. Statistics must always be closely scrutinized for relevance. We must always ask whether the statistics apply to the same fact pattern that we are discussing. Also, be wary of statistics that are out of date or are drawn from samples that differ in some fundamental way from the population being discussed.

Ad Hominem Argument

This refers to a statement that attacks you personally (or personally attacks an authority upon whom you are relying), rather than addressing the argument that you are making. In everyday discussions, this is perhaps the most dangerous of rhetorical fallacies. Not only is it irrelevant, but it frequently arouses such negative emotions that the opponent retaliates in kind. Everyone, including the instructor and other classmates, should be attentive to ad hominem arguments, and the person making them should be gently but firmly admonished against this tactic.

The Problem of Cognitive Bias

One of the difficulties encountered in everyday discussions of social and political affairs is that people enter the discussion with their minds already made up. No matter how compelling the reasoning or convincing the evidence, they will refuse to consider the other side. If asked to research the facts, they will only look for facts that support the views they already had. Such people could be said to be wearing "intellectual blinders." In a classroom or college context, this attitude is unfortunate: It closes us off from learning and from growing intellectually. In order to detect it in others and avoid it ourselves, it pays to learn about this tendency toward stubborn consistency, which is sometimes referred to by psychologists as cognitive bias.

One of the great discoveries of modern psychology is that humans are, in fact, extremely susceptible to biased thinking. Much of our understanding of the powerful influence of cognitive bias is due to the work of two psychologists, Daniel Kahneman and Amos Tversky. (Kahneman won the Nobel Prize for his efforts in 2002.) Kahneman postulates that humans use two different kinds of thinking systems, fast and slow.1 Fast thinking is instinctive, emotional, and reactive, and can be useful in contexts when you have to make a decision quickly (e.g., you see a bear coming toward you in the forest, so it is time to think quickly about climbing a tree). Slow thinking is logical, laborious, and difficult: the kind of thinking that we use when we solve a math problem or a logic puzzle.

Cognitive bias represents the tendency toward instinctive, reflexive modes of thought, or fast thinking, when we might be better off using our slower, more laborious mode of thinking. One might suppose that when it comes to politics and social issues, such as those involved in analyzing corporate social responsibility, people would always rely on slow, logical thinking. However, Kahneman's research (as well as that of many other cognitive psychologists) indicates the opposite.

Let us consider the power of some important cognitive biases that draw us astray.

Confirmation Bias

Confirmation bias is the human tendency to discredit or ignore information that contradicts our beliefs, while we uncritically adopt information that supports our beliefs. Studies have demonstrated that most people are only open to hearing new information if it confirms their previously-held beliefs.

Confirmation bias explains why information exchange tends to reinforce our beliefs. The more we learn about ethical, social, or political issues, the more biased we become. Confirmation bias is thus the motor of prejudice. Once we get a tiny bit biased one way or another, the confirmation bias pushes us further and further in that direction. Increased education and research, strangely, can end up making us all more deeply biased.

In one classic study, a group of pro–death penalty students and a group of anti–death penalty students evaluated two “opposing” studies on capital punishment. In fact, the studies were identical, except that they carried different titles and came to different conclusions. The students were asked to decide which of these studies was better and more convincing (despite their being virtually identical). Almost invariably, the students concluded that the study with the title that supported their pre-existing views was superior to the other study. Not only that, but when the students were asked why they preferred the study they felt was superior, they were able to present a number of highly-specific examples to support their evaluations. Since both studies were based on exactly the same information, the students’ preference for one study over the other was derived purely from bias.

When we are exposed to mixed information, part of it supporting our views and part of it contradicting our views, we are more attentive to the part that supports our views, which we are likely to accept as accurate and true, while we ignore the part that contradicts our views. Indeed, sometimes these contrary arguments barely register in our consciousness.

Partisan Bias

Partisan bias is a form of prejudice and overconfidence that takes hold of people whenever they feel loyalty or affiliation with a group or a team. We witness partisan bias in the political sphere when presidential campaigns are under way, as Democrats are always quick to point out that their preferred candidate is vastly superior to the Republican candidate, while Republicans are equally certain of the contrary.

Partisan bias does not only rule the world of politics, but can occur in any sphere where people feel drawn to one group over another. We can relate this concept to CSR: If you begin to perceive that you are part of a group that is a big supporter of a certain kind of CSR activity, then you will probably be susceptible to the assumption that your group is always right in all aspects. As soon as we feel we belong to a group, we begin to view that group as superior to other groups. It is so easy to elicit group bias that psychologists have proposed the existence of implicit partisanship—a hard-wired human predisposition to take sides and then prefer that side.

One experiment relating to implicit partisanship showed that, if people are shown a list of names and asked to study it for as briefly as a few minutes, they develop a preference for the names on the list and consider them superior to other names.2 In another experiment, a group of college students was assigned to one of two teams to watch a taped football game. The students displayed a clear preference for their assigned team and later argued that the referee had unfairly called fouls against their team.3

If a group of people are told that they will be assigned to either group A or group B according to a coin toss, they begin to prefer their group even before they are sure they are assigned to it. Those to whom it has been merely hinted that they may have been assigned to group B begin nonetheless to express a clear preference for the members of group B and a belief that group B is generally superior to group A.4

While the existence of the partisan bias has been confirmed by recent research, it has long been apparent to perceptive observers of political argument. In fact, Socrates noted the following in Plato's Phaedo:

The partisan, when he is engaged in a dispute, cares nothing about the rights of the question, but is anxious only to convince his hearers of his own assertions.5

Availability Bias

Availability bias refers to the fact that, in an uncertain situation, people tend to use the most obvious fact or statistic in order to come to a conclusion—even if a moment's thought or the slightest bit of research would have demonstrated that the particular fact or statistic was unreliable. You can test your own susceptibility to the availability bias by trying to correctly answer the following question as quickly as possible:

Facts: A bat and a ball cost $1.10 in total. The bat costs $1 more than the ball.

Question: How much does the ball cost?

Most people answer 10 cents. However, this is clearly wrong, as you will probably realize if you think about it carefully for a few more seconds. The correct answer is that the ball costs 5 cents.

If you answered incorrectly, don't feel bad—more than half of a group of Princeton students got the answer wrong as well. How is it possible that even smart people can be so dumb when it comes to such a simple question? In Kahneman's words, "The respondents offered their responses without checking. People are not accustomed to thinking hard and are often content to trust a plausible judgment that comes quickly to mind."6 Since $1.10 divides neatly into $1.00 and ten cents, respondents leapt to this seemingly obvious answer, though it was incorrect. Kahneman named this the availability heuristic, the tendency to rely on a mental shortcut to choose answers from the most obvious (available) options.

Kahneman amusingly illustrated a variant of the availability bias, which he called the anchoring bias. When asked to estimate anything numerically, we have a tendency to over-rely (or "anchor") on any number that has recently been suggested to us, regardless of its relevance. Kahneman asks an audience to think of the last four digits of their social security number, and then asks them to estimate the number of physicians living in New York City. To a remarkable and entirely illogical extent, people's subsequent estimates of the number of New York physicians correlated with the last four digits of their own social security number. (Amazingly, this held true even when the audience was composed of math teachers.) Numbers hold a mystical sway over the human brain and it appears we are frighteningly suggestible when it comes to arguments based on data, even when the data is irrelevant. Thus we acquire newfound respect for the prescience of Mark Twain's famous quip, "There are three kinds of lies: lies, damned lies, and statistics."

One example of availability bias that comes up in the context of CSR relates to the impact of global warming on polar bears. Global warming contrarian Bjorn Lomborg often uses this example to show that most people think they understand global warming better than they actually do. Thus, he opens his book Cool It with a long chapter that provides abundant statistics to show that, over the past 25 years, the global population of polar bears has been increasing.[7] This comes as a profound shock to most citizens who are concerned about global warming that they can scarcely believe it. Is Bjorn Lomborg telling the truth, or is he pulling our leg? Some students even become angry when presented with the evidence.

Actually, Lomborg does not deny that in the long term global warming may have a highly negative impact on polar bear populations. The point he is trying to make is that people leap to assumptions without checking the facts. People are concerned about polar bears because so many groups that try to raise awareness about the dangers of global warming have used the endangered polar bear as their favored mascot. Consequently, many people have simply assumed polar bear populations were already being decimated by global warming. While, polar bear populations may become under severe strain from global warming in the 21st century, for the past several decades, as well as the current decade, the main danger to polar bears comes from legally licensed hunters.

This point is raised here not to advance any argument about global warming. We will devote an entire chapter to global warming issues, and you will have an opportunity to learn more there about the very real dangers associated with global warming. The point here is that people have a tendency to leap to the easiest assumption, and that is one tendency that we should try to resist when we engage in formal research and debate.

Debating CSR: What are the Key Issues?

As noted at the beginning of this chapter, some people are surprised to hear that there is anything to debate about CSR. After all, such people may ask, isn't CSR a matter of corporations doing good things? And what could possibly be wrong with corporations doing good things?

Actually, even corporations that fully support CSR do engage in debates about CSR, but these are usually about how to do CSR, not about whether CSR is in general a positive thing or not. Corporations, like individuals, sometimes have to make difficult choices about how to spend their money. It can be quite challenging for a corporation to choose among different options for CSR, and equally difficult to decide how much to spend on a particular CSR project in terms of cash and organizational resources. Several of the case studies in this book deal these types of strategic CSR questions.

However, it is worth noting at the outset that many CSR skeptics also believe that CSR merits greater ethical scrutiny, and thus there are some prominent voices who have expressed doubts about the perceived social benefits of CSR.

So that you can begin to develop your own informed opinion on this topic, let us begin with a review of the potential benefits and drawbacks to CSR.

CSR: Potential Benefits

Neglected Social Problems Are Addressed

It is undeniable that even governments in the wealthiest countries cannot effectively address all social problems. Every society is to some extent plagued by issues such as unemployment, criminality, homelessness, disease, discrimination, pollution, and natural disaster. Why not mobilize the vast economic and organizational resources of corporations to help alleviate the damage caused by such problems?

Corporate Employees Are Energized and Motivated

A large percentage of the workforce in most countries is employed in the corporate sector (38% of Americans are employed by large companies).8 CSR allows corporate employees to feel an added level of meaning in their lives by enriching their jobs with an ethical dimension. Such employees may be more productive on the job and may be more willing to volunteer for community service and contribute to charitable organizations.

Links between Business, Nonprofits and the Government Are Enhanced

Today, a great deal of CSR involves partnerships between corporations, nonprofit organizations, and governmental bodies. For example, the Timberland footwear and apparel company developed a partnership with the Boston-based nonprofit organization City Year in 1989, beginning with a small contribution of 50 boots.9 City Year engages young people from 17 to 24 in a 10-month program of community service. By 1994, Timberland had provided $5 million to help City Year expand into 6 cities, and by 1998, Timberland employees had contributed 20,000 hours to City

Year efforts. President Bill Clinton was so impressed by the City Year story in 1992 that, in 1993, he enlisted its founders to help him establish the AmeriCorps program, a federally-funded means of supporting community service by young people. Since its founding, 575,000 AmeriCorps volunteers have contributed over 700 million hours of community service.

Corporate Image Is Improved

In a competitive global marketplace, corporations want to maintain a strong, positive image in the minds of consumers and legislators, and CSR helps them achieve this. For example, Estée Lauder has become closely associated with the pink ribbon symbol of its Estée Lauder Breast Cancer Awareness Campaign, a program that has raised over $35 million for breast cancer research and has spread to over 70 countries.

CSR: Potential Drawbacks

Bad Corporations Are Able to Buy a Positive Image

Some of the biggest contributors to CSR are companies in the oil, tobacco, and alcohol sectors, arguably those who have the most to gain from repairing negative associations with the harm caused by their products. Although the World Health Organization has declared that tobacco is the single greatest cause of preventable deaths worldwide, that fact has not stopped global tobacco companies, such as Philip Morris International (owner of the Marlboro brand) from spending huge sums to improve their image. Philip Morris not only contributes over $30 million per year to a variety of charitable causes in over 50 countries, it is also a leading sponsor of sporting events (notably Formula 1 racing).10

The Public Is Misled on the True Impact of Corporate Activities, e.g., "Greenwashing"

Greenwashing refers to the corporate practice of making misleading environmental claims. By the early 1990s, nearly a quarter of all consumer products were marketed with some sort of environmental claim, using terms such as "green" or "environmentally friendly."11 So many of these claims were later found to be exaggerated or deceptive that a number of advertising regulatory bodies and consumer protection agencies around the world enacted strict controls on environmental claims in advertising.

Among the leaders in making environmental claims have been oil, chemical, and automobile companies, all of which are arguably linked to increasing levels of pollution. Thus, in Norway, for example, strict regulations prohibit car manufacturers from making virtually any environmental claims, because in the view of the Norwegian Consumers Ombudsman, "cars can't be environmentally beneficial."

As early as the mid-1990s, the Chevron oil company had become a leader in touting its commitment to environmentalism, but that did not prevent it from getting embroiled in a controversial lawsuit involving claims of massive amounts of pollution in the Ecuadorian Amazon, with Chevron suffering an adverse $19 billion legal judgment for the environmental damage it caused. Similarly, BP (British Petroleum), went so far as to revamp the corporate logo in its attempt to become recognized for environmentalism despite evidence that BP management was aware of the risks that led to the offshore oil platform explosion off the coast of Louisiana in 2010, considered the worst marine oil spill in the world and the greatest environmental disaster in the history of the United States. Evidence uncovered in a U.S. Congressional hearing suggested that BP management had overruled its own staff and consultants to undertake riskier procedures because these were perceived to save time and money.12

Nonprofits and Charities May Rely Too Heavily on Corporate Handouts

Many charities and nonprofits come to rely heavily on corporate contributions and often on contributions from a single corporation, which leaves them at the mercy of corporate goodwill, and at the risk of economic or management reversals which could lead to a cutoff of their funds. Thus, in the Timberland–City Year example discussed earlier, by 1997, City Year found that it was almost wholly dependent on Timberland for financial support, and it was only at that point that Timberland and City Year reached out for help from other corporations. Indeed, the City Year sponsorship had even caused a problem within Timberland when the company suffered a sharp decline in revenue in 1995 that led to layoffs. Employees were angry that management continued to spend millions on charitable contributions at the same time it was terminating jobs.

From a similar perspective, consider the cases of Enron and Lehman Brothers, enormous companies that disappeared virtually overnight due to fraud and mismanagement, respectively. Both companies maintained large CSR programs that had to be suddenly abandoned.13 Indeed, Enron had become known as a leading “poster child” for CSR, with widely reported commitments to green energy, so that at the 1997 Kyoto Conference it received an award from the Climate Institute.

Topic for Debate: To CSR or Not to CSR?

You have a close friend, John Goodie, who is considering obtaining a graduate degree in business and is trying to decide between two programs. One program is part of the MBA (master of business administration degree) curriculum at University A, and it focuses on CSR. The other program is part of the MBA curriculum at University

B, and it focuses on the management of nonprofits and charities. John has always considered himself a very ethical and responsible citizen and has spent most of his summers since his teenage years volunteering in a number of community service positions. Both schools have excellent reputations, but University B is slightly more prestigious.

John tells you that his ultimate goal is simply "to make the world a better place." He asks for your advice. What do you tell him? Provide the strongest arguments in favor of either University A or University B, as follows:

Affirmative Position

John should attend University A, which has a strong program in CSR.

Possible Arguments:

- CSR is likely to be the most powerful and effective way of making the world a better place.
- CSR is a rapidly growing field with lots of jobs.
- John is already implicitly interested in CSR since he wants to make the world a better place.

Negative Position

John should attend University B, which is slightly more prestigious but does not have a well-developed CSR program.

Possible Arguments:

- There are problems with CSR, such as greenwashing.
- If John wants to make the world a better place, he will be better off developing his skills in the more prestigious

institution.

- With a more prestigious degree, he will be able to get a job in a nonprofit or charitable organization if he wants.

Readings

CSR Isn't Working

Morrell, Marcus. "Anita Roddick: Corporate Social Responsibility?" Transcript of video, 5:02. Filmed September 15, 2006. http://www.globalissues.org/video/733/anita-roddick-corporate-social-responsibility.

Corporate social responsibility, I don't think it's working. I think it's been taken over by the big management houses, marketing houses, been taken over by the big groups like KPMG, like Arthur Anderson. It's a huge money-building operation now. I think maybe it's the word "corporate."

When I was part of the architects of this responsibility business movement, that was so different; that was an alternative to the International Chamber of Commerce, it was a traders' alliance, it had progressive thinkers, progressive academics, it had, you know, people who were philanthropists.

Things happened. We didn't see the whole growth of corporate globalization; we didn't see the immense power of businesses playing, especially in the political arena. We didn't look at the language, the economic language which was about control, which was about everything had to be for the market economy. We were just flowering around on our own thinking and so we took our eyes off the ball and when we put it on the ball again we thought, "you know, it's been hijacked, this social responsibility in business"; and it became corporate social responsibility.

And it was a huge money-earner, for these big management companies, like KPMG, like Arthur Anderson, like PriceWaterHouseCoopers, all of those. They were making shed-loads of money by actually doing a system of analysis about how you measure your behavior. But it was no good; it was like this obsession for measurement. It wasn't showing you how you can put these ideas into practice and they never told you it meant a truth—truth that nobody wants to discuss, that if it gets in the way of profit, businesses aren't going to do anything about it. So we still have rapacious businesses, you still have businesses in bed with government, you still have governments' inability to measure their greatness by how they look after the weak and the frail. You still have government's only true measurement of success as economic measurement. And you still have businesses that can legitimately kill, can legitimately have boardroom murder, can legitimately have a slave-labor economy, so that all of us in the West—primarily in the West, or all of us who are wealthy—are guaranteed a standard of living to which we are used to.

But for me, corporate social responsibility in my life, I don't think it has worked. And that's a shame. Because it's controlled the language and it's hijacked the language.

Morrell, Marcus. "Anita Roddick: Corporate Social Responsibility?" Transcript of video, 5:02. Filmed September 15, 2006. http://www.globalissues.org/video/733/anita-roddick-corporate-social-responsibility.

Paul Newman reflects on founding Newman's Own

Newman, Paul and A.E. Hotchner. In Pursuit of the Common Good, 197-199. New York: Broadway Books, 2003. Find this book in a library.

I really cannot lay claim to some terribly philanthropic instinct in my base nature. It was just a combination of circumstances. If the business had stayed small and had just been in three local stores, it would never have gone charitable. It was just an abhorrence of combining tackiness, exploitation, and putting money in my pocket, which was excessive in every direction.

Now that I'm heavily into peddling food, I begin to understand the romance of the business—the allure of being the biggest fish in the pond and the juice you get from beating out your competitors. I would like to see the company reach $300 million in sales, and be able to support new philanthropic initiatives. We were a joke in 1982, but the joke has given away $250 million so far—so we are a very practical joke.

One thing that really bothers me is what I call "noisy philanthropy." Philanthropy ought to be anonymous, but in order for this to be successful you have to be noisy. Because when a shopper walks up to the shelf and says, "Should I take this one or that one?" you've got to let her know that the money goes to a good purpose. But overcoming that dichotomy has provided us with the means of bringing thousands of unlucky children to the Hole in the Wall Gang Camps.

Since the Connecticut camp opened in 1988, a time when only 30 percent of the children who attended survived, medical progress has been phenomenal, especially in the field of bone marrow transplants; the result is that the percentages have been completely reversed—70 percent of those children who come to camp will now survive; but during the critical time of treatment and recovery we furnish them with much needed respite....

It is also thrilling to note that thirty-five of last summer's counselors were former campers who had overcome cancer and were now taking care of kids afflicted as they were. At the end of last summer's session, a counselor who had been a media major in college, on the basis of her experience at the camp changed her course of studies to pursue a medical career in pediatric oncology....

Another experience last summer, a marvelous African-American girl who told me, "Coming up here is what I live for, what I stay alive for during those miserable eleven months and two weeks is to come up here for the summer."

"Corporate Conscience Survey Says Workers Should Come First"

Strom, Stephanie. "Corporate Conscience Survey Says Workers Should Come First." The New York Times online. May 31, 2006. http://www.nytimes.com/2006/05/31/business/31charity.html?_r=0.

Corporate Watch Critiques CSR

"What's Wrong with Corporate Social Responsibility? The Arguments against CSR," Corporate Watch, accessed November 30, 2014, http://www.corporatewatch.org/content/whats-wrong-corporate-social-responsibility-arguments-against-csr.

Like the iceberg, most CSR activity is invisible…It is often an active attempt to increase corporate domination rather than simply a defensive "image management" operation.

CSR is supposed to be win-win. The companies make profits and society benefits. But who really wins? If there is a benefit to society, which in many cases is doubtful, is this outweighed by losses to society in other areas of the company's operation and by gains the corporation is able to make as a result? CSR has ulterior motives. One study showed that over 80% of corporate CSR decision-makers were very confident in the ability of good CSR practice to deliver branding and employee benefits. To take the example of simple corporate philanthropy, when corporations make donations to charity they are giving away their shareholders' money, which they can only do if they see potential profit in it. This may be because they want to improve their image by associating themselves with a cause, to exploit a cheap vehicle for advertising, or to counter the claims of pressure groups, but there is always an underlying financial motive, so the company benefits more than the charity.

…CSR diverts attention from real issues, helping corporations to avoid regulation, gain legitimacy and access to markets and decision makers, and shift the ground towards privatization of public functions. CSR enables business to pose ineffective market-based solutions to social and environmental crises, deflecting blame or problems caused by corporate operations onto the consumer and protecting their interests while hampering efforts to find just and sustainable solutions.

CSR as Public Relations

CSR sells. By appealing to customers' consciences and desires CSR helps companies to build brand loyalty and develop a personal connection with their customers. Many corporate charity tie-ins gain companies access to target markets and the involvement of the charity gives the company's message much greater power. In our media-saturated culture, companies are looking for ever more innovative ways to get across their message, and CSR offers up many potential avenues, such as word of mouth or guerilla marketing, for subtly reaching consumers.

CSR also helps to greenwash the company's image, to cover up negative impacts by saturating the media with positive images of the company's CSR credentials.…

A prominent case against Nike in the US Supreme Court illustrates this point. When, in 2002, the Californian Supreme Court ruled that Nike did not have the right to lie in defending itself against criticism, chaos ensued in the CSR movement. Activist Marc Kasky attempted to sue the company over a misleading public relations campaign. Nike defended itself using the First Amendment right to free speech. The court ruled that Nike was not protected by the First Amendment, on the grounds that the publications in question were commercial speech. The case proceeded to the US Supreme Court. Legal briefs were submitted to the Supreme Court by public relations and advertising trade associations, major media groups, and leading multinationals, arguing that if a company's claims on human rights, environmental and social issues are legally required to be true, then companies won't continue to make statements on these matters.

The submission from Exxon-Mobil, Monsanto, Microsoft, Bank of America, and Pfizer contended that "if a corporation's every press release, letter to an editor, customer mailing, and website posting may be the basis for civil and criminal actions, corporate speakers will find it difficult to address issues of public concern implicating their products, services, or business operations."

This case simply reinforces the criticism that CSR is nothing more than a PR exercise. Corporations would not be so concerned about potential legal actions if they valued truth, transparency, and accountability as much as they claim.

CSR is a strategy for avoiding regulation

CSR is a corporate reaction to public mistrust and calls for regulation. In an Echo research poll, most financial executives interviewed strongly resisted binding regulation of companies. Companies argue that setting minimum standards stops innovation; that you can't regulate for ethics, you either have them or you don't; and that unless they are able to gain competitive advantage from CSR, companies cannot justify the cost.

Companies are essentially holding the government to ransom on the issue of regulation, saying that regulation will threaten the positive work they are doing. CSR consultancy Business in the Community supports corporate lobbying against regulation, arguing that "regulation can only defend against bad practice—it can never promote best practice." These arguments, however, simply serve to expose the sham of CSR. Why would a "socially responsible company" take issue with government regulation to tackle bad corporate practice?

…The argument that regulation would hinder voluntary efforts on the part of the company to improve their behavior has been readily accepted by a government keen to avoid its regulatory duties when it comes to curbing corporate power. The UK Department for International Development (the department charged with tackling global poverty…) dismissed the idea of an international legally binding framework for multinational companies saying that it would "divert attention and energy away from encouraging corporate social responsibility and towards legal processes." As this quotation shows, without any evidence for its effectiveness, the government is choosing CSR over making corporate exploitation and abuse illegal.

"Leading Organizations Build Case for Green Infrastructure"

"Leading Organizations Build Case for Green Infrastructure," The Nature Conservancy, accessed June 11, 2013, http://www.nature.org/newsfeatures/pressreleases/leading-organizations-build-case-for-green-infrastructure.xml.

Research by experts from industry and an environmental organization finds that incorporating nature into man-made infrastructure can improve business resilience—and bring additional economic, environmental, and socio-political benefits.

Experts from The Dow Chemical Company, Shell, Swiss Re, and Unilever, working with The Nature Conservancy and a resiliency expert, evaluated a number of business Case Studies, and recommend in their newly published White Paper that green infrastructure solutions should become part of the standard toolkit for modern engineers.

Green infrastructure employs elements of natural systems, while traditional gray infrastructure is man-made. Examples of green infrastructure include creating oyster reefs for coastal protection, and reed beds that treat industrial wastewater.

"Instead of thinking about independent solutions, we must look at integrated systems," said Andrew Liveris, Chairman and Chief Executive Officer of Dow. "Natural systems not only serve multiple functions, but have multiple benefits–often requiring less capital and less maintenance while promoting biodiversity that we all enjoy."

"Green infrastructure can bring benefits for companies, for communities and for the environment," said Peter Voser, Chief Executive Officer of Royal Dutch Shell plc. "It can be cheaper, provide new opportunities for engagement with stakeholders, and create wildlife habitats. Green infrastructure should be part of mainstream business thinking."

"Protecting nature and the services it provides to people and business is one of the smartest investments we can make," said Mark R. Tercek, president and CEO of The Nature Conservancy.

"This is the case whether we are talking about the production of clean, abundant freshwater, protection from storms, or healthy and productive soils. Green infrastructure solutions also provide many co-benefits, such as wildlife habitat, and typically appreciate over time, rather than depreciate as happens with gray infrastructure."

Union Carbide Corporation (subsidiary of The Dow Chemical Company) uses constructed wetlands to treat wastewater near Seadrift in Texas.

This 110-acre (approximately 44.5-hectare) engineered wetland was designed to consistently meet regulatory requirements for water discharge from the manufacturing plant, and has operated successfully for over a decade.

Petroleum Development Oman LLC (PDO) uses constructed wetlands to treat produced water from oil fields in Oman.

The Nimr oilfields, in which The Shell Petroleum Company Ltd is a joint venture partner, not only produce oil, but also more than 330,000 m3 of water per day. PDO built the world's largest commercial wetland, and it treats more than 30% (or 95,000 m3 per day) of the total produced water. This volume would normally require extensive infrastructure to treat and inject the water into a subsurface disposal well. As gravity pulls the water downhill, reeds act as filters, removing oil from the water. The oil is eaten by microbes that naturally feed on hydrocarbons underground. Oil content in the produced water is consistently reduced from 400 mg/l to less than 0.5 mg/l when leaving the wetlands.

Power consumption and CO_2 emissions are 98% lower than they would have been with the alternative man-made solution. Also, the wetlands are providing habitat for fish and hundreds of species of migratory birds.

The Nature Conservancy is a leading conservation organization working around the world to protect ecologically important lands and waters for nature and people. The Conservancy and its more than 1 million members have protected nearly 120 million acres worldwide.

Synthesis Questions

1. **Are there companies you can name whose social responsibility actions you admire and trust? What do they do that inspires you?**
2. **Are there companies you can name whose social responsibility actions you would not trust, or even doubt? Which companies are they, and why do they fail to convince you?**
3. **Would you like to work in the field of CSR? Why or why not?**

13. Corporations and Politics: After Citizens United

Source: courtesy of John Montgomery, (CC-BY 2012), http://www.commondreams.org/views/2012/10/17/freedom-beach-dump-citizens-united Figure 13.1 The Supreme Court's decision in Citizens United v. Federal Elections Committee gave First Amendment rights to corporations in election periods, allowing business interests to spend unlimited amounts on U.S. elections. Do corporations deserve the same rights as individuals when it comes to political speech?

Corporate Influence on Politics

Corporations today exert a considerable (and occasionally overwhelming) influence on global politics. In some countries, the influence of corporations on government is so great as to give rise to the suspicion that the government is actually controlled by corporations. Even in those countries that strictly limit corporate influence on political campaigns, the corporate sector can still play an important role in the development of governmental policies through sophisticated, high-level lobbying. In this chapter we ask, how much of this corporate influence is acceptable? We will also explore the following related questions: How can corporate influence be controlled? What is the appropriate level of corporate participation in the drafting of laws and regulations? Should corporations be allowed to contribute freely to political campaigns? What is the role of foreign and multinational corporations? Should they also be allowed to influence domestic politics?

Although we will focus on corporate influence, let us note at the outset that they are not the only source of money in politics; wealthy individuals, unions, and other participants in the electoral process also contribute significant funds and resources to campaigns. In the United States, as in most other industrialized democracies, electoral campaigns have become increasingly expensive despite attempts to limit allowable expenditures.

Given the importance of the issue, it is not surprising that a storm of controversy arose over a US Supreme Court's ruling in 2010 that government limits on corporate spending in political campaigns violated the First Amendment right to freedom of speech. In the view of an openly dismayed President Barack Obama, the Court's decision in Citizens United v. Federal Elections Commission "reversed a century of law to open the floodgates for special interests—including foreign corporations—to spend without limit in our elections."[1]

The validity of President Obama's objection to Citizen United has been hotly contested, and it will provide us with a focal point for our discussion: Is it true that corporations have achieved excessive influence over national politics? Are corporations entitled to be treated as “persons” when it comes to freedom of speech?

A Basic Distinction: Private vs. Public Funding of Campaigns

While private election spending in the United States is increasing, the situation around the world is quite diverse. In some countries, expenditures are increasing while elsewhere they are decreasing. A basic distinction in national campaign finance regulations is that some countries allow private support for political campaigns while other countries provide public funds to candidates.

Private Finance

In the United Kingdom there are no limits on corporate or individual giving in the general election, yet total spending on the 2010 general election was down 26 percent from 2005.[2] However, in the United Kingdom, the Prime Minister may call for elections at any time within a maximum period, which shortens the total time available for campaigning and explains the need for funds. National elections tend to be more expensive in the United States because they come along at predictable four-year intervals.

In Brazil, it is estimated that $2 billion was spent by parties and candidates in the 2010 presidential election, with nearly 100 percent of total campaign donations coming from corporations.

Public Funding

In countries such as Norway, government funding accounts for up to 74 percent of political campaigns, and political ads are banned from television and radio.

In Canada, candidates are given strict spending limits based on the number of voters in their districts, in order to even the playing field in elections, and private donations (a maximum of $1,200 to any party) are heavily subsidized by public funds paid out through tax credits. Although the price of elections has grown 50 percent in the past decade, Canadians spent just $300 million on the 2008 general election.[3]

Campaign Finance in the U.S.

US Campaign Finance Law, PACs and Super PACs

"There are two things that are important in politics. The first is money, and I can't remember what the second one is."

—Mark Hanna, campaign manager of President McKinley's successful bid for the Presidency in 1896.

Concern over the influence of money in politics began at an early stage in the life of the United States, with Thomas Jefferson stating in 1816 that he feared it would be necessary to "crush in its birth the aristocracy of our moneyed corporations, which dare already to challenge our government to a trial of strength and bid defiance to the laws of our country."[4]

Despite Jefferson's hopes, the influence of corporations on politics grew substantially in the latter half of the nineteenth century. The presidential elections of 1896 and 1904 left much of the American populace disgusted and convinced that political office in the United States was up for sale. In 1896, the victor in the presidential election, William McKinley, outspent his competitor, the populist William Jennings Bryan, by a factor of 10 to 1. In 1904, the Democratic candidate, Alton Parker, lost the election and complained bitterly afterward that he had been defeated by large insurance companies. Parker challenged the nation to face the reality that corporations were taking over the political process: “The greatest moral question which now confronts us is shall the trusts and corporations be prevented from contributing money to control or aid in controlling elections?”[5]

President-elect Theodore Roosevelt took the accusation seriously and joined his own voice in the call for control of corporate contributions. In a 1905 address to Congress, Roosevelt called for legislation:

> All contributions by corporations to any political committee or for any political purpose should be forbidden by law; directors should not be permitted to use stockholders’ money for such purposes; and, moreover, a prohibition of this kind would be, as far as it went, an effective method of stopping the evils aimed at in corrupt practices acts. Not only should both the National and the several State Legislatures forbid any officer of a corporation from using the money of the corporation in or about any election, but they should also forbid such use of money in connection with any legislation save by the employment of counsel in public manner for distinctly legal services.

As a result, Congress passed the 1907 Tillman Act, the first US law prohibiting corporations from contributing directly to federal elections. However, it turned out that the law was easy to circumvent. Not only was there no enforcement mechanism or agency, the Tillman Act did not prevent corporate contributions to party primaries, and in many Congressional districts these were even more determinative than the general election. Moreover, the Tillman Act did not prohibit corporate officers from giving money personally to campaigns (the executives were then often reimbursed by bonuses from the corporations). It rapidly became clear that the Tillman Act would only be the beginning of a long and tortuous effort to curtail corporate influence.

After World War II, labor unrest reached a historical high. From 1945–1946, millions of railroad, auto, meatpacking, electric, steel, and coal workers went on strike, protesting falling wages amid rising corporate profits. Corporate fears of powerful labor unions and the perception among politicians that labor unions had communist leanings convinced Congress to pass the Taft–Hartley Act (also known as the Labor Management Relations Act) in 1947, which limited workers' rights to strike, boycott, and picket. The law also prohibited labor unions from spending money in federal elections and campaigns. As an extension of the Tillman Act of 1907, Taft–Hartley constrained labor unions to raising money for campaign contributions only through so-called political action committees (PACs).

It was not until the 1970s that PACs were firmly regulated by the federal government. With the passing of the Federal Election Campaign Act (FECA) in 1971 (and subsequent Amendments in 1974, 1976, and 1979), the modern campaign finance system was born, along with an independent body to enforce it—the Federal Election Commission (FEC). The new law defined how PACs could operate, set contribution limits, and instituted public financing for presidential elections.[7]

Until 2010, individuals were limited to $2,500 contributions to PACs, and corporations were strictly banned from donating. However, as we shall see below, the Citizens United case radically altered this landscape, removing all corporate restrictions and giving rise to the so-called Super PAC—a political action committee that can accept unlimited donations from individuals, corporations, and unions, and engage in unlimited spending. The only restriction on Super PACs is that the donors cannot coordinate activities with any candidate or campaign. As we can see below from the satirical commentary by television personality Stephen Colbert on the effectiveness of such a bar on coordination, many felt that Super PACs were in reality little more than funding mechanisms under the control of politicians themselves. It seemed that the efforts to control corporate contributions, begun with the Tillman Act, had finally reached a dead end.

Source: Cliff, (CC-BY 2.0 2010) Figure 13.2 In 2011, comedian Stephen Colbert formed a Super PAC called, "Americans for a Better Tomorrow, Tomorrow." While it was intended as a satire of existing Super PACs, it was also a way to educate viewers about the Citizens United decision. In January 2012, Colbert decided to run for "President of the United States of South Carolina." As was legally required, he passed off control of his Super PAC to someone totally *unconnected to the committee–his Comedy Central cohort Jon Stewart.*

Milestones in Campaign Finance [8]

- 1907: Passage of the Tillman Act, which banned corporate political contributions to national campaigns.
- 1925: The Federal Corrupt Practices Act increased disclosure requirements and spending limits on general elections.
- 1971: Passage of the Federal Election Campaign Act (FECA), the first comprehensive campaign finance law.
- 1974: Amendments made to the Federal Election Campaign Act: limits on contributions, increased disclosure, creation of the Federal Election Commission (FEC) as a regulatory agency, government funding of presidential campaigns.
- 1976: Buckley v. Valeo: The Supreme Court upheld limits on campaign contributions, but held that spending money to influence elections is protected speech under the First Amendment.
- 1978: First National Bank of Boston v. Bellotti: The Supreme Court upheld the rights of corporations to spend money in non-candidate elections (i.e., ballot initiatives and referendums).
- 1990: Austin v. Michigan Chamber of Commerce: The Supreme Court upheld the right of the state of Michigan to prohibit corporations from using money from their corporate treasuries to support or oppose candidates in elections, noting: "corporate wealth can unfairly influence elections."[9]
- 2002: Passage of the Bipartisan Campaign Reform Act of 2002 (McCain–Feingold), which banned corporate funding of issue

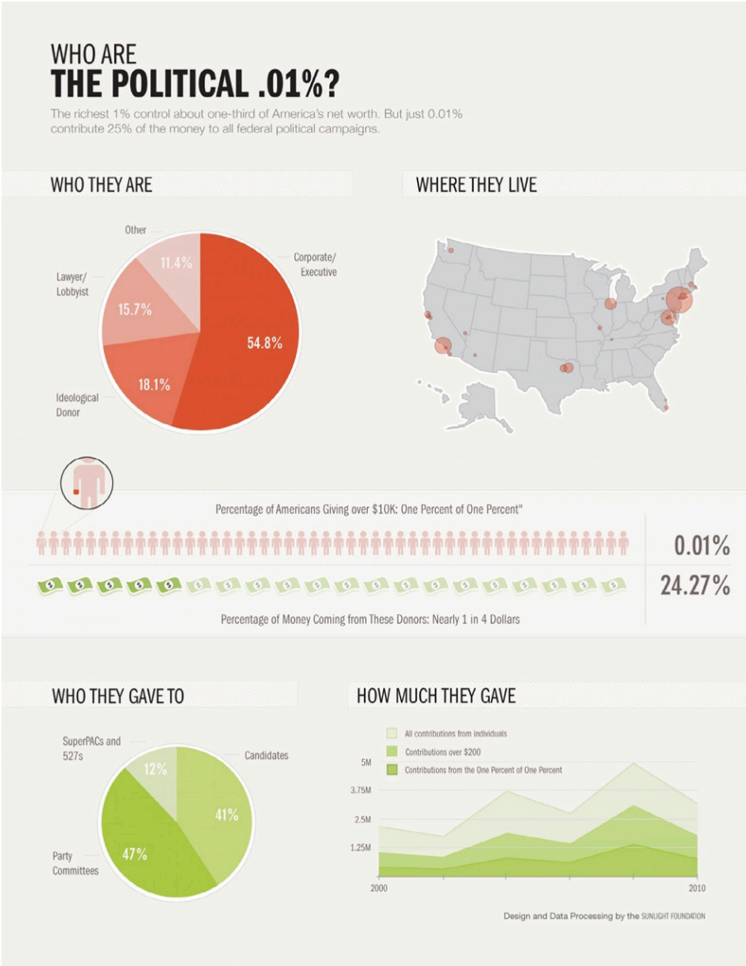
advocacy ads that mentioned candidates close to an election.

- 2010: Citizens United v. FEC: The Supreme Court held that corporate funding of independent political broadcasts in candidate elections cannot be limited under the First Amendment, overruling Austin (1990).

The 2012 Presidential Election

The 2012 US presidential race was the most expensive in history. According to the Federal Election Commission, approximately $6 billion was spent on the election by candidates, parties, and outside groups. Of that, $933 million came directly from companies, unions, and individuals funneling money into Super PACs specifically enabled by Citizens United. The Center for Public Integrity found that nearly two-thirds (approximately $611 million) went to just ten political consulting firms, who spent 89 percent of the money on negative advertising spots attacking candidates.[10] Influence of the Wealthy: The One Percent of the One Percent

According to the Sunlight Foundation, there is a growing dependence on the One Percent of the One Percent—an elite group of the wealthiest Americans, including corporate executives, investors, lobbyists, and lawyers in metropolitan areas who give to multiple candidates, parties, and independent issue groups. Data suggests that, while these ideological donors make up less than 1 percent of the US population, they control about one-third of America's net worth and contribute up to 25 percent of the money provided to all federal political campaigns.[11]



Source: Courtesy of Sunlight Foundation (2013) Figure 13.3 Statistics show that the wealthiest 0.01% of the U.S. population contributes a major share of all American political campaign funding.

Case Study: Citizens United v. Federal Elections Commission

In early 2010, the United States Supreme Court shocked much of the nation when it ruled that corporations have the same rights of political free speech as individuals under the First Amendment to the US Constitution.

Citizens United v. Federal Elections Commission was a constitutional law case challenging the Bipartisan Campaign Reform Act (BCRA) of 2002, otherwise known as the McCain–Feingold campaign finance law. The BCRA barred corporations and unions from running broadcast, cable, or television ads for or against Presidential candidates for thirty days before primary elections, and within 60 days of general elections. In addition, the law required donor disclosure and disclaimers on all materials not authorized or endorsed by the candidate.

The Supreme Court

The United States Supreme Court plays a central and occasionally polarizing role in the American democratic system. Created by the Judiciary Act of 1789, the Supreme Court is the only court specifically prescribed by the Constitution. As the "highest court in the land," it remains the functional and symbolic defender of American civil rights and liberties.

As the United States' final court of appeal, the Supreme Court is the ultimate interpreter of law in the United States. With the authority to strike down any federal and state law it deems unconstitutional, the Court acts as a check on the power of the executive and legislative branches of government. In theory, the Supreme Court guarantees that changing majority views don't subjugate vulnerable minorities or undermine fundamental American values such as freedom of speech.

Because it often appears to defend these values in direct opposition to popular opinion, the Supreme Court has been criticized as an antidemocratic institution that fails to take into account progressive social evolution. Indeed, justices are often accused of ideological activism, constitutional fundamentalism, and ignorance of the changing face of the American public. It can also be argued, however, that the Supreme Court's decisions historically have reflected growing national sentiments about constitutional issues more consistently than it has rejected them.

Virtually every political and social hot-button issue—abortion, gay marriage, affirmative action, civil rights, immigration, and so on—appears before the Supreme Court at some point. Justices are appointed for life so that, ideally, they will not be swayed by outside political influences; unlike the president or Congress, they do not have to worry about re-election campaigns or approval ratings. The Supreme Court's decisions have often had sweeping and profound consequences to society, and they almost always inflame passions on both sides of the political spectrum.

The Plaintiff

Citizens United, a conservative nonprofit corporation, wanted to run an on-demand cable documentary called Hillary: The Movie, which harshly criticized then-Senator Hillary Clinton during the Democratic presidential primary in 2008. The documentary featured interviews with conservative pundits and politicians who claimed that Clinton would be a presidential disaster.

The Federal Elections Committee (FEC) blocked the documentary from being broadcast, designating it as "electioneering communication" under the BCRA. Citizens United brought its case to the United States District Court for the District of Columbia, citing violation of the group's First Amendment rights, but the lower court sided with the FEC. The case was appealed and appeared before the Supreme Court in early 2009.

Origins

In 2004, Michael Moore released a documentary, Fahrenheit 9/11, shortly before the GOP primary elections. The movie was a scathing indictment of George W. Bush, his administration's War on Terror, and the far-reaching consequences of his first term as President. Citizens United filed a complaint with the FEC, stating that ads for the film were television broadcast communications designed to influence voters, and therefore violated federal election law. The FEC dismissed the complaint, saying it was clear that Fahrenheit 9/11, along with its television trailers and website, were purely commercial pursuits. In response, Citizens United decided to start producing its own "commercial" documentaries.

Arguments

Before the Supreme Court, Citizens United argued that the BCRA (the McCain–Feingold Act) only applied to commercial advertisements, not to video-on-demand, 90-minute documentaries such as Hillary: The Movie. The group's lawyer, Ted Olson, did not even mention the First Amendment, nor did he call for the repeal of any part of federal election law.

Taking the opposite position was the deputy solicitor general, who argued that the Clinton documentary was the equivalent of an extended campaign advertisement, recalling the Supreme Court's decisions in Austin v. Michigan Chamber of Commerce (1990), which held that state legislatures may prohibit corporations from using treasury funds on electoral speech, and McConnell v. Federal Election Commission (2003), which validated the BCRA's spending limitations, stating that "express advocacy and its functional equivalent may be treated alike, and that BCRA's definition of 'electioneering communication' is not facially overbroad."[12]

First Opinion

After the case was argued, the Court decided that the BCRA did not apply to Hillary: The Movie, and therefore Citizens United could air it unhindered. Chief Justice John Roberts drafted an opinion, but it soon became clear that many of the justices didn't think it went far enough. The conservative majority felt that the case was a perfect opportunity to broaden the discussion to address whether or not corporate speech should be regulated at all under the Constitution.

Roberts withdrew his opinion, and the Court called for the case to be reargued in September, almost a month before the official start of the fall term and two months before the 2010 midterm election. The justices directed the parties to file supplemental briefs addressing the question of whether the Court should overrule Austin v. Michigan and parts of McConnell v. FEC, which would amount to eliminating decades of restrictions on corporate electoral spending.

Second Opinion

The Citizens United case was reargued on September 9, 2009. By a five-to-four vote, the conservative majority held that the First Amendment to the United States Constitution prohibits the government from imposing any limits on political spending by corporations, associations, and unions. Justice Anthony Kennedy wrote the majority opinion, which he summarized from the bench in this way: “Political speech is indispensable to decision making in a democracy and this is no less true because the speech comes from a corporation rather than an individual.”[13]

Justice Kennedy was joined by Chief Justice John Roberts and Justices Antonin Scalia, Samuel Alito, and Clarence Thomas. To the conservative judges, the ruling was a vindication of the power of free speech; because of Citizens United, the First Amendment could now be applied universally and without prejudice.

Dissent

Justice John Paul Stevens wrote a highly critical 90-page dissent, arguing that Justice Kennedy’s opinion constituted “a rejection of the common sense of the American people, who have recognized a need to prevent corporations from undermining self-government since the founding.”[14] Stevens believed that the limits Congress had for years imposed on corporate spending were necessary to curb political corruption by the wealthiest Americans, who would inevitably out-spend, out-lobby, and “out-speech” the vast majority of Americans. Stevens also argued that corporations are not “people” in the real sense—they do not have consciences, feelings, beliefs, or desires—and therefore are not true members of society, or “‘We the People,’ by whom and for whom [the] Constitution was established.”

Justice Stevens was joined in his dissent by Justices Ruth Bader Ginsburg, Stephen Breyer, and Sonia Sotomayor. These liberal justices recognized that the decision would open the floodgates for spending in electoral campaigns, making it “exceedingly difficult to maintain that independent expenditures by corporations ‘do not give rise to corruption or the appearance of corruption.’”[15]

Corporate "Personhood"

Widespread public criticism of the Citizens United decision has not diminished with time, particularly from liberal or progressive voters and pundits. Protesters, lawmakers, and organizations such as Move to Amend have called for a constitutional amendment to overturn the ruling. Across the country, a number of public demonstrations were held where participants waved signs reading, "Corporations Are Not People." Despite the widespread outrage, the reality is that corporations have had many of the same rights as individuals for a very long time.

Corporate personhood refers to the legal concept that allows organizations of people, as individuals acting collectively, to be both protected by the Constitution and subject to the same laws as citizens. The word corporation derives from the Latin, corpus, meaning body, and is defined as "a body of people acting jointly, …recognized by law as acting as an individual."[16]

The Romans first devised corporate personhood as a way for cities and churches to legally organize for the purposes of joint land ownership, taxation, and institutional perpetuity. Creating a "legal" or "artificial" person made it unnecessary to develop separate laws enabling large groups of people to do the same things as individuals: for instance, make contracts, own property, pay taxes, borrow money, enter into law suits, and be protected from persecution.

Since at least 1819, in Trustees of Dartmouth College v. Woodward, the Supreme Court has recognized corporations as having the same rights as "natural persons" for the purpose of contracts. Since then, the Supreme Court has given corporations increasingly more rights traditionally reserved for natural people: Fourteenth Amendment rights of equal protection (Pembina Consolidated Silver Mining Co. v. Pennsylvania, 1888), Fifth Amendment protections of due process (Noble v. Union River Logging, 1893), Fourth Amendment search and seizure protection (Hale v. Henkel, 1906), double-jeopardy immunity (Fong Foo v. United States, 1962), First Amendment protection

(Grosjean v. American Press Company, 1936), Seventh Amendment rights to trial by jury (Ross v. Bernhard, 1970), the right to spend money in noncandidate elections (First National Bank of Boston v. Bellotti, 1978), and the right to spend in campaigns as a form of "speech" (Buckley v Valeo, 1976).[17]

Amending the Constitution to Overrule Citizens United

Move to Amend, a coalition of political interest organizations, lead the campaign for a Constitutional amendment that would overturn the Supreme Court's decision in Citizens United. MoveToAmend.org clearly states:

> We, the People of the United States of America, reject the US Supreme Court's ruling in Citizens United and other related cases, and move to amend our Constitution to firmly establish that money is not speech, and that human beings, not corporations, are persons entitled to constitutional rights.[18]

Consequences

Specialists in campaign finance law predict that the Supreme Court's ruling will shape the US electoral process for years to come. The matter is far from settled, however, as there is a growing movement of nonpartisan municipal, county, and state bodies calling for a constitutional amendment to overturn the decision. Citizens United's legacy is far from over.

Topic for Debate: Overrule Citizens United

In this debate section, you will be asked to assume the role of a college student at a SUNY campus in New York State. The Congressional representative who has been elected from your university's district has introduced a bill in Congress that would authorize a constitutional amendment to overturn Citizens United. The university newspaper has sponsored a public debate so that the it can determine what position to take—should the newspaper endorse (or not) the proposed amendment? You have been invited to be a part of one of the two debate teams that will address the issue at a public forum. You are expected to base your arguments to some extent on the statements and publications of legal and public policy experts.

Affirmative

The university newspaper should endorse a constitutional amendment to overturn Citizens United.

Possible Arguments

- Corporations are not people, and should not have the same rights as individuals.
- The Supreme Court erred with its decision in Citizens United, due to judicial activism.
- Electoral issues should be decided by elected officials and not by the Supreme Court.
- Corporate money inherently leads to political corruption and "secret" financing.
- Wealthy Americans by and large represent the corporate interests of America and should not drown out the voices of those with less power and money.

Negative

The university newspaper should oppose a constitutional amendment to overturn Citizens United.

Possible Arguments

- American democracy relies on freedom of speech, which should therefore be enjoyed by everyone, regardless of their legal status.
- Corporate money in elections increases political competition and awareness of issues.
- Americans can decide for themselves whether or not to elect a candidate; ads don't make a difference either way.
- Corporations advocate for their employees, customers, and communities, and regulation will only constrain this ability.
- Corporations are fundamental to American economic progress and should be allowed to influence the political process to maintain their positive contributions to society.

Readings

Supreme Court Opinion and Pleadings

The Supreme Court's majority opinion, the various dissenting and concurring opinions, and the parties' briefs, may be accessed on the Internet at the following links:

The official arguments and decision can be found at "Citizens United v. Federal Election Commission." The Oyez Project at IIT Chicago-Kent College of Law. Last updated August 25, 2014. http://www.oyez.org/cases/2000-2009/2008/2008_08_205.

The official briefs and amicus briefs can be found at "Citizens United v. Federal Election Commission." SCOTUSblog. June 17, 2010.

http://www.scotusblog.com/case-files/cases/citizens-united-v-federal-election-commission/

A video can be found at "The Story of Citizens United v. FEC (2011)." YouTube video, 8:50. Posted by "storyofstuffproject" on February 25, 2011. https://www.youtube.com/watch?v=k5kHACjrdEY.

"Why Super PACs Are Good for Democracy: Super PACs Get Government out of the Business of Regulating Speech"

Smith, Bradley A. "Why Super PACs Are Good for Democracy: Super PACs Get Government out of the Business of Regulating Speech." U.S. News and World Report. February 17, 2012. http://www.usnews.com/opinion/articles/2012/02/17/why-super-pacs-are-good-for-democracy.

"The New York Times' Disingenuous Campaign against Citizens United"

Kaminer, Wendy. "The New York Times' Disingenuous Campaign against Citizens United." The Atlantic. February 24, 2012. http://www.theatlantic.com/politics/archive/2012/02/the-new-york-times-disingenuous-campaign-against-citizens-united/253560/.

The paper is promoting the misconception that the ruling allowed for unlimited campaign contributions from super-rich individuals. It didn't.

Like Fox News, the New York Times has a First Amendment right to spread misinformation about important public issues, and it is exercising that right in its campaign against the Citizens United ruling. In news stories, as well as columns, it has repeatedly mischaracterized Citizens United, explicitly or implicitly blaming it for allowing unlimited “super PAC” contributions from megarich individuals. In fact, Citizens United enabled corporations and unions to use general treasury funds for independent political expenditures; it did not expand or address the longstanding, individual rights of the rich to support independent groups. And, as recent reports have made clear, individual donors, not corporations, are the primary funders of super PACs.

When I first focused on the inaccurate reference to Citizens United in a front-page story about Sheldon Adelson, I assumed it was a more or less honest if negligent mistake. (And I still don’t blame columnists for misconceptions about a complicated case that are gleaned from news stories and apparently shared by their editors.) But mistakes about Citizens United are beginning to look more like propaganda, because even after being alerted to its misstatements, the Times has continued to repeat them. First Amendment lawyer Floyd Abrams wrote to the editors pointing out mischaracterizations of Citizens United in two news stories, but instead of publishing corrections, the Times published Abrams’ letter on the editorial page, effectively framing a factual error as a difference of opinion…

As these examples suggest, …campaign-finance reforms dating back decades have produced an overcomplicated, overreaching web of laws and regulations that are easily abused, misunderstood, or intentionally obfuscated. The complexities of campaign finance law (and tax-code provisions governing independent groups) also create incentives to oversimplify the problems caused by the campaign-finance regime by naming Citizens United as the root of all evils. This helps advance what appears to be a simple solution—repeal Citizens United with a “free speech for people” constitutional amendment declaring that corporations aren’t people. Putting aside the dangers of this approach, it wouldn’t solve the problem of super PACs: The billionaires funding them may lack personal appeal but they are, after all, people, whose expenditures were not at issue in

Citizens United. When the press promotes false understandings of Citizens United and the problems of campaign finance, it "paves the way" for false solutions.

It's worth noting that the Times is not alone among proponents of reform in scapegoating Citizens United (although it seems to have taken the lead.) The New York Times, the Washington Post, and MSNBC regularly and routinely misstate the meaning and impact of the Supreme Court's Citizens United decision on campaign finance rules," Steve Brill recently observed, citing a post by Dan Abrams. Brill recommends confronting reporters and commentators with their frequent misstatements. Former ACLU Executive Director Ira Glasser has gamely tried engaging New York Times Public Editor Arthur Brisbane in an effort to stop misleading readers…Are you confused yet? What does the Times believe or want you to believe about Citizens United? Whatever.

"The Citizens United Catastrophe"

Dionne, E. J., Jr. "The Citizens United Catastrophe." The Washington Post. February 5, 2012. http://www.washingtonpost.com/opinions/the-citizens-unitedcatastrophe/2012/02/05/gIQATOEfsQ_story.html

Experts Assess Impact of Citizens United: HLS Professor Suggests Constitutional Amendment Stating Corporations Are Not People

Greenfield, Jill. "Experts Assess Impact of Citizens United." Harvard Gazette. February 3, 2012. http://news.harvard.edu/gazette/story/2012/02/experts-assess-impact-of-citizens-united/.

Few recent Supreme Court cases have received as much attention—and drawn as much ire—as Citizens United v. Federal Election Commission. In a 5–4 decision, the court ruled that the First Amendment prohibits government from placing limits on independent spending for political purposes by corporations and unions. To proponents of campaign finance reform, Citizens United had the detrimental effect of inundating an already-broken campaign finance system with corporate influence. At an event sponsored by the Harvard Law School (HLS) American Constitution Society on Tuesday, HLS Professor Lawrence Lessig, author of Republic Lost, and Jeff Clements, author of Corporations Are Not People, reviewed the impact that Citizens United has had on the political process.

Clements said that the court's decision exacerbates two problems that the American political and electoral system had already been facing—the large amount of campaign spending and the growing influence of corporate power on the political process. Clements said that both problems need to be fixed in order to restore democracy but that, rather than addressing these problems, the Citizens United decision instead requires that the American people fundamentally reframe their notion of corporations.

"We need to look at what Citizens United really asks us to do, which is to accept a lot. The court asks us to pretend that corporations are not massive creations of state, federal, and foreign laws. It asks us to pretend that they're just like people, that they have voices, and that we're not allowed to make separate rules for them," he said.

Although some legal observers regard the decision as simply a bad day on the court, Clements said that Citizens United actually represents the culmination of a steady creation of a corporate rights doctrine that is radical in terms of American jurisprudence. He provided a history of the idea of corporate personhood and corporate speech, which began only in the 1970s under Chief Justice William Rehnquist. Lessig added that the system that has resulted is one in which elected officials must spend 30 to 50 percent of their time fundraising, and thus make decisions based not on what is best for their constituents, but on what their super PACs and other major donors want to see.

"We have a corrupt government, yet one that is perfectly legal," said Lessig. "We've allowed a government to evolve in which Congress isn't dependent on people alone, but is instead increasingly dependent on its funders. As you bend to the green, that corrupts the government."

As a result, he said, members of Congress develop a sixth sense as to what will raise money, which has led them to bend government away from what the people want government to do and toward what their funders want government to do. To fix the problem, we need to produce a system where the funders and the people are one and the same. The solution, Lessig said, is a multipronged approach that includes a constitutional amendment explicitly stating that corporations are not people, as well as a movement to publicly fund elections and provide Congress with the power to limit independent expenditures.

Synthesis Questions

1. Do corporations have too much influence on American politics? Support your arguments with examples of excessive influence or lack of excessive influence.
2. Why do so many people find it repugnant to treat corporations as "persons"? Is this disfavor justifiable?

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14. Marketing Ethics: Selling Controversial Products

Source: Frank Gruber, (CC BY-NC-NDS, 2.0, 2008) Figure 14.1 Advertisers are continually exploring new media for advertising as they seek to break through the promotional clutter of modern life to attract the attention of consumers. Here, the Budweiser beer logo is imprinted on the top of a house adjacent to the Wrigley Field baseball park in Chicago, Illinois.

Legal and Ethical Constraints on Marketing and Advertising

This chapter explores the ethics of marketing and advertising. As the most visible form of marketing, advertising is one of the principal motors of a capitalist economy and also one of the largest modern industries: The global advertising market was valued at $495 billion in 2013 (the United States was the largest national market at $152 billion).[1] Advertisements not only inform consumers of available products, services, promotions, and sales, they serve a vital business function by allowing brands to distinguish themselves from competitors, which rewards firms for improving the quality of their offerings. Advertising is a key ally for innovation, because advertising allows firms to create awareness and desire among consumers to buy new products. Despite these benefits, the advertising industry has long been suspected of using devious tactics. As a result, many consumers are highly skeptical and even disdainful of advertising in general.

Advertisers sometimes take the risk of shocking the public with their ads because they are seeking to break through the communications clutter of modern life. Today, the average American is exposed to a great number of advertising messages every day, with estimates running from several hundred to several thousand ads per day.[2] In order to attract the public's attention, advertisers may resort to appeals and tactics of questionable taste. Little wonder that more than half of Americans believe that advertising today is out of control. Social critics point to advertising as one of the most objectionable aspects of our consumer economy. From the billboards that blot out the countryside along highways, to the television shows that are interrupted every few minutes by outlandish commercials, to the mailboxes and e-mail accounts that become cluttered with direct marketing, advertising methods are often criticized for being intrusive, offensive, silly, and even dishonest.

As a result of the perceived abuses of advertising, national governments all over the world have imposed laws and regulations on the advertising industry. Every country or region has its own area of sensitivity. In many Muslim nations, for example, there are prohibitions against advertisements that display nudity or offend traditional notions of decency. France and Germany prohibit comparative advertisements in which one brand claims to be superior to another.

The modern marketplace abounds with products that pose difficult challenges for regulators. Consider the example of tobacco and alcohol. These products can be harmful or dangerous, but many people nonetheless desire to consume them. Most Western countries have decided that it is counterproductive to outlaw the sale of tobacco and alcohol, as doing so may create a black market and stimulate organized crime. The official response of most governments has been to allow the sale of such products but to prohibit or strictly constrain their advertising. Other product categories that tend to be governed by specific advertising regulations include pharmaceuticals and financial products.

Many products have positive uses but can also be dangerous if misused, like automobiles, knives, razors, lighter fluid, pesticides, toys, athletic equipment, and so on. In such cases, the law usually prohibits advertising that encourages the consumer to use the product in a dangerous fashion. Another common type of marketing regulation is one that prohibits advertisements from making false, deceptive, or misleading claims. In most countries, such rules are enforced by the ministry for consumer affairs. In the United States, rules against deceptive advertisements are promulgated and enforced by the Federal Trade Commission (FTC).

There are certain product categories in which exaggerated claims are commonly made. For example, in the case of skin creams, cosmetics, perfumes, deodorants, toothpaste, mouthwash, and so on, advertisers typically claim (or suggest indirectly) that their products make the consumer more physically attractive, especially to the opposite sex. The problem is that some consumers may not be sophisticated enough to discern the difference between innocent puffery and claims of effectiveness. Thus, teenage boys have been known to douse themselves with Unilever's Axe deodorant products in the hope that they will attract females as effectively as is suggested in Axe's notoriously provocative advertising. Many advertisements for such products come so close to making deceptive appeals that they may trigger the FTC's attention. As a result, advertisers have learned to be cautious in the precise wording of their claims. For example, advertisements for skin cream may permissibly suggest that the user's skin will "look and feel better" after use of the product, but they cannot include text guaranteeing the disappearance of wrinkles.

In many countries, regulators are especially vigilant when it comes to advertising aimed at children, because it is felt that children are sometimes more susceptible to manipulation or suggestion and are less likely to understand the dangers associated with the use of an advertised product. In Greece, for example, toy advertisements are prohibited between the hours of 7 a.m. and 10 p.m. In Sweden and Norway, all advertising aimed at children is prohibited, and in France, a child may not appear as the spokesperson in a commercial. In Holland, advertisements for sweets must include a toothbrush at the bottom of the ad to remind children to brush their teeth after eating sweets.

In this chapter, we will begin with a review of the advertising industry's "self-regulation" of objectionable or unethical advertising. Many advertisements and marketing tactics fall into a regulatory gray area, where the advertisement is technically legal but still manages to offend some of the population. A frequent cause of such offense is the advertiser's quest to develop a humorous or surprising advertisement. For example, one Danish advertisement featured an image of the Pope wearing a particular brand of sneakers, which offended many Catholics. In Italy, the fashion company Benetton shocked the nation by using an advertisement in which a priest is seen kissing a nun. In cases like these, it is not possible to make the advertisements illegal, but advertising industry associations feel it is necessary nonetheless to police the market for objectionable advertisements.

Our chapter-ending case study will deal with the ethical dilemma faced by executives at an advertising consultancy that is considering accepting an account for a global brand that manufactures skin-whitening products. The CEO of our company will call upon us to consider and debate the pros and cons of developing a US advertising campaign for Fair and Lovely, an Indian brand. In the United States, this product is demanded primarily by immigrants from South Asian countries, a large and growing demographic.

Many people feel that advertisements for such products contain racist appeals, since they are implicitly based on promoting the superiority of white skin. Is it ethical to market and promote such a product? Why or why not? Let us first consider some background to allow us to answer these questions.

Principles of Marketing Ethics

As stated earlier, every country has a basic framework of advertising law. Many types of advertisement are simply prohibited by law. However, with respect to advertisements that are legal but morally questionable (or otherwise objectionable), the advertising sector polices itself by applying self-regulatory codes of marketing and advertising ethics. This means that the advertising industry sets up its own committees to police questionable advertisements. Virtually every country has at least one advertising industry trade association with a self-regulatory panel or committee that reviews consumer complaints. After examining the advertisement in question, the panel decides whether or not to ask the advertiser to remove the advertisement; although advertisers are not legally obliged to follow the decisions of such committees, they usually do.

The self-regulatory panels base their decisions on ethical principles contained in codes of advertising ethics. The most influential codes are those established by the International Chamber of Commerce (ICC); ICC Codes are followed by advertising bodies in over 30 countries. The ICC Codes are based on the core principles of legality, decency, honesty, and truthfulness in all marketing communications. The ICC further emphasizes that "all marketing communications should be prepared with a due sense of social and professional responsibility and should conform to the principles of fair competition, as generally accepted in business. No communication should be such as to impair public confidence in marketing." Self-regulatory codes are deliberately framed in general terms, because it can be very difficult to objectively define what kind of advertisement can be considered "decent." It is assumed that standards of decency vary on a national or cultural basis, and in addition are likely to change over time. Thus, the ICC Code thus provides general guidelines: "Marketing communications should not contain statements or audio or visual treatments which offend standards of decency currently prevailing in the country and culture concerned." The ICC Code further stipulates the following: [3]

- Marketing communications should be so framed as not to abuse the trust of consumers or exploit their lack of experience or knowledge. Relevant factors likely to affect consumers' decisions should be communicated in such a way and at such a time that consumers can take them into account.
- Marketing communications should respect human dignity and should not incite or condone any form of discrimination, including that based upon race, national origin, religion, gender, age, disability, or sexual orientation.
- Marketing communications should not without justifiable reason play on fear or exploit misfortune or suffering.
- Marketing communications should not appear to condone or incite violent, unlawful, or antisocial behavior.
- Marketing communications should not play on superstition.

Examples of Objectionable Advertising

Discriminatory Advertisements

Source: Kim Bhasin and Patricia Laya, "26 Shockingly Offensive Vintage Ads," Business Insider, June 14, 2011. Figure 14.2 This is a vintage Schlitz beer advertisement from 1951.

As we review the history of advertising, we will observe that certain ads and campaigns were previously considered acceptable, and even popular, but today would generally be regarded as objectionable (in clear violation of one or more of the principles outlined above). Such cases can help illustrate the ongoing evolution of community standards in marketing ethics.

Consider the vintage ad for Schlitz beer in Figure 14.2. A suit-clad husband is comforting his tearful wife, who has just burned the evening's dinner. The advertising copy reads as follows: "Don't worry, darling, you didn't burn the beer." This advertisement appears to be aimed at men and contains a mocking and patronizing reference to young housewives of the day. In its time, such an advertisement was probably considered by many to represent light-hearted humor, but today it would be considered offensive by many viewers. The unstated implication is that men are breadwinners while women are weepy and emotional homemakers. By contemporary standards, the Schlitz ad is overtly sexist.

While it might seem that such advertisements are relics of the past, controversial discriminatory appeals and references continue to appear in the media. As a further example, consider the advertisement for the Mountain Dew soft-drink in Figure 14.3: [4]

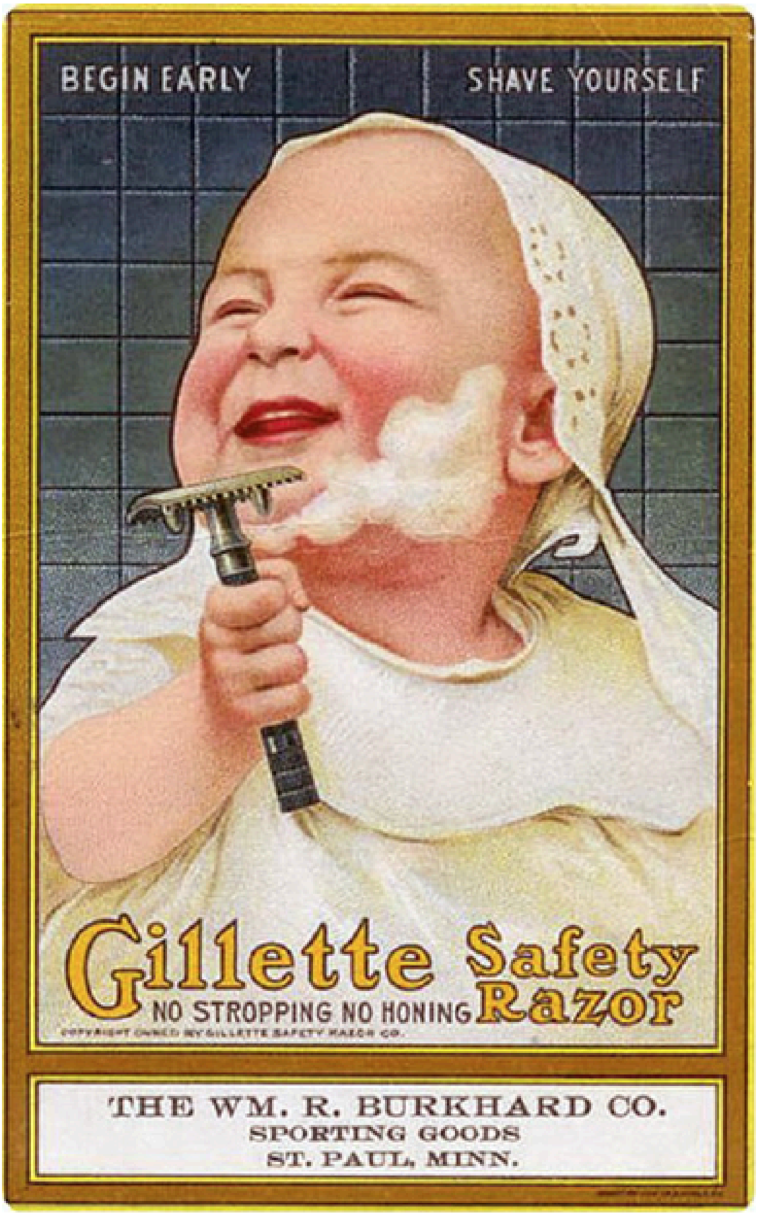
Source: Christopher Heine, "Mountain Dew Pulls 'Arguably Most Racist Commercial in History'," Adweek (2013) Figure 14.3 Mountain Dew's zany but ill-fated campaign featuring a Mountain Dew-crazed goat.

Mountain Dew had run a successful series of edgy commercials targeted at Internet viewers and users of social media (an increasingly popular tactic). Perhaps influenced by the remarkable success of insurance company GEICO's advertising mascot (a green gecko with a cockney accent), Mountain Dew had created a series of ads featuring a goat with a crazed passion for the caffeine-laced green soda. For one of these commercials, Mountain Dew hired hip-hop artist Tyler the Creator to create and produce the advertisement. In the ad in question, the goat is driving a car and is pulled over and arrested by a policeman. In flashback, we see the goat attacking a woman to wrench away her bottle of Mountain Dew, leaving the woman bloodied and wounded. In the next scene, the woman tries to identify her assailant from a police line-up that features the goat and four black men. Drinking steadily from a bottle of Mountain Dew, the policeman prods the woman to make a choice. The goat responds to the situation by speaking in a parodic hip-hop style, employing slang phrases such as "do her up" and "ya better not snitch on a playa." Meanwhile, the Dew-amped policeman urges the woman to “nail this little sucker” and suggests it is “the one with the doo-rag.”

In retrospect, one wonders how such an offensive advertisement could have been released by a subsidiary of one of the world’s largest marketing organizations (Mountain Dew is a PepsiCo subsidiary). There was a great deal of outrage voiced when the ad was posted on Mountain Dew’s music/arts website. One college professor labeled the commercial as “arguably the most racist commercial in history.” The ad was promptly pulled and PepsiCo accepted full responsibility and apologized. To no avail, PepsiCo had pointed out that Tyler was African-American and that the four black men featured in the lineup were actually his close friends. Apparently, the irony intended by Tyler was meant to mock racism and discriminatory police practices. However, as many other advertisers had learned before, humor is a two-edged sword in advertising. It can attract attention, but it can also be misunderstood and cause offense.

Encouraging Harmful or Dangerous Practices

The advertisement in Figure 6.4 illustrates two categories of advertising that merit special scrutiny: advertisements featuring children and advertisements encouraging misuse of a product. Would any parent think it appropriate to have his or her infant shave himself with a razor? Of course not, but clearly that was not the intent of the advertiser.



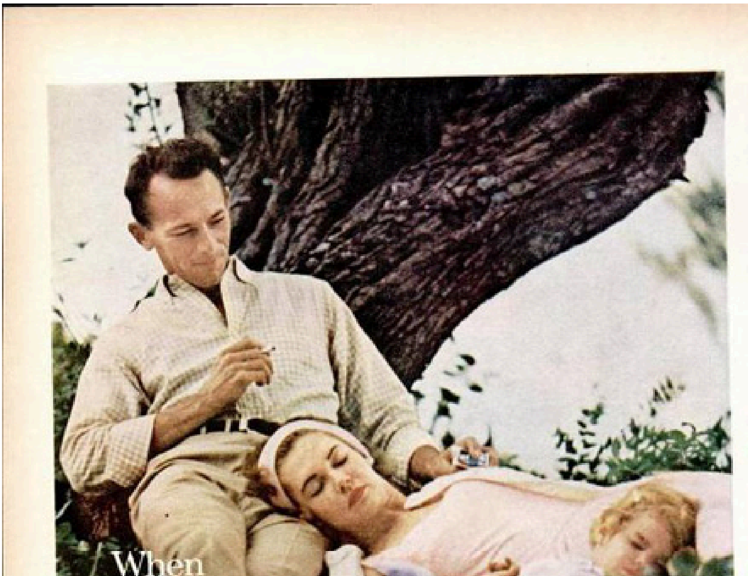
Source: Kim Bashin, "20 Creepy Ads Featuring Children," Business Insider, Oct. 26, 2011. Figure 6.4 This is a vintage Gillette advertisement from 1905.

The ad is attempting to be humorous by employing an absurd image, a baby shaving itself. The ad is also trying to make the point that the new Gillette safety razor is so safe that even a baby could use it without harm. There also may have been an intention to create an association between the smoothness of a baby's skin and the closeness of the shave provided by the razor. By today's standards, however, the advertisement appears reckless. While it is not possible that a baby would be influenced by an advertisement, it is not inconceivable that a small child of five or six years of age might be encouraged by this advertisement to play with a razor: The baby seems to be having such fun, and the small child might have seen his or her father shaving. Regardless of the likelihood that the advertisement could cause harm, today's advertisers have become increasingly wary of using advertising that features children engaged in dangerous activities.

Potentially Dangerous Products: Advertising Bans and Restrictions

As stated above, there are products that are sold legally but that are considered to have such a high potential for harm or abuse such that their advertising has been banned or regulated. Let us consider just two such product areas: cigarettes and alcoholic beverages.

Cigarettes



Source: Cory Doctorow, "Particularly Despicable Cigarette Ad,", Nov. 25, 2011. Figure 14.5 This is a 1962 advertisement for the L&M cigarette brand featured in the edition of Popular Science magazine.

Concerned with medical research that revealed the health hazards of smoking, the US and European governments began to regulate tobacco advertising in the 1960s. The print ad in Figure 14.5, from 1962, features an idyllic family scene that suggests that a smoker gets "lots more" from a particular brand. The ad suggests that one acceptable way to enjoy the smoking experience is to smoke in the company of one's spouse and children. In 1964, however, the US Surgeon General issued a formal report that concluded that smoking caused lung cancer and chronic bronchitis. This led to the government instituting a series of regulations aimed at the tobacco industry. The new laws required health warning labels on all cigarette packages and required that all cigarette companies file annual reports to the FTC. One goal of these regulations was to oblige the large tobacco companies to disclose their advertising expenditures and strategies, so that the government would be able to assess the link between tobacco advertising and smoking-related health risks.

Throughout the late 1960s, the US government accumulated and analyzed data on the marketing and advertising practices of the large cigarette companies and finally concluded that tobacco advertising encouraged smoking. As a result, the Public Health Cigarette Smoking Act was passed and signed into law in 1970. This act banned all cigarette advertising on television and radio advertising in the United States. At the time the prohibition went into effect, tobacco companies were spending eighty percent of their advertising budgets on television advertising, so the impact of the law was significant.

Subsequently, the United States enacted further restrictions on cigarette advertising. In 1999, billboard advertising of tobacco products was banned. In 2010, tobacco companies were prohibited from sponsoring athletic, musical, or artistic events, and from featuring their logos on apparel. However, the government has stopped short of banning print advertising. These governmental efforts have been matched by a certain level of self-regulation on the part of tobacco companies. For example, after a public outcry over its use of a cartoonish camel to sell cigarettes (it was feared that such advertising would be appealing to children and teenagers), Camel Cigarettes voluntarily stopped advertising in magazines in 2007. However, in 2013 Camel resumed its practice of advertising in magazines.

Alcohol

Alcohol has been classified by the International Agency on Research for Cancer (IARC) as a Group 1 carcinogen, meaning that the circumstances in which humans are exposed to alcohol are sufficient to create a risk of cancer. According to the World Health Organization (WHO), alcohol causes approximately 1.8 million deaths per year. In the United States alone, approximately 10,000 deaths per year are the result of automobile accidents caused by drunk driving. Despite these sobering statistics, the US government has taken a very different approach to alcohol advertising as compared with tobacco advertising. In essence, the FTC has primarily asked the alcohol industry to self-regulate.

Given that advertising is known to be an effective means of increasing sales and market share, why would alcoholic beverage companies agree to abide by self-regulation? Here, the example of advertising bans on tobacco products is instructive. Other industries whose products are seen as controversial have been influenced by the threat of an advertising ban similar to that placed on tobacco products. Consequently, trade associations for such industries have sought to maintain an open dialogue with legislators in the hope of appeasing them with effective self-regulation, so as not to be faced with a total ban. In the United States, the self-regulatory focus has been to minimize the exposure of underage drinkers to the advertising of alcoholic beverages. Currently, the alcoholic beverage industry has agreed to restrict advertising in print, TV, and radio to those venues where studies show that more than 70% of viewers will be of drinking age (i.e., older than 21). Further, the industry has agreed to support a public campaign against underage drinking and to include warnings about drinking responsibly in all advertising. The FTC has urged industry to apply the 70% rule to sponsorship of musical and sporting events as well but no agreement has been reached.

Even with these self-regulatory measures in place, there remains a good deal of concern among watchdog groups about the appeal of TV advertising to young people, who are considered more likely to abuse alcohol than older viewers. Moreover, the alcohol industry continues to employ advertising appeals based on the implicit sexual allure of drinking in bars or at parties. This approach is disturbing to industry critics who see the glamorizing and sexualizing of alcohol consumption as another way of attracting young people to alcohol products. As with cigarettes, the implicit threat is that if the industry can get young people "hooked" early in life, then they will become lifelong consumers of a product with known health risks. Youths who begin drinking at age 15 are four times more likely to become alcoholics than those who begin drinking at age 21.[5]

Case Study: The Marketing of Skin-Whitening Creams

Americans—in particular, white Americans—spend hours in tanning salons going to great efforts (and sometimes even incurring great pain and health risks) to make their skin darker. In other parts of the world, such as the Caribbean, Africa, East Asia, and the Indian sub-continent, people go to much expense to lighten their skin. They do so through the purchase and application of skin-whitening or skin-lightening creams that purport to make dark skin lighter. (Whether or not they actually work is controversial.) In many of these regions, lighter skin is more highly regarded socially. Arguably, this phenomenon is a sad by-product of colonialism, in that it is based on a positive association with the skin color of Caucasians. The flip-side is that, in the United States and Europe, darker skin is often considered attractive and exotic.

Fair and Lovely is an Indian brand of skin-whitening products manufactured and marketed by Hindustan Lever Ltd. (HLL). Fair and Lovely is the top-selling skin-whitening brand in India, followed closely by Fairever which is made by CavinKare. HLL advertising touts Fair and Lovely as a "miracle worker" and claims that it is "proven to deliver one to three shades of change." As a result of competition from Fairever, HLL stepped up its marketing efforts in recent years, which led to a great deal of controversy. One of the controversial HLL ad campaigns was based on the theme "The fairer girl gets the boy."

In one of the typical television commercials used in this campaign, a poor father is lamenting the fact that he does not have a son who can work and help support the family. His daughter, who has dark skin, looks on and clearly feels a sense of guilt. When she seeks employment, she is rebuffed because of her dark skin. Her unhappy lot is magically transformed with the use of Fair and Lovely skin-whitening cream. Suddenly, she not only appears to have much lighter skin, but the other characters in the commercial perceive her as much more beautiful. She dons a miniskirt and finds employment as a flight attendant, receiving the romantic attention of a fair-skinned Westerner. Among the many improbable benefits associated with use of Fair and Lovely, it seems, are a wardrobe change, secure employment, and a foreign boyfriend. The newly confident young woman is now a success and can take her proud father out for a lavish dinner.

The popularity of Fair and Lovely, as well as other skin-whitening creams, is tied to Indian cultural traditions. Lighter skin has been associated with a higher caste and therefore greater social status. Most of the famous female stars in India's popular Bollywood movie industry are light-skinned. Do the Fair and Lovely products—or those of competitors—really make someone's skin lighter? Or is this idea just an illusion perpetuated by effective advertising? In its official documentation regarding Fair and Lovely, HLL only states that the cream contains vitamins essential to skin care and UV blocking agents (as in sunscreens). In other words, rather than actually turning the skin lighter, Fair and Lovely may only work by keeping skin from getting darker, something likely to happen in sun-drenched areas of India. Critics claim that at best such products temporarily bleach skin lighter.

Not everyone in India is comfortable with the promotion of skin-whitening creams. A number of groups have come out against HLL and Fair and Lovely, charging the company with deceptive advertising and the promotion of discrimination and sexism. Many critics point out that the celebration of lighter skin is implicitly a rejection of darker skin. Thus, the Women of Worth Foundation launched a campaign called "Dark is Beautiful" to protest skin-whitening products.

Indian fashion writer Rumnique Nannar observed the following:

> "I've heard the stray dig "for a Punjabi, you're quite dark" or jokingly mentioned, "are you sure you haven't been adopted from Kerala?" or even the infamous, "wow, you are, like, so exotic"—all standard fare for me as the darker blip in family photos. Having your identity reduced to skin tone can be crushing, particularly when it doesn't fit with the more fair ideal admired by most cultures. In India, ads by Emami and Fair and Lovely often seemed laughable and pompous to me, with grandfathers sanctioning the use of skin lightening creams to ensure the success and subsequent beauty of their dusky daughters." [6]

Nannar points out that to be identified or even judged according to one's skin color is demeaning and diminishes a woman's self-esteem and creates a sense of insecurity.

Topic for Debate: Should an American Advertising Agency Represent Fair and Lovely?

In this fictional case, a small but highly successful new advertising agency based in New York City, Enviralism, Inc., has become known for its ability to craft effective social media campaigns targeting the so-called millennial generation (young people born between the early 1980s and early 2000s). Enviralism has become successful especially with rapidly growing high-tech, fashion, and communications groups. This small agency is known for its cutting-edge creativity.

The CEO of Enviralism, Ralph Rodriguez, has been approached by Unilever, one of the world's largest consumer goods conglomerates, with a US advertising budget in the tens of millions, to craft a strategy for marketing Fair and Lovely products to South Asian and East Asian immigrants and their first-generation children. Unilever is aware of the controversies surrounding Fair and Lovely products, but is also aware that there is a significant US market for skin-whitening products. As a result, Unilever would like to tap into Enviralism's knack for thinking up unusual, outside-the-box marketing strategies. In its initial discussions, Unilever has talked about starting with an annual $2 million budget, which might be doubled or tripled in subsequent years. This would instantly make Unilever the largest client at Enviralism, which is still a very small boutique agency with only 18 employees.

However, when Rodriguez discusses the opportunity with his Creative Director, Elaine Williams, she demurs: "That's a straight-up racist product, Ralph. We can't go there, no matter how much money it makes us."

Ralph, who has just invested $200,000 in renovating a

Williamsburg loft into beautiful new offices for Enviralism (complete with state-of-the-art computer and graphics equipment), is not so sure.

He counters, "What about Coppertone? What about Hawaiian Tropic? Those products make people's skin darker, supposedly, but nobody complains. What about Afro Sheen and other hair-straighteners for the black community? Nobody says those are racist. This is a $500 million market in India alone, not to mention a standard skin-care product category in Japan, China, Indonesia, and Thailand—we're talking about a market with well over two and a half billion people!"

Ralph can see that Elaine is not convinced, so he schedules a board meeting where his top executives will argue the case, pro and con, for accepting the Unilever account. You will be assigned to one of those teams. Should Enviralism agree to craft advertising campaigns for the Fair and Lovely product line?

Affirmative

Enviralism should agree to represent Fair and Lovely in the United States.

Possible Arguments

- We have a responsibility to customers to provide them with the products they desire; we should not demean our customers by treating them like children.
- Fair and Lovely is not dangerous and may provide psychological benefits to customers, like other cosmetics products.
- Fair and Lovely's skin enrichment, sun blocking, and moisturizing features are beneficial.

Negative

Enviralism should refuse to represent Fair and Lovely.

Possible Arguments

- Fair and Lovely is an ineffective product and its related

advertising claims are therefore deceptive.
- Fair and Lovely promotes and sustains social, racial, and ethnic stereotypes and prejudices.
- Marketing Fair and Lovely would be socially irresponsible

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Synthesis Questions

1. **Is there anything wrong in marketing cosmetics products with the suggestion that they make the buyer more beautiful, even if this is unrealistic in many cases?**
2. **Should skin-whitening products be legal? Why or why not?**
3. **Does modern society have too much advertising? How could we control it? Can you suggest any specific mechanisms or regulations that should be implemented?**

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3. "ICC Code of Consolidated Advertising and Marketing Practice," International Chamber of Commerce (2011), accessed

December 2, 2014, http://codescentre.com/about-you/marketer-view.aspx.

4. The commercial can be viewed on YouTube via the following link: http://www.youtube.com/watch?feature=player_embedded&v=MdFRWf-CNC8
5. AAFP, "Alcohol Advertising and Youth" (Position Paper), American Academy of Family Physicians, accessed October 25, 2013, http://www.aafp.org/about/policies/all/alcohol-advertising.html.
6. Rumnique Nannar, "Is Dark Beautiful? The Fairness Debate Opens Wide in India," Huffington Post, August 26, 2013, http://www.huffingtonpost.ca/jugni-style/is-dark-beautiful-the-fai_b_3793257.html.

15. The Influence of Advertising

Learning Objectives

By the end of this section, you will be able to:

- **Discuss how social media has altered the advertising landscape**
- **Explain the influence of advertising on consumers**
- **Analyze the potential for subliminal advertising**

The advertising industry revolves around creating commercial messages urging the purchase of new or improved products or services in a variety of media: print, online, digital, television, radio, and outdoor. Because as consumers we need and want to be informed, this feature of advertising is to the good. Yet some advertising is intended to lead to the purchase of goods and services we do not need. Some ads may make claims containing only the thinnest slice of truth or exaggerate and distort what the goods and services can actually deliver. All these tactics raise serious ethical concerns that we will consider here.

The Rise of Social Media

Relevant to any discussion of the influence and ethics of advertising is the emergence and dominance of social media, which now serve as the format within which many people most often encounter ads. Kelly Jensen, a digital-marketing consultant, observed that we inhabit a “Digital Era” in which “the internet is arguably the single most influential factor of our culture—transforming the way we view communication, relationships, and even ourselves. Social media platforms have evolved to symbolize the status of both individuals and businesses alike. . . Today, using social media to create brand awareness, drive revenue, engage current customers, and attract new ones isn’t optional anymore. Now it is an absolute ‘must.’”[1]

These are bold claims—as are the claims of some advertising—but Jensen argues convincingly that social media platforms reach many consumers, especially younger ones, who simply cannot be captured by conventional advertising schemes. For those who derive most of the significant information that shapes their lives solely through electronic sources, nothing other than social media–based appeals stands much chance of influencing their purchasing decisions.

This upending of conventional modes of advertising has begun to change the content of ads dramatically. It certainly presents a new stage on which people as young as their teens increasingly rely for help in choosing what to buy. Many marketers have come to appreciate that if they are not spreading the word about their products and services via an electronic source, many millennials will ignore it.[2]

Undeniably, a digital environment for advertising, selling, and delivering products and services functions as a two-edged sword for business. It provides lightning-quick access to potential customers, but it also opens pathways for sensitive corporate and consumer data to be hacked on an alarming scale. It offers astute companies nearly unlimited capacity to brand themselves positively in the minds of purchasers, but it simultaneously offers a platform for disgruntled stakeholders to assail companies for both legitimate and self-serving reasons.

Paul A. Argenti, who has taught business communication for many years at the Tuck School of Business at Dartmouth University, has studied this dilemma. As he put it, "mobile apps have created a new playground for cyber-thieves."[3] And consumer advocates and purchasers alike "now use technology to rally together and fuel or escalate a crisis—posing additional challenges for the corporation" in the crosshairs of criticism. Finally, "the proliferation of online blogs and social networking sites has greatly increased the visibility and reach of all current events, not excluding large corporate"[4] bungling.

Regardless of the delivery platform, however, any threat that the advertising of unnecessary or harmful products may pose to our autonomy as consumers is complicated by the fact that sometimes we willingly choose to buy goods or services we may not necessarily require. Sometimes we even buy things that have been proven to be harmful to us, such as cigarettes and sugary drinks. Yet we may desire these products even if we do not need them. If we have the disposable income to make these discretionary purchases, why should we not do so, and why should advertisers not advise us of their availability?

Does Advertising Drive Us to Unnecessary Purchases?

By definition, advertising aims to persuade consumers to buy goods and services, many of which are nonessential. Although consumers have long been encouraged to heed the warning caveat emptor (let the buyer beware), it is a valid question whether advertisers have any ethical obligation to rein in the oft-exaggerated claims of their marketing pitches. Most consumers emphatically would agree that they do.

The award-winning Harvard University economist John Kenneth Galbraith directly addressed this issue in The Affluent Society, first published in 1958. In what he depicted as the "the dependence effect," Galbraith bemoaned the power of corporations to harness wide-ranging advertising strategies, marketing efforts, and sales pitches to influence consumer purchasing decisions.[5] He asked whether it is possible for a sophisticated advertising campaign to create a demand for a product whose benefits are frivolous at best. If so, is there anything inherently wrong with that? Or are informed consumers themselves responsible for resisting tempting—though misleading—advertising claims and exercising their own best judgment about whether to buy a product that might be successful, not because it deserves to be but simply because of the marketing hype behind it? These questions remain fundamental to the manager's task of creating ethical advertising campaigns in which truthful content is prioritized over inducing wasteful consumption.

Psychological appeals form the basis of the most successful ads. Going beyond the standard ad pitch about the product's advantages, psychological appeals try to reach our self-esteem and persuade us that we will feel better about ourselves if we use certain products. If advertising frames the purchase of a popular toy as the act of a loving parent rather than an extravagance, for instance, consumers may buy it not because their child needs it but because it makes them feel good about what generous parents they are. This is how psychological appeals become successful, and when they do work, this often constitutes a victory for the power of psychological persuasion at the expense of ethical truthfulness.

Purchases are also affected by our notion of what constitutes a necessity versus a luxury, and that perception often differs across generations. Older consumers today can probably remember when a cell phone was considered a luxury, for instance, rather than a necessity for every schoolchild. On the other hand, many younger consumers consider the purchase of a landline unnecessary, whereas some older people still use a conventional phone as their main or even preferred means of communication. The cars and suburban homes that were once considered essential purchases for every young family are slowly becoming luxuries, replaced, for many millennials, by travel. Generational differences like these are carefully studied by advertisers who are anxious to make use of psychological appeals in their campaigns.

A consumer craze based on little more than novelty—or, at least, not on necessity or luxury in the conventional sense—is the Pet Rock, a recurring phenomenon that began in 1977. Pet Rocks have been purchased by the millions over the years, despite being nothing more than rocks. During the 2017 holiday shopping season, they retailed at $19.95.[6] Is this a harmless fad, or a rip-off of gullible consumers who are persuaded it can satisfy a real need? In the annals of marketing, the Pet Rock craze denotes one of the most successful campaigns—still unfolding today, though in subdued fashion—in support of so dubious a product.

As long as marketers refrain from breaking the law or engaging in outright lies, are they still acting ethically in undertaking influential advertising campaigns that may drive gullible consumers to purchase products with minimal usefulness? Is this simply the free market in operation? In other words, are manufacturers just supplying a product, promoting it, and then seeing whether customers respond positively to it? Or are savvy marketing campaigns exerting too much influence on consumers ill prepared to resist them? Many people have long asked exactly these questions, and we still have arrived at no clear consensus as to how to answer them. Yet it remains an obligation of each new generation of marketers to reflect on these points and, at the very least, establish their convictions about them.

A second ethical question is how we should expect reasonable people to respond to an avalanche of marketing schemes deliberately intended to separate them from their hard-earned cash. Are consumers obligated to sift through all the messages and ultimately make purchasing decisions in their own best interest? For example, does a perceived “deal” on an unhealthy food option justify the purchase (Figure 15.1)? These questions have no consensus answers, but they underlie any discussion of the point at which sophisticated advertising runs headlong into people’s obligation to take responsibility for the wisdom of their purchases.

Figure 15.1 When an unwise purchase is made appealing, where does the consumer’s responsibility for decision-making lie? Furthermore, if the purchase is spurred by children who are responding to advertising specifically directed at them, is consumer responsibility diminished? (credit: “Big Burgers – Asia (5490379696)” by Kinoko kokonotsu/Wikimedia Commons, CC BY 2.0)

No one would argue that children are particularly susceptible to the ads commercial television rains over them regularly. Generally, young children have not developed sufficient judgment to know what advertised products are good for them and which ones have little or no benefit or perhaps can even harm. Research has even shown that very young children have difficulty separating what is real on television from what is not. This is especially so as it pertains to advertising for junk food. Savvy marketers take advantage of the fact that young children (those younger than age seven or eight years) view advertising in the same manner they do information from trustworthy adults—that is, as very credible—and so marketers hone pitches for junk food directly to these children.[7]

What restrictions could we reasonably impose on those who gear their ads toward children? We could argue that they should take special care that ads targeting children make absolutely no exaggerated claims, because children are less capable of seeing through the usual puffery that most of us ignore. Children are more literal, and once they gain the ability to understand messages directed toward them, especially when voiced by adult authority figures, they typically accept these as truthful statements.

When adults make poor consumer choices, who is responsible? Is it ourselves? Is it our society and culture, which permit the barrage of marketing to influence us in ways we often come to regret? Is it the persuasive power of marketers, which we should rein in through law? Do adults have the right to some assistance from marketers as they attempt to carry out their responsibility to protect children from manipulative ads? We have no easy answers to these questions, though they have taken on special urgency as technology has expanded the range of advertising even to our smartphones.

Is Subliminal Advertising Real?

It may be possible for marketing to be unfairly persuasive in ways that overwhelm the better judgment of consumers. Whether it is the consumers' responsibility to resist or marketers' to tone down their appeals, or both, will continue to be debated. Yet the question of where responsibility lies when consumers are steered to make choices certainly has ethical ramifications.

Some psychologists and educational specialists claim that the very old and the very young are particularly ill prepared to exercise good judgment in the face of subliminal advertising, that is, embedded words or images that allegedly reach us only beneath the level of our consciousness. Other experts, however, disagree and insist that subliminal advertising is an urban myth that no current technology could create or sustain.

A U.S. journalist, Vance Packard, published The Hidden Persuaders in 1957, contending that subliminal messaging had already been introduced into some U.S. cinemas to sell more refreshments at the theaters' snack bars. Alarms sounded at the prospect, but it turned out that any data on which Packard was relying came from James Vicary, a U.S. market researcher who insisted he had engineered the feat in a cinema in New Jersey. No other substantiation was provided, and Vicary's claim was eventually dismissed as self-promotion, which he seemed to concede in an interview five years later. Although the immediate threat of subliminal advertising receded, some people remain concerned that such persuasion might indeed be possible, especially with the advent of better technologies, like virtual reality, to implement it.[8]

A 2015 study at the University of South Carolina found that thirsty test subjects placed in the role of shoppers in a simulated grocery store could be subliminally influenced in their choice of beverages if they were primed by images of various beverage brands within fifteen minutes of acknowledging being thirsty. After that window of time passed, however, any impact of subliminal messaging receded.[9]

So the scientific evidence establishing any real phenomenon of subliminal advertising is inconclusive. Put another way, the evidence to this point does not definitively demonstrate the existence of a current technology making subliminal marketing pitches possible. Given this, it cannot be clearly determined whether such a technology, if it did exist, would be effective. Another question is whether virtual reality and augmented reality might eventually make subliminal advertising viable. Real subliminal persuasion might render children, the elderly, and those with developmental disabilities more vulnerable to falling prey. Could even the most skeptical viewer resist a message so powerfully enhanced that the product can be sampled without leaving home? Would you be in favor of federal government regulation to prevent such ads? What sort of ethical imperatives would you be willing to request of or impose on sophisticated marketers?

LINK TO LEARNING

Is subliminal messaging real? Watch this video where BBC Earth Lab investigates a bit whimsically what truth might lie in the claim that subliminal advertising is real to learn more.

Advertising plays a useful role in informing consumers of new or modified products and services in the marketplace, and wise purchasers will pay attention to it but with a discerning eye. Even the exaggerated claims that often accompany ads can serve a purpose as long as we do not unquestioningly accept every pitch as true.

16. The Insurance Industry

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Discuss whether the underlying business model of the insurance industry is an ethical one**
- **Identify the reasons why the government offers certain kinds of insurance**
- **Discuss the ethical issues in insurers' decisions whether to offer disaster insurance**
- **Explain the concept of redlining**

Although the concept of insurance dates back to antiquity, the insurance industry as a profession came of age in the seventeenth century, when maritime trade in valuable commodities like coffee, tea, cocoa, sugar, and silk became an immense industry, but one fraught with uncertainty. Merchants sought a means to limit their financial losses in the event their cargoes were lost at sea.

In England, merchants and shippers gathered together in associations, or syndicates, to distribute the risk of loss as evenly as possible. For a fee, individual merchants and ships' owners in these syndicates could buy insurance, essentially the right to be financially compensated by the syndicate's fund for their loss if their shipments or vessels sank. The first such association of traders and shippers began at Samuel Lloyd's coffee house, on Tower Street near the River Thames, in 1688. This was the origin of the huge insurance market now known as Lloyd's of London,[1] and from these early forms of group insurance sprang the profession as it exists today.

From the seventeenth century to the present, the profession has faced a fundamental ethical quandary: An insurance company makes money when purchaser fees, called premiums, are numerous and claims, requests for monetary compensation for covered losses, are few. But the reality is that accidents occur, whether they take the form of shipping losses, vehicular collisions, or home or business fires. So insurance carriers set customer premiums at a high enough rate to compensate themselves with a baseline profit when claims for compensation arise. The ethical question then is what constitutes a reasonable profit. The way the industry defines "reasonable" is directly reflected in the premiums it sets, which also take into account actuarial and statistical calculations of the historic frequency of the occurrence of various claims.

How Insurance Works

The irony of insurance coverage of any sort is that we buy it hoping never to use it. Still, business and consumers alike appreciate that a catastrophic loss can be financially devastating and so they seek to protect against it. Insurance coverage does not prevent illness, accidents, or other unforeseen events from occurring, but it does offer a means to recover, at least partially, from the monetary costs associated with them.

Insurance policies constitute a form of contract between insurers and the insured. To reduce their losses in those situations in which they must pay on a claim, insurers do their best to attach high premiums to the coverage and identify exclusions and limits on it. They worry about being forced to pay out on frivolous and exaggerated claims, while policyholders fear that on the rare occasions when they will have to file a claim, their reimbursement will be minuscule and/or their future premiums will rise. From the perspective of the consumer, the guarantee of a fair payout on a claim is the only inducement to pay insurance premiums in the first place.

WHAT WOULD YOU DO?

Valuing Your Inventory versus Valuing Your Employees

Assume you are the owner of a small apparel manufacturer with approximately fifty employees. Your business is located in a blighted area of town where the jobs you provide are important, but the insurance costs of doing business there are significant, too. Recently, fire and theft coverage has escalated in cost, but it is essential to protect your premises and inventory, and local ordinances require that you purchase it. You have customarily provided health coverage for your employees and their families, which many of them would not be able to afford if they had to bear the cost themselves. You would like to continue providing this coverage—though, due to your small employee base, you are not legally obligated to do so—but these costs have risen too. Finally, you would prefer to stay in this location, because you feel an obligation to your workers, most of whom live nearby, and because you feel welcomed by the community itself, which includes some longtime customers. Still, you may be forced to choose between paying for your employee health care costs and moving to a different area of town where fire and theft coverage would not cost as much.

Critical Thinking

- How will you make the decision within an ethical framework?
- What will you, your business, and your employees gain and lose based on what you decide?
- What, if anything, do you and your business owe the community of which you have been a part for so long?

Insurance protections are, in fact, limited. In August 2017, Hurricane Harvey dumped fifty-two inches of rain on Houston, Texas, accompanied by fierce winds. Tens of thousands of homes, stores, factories, and other industrial sites suffered severe damage and flooding. Although normal homeowners' and business owners' insurance provides for loss due to hurricane winds, it does not cover loss due to flooding. As The Economist observed in the immediate aftermath of the hurricane, “whereas wind damage is covered under most standard insurance policies in America, flood insurance is a government-run add-on that far from all homeowners buy. As a result, of over $30 billion in property losses in Texas, only 40 percent may be insured.”[1]

Not only do few homeowners buy flood insurance; few private insurers offer it. After all, most insurance carriers are for-profit, and companies would make little money insuring everyone against flood damage in flood-prone areas. It would be a losing proposition for any carrier to undertake, because insurance companies enjoy their highest returns when claims are few and payouts small. But the federal government is not a commercial broker and does not intend to make a profit from extending any sort of insurance coverage. For that reason, the National Flood Insurance Act of 1968 established a way to dispense flood coverage through a federal agency. Today that supervising agency is the Federal Emergency Management Authority (FEMA), in partnership with the Department of Homeland Security (Figure 16.1). As of August 2017, just before Harvey struck, some five million households had taken out FEMA-sponsored flood coverage.[2]

Figure 16.1 The National Flood Insurance Program in the United States is part of the Federal Emergency Management Agency (FEMA). (credit: modification of "National Flood Insurance Program 50th Anniversary Logo – white background" by FEMA/fema.gov, Public Domain)

LINK TO LEARNING

Consumers' criticisms of the insurance industry are not limited to the United States; they pose an international issue for the profession. Read this Sydney

> Morning Herald article that explores the causes of controversy that haunt insurance carriers in Australia to learn more. Principally, they center on the lengths to which insurers might go to disallow a claim and so dispose of their obligation to pay out on it, at least according to some consumer watchdogs.

The California Earthquake Authority serves a similar function at the state level by managing privately funded insurance against earthquakes in California. The private brokers in the program make no profit from offering this coverage, but they do earn the right to offer (and profit from) other insurance in California.

The Ethical Dilemma of Insuring against Natural Disasters

We do not know with certainty what effect climate change will have on the incidence or severity of natural disasters (i.e., accidents that do not appear to have any direct human cause). We do know, however, that these events can be ruinously expensive, for the carriers that insure against them and for those who suffer them and must put their lives back together afterward.

Business writer Don Jergler said, for example, that "climate change has created a 'wildfire crisis in California,' which in turn is 'causing a fire insurance predicament.'" California insurance commissioner Dave Jones warned in December 2017, after a particularly disastrous fire season in California, that "insurers may start to back off writing insurance in some areas [of the state]," and this would pose a crisis for homeowners who consequently lost insurance protection against losses caused by wildfires.[3]

In Canada, too, "environmental risks linked to climate change are becoming important issues for insurers who need to consider their response to related risks and climate related losses whether arising from weather related events such as flood and storms or liability risks from third party claims."[4]

When insurance carriers must pay claimholders more often on claims arising from natural disasters, they lose money at a rate that could make them less willing to underwrite similar policies in the future. This unwillingness, in turn, would deny coverage against these disasters to an increasing number of individuals and companies. The high cost of disaster claims and subsequent shrinking of policy offerings are losses first experienced by the insurance industry, but they have rapid and dire consequences for policyholders.

Again, we come to the ethical conundrum as to what we might fairly expect from insurance carriers and from clients who seek to indemnify themselves against natural disasters. In regions where certain kinds of disasters are more likely to occur, is it reasonable to dictate that carriers still must provide coverage? If so, should we consider extending public subsidies to the carriers to protect them against catastrophic payouts? Should premiums be assigned on the basis of the incidence patterns and severity of risk associated with particular disasters in certain regions? With these questions, we return to the ethical consideration of what constitutes a reasonable profit for carriers and what premium policy holders ought to be charged for sufficient coverage.

The United States does not have the strong tradition of private/public ownership of industries, such as petroleum extraction or air travel that some other nations do.[5] Essentially, private/public ownership is an arrangement in which private (industry) and public (government) monies are combined to more safely bear an industry's risk and also share in its profit. It is often a successful partnership. When we consider the scale of loss that can result from natural disasters, and the extent of the public's need for protection from such loss, insurance may be a U.S. industry in which private/

public ownership of some policies would be appropriate. The National Flood Insurance Program and the California Earthquake Authority are rare examples of public agencies managing insurance coverage that private insurers have declined to provide because the potential for profit is too low. Whether partnerships like this can and should be expanded, and whether they can be funded from federal and state budgets, are ethical questions for federal and state governments and policyholders alike.

CASES FROM THE REAL WORLD

What Does the Future Hold for the Insurance Industry?

Many insurance carriers enjoy a robust business. As an example, UnitedHealth Group Incorporated, headquartered in Minnesota, had about $185 million in sales in 2017 and employed approximately 230,000 people. Still, as an industry report from the business research company Hoovers established, insurers of all stripes, health or auto or property or anything else, face two major hurdles. First, they "are increasingly subject to a large number of regulations and reporting requirements by states. Consequently, some insurers have withdrawn from states that impose burdensome requirements." Second, large-scale "claims have become more common, creating problematic concentrations of risk for individual insurers. . . . And some risks can be large enough to drive insurers out of business or cause them to curtail services offered, increase rates, or leave states where risk is highest."26 Thus, profits can be high within the industry, but so can payouts in the aftermath of major catastrophes. The report goes on to say that "floods, hurricanes, and tornadoes" produce the riskiest economic circumstances for the industry. Consequently, states in which these weather events are more common—Alabama, Florida, and North Carolina—have seen some carriers cease business operations within them. 27

Critical Thinking

In selecting coverage and setting prices, how does an insurance company choose the ethical balance between making a reasonable profit and risking catastrophic losses of its own?

Should the law require that carriers offer property insurance in states where harsh natural disasters occur? Or should federal and state monies be used to subsidize insurance companies' resources in these circumstances? In each case, why or why not?

Redlining: Discrimination in Insurance

A specific ethical challenge within the insurance profession is the tendency to engage in redlining. Redlining is the practice of assigning or denying coverage for certain policies, such as auto, homeowners, or business insurance, on the basis of the geographic neighborhoods where applicants for such coverage live, particularly inner-city neighborhoods. A variation on the practice is to charge considerably higher prices for the same coverage in different neighborhoods. Redlining assumes that the propensity for accidents, burglaries, fires, and other catastrophes is higher in some areas than others, so claims and costs will be higher for the insurance carrier.

At first glance, this practice appears to make economic sense from the perspective of both the insurer and the insured. Looking beneath the surface, however, reveals that redlined neighborhoods are often areas where racial and ethnic minorities live. No insurance carrier ever admits to engaging in discriminatory redlining (the term refers to an older practice by which insurance companies marked certain neighborhoods in red on print copies of coverage maps). Nearly every state in the United States forbids the practice. Yet a comprehensive 2017 study by Consumer Reports and ProPublica, a nonprofit research organization, indicated the phenomenon may remain very much a reality. This study focused on rates for auto insurance and found that for "decades, auto insurers have been observed to charge higher average premiums to drivers living in predominantly minority urban neighborhoods than to drivers with similar safety records living in majority white neighborhoods. Insurers have long defended their pricing by saying that the risk of accidents is greater in those neighborhoods, even for motorists who have never had one."[6]

The authors of the report compared auto insurance premiums and claims paid in four states (California, Illinois, Missouri, and Texas) and found similar results whether the carrier was Allstate, Geico, Liberty Mutual, or another. They contended "that many of the disparities in auto insurance prices between minority and white neighborhoods are wider than differences in risk can explain."[7] This is significant because laws do typically permit premium rates to be set according to the incidence of claims filed within certain neighborhoods. Yet laws never allow rates to be based solely or predominantly on the race or ethnicity of the residents in different neighborhoods. This is the essence of prohibited redlining.

Professionals in the industry do well to steer clear of this practice or even the appearance of it, and that is the overriding theme of this study.

Drawing back, the ethical challenge for any responsible carrier is to ensure that the race, ethnicity, or creed of any policyholder plays absolutely no role in the premiums assigned him or her. There is no defensible reason to base a carrier's decision to extend or deny insurance coverage or assign the premium amount for it on these factors.

17. Ethical Issues in the Provision of Health Care

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Identify ethical problems related to the availability and cost of health care in the United States and elsewhere**
- **Discuss recent developments in insuring or otherwise providing for health care in the United States**

Private health care in the United States has historically been of high quality and readily available, but only for those who could afford it. This model for rationing health services is rare in the developed world and stands in dramatic contrast to the provision of health care in other industrialized economies. Those who provide health care and administer the health care system find that balancing the quality of, access to, and cost of medical care is an ethical dilemma in which they must continually engage.[1]

Multipayer Health Care in the United States

Typically in the United States, medical services have been dispensed through a multipayer health care system, in which the patient and others, such as an employer and a private health insurance company, all contribute to pay for the patient's care. Germany, France, and Japan also have multipayer systems. In a single-payer health care system such as those in the United Kingdom and Canada, national tax revenues pay the largest portion of citizens' medical care, and the government is the sole payer compensating those who provide that care. Contributions provided by employers and employees provide the rest. Both single- and multipayer systems help reduce costs for patients, employers, and insurers; both, especially single-payer, are also heavily dependent on taxes apportioned across employers and the country's population. In a single-payer system, however, because payment for health care is coordinated and dispensed by the government, almost no one lacks access to medical services, including visitors and nonpermanent residents.

Many reasons exist for the predominance of the multipayer system in the United States. Chief among these is the U.S. tradition that doctors' services and hospital care are privatized and run for profit. The United States has no federal health care apparatus that organizes physicians, clinics, and medical centers under a single government umbrella. Along with the profit motive, the fact that providers are compensated at a higher average rate than their peers abroad ensures that health care is more expensive in the United States than in most other nations.

The United States also has more health care professionals per citizen than most other countries, and more medical centers and clinics (Figure 17.1). One positive result is that the wait for most elective medical procedures is often shorter than in other countries, and travel time to a nearby medical facility is often less. Still, paying for health care remains one of the most controversial topics in the

United States, and many question what it is that Americans gain from the current system to balance the cost. As an exhaustive study from The Commonwealth Fund asserted, “the United States spends far more on health care than other high-income countries, with spending levels that rose continuously over the past three decades. . . . Yet the U.S. population has poorer health than other countries.”[2]

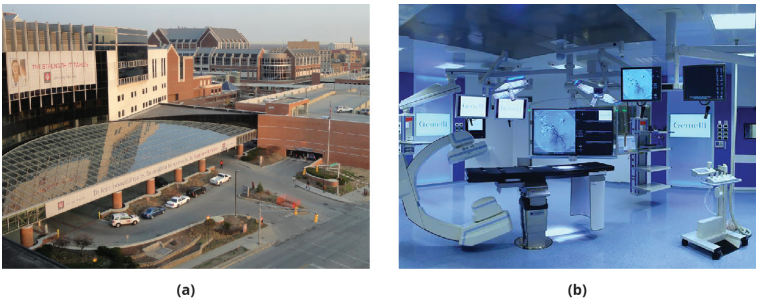


Figure 17.1 The Indiana University Health University Hospital (a) is an example of a contemporary medical center affiliated with a university medical school, in this case on the Indiana University–Purdue University Indianapolis campus. This is indicative of a common partnership through which hospitalization and medical-school education are made available in the United States. This type of affiliation also exists abroad, as evidenced by this state-of-the-art operating facility (b) at the Gemelli University Hospital in Rome, Italy. (credit a: modification of “Indiana University Hospital – IUPUI – DSC00508” by “Daderot”/Wikimedia Commons, Public Domain; credit b: modification of “Hybrid operating room for cardiovascular surgery at Gemelli Hospital in Rome” by “Pfree2014”/Wikimedia Commons, CC0)

Besides its inefficiencies, the state of U.S. health care raises challenging ethical issues for professionals in the field and for patients as well. What happens if many poorer people cannot afford health care? Should doctors treat them anyway? Who is qualified to receive subsidized (insured) health care? In the absence of universal health care, which is generally ensured elsewhere by a single-payer system that entitles everyone to receive care at very low cost, can the United States truly boast of being the richest nation on Earth? Put another way, when the least materially advantaged in a country do not have access to quality health care, what is the worth such a nation patently is assigning to those human beings residing within it?

Supporters of the status quo for health care in the United States may point to state-of-the-art facilities as evidence of its success. Yet other nations, such as Australia, the United Kingdom, and the Netherlands, have equal levels of medical technologies available for patients and are given much more favorable marks for universal health insurance and accessibility by The Commonwealth Fund.

The High Cost of Prescription Drugs

Discussions of health care accessibility have become politically charged, so for now it is enough to observe that not only is medical care enormously expensive in the United States but so are prescription drugs. According to William B. Schultz, an attorney writing in the Washington Post in 2017, "in the past 35 years, the only significant victory in the battle to control drug prices has been the enactment of legislation that established the generic drug program at the FDA [Federal Drug Administration]." Otherwise, he stated, "prescription drug prices account for 17 percent of the nation's health-care costs, up from 7 percent in the 1990s," and "prescription drug spending accounts for nearly 20 percent of total program spending for Medicare, the largest of the governmental health-care programs."[3] (Schultz is not entirely impartial; he is a partner in a law firm that represents generic drug providers, among other clients.)

LINK TO LEARNING

The New York Times asked its readers to relay their experiences as purchasers of prescribed medicines that they thought carried much too high a price tag. This article on some of the reader responses to drug prices was reported by two journalists at the paper, Katie Thomas and Charles Ornstein.

The only way to recoup the enormous cost of developing new drugs, says the pharmaceutical industry, is to pass it along to consumers. Critics, on the other hand, assert that the much of the expense incurred within the industry results from the high cost of marketing new drugs. Wherever the truth lies in this debate, it remains that exorbitant prices for much-needed medicines dramatically reduce their social value when only a few individuals can actually afford to obtain them. What does it say of our priorities if we have the technology to create life-saving medicines but allow astronomic prices effectively to deny them to many patients who require them?

Paying for Health Care and Wellness

Within the multipayer system, many U.S. workers have traditionally looked to their employers or their unions to subsidize the cost of care and thereby make it available for them and their families. Many reasons explain why this is so. In contrast to the European and Canadian perspective, for example, in which both the state and employers are presumed to have an interest in and responsibility for underwriting the cost of health care, the traditional U.S. approach is that workers and their employers should be responsible for securing this coverage. This belief reflects an unease on the part of some about assigning services to the government, because this implies the need for a larger governing entity as well as additional taxes to sustain it. The sentiment also reflects a conviction on the part of some that self-reliance is always to be preferred when securing the necessities of life.

John E. Murray, a professor of economics at the University of Toledo, offered a related explanation. He cited the existence of industrial sickness funds in the United States, which arose in the late nineteenth and early twentieth centuries. These were monies "organized by workers through their employer or union [that] provided the rudiments of health insurance, principally consisting of paid sick leave, to a large minority of the industrial workforce of the late nineteenth and early twentieth centuries."[4] Murray stated that these funds declined in popularity not because they were ineptly administered or rendered bankrupt by World War I or the Great Depression but rather because they gave way to even more effective instruments in the form of group insurance policies offered by employers or labor unions.

So the U.S. worker's experience differed from that of European labor in that much significant health care coverage was provided under the auspices of unions and employers rather than the state. Murray noted another source of relief for workers who experienced illness or injury that prevented them from working for any period of time, and that was charity.[5] Specific versions of charity were offered by religious organizations, including Christian churches and Jewish synagogues. Often, these religious bodies banded together to provide monetary benefits for sick or injured members of their own faith who might otherwise have been denied health coverage due to prejudice.[6] The U.S. social experience featured more ethnic and cultural diversity, especially in the nineteenth and early twentieth centuries, than was present in many European nations, and a downside is the racial, ethnic, and religious prejudice it inspired.

A final distinction Murray pointed to is the past opposition of the American Medical Association to any sort of state-sponsored insurance. Early supporters of industrial sickness funds, including some physicians, anticipated that most doctors would support these funds as pathways ultimately directed to state-provided coverage. Instead, in 1920, "the American Medical Association voted officially to state its opposition to government health insurance. A sociologist concluded that from this time to the 1960s, physicians were the loudest opponents of government insurance."[7] By default, then, many U.S. workers came to rely more on their employers or unions than on any other source for coverage. However, this explanation does not answer the larger ethical question of who should provide health insurance to residents and citizens, a question that continues to roil politics and society in the nation even today.

More recently, large corporations have moved from providing one-size-fits-all insurance plans to compiling a menu of offerings to accommodate the different needs of their employees. Workers with dependent children may opt for maximum health care coverage for their children. Employees without dependents or a partner may elect a plan without this coverage and thereby pay lower premiums (the initial cost for coverage). Yet others might minimize their health-insurance coverage and convert some of the employer costs that are freed up into added pension or retirement plan value. Employers and workers have become creative in tailoring benefit plans that best suit the needs of employees (Figure 17.2). Some standard features of such plans are the copayment, a set fee per service paid by the patient and typically negotiated between the insurance carrier and the employer; the annual deductible, a preset minimum cost for health care for which the patient is responsible each year before the carrier will assume subsequent costs; and percent totals for certain medical or dental procedures that patients must pay before the carrier picks up the remainder.

Figure 17.2 Anthem Inc. (formerly WellPoint, Inc.), headquartered in Indianapolis, Indiana, is one of the largest health care vendors in the nation, with more than fifty thousand employees and nearly $2.5 billion in net revenue in fiscal year 2016. (credit: modification of "Company headquarters on Monument Circle in Indianapolis" by Serge Melki/Wikimedia Commons, CC BY 2.0)

Despite the intricacies of this customization, employers have found the group coverage policies they offer to be expensive for them too, more so with each passing year. Full health care coverage is becoming rarer as a standard employment benefit, and it is often available only to those who work full time. California, for example, stipulates that most workers need not be provided with employer health care coverage unless they work at least twenty hours a week.

Rising costs for both employers and employees have combined to leave fewer employees with health care benefits at any given time. Employees with limited or no coverage for themselves and their dependents often cope by cutting back on the medical attention they seek, even when doing so places their health at risk. Whenever workers must skip medical services due to cost considerations, this places both them and their employers in an ethical quandary, because both typically want workers to be in good health. Furthermore, when employees must deny their dependents appropriate health care, this dilemma is all the more intensified.

To try to reduce the costs to themselves of employee health care insurance coverage, some companies have instituted wellness programs to try to ensure that their workforces are as healthy as possible. Some popular wellness program offerings are measures to help smokers quit, workout rooms on work premises or subsidized gym memberships, and revamped vending and cafeteria offerings that provide a range of healthier choices. Some companies even offer employees bonuses or other rewards for quitting smoking or achieving specific fitness goals such as weight loss or miles walked per week. Such employer efforts appear benign at first glance, because these measures truly can produce better health on the part of workers. Still, ethical questions arise as to who the true beneficiaries of such policies are. Is it the employees themselves or the companies for which they work? Furthermore, if such measures were to become compulsory rather than optional, would it still reflect managerial benevolence toward employees? We discuss this in the following paragraphs.

Wellness programs were inspired by safety programs first created by U.S. manufacturers in the 1960s. These companies included Chrysler, DuPont, and Steelcase. Safety programs were intended to reduce workplace accidents resulting in injuries and deaths. Over the years, such programs slowly but steadily grew in scope to encompass the general health of employees on the job. As these policies have expanded, they also have fostered some skepticism and resistance: "Wellness programs have attracted their share of criticism. Some critics argue workplace programs cross the line into employees' personal lives."[8] Ann Mirabito, a marketing professor at the Hankamer School of Business at Baylor University agrees there is potential for abuse: "It comes back to the corporate leader. . . . The best companies respect employees' dignity and offer programs that help employees achieve their personal goals."[9]

Employees who exercise, eat healthily, maintain their ideal weight, abstain from smoking, and limit their alcoholic consumption have a much better chance of remaining well than do their peers who undertake none of these activities. The participating employees benefit, of course, and so do their employers, because the health insurance they provide grows cheaper as their workers draw on it less. As Michael Hiltzik, a consumer affairs columnist for the Los Angeles Times, noted, “Smoking-cessation, weight-loss and disease-screening programs give workers the impression that their employers really care about their health. Ostensibly they save money too, since a healthy workforce is cheaper to cover and less prone to absenteeism.”[10]

Certainly, employers are also serving their own interests by trying to reduce the cost of insuring their workers. But are there any actual disadvantages for employees of such wellness programs that employers might unethically exploit? Hiltzik suggested one: “The dark downside is that ‘voluntary’ wellness programs also give employers a window into their workers’ health profiles that is otherwise an illegal invasion of their privacy.”[11] Thus the health histories of workers become more transparent to their bosses, and, Hiltzik and others worry, this previously confidential information could allow managers to act with bias (in employee evaluation and promotion decisions, for instance) under cover of concern about employees’ health.

The potential for intrusion into employee privacy through wellness programs is alarming; further, the chance for personal health data to become public as a consequence of enrolling in such programs is concerning. Additionally, what about wellness rules that extend to workers’ behavior off the job? Is it ethical for a company to assert the right to restrict the actions of its employees when they are not on the clock? Some, such as researchers Richard J. Herzog, Katie Counts McClain, and Kymberleigh R. Rigard, argue that workers surrender a degree of privacy simply by going onto payroll: “When employees enter the workplace, they forfeit external privacy. For example, BMI [body mass index] can be visually calculated, smokers can be observed, and food intake monitored.” They acknowledge, however, that “protecting privacy and enhancing productivity can provide a delicate balance.”[12]

LINK TO LEARNING

As noted in previous chapters, we can find out a great deal about the ethical intentions of a company by studying its mission statement, although even the noblest statement is irrelevant if the firm fails to live up to it. Here is Anthem, Inc.'s very simple and direct mission statement as an example from a health care insurer. What impression does this statement leave with you? Would you add or delete anything to it? Why or why not?

The Affordable Care Act

Health care reform on a major scale emerged in the United States with the passage of the Patient Protection and Affordable Care Act, more commonly known as the Affordable Care Act (ACA), in March 2010, during the Obama Administration. The ACA (so-called Obamacare) represents a controversial plan that strikes its opponents as socialist. For its supporters, however, it is the first effective and comprehensive plan to extend affordable health care to the widest segment of the U.S. population. Furthermore, like most new federal policies, it has undergone tweaks and revision each year since becoming law. The ACA is funded by a combination of payments by enrollees and supplemental federal monies earmarked for this task.

The ACA mandates a certain level of preventive care, a choice of physicians and health care facilities, coverage at no extra cost for individuals with preexisting health conditions, protection against the cancellation of coverage solely on the basis of becoming ill, and mental health and substance abuse treatment, all of which must be met by carriers that participate in the plan. The ACA also permits its holders to select from a number of marketplace plans as opposed to the limited number of plans typically offered by any given employer.[13] All in all, it is a far-reaching and complex plan whose full implications for employers and their employees have yet to be appreciated. Preliminary results seem to indicate that employer-provided coverage on a comprehensive scale remains a cheaper alternative for those workers eligible to receive it.[14] Given the general efficiency of group insurance policies provided by U.S. employers, an ethical issue for all managers is whether these policies offer the best care for the greatest number of employees and so should be the responsibility of management to offer whenever it is possible to do so. Current law requires all companies employing fifty or more workers to make insurance available to that part of their workforce that qualifies for such coverage (e.g., by virtue of hours worked). Is it right, however, to leave the employees of smaller firms to their own devices in securing health care? Even if the law does not require it, we hold that an ethical obligation resides with small businesses to do everything in their power to provide this coverage for their employees.

Evidence of the intense debate the act has engendered is the Trump administration's attempts, beginning in January 2017, to repeal the ACA entirely, or at least to dilute significantly many of its provisions. Nearly immediately upon his inauguration, President Trump signed Executive Order 13765 in anticipation of ending the ACA. Also that same month, the American Health Care Act was introduced in the House of Representatives, again with an eye to eliminating or seriously weakening the existing act. Much political debate within both the House and Senate ensued in 2017, with proponents of the ACA seeking to ensure its survival and opponents attempting (but, as of this writing, failing) to repeal it.

The ACA represents the first far-reaching health care coverage to take effect since 1965, after many stalled or otherwise frustrated attempts. Since the passage that year of the Medicare and Medicaid Act, which provided health coverage to retired, elderly, and indigent citizens, many presidential administrations, Democrat and Republican alike, have worked to enlarge health care coverage for different segments of the national population. In addition to expanding eligibility for benefits, the Medicare and Medicaid Act had direct implications for business proprietors and their employees. For one, the act set up new automatic earnings deductions and tax schedules for workers and employers, and employers were made responsible for administering these plans, which help fund the programs' benefits.

The future of the ACA appears to depend on whether a Democrat or Republican sits in the White House and which party controls the Senate and the House in the U.S. Congress. Although legislation does hinge on the political sentiments of the president and the majority party in Congress, what is ethical does not lend itself to a majority vote. So regardless of whether the ACA survives, is revised, or is replaced entirely by new health care legislation, the provision of health care will likely continue to pose ethical implications for U.S. business and the workers who are employed by it.

The ethical debate over universal health care coverage is larger even than business and its employees, of course, but it still carries immense consequences for management and labor irrespective of how the ACA or other legislation fares in the halls of government and the courts. An ethical dilemma for employers is the extent to which they should make health coverage available to their workers at affordable rates, particularly if federal and state government plans provide little or no coverage for residents and the costs of employer-provided coverage continues to climb.

State-Level Experiments with Single-Payer

Health Care Plans

Against the backdrop of federal attempts to institute national health care over the past several decades, some individual states in the United States have used their own resources to advance this issue by proposing mandated health care coverage for their citizens. For example, in April 2006, Massachusetts passed An Act Providing Access to Affordable, Quality, Accountable Heath Care, the first significant effort at the state level to ensure near-universal health care coverage.

The Massachusetts act created a state agency, the Commonwealth Health Insurance Connector Authority, to administer the extension of health care coverage to Massachusetts residents. In many ways, it served as the most significant precursor of and guide for the federal ACA, which would follow approximately four years later. By many accounts, the Massachusetts legislation has achieved its purposes with few negative consequences. As Brian C. Mooney, reporting in the Boston Globe, put it about five years after the act's passage: "A detailed Globe examination [of the implementation of the act] makes it clear that while there have been some stumbles—and some elements of the effort merit a grade of 'incomplete'—the overhaul, after five years, worked as well as or better than expected."[15]

The proposed Healthy California Act (SB 562) is another example. SB 562 passed in the California State Senate in June 2017. However, the Speaker of the Assembly, the lower house of the legislature, blocked a hearing of the bill at that time, and a hearing is necessary for the bill to advance to ratification. A new effort was initiated in February 2018 to permit the bill finally to be considered by the lower house. (Two differences between the California bill and the Massachusetts Act include the number of state residents who would be affected. Massachusetts has a population of about seven million compared to California's nearly forty million. A second distinction is that SB 562 is constitutes a single-payer plan, whereas the Massachusetts Act does not.)

Single-payer health care plans essentially concentrate both the administration of and payment for health care within one entity, such as a state agency. California's effort is a very simple plan on its face but complex in its implementation. Here is how Michael Hiltzik summarized the intent of California Senate Bill 562: "The program would take over responsibility for almost all medical spending in the state, including federal programs such as Medicare and Medicaid, employer-sponsored health plans, and Affordable Care Act plans. It would relieve employers, their workers and buyers in the individual market of premiums, deductibles and copays, paying the costs out of a state fund."[16] The bill would create a large, special program apparatus tentatively entitled Healthy California. It is contentious on many fronts, particularly in that it would create the largest single-payer health insurance plan sponsored by a U.S. state and the scope of the plan would necessitate a huge bureaucracy to administer it as well an infusion of state monies to sustain it. Furthermore, it would extend health care coverage to all residents of the state, including undocumented immigrants.

A specific hurdle to passage of Healthy California is that it would cost anywhere from $370 billion to $400 billion and would require federal waivers so California could assume the administration of Medicare and Medicaid in the state as well as the federal funds currently allotted to it. All these conditions would be enormously difficult and time consuming to meet, even if the federal government were sympathetic to California's attempts to do so. In 2018, that was decidedly not the case.

Is free or inexpensive access to health care a basic human right? If so, which elements within society bear the principal responsibility for providing it: government, business, workers, all these, or other agencies or individuals? This is a foundational ethical question that would invoke different responses on the part of nearly everyone you may ask.

ETHICS ACROSS TIME AND CULTURES

Free Universal Health Care

Except for the United States, the largest advanced economies in the world all provide a heavily subsidized universal health care system, that is, a publicly funded system that provides primary health services to all, usually at a nominal fee only and with no exclusions based on income or wealth. Although these systems are not perfect, their continued existence seems assured, regardless of the cultural or political framework of the various countries. A logical question is why the United States would be an outlier on this issue, and whether that might change in the future.

Some answers, as noted in the text, lie in the United States' historical reliance on a mostly private system, with approximately 83 percent of health care expenses provided by the private sector through insurers and employers (in contrast, this percentage in the United Kingdom is 17). A solution that has gained traction in recent years is conversion to a single-payer system. How might this work? One article estimates that the cost of instituting a national, single-payer health care insurance program in the United States would be $32 trillion over ten years. If this estimate is accurate, would it be an exorbitant price tag for such a program, or would it be money well spent in terms of making good health care available to all citizens?[17]

Critical Thinking

- Do you find it appropriate that health care costs be provided by a mix of private versus public sources?
- What advantages might single-payer health care offer over employer-provided coverage, care provided under the ACA, or privately purchased health insurance?

As a nation, the United States has usually preferred a system predicated on private health care providers and insurers to pay for it. This arrangement has worked best in instituting high-quality care with minimal delays even for elective medical procedures. It has systematically failed, however, in establishing any sort of universal dispensation that is affordable for many citizens.

In the early twenty-first century, the United States is moving ever so slowly and with plenty of hiccups toward some degree of national or state management of health care. Precisely where these efforts will take us may not be clear for the next several years. The political, economic, and ethical dimensions of public management of our health care drive considerable controversy and very little agreement.

18. What Constitutes a Fair Wage?

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Explain why compensation is a controversial issue in the United States**
- **Discuss statistics about the gender pay gap**
- **Identify possible ways to achieve equal pay for equal work**
- **Discuss the ethics of some innovative compensation methods**

The Center for Financial Services Innovation (CFSI) is a nonprofit, nonpartisan organization funded by many of the largest American companies to research issues affecting workers and their employers. Findings of CFSI studies indicate that employee financial stress permeates the workplaces of virtually all industries and professions. This stress eats away at morale and affects business profits. A recent CFSI report details data showing that "85% of Americans are anxious about their personal financial situation, and admit that their anxiety interferes with work. Furthermore, this financial stress leads to productivity losses and increased absenteeism, healthcare claims, turnover and costs affecting workers who cannot afford to retire."[1] The report also indicates that employees with high financial anxiety are twice as likely to take unnecessary sick time, which is can be expensive for an employer.

The CFSI report makes clear that ensuring workers are paid a fair wage is not only an ethical practice; it is also an effective way to achieve employees' highest and most productive level of performance, which is what every manager wants. In the process, it also makes workers more loyal to the company and less likely to jump ship at the first sign of a slightly better wage somewhere else.

The concept of a fair wage has a greater significance than simply one worker's pay or one company's policy. It is an economic concept critical to the nation as a whole in an economic system like capitalism, in which individuals pay for most of what they need in life rather than receiving government benefits funded by taxes. The ethical issues for the business community and for society at large are to identify democratic systems that can effectively eradicate the financial suffering of the poorest citizens and to generate sufficient wages to support the economic sustainability of all workers in the United States. Put another way, has the real income of average American workers declined so much over the past few decades that it now threatens the productivity of the largest economy in the world?

Economic Data as an Indicator of Fair Wages

The Pew Research Center indicates that over the thirty-five years between 1980 and 2014, the inflation-adjusted hourly wages of most middle-income American workers were nearly stagnant, rising just 6 percent, or an average of less than 0.2 percent, per year.[2] (The Pew Research Center defines middle-class adults as those living in households with disposable incomes ranging from 65 percent to 200 percent of the national median, which is approximately $60,000.) The data collected by the Economic Policy Institute, a nonprofit, nonpartisan think tank, show the same stagnant trend.[3] Contrast this picture with the wages of high-income workers, which rose 41 percent over the same years. Many economists, political leaders, and even business leaders admit that increasing wage and wealth disparities are not a sustainable pattern if the U.S. economy is to succeed in the long term.[4] Wage growth for all workers must be fair, which, in most cases, means higher wages for low- and middle-income workers. Figure 19.1 presents evidence of the growth of the income gap in the United Sates since the start of the great recession in 2007.

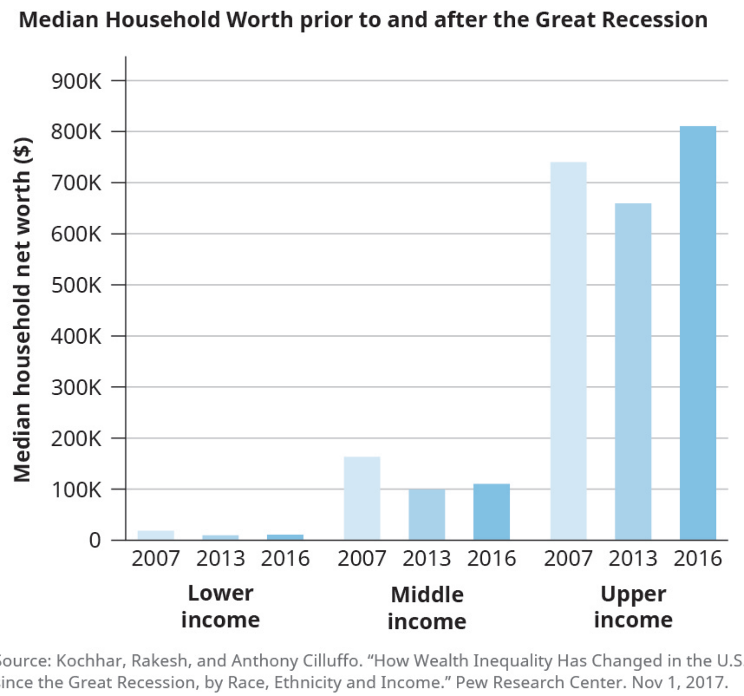


Figure 19.1 Stagnant income has been the reality for lower- and middle-income American adults, with income in 2016 actually lower than it was 10 years before. This has not been the case for upper-income adults. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

No reasonable person, regardless of profession or political party, would dispute that employees are entitled to a fair or just wage. Rather, it is in the calculation of a fair wage that the debate begins. Economists, sociologists, psychologists, and politicians all have opinions about this, as have most workers. Some of the factors that feature in calculations are federal and state minimum-wage standards, the cost of living, and the rate of inflation. Should a fair wage include enough money to raise a family, too, if the wage earner is the sole or principal support of a family?

Figure 19.2 shows the growth, or lack of growth, in the buying power of a minimum-wage earner since 1940. Compare the twenty-year period of 1949 through 1968 with the fifty-year period from 1968 through 2017. The difference has created a sobering reality for many workers. In the nearly six decades since 1960, the inflation-adjusted real minimum wage actually declined by 23 percent. That means minimum-wage workers did not even break even; the value of their wages declined over fifty years, meaning they have effectively worked half a century with no raise. In the following chart, nominal wage represents the actual amount of money a worker earns per hour; real wage represents the nominal wage adjusted for inflation. We consider real wages because nominal wages do not take into account changes in prices and, therefore, do not measure workers' actual purchasing power.

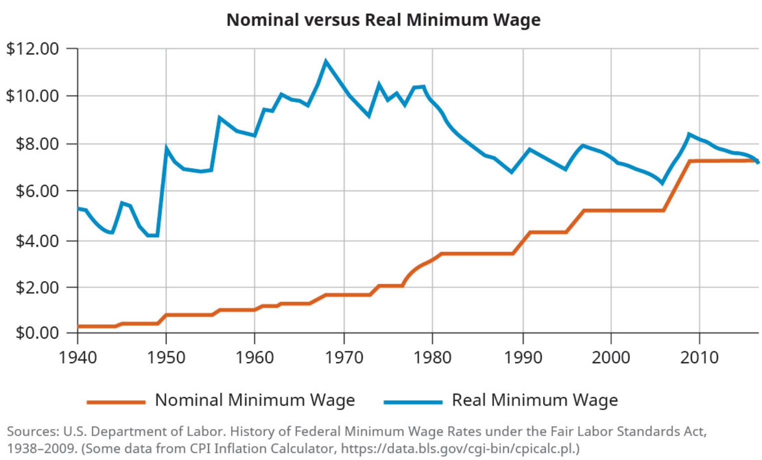


Figure 19.2 The graph contrasts the U.S. nominal wage (dollar amount) and the real wage (dollar amount's purchasing power) over the last seventy-five years, indicating a steady decline in purchasing power experienced by most workers. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

One positive development for minimum-wage workers is that state governments have taken the lead in what was once viewed primarily as a federal issue. Today, most states have a higher minimum hourly wage than the federal minimum of $7.25. States with the highest minimum hourly wages are Washington ($11.50), California and Massachusetts ($11.00), Arizona and Vermont ($10.50), New York and Colorado ($10.40), and Connecticut ($10.00). Some cities have even higher minimum hourly wages than under state law; for example, San Francisco and Seattle are at $15.00. As of the end of 2017, twenty-nine states had higher minimum hourly wages than the federal rate, according to Bankrate.com (Figure 19.3).

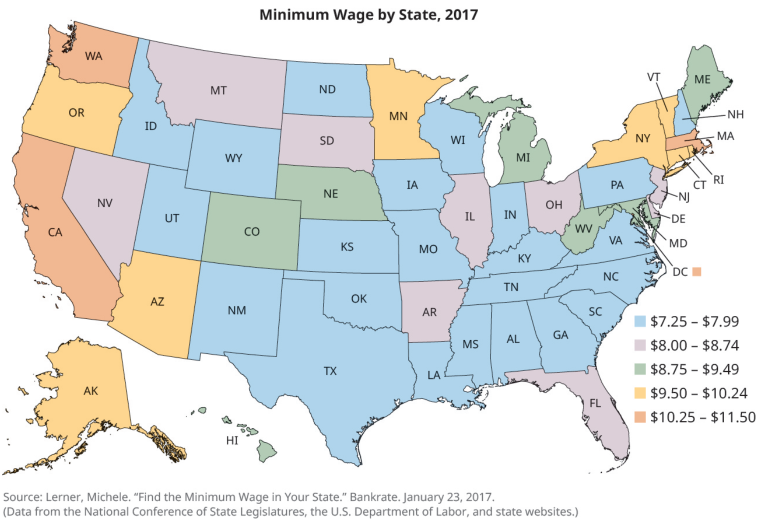


Figure 19.3 As of 2017, there is a patchwork quilt of state-level minimum wage laws. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 *license)*

Unfair Wages: The Gender Pay Gap

Even after all possible qualifiers have been added, it remains true that women earn less than men. Managers sometimes offer multiple excuses to justify pay inequities between women and men, such as, "Women take time off for having babies" or "Women have less experience," but these usually do not explain away the differences. The data show that a woman with the same education, experience, and skills, doing the same job as a man, is still likely to earn less, at all levels from bottom to top. According to a study by the Institute for Women's Policy Research, even women in top positions such as CEO, vice president, and general counsel often earn only about 80 percent of what men with the same job titles earn.[5] Data from the EEOC over the five years from 2011 through 2015 for salaries of senior-level officials and managers (defined by the EEOC as those who set broad policy and are responsible for overseeing execution of those policies) show women in these roles earned an average of about $600,000 per year, compared with their male counterparts, who earned more than $800,000 per year.[6] That $200,000 difference amounts to a wage gap of about 35 percent each year.

The same is true in mid-level jobs as well. In a long-term study of compensation in the energy industry, researchers looked at the job of a land professional—who negotiates with property owners to lease land on which the oil companies then drill wells—and found evidence of women consistently getting paid less than men for doing the same job. Median salaries were compared for male and female land professionals with similar experience (one to five years) and educational background (bachelor's degree), and men earned $7000 more per year than their female counterparts.[7]

Doesn't the law require men and women to be paid the same? The answer is yes and no. Compensation discrimination has been illegal for more than fifty years under a U.S. law called the Equal Pay Act, passed in 1963. But the problem persists. Women earned about 60 percent of what men earned in 1960, and that value had risen to only 80 percent by 2016. Given these historic rates, women are not projected to reach pay equity until at least 2059, with projections based on recent trends predicting dates as late as 2119.[8] These are aggregate data; thus, they include women and men with the same job, or similar jobs, or jobs considered to fall in the same general category, but the data do not compare the salary of a secretary to that of a CEO, which would be an unrealistic comparison.

Equal pay under the law means equal pay for the "same" job, but not for the "equivalent" job. Those companies wishing to avoid strict compliance with the law may use several devices to justify unequal pay, including using slightly different job titles, slightly different lists of job duties, and other techniques that lead to different pay for different employees doing essentially the same job. Women have taken employers to court for decades, only to find their lawsuits unsuccessful because proving individual compensation discrimination is very difficult, especially given that multiple factors can come into play in compensation decisions. Sometimes class-action lawsuits have been more successful, but even then plaintiffs often lose.

Can anything be done to achieve equal pay? One step would be to pass a new law strengthening the rules on equal pay, but two recent attempts to pass the Paycheck Fairness Act (S.84, H.R.377) and the Fair Pay Act (S.168, H.R.438) narrowly failed.[9] These or similar bills, if ever enacted into law, would significantly reduce wage discrimination against those who work in similar job categories by establishing equal pay for "equivalent" work, rather than the current law which uses the term "same" job. The idea of pay equivalency is closely related to comparable worth, a concept that has been put into action on a limited basis over the years, but never on a large scale. Comparable worth holds that workers should be paid on the basis of the worth of their job to the organization. Equivalent work and comparable worth can be important next steps in the path to equal pay, but they are challenging to implement because they require rethinking the entire basis for pay decisions.

LINK TO LEARNING

Though the federal government has not yet passed the Paycheck Fairness Act, some states have taken action on their own. The website for the National Conference of State Legislatures' section on state equal pay laws provides a chart listing states that go beyond the current federal law to mandate equal pay for comparable or equivalent work. Look up your state in the chart. How does it compare with others in this regard?

If a woman's starting salary for the first job of her career is less than that of a man, the initial difference, even if small, tends to cause a systemic, career-long problem in terms of pay equity. Researchers at Temple University and George Mason University found that if a new hire gets $5000 more than another worker hired at the same time, the difference is significantly magnified over time. Assuming an average annual pay increase of 5 percent, an employee starting with a $55,000 salary will earn at least $600,000 more over a forty-year career than an employee who starts an equivalent job with a $50,000 salary. This significantly affects many personal decisions, including retirement, because, all other things equal, a lower-paid woman will have to work three years longer than a man to earn the same amount of money over the course of her career.[10]

ETHICS ACROSS TIME AND CULTURES

European Approaches to the Gender Pay Gap

The policies of other nations can offer some insight into how to address pay inequality. Iceland, for example, has consistently been at the top of the world rankings for workplace gender equality in the World Economic Forum survey.[11] A new Icelandic law went into effect on January 1, 2018, that makes it illegal to pay men more than women, gauged not by specific job category, but rather in all jobs collectively at any employer with twenty-five or more employees, a concept known as an aggregate salary data approach.[12] The burden of proof is on employers to show that men and women are paid equally or they face a fine. The ultimate goal is to eliminate all pay inequities in Iceland by the year 2022. The United Kingdom has taken a first step toward addressing this issue by mandating pay transparency, which requires employers with 250 workers or more to publish details on the gaps in average pay between their male and female employees.[13]

Policies not directly linked to salary can help as well. German children have a legal right to a place in kindergarten from the age of three years, which has allowed one-third of mothers who could not otherwise afford nursery school or kindergarten to join the workforce.[14] In the United Kingdom, the government offers up to thirty hours weekly of free care for three- and four-year-old children to help mothers get back in the workforce. Laws such as these allow women, who are often the primary caregivers in a household, to experience fewer interruptions in their careers, a factor often blamed for the wage gap in the United States.

The World Economic Forum reports that about 65 percent of all Organization for Economic Cooperation and Development (OECD) countries have introduced new policies on pay equality, including requiring many employers to publish calculations every year showing the gender pay gap.[15] Steps such as the collection and reporting of aggregate salary data, or some form of early education or subsidized childcare, are positive steps toward eventually achieving the goal of wage equality.

Critical Thinking

- **Which of these policies do you think would be the most likely to be implemented in the United States and why?**
- **How would each of the normative theories of ethical behavior (virtue ethics, utilitarianism, deontology, and justice theory) view this issue and these proposed solutions?**

Part of the reason that initial pay disparity is heightened over a career is that when a worker changes jobs, the new employer usually asks what the employee was making in his or her last job and uses that as a baseline for pay in the new job. To combat the problem of history-based pay, which often hurts women, eight states (and numerous municipalities) in the United States now ban employers from asking job applicants to name their last salary.[16] Although this restriction will not solve the entire problem, it could have a positive effect if it spreads nationally. In a survey by the executive search firm Korn Ferry, forty-six of one hundred companies said they usually comply with the legal requirements in force in the strictest of the locations in which they operate, meaning workers in states without this law might not be asked about their salary history during new-job negotiations either.[17]

Experiments in Compensation

Whether we are discussing fair wages, minimum wages, or equal wages, the essence of the debate often boils down to ethics. What should people get paid, who should determine that, and should managers and upper management do only what is required by law or go above and beyond if that means doing what they think is right? Organizational pay structures are set by a variety of methods, including internal policies, the advice of outside compensation consultants, and external data, such as market salaries.

An innovative compensation decision in Seattle may provide some insight. In 2011, a young man earning $35,000 a year told his boss at Gravity, a credit-card payments business, that his earnings were not sufficient for a decent life in expensive Seattle. The boss, Dan Price, who cofounded the company in 2004, was somewhat surprised as he had always taken pride in treating employees well. Nevertheless, he decided his employee was right. For the next three years, Gravity gave every employee a 20 percent annual raise. Still, profit continued to outgrow wages. So Price announced that over the next three years, Gravity would phase in a minimum salary of $70,000 for all employees. He reduced his own salary from $1 million to $70,000, to demonstrate the point and help fund it. The following week, five thousand people applied for jobs at Gravity, including a Yahoo executive who took a pay cut to transfer to a company she considered fun and meaningful to work for.

Price's decision started a national debate: How much should people be paid? Since 2000, U.S. productivity has increased 22 percent, yet inflation-adjusted median wages have increased only 2 percent. That means a larger share of capitalism's rewards are going to shareholders and top executives (who already earn an average of three hundred times more than typical workers, up from seventy times more just a decade ago), and a smaller share is going to workers. If Gravity profits while sharing the benefits of capitalism more broadly, Price's actions will be seen as demonstrating that underpaying the workforce hurts employers. If it fails, it may look like proof that companies should not overpay.

Price recognized that low starting salaries were antithetical to his values and felt that struggling employees would not be motivated to maintain the high quality that made his company successful with that compensation. He calls the $70,000 minimum wage an ethical and moral imperative rather than a business strategy, and, though it will cost Gravity about $2 million per year, he has ruled out price increases and layoffs. More than half the initial cost was offset by his own pay cut, the rest by profit. Revenue continues to grow at Gravity, along with the customer base and the workforce. Currently, the firm has a retention rate of 91 percent.[18] Yet Price says managers' scorecards should measure purpose, impact, and service, as much as profit.

Michael Wheeler, a professor at Harvard Business School who teaches a course called "Negotiation and The Moral Leader," recently discussed the aftermath of Dan Price's decision at Gravity. He interviewed other entrepreneurs about their plans for creative compensation to help develop a happy and motivated workforce, and it appears that some other companies are taking notice of how successful Gravity has been since Price made the decision to pay his workers more.[19] One of these entrepreneurs was Megan Driscoll, the CEO of Pharmalogics Recruiting, who, after hearing Dan Price speak to a group of executives, was inspired to raise the starting base pay of her employees by 33 percent. When Driscoll put her plan to work, her business had forty-six employees and $6.7 million in revenue. A year later, staff and revenues had jumped to seventy-two and $15 million, respectively. Driscoll points to data showing her people are working harder and smarter after the pay raise than before. There has been a 32 percent increase in clients, and the client retention rate doubled to 80 percent.[20]

Stephan Aarstol, CEO of Tower Paddleboards, wanted to give his workers a raise, but his company did not have the cash. Instead, Aarstol boldly cut the work day to five hours from the ten hours most employees had been working. Essentially that doubled their pay, and as a result, he says, employee focus and engagement have skyrocketed, as have company profits.[21]

Managers must carefully balance the short term, such as quarterly profits, versus long-term sustainability as a successful company. This requires recognizing the value of work that each person contributes and devising a fair, and sometimes creative, compensation plan.

19. An Organized Workforce

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Discuss trends in U.S. labor union membership**
- Define **codetermination**
- **Compare labor union membership in the United States with that in other nations**
- **Explain the relationship between labor productivity gains and the pay ratio in the United States**

The issue of worker representation in the United States is a century-old debate, with economic, ethical, and political aspects. Are unions good for workers, good for companies, good for the nation? There is no single correct response. Your answer depends upon your perspective—whether you are a worker, a manager, an executive, a shareholder, or an economist. How might an ethical leader address the issue of the gap between labor's productivity gains and their relatively stagnant wages as compared with that of management?

Organized Labor

Americans' longstanding belief in individualism makes some managers wonder why employees would want or need to be represented by a labor union. The answer is, for the same reasons a CEO wants to be represented by an attorney when negotiating an employment contract, or that an entertainer wants to be represented by an agent. Unions act as the agent/lawyer/negotiator for employees during collective bargaining, a negotiation process aimed at getting management's agreement to a fair employment contract for members of the union. Everyone wants to be successful in any important negotiation, and people often turn to professionals to help them in such a situation.

However, in the United States, as elsewhere around the globe, the concept of worker organization has been about more than simply good representation. Unionization and worker rights have often been at the core of debates related to class economics, political power, and ethical values. There are legitimate points on each side of the union debate (Table 20.1).

(Table 20.1) Pros and Cons of Unions

Pros of Unions	Cons of Unions
Unions negotiate increased pay and benefits for workers.	Unions can make it harder to fast-track promotions for high-performing workers and/or get rid of low-performing ones.
Unions create a formal dispute resolution process for workers.	Workers are required to pay union dues/fees that some might rather not pay.
Unions act as an organized lobbying group for worker rights.	Unions sometimes lead to a closed culture that makes it harder to diversify the workforce.
Collective bargaining agreements often set norms for employment for an entire industry—benefiting all workers, including those who are not at a union company.	Collective bargaining contracts can drive up costs for employers and lead to an adversarial relationship between management and workers.

The value of unions is a topic that produces significant disagreement. Historically, unions have attained many improvements for workers in terms of wages and benefits, standardized employment practices, labor protections (e.g., child labor laws), workplace environment, and on-the-job safety. Nevertheless, sometimes unions have acted in their own interests to sustain their own existence, without primary concern for the workers they represent.

The history of the worker movement (summarized in the video in the following Link to Learning) reveals that in the first half of the twentieth century, wages were abysmally low, few workplace safety laws existed, and exploitive working conditions allowed businesses to use child labor. Unions stepped in and played an important role in leveling the playing field by representing the interests of the workers. Union membership grew to a relatively high level (33% of wage and salary workers) in the 1950s, and unions became a force in politics. However, their dominance was relatively short-lived, not least because in the 1960s, the federal government started to enact employment laws that codified many of the worker protections unions had championed. In the 1980s and 1990s, the U.S. economy gradually evolved from manufacturing, where unions were strong, to services, where unions were not as prevalent. The service sector is more difficult to organize, due to a variety of factors such as the historical absence of unions in the sector, workers' widely differing work functions and schedules, challenging organizational status, and white-collar bias against unions.

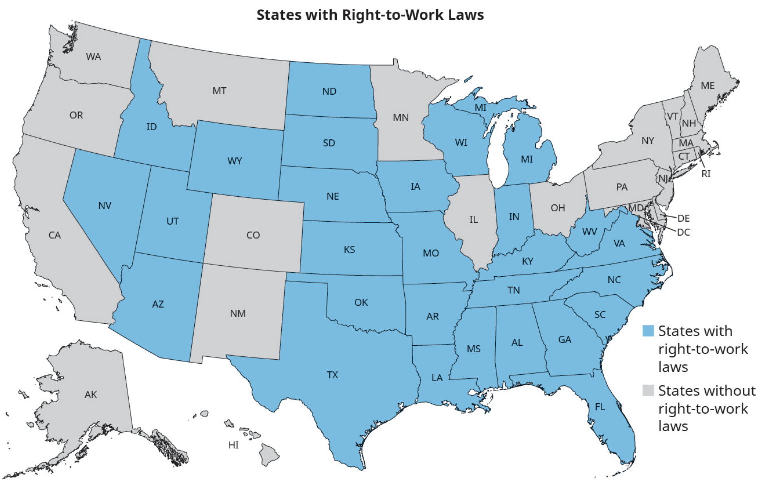
LINK TO LEARNING

This three-minute video entitled "The Rise and Fall of U.S. Labor Unions" summarizes the history of the union movement. It is based on information from University of California Santa Cruz Professor William Domhoff and the University of Houston Bauer College of Business.

These developments, along with the appearance of state right-to-work laws, have led to a decline in unions and their membership. Right-to-work laws give workers the option of not joining the union, even at companies where the majority has voted to be represented by a union, resulting in lower membership. Right-to-work laws attempt to counter the concept of a union shop or closed shop, which requires that all new hires automatically be enrolled in the labor union appropriate to their job function and that union dues automatically be deducted from their pay.

Some question the fairness of right-to-work laws, because they allow those who do not join the union to get the same pay and benefits as those who do join and who pay unions dues for their representation. On the other hand, right-to-work laws provide workers the right of choice; those who do not want to join a union are not forced to do so. Those who do not choose to join may end up having a strained relationship with union workers, however, when a union-mandated strike occurs. Some non-union members, and even union members, elect to cross the picket line and continue to work. Traditionally, these "scabs," as they are derisively labeled by unions, have faced both overt and subtle retaliation at the hands of their coworkers, who prioritize loyalty to the union.

Twenty-eight states have right-to-work laws (Figure 20.2). Notice that many right-to-work states, such as Michigan, Missouri, Indiana, Wisconsin, Kentucky, Tennessee, Alabama, and Mississippi, are among the top ten states where automobiles are manufactured and unions once were strong.



Source: National Conference of State Legislatures. "Right-to-Work Resources." http://www.ncsl.org/research/labor-and-employment/right-to-work-laws-and-bills.aspx.

Figure 20.2 Right-to-work states have typically been clustered in the South and Southeast, where unions have been traditionally less prevalent. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

According to the U.S. Bureau of Labor Statistics, total union membership in the United States dropped to 20 percent of the workforce in 1980; by 2016, it was down to about half that (Figure

20.3).[1] Public sector (government) workers have a relatively high union membership rate of 35 percent, more than five times that of private-sector workers, which is at an all-time low of 6.5 percent. White-collar workers in education and training, as well as first responders such as police and firefighters now have some of the highest unionization rates, also 35 percent. Among states, New York continues to have the highest union membership rate at 23 percent, whereas South Carolina has the lowest, at slightly more than 1 percent.

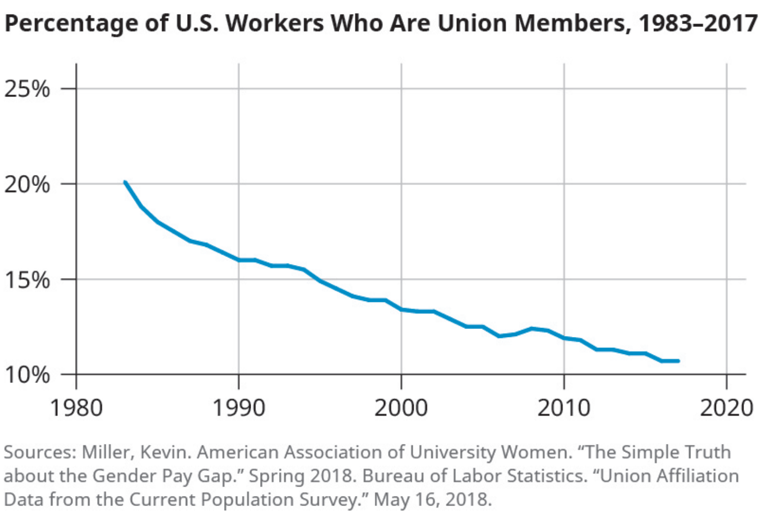


Figure 20.3 Union membership in the United States has steadily declined since 1980. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Codetermination is a workplace concept that goes beyond unionization to embrace shared governance, in which management and workers cooperate in decision-making and workers have the right to participate on the board of directors of their company. Board-level representation by employees is widespread in European Union countries. Most codetermination laws apply to companies over a certain size. For example, in Germany, they apply to companies with more than five hundred employees.[2] The labor union movement never has been quite as strong in the United States as in Europe—the trade-union movement began in Europe and remains more vibrant there even today—and codetermination is thus not common in U.S. companies (Table 20.4).

(Table 20.4) Unionization as Percentage of Workforce in Eight Industrialized Nations

Country	Workforce in Unions, %
Australia	25
Canada	30
France	9
Germany	26
Italy	35
Japan	22
Sweden	82
United Kingdom	29
United States	12

Labor union membership remains much higher in Europe and other Group of Seven (G7) countries than in the United States. Only France has a lower percentage of union membership.[3]

Codetermination has worked relatively well in some countries. For example, in Germany, workers, managers, and the public at large support the system, and it has often resulted in workers who are more engaged and have a real voice in their workplaces. Management and labor have cooperated, which, in turn, has led to higher productivity, fewer strikes, better pay, and safer working conditions for employees, which is a classic win-win for both sides.

Pay and Productivity in the United States

Some managers, politicians, and even members of the general public believe unions are a big part of the reason that U.S. companies have difficulty competing in the global economy. The conservative think tank Heritage Foundation conducted a study that concluded unions may be responsible, in part, for a slower work process and reduced productivity.[4] However, multiple other studies indicate that U.S. productivity is up.[5]

Productivity in the United States increased 74 percent in the period 1973 to 2016, according to the OECD. In global productivity rankings, most studies indicate the United States ranks quite high, among the top five or six countries in the world and number two on the list compiled by the OECD (Table 20.5).

(Table 20.5) Productivity in 2015 by Country – Sample of Eight Industrialized Nations

Country	Productivity (output/hours worked)
Australia	102.20
Canada	109.45
Germany	105.90
Japan	103.90
Mexico	105.10
South Korea	97.60
United Kingdom	100.80
United States	108.87

This table compares 2015 productivity among several industrialized nations. U.S. productivity ranks high on the list. [6]

During the same period as the productivity gains discussed in the preceding paragraph, 1973 to 2016, wages for U.S. workers increased only 12 percent. In other words, productivity has grown six times more than pay. Taken together, these facts mean that American workers, union members or not, should not shoulder the blame for competitive challenges faced by U.S. companies. Instead, they are a relative bargain for most companies. Figure 20.6 compares productivity and pay and demonstrates the growing disparity between the two, based on data collected by the Economic Policy Institute.

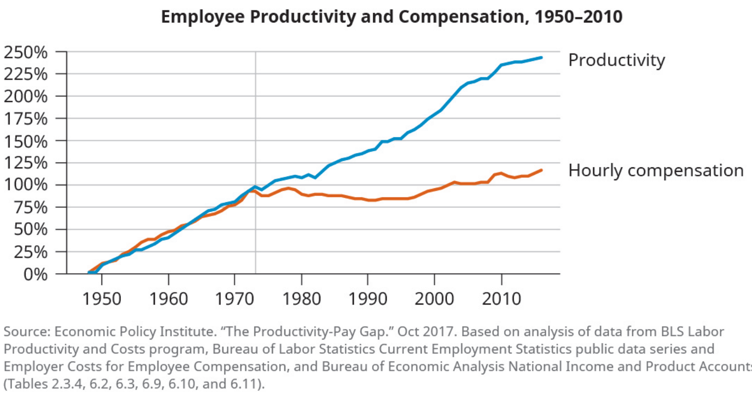


Figure 20.6 In the last four decades, wages in the United States have not kept up with productivity. According to the Economic Policy Institute, from 1948 to 1973, hourly compensation rose 91 percent, which closely follows productivity gains of 97 percent. However, from 1973 to 2013, hourly compensation rose only 9 percent, whereas productivity rose 74 percent in the same period. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Is Management Compensation Fair?

We gain yet another perspective on labor by looking at management compensation relative to that of employees. Between 1978 and 2014, inflation-adjusted CEO pay increased by almost 1,000 percent in the United States, while worker pay rose 11 percent.[7] A popular way to compare the fairness of a company's compensation system with that in other countries is the widely reported pay ratio, which measures how many times greater CEO pay is than the wages for the average employee.

The average multiplier effect in the United States is in the range of three hundred. This means that CEO pay is, on average, three hundred times as high as the pay of the average worker in the same company. In the United Kingdom, the multiplier is twenty-two; in France, it is fifteen; and in Germany, it is twelve.[8] The 1965 U.S. ratio was only twenty to one, which raises the question, why and how did CEO pay rise so dramatically high in the United States compared with the rest of the world? Are CEOs in the United States that much better than CEOs in Germany or Japan? Do American companies perform that much better? Is this ratio fair to investors and employees? A large part of executive compensation is in the form of stock options, which frequently are included in the calculation of an executive's salary and benefits, rather than direct salary. However, this, in turn, raises the question of whether all or a portion of the general workforce should also share in some form of stock options.

LINK TO LEARNING

Some corporate boards claim executive pay is performance based; others claim it is a retention strategy to prevent CEOs from going to another company for more money. This video shows former CEO Steven Clifford discussing CEO pay and claiming that U.S. executives often dramatically, and in many cases unjustifiably, boost their own pay to astronomical levels, leaving shareholders and workers wondering why. He also discusses how it can be stopped.

Everyone wants to be paid fairly for their work. Whether CEO or administrative assistant, engineer or assembly-line worker, we naturally look out for our own best interest. Thus, management compensation is a topic that often causes resentment among the rank and file, especially when organized workers go on strike. From the employee viewpoint, the question is why management often wants to hold the line when it comes to everyone's wages but their own.

CASES FROM THE REAL WORLD

Verizon Strike

More than forty thousand Verizon workers went on strike in 2016 (Figure 20.7). The strike was eventually settled, with workers getting a raise, but bitter feelings and distrust remained on both sides. Workers thought management salaries were too high; management thought workers were seeking excessive raises. To continue basic phone services for its customers during the strike, Verizon called on thousands of non-union employees to perform the strikers' work. Non-union staff had to cross picket lines formed by fellow employees to go to work each day during the strike. Enmity toward these picket-line crossers was exceptionally high among some union members.

Figure 20.7 Union workers from the Communications Workers of America and the International Brotherhood of Electrical Workers are shown walking a Verizon picket line. They are protesting Verizon's decision to not provide pay raises. (credit: modification of "Verizon on Strike" by Marco Verch/Flickr, CC BY 2.0)

Critical Thinking

- **How does management reintroduce civility to the workplace to keep peace between different factions?**
- **How could Verizon please union workers after the strike without firing the picket-line crossers, some of whom were Verizon union employees who consciously chose to cross the picket line?**

20. Privacy in the Workplace

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Explain what constitutes a reasonable right to privacy on the job**
- **Identify management's responsibilities when monitoring employee behavior at work**

Employers are justifiably concerned about threats to and in the workplace, such as theft of property, breaches of data security, identity theft, viewing of pornography, inappropriate and/or offensive behavior, violence, drug use, and others. They seek to minimize these risks, and that often requires monitoring employees at work. Employers might also be concerned about the productivity loss resulting from employees using office technology for personal matters while on the job. At the same time, however, organizations must balance the valid business interests of the company with employees' reasonable expectations of privacy.

Magnifying ethical and legal questions in the area of privacy is the availability of new technology that lets employers track all employee Internet, e-mail, social media, and telephone use. What kind and extent of monitoring do you believe should be allowed? What basic rights to privacy ought a person have at work? Does your view align more closely with the employer's or the employee's?

Legal and Ethical Aspects of Electronic Monitoring

Monitored workstations, cameras, microphones, and other electronic monitoring devices permit employers to oversee virtually every aspect of employees' at-work behavior (Figure 21.1). Technology also allows employers to monitor every aspect of computer use by employees, such as downloads of software and documents, Internet use, images displayed, time a computer has been idle, number of keystrokes per hour, words typed, and the content of e-mails. According to a survey by the American Management Association, 48 percent of employers used a form of video monitoring in the workplace, and 67 percent monitored employee Internet use. In 30 percent of the organizations responding to the survey, this electronic monitoring had ultimately led to an employee's termination. [1]

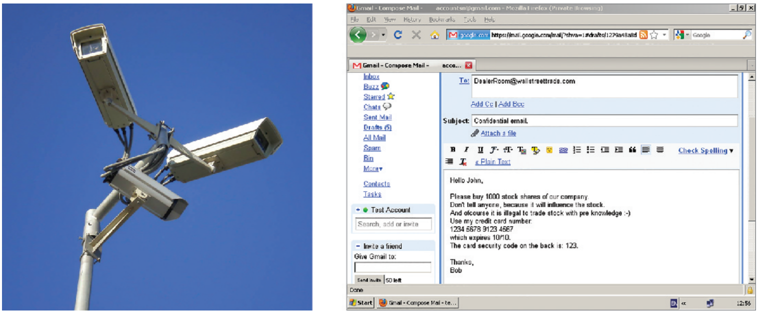


Figure 21.1 Electronic monitoring often captures data from cameras, computers, and listening devices. This information can then be used against employees accused of violating company policy, raising privacy concerns. (credit left: modification of "Surveillance video cameras, Gdynia" by Paweł Zdziarski/Wikimedia Commons, CC 2.5; credit right: credit: modification of "Keylogger-screen-capture-example" by "FlippyFlink"/Wikimedia Commons, Public Domain)

The laws and regulations governing electronic monitoring are somewhat indirect and inconsistent. Very few specific federal statutes directly regulate private employers when it comes to broad workplace privacy issues. However, monitoring is subject to various state rules under both statutory and common law, and sometimes federal and state constitutional provisions as well. The two primary areas of the law related to workplace monitoring are a federal statute called the Electronic Communications Privacy Act of 1986 (ECPA) and various state common law protections against invasion of privacy.[2]

Although the ECPA may appear to prohibit an employer from monitoring its employees' oral, wire, and electronic communications, it contains two big exceptions that weaken its protection of employees' rights. One is the business purpose exception. This allows employers—on the basis of legitimate business purposes—to monitor electronic and oral communications, and employers generally assert a legitimate business purpose to be present. The other widely used exception is the consent exception, which allows employers to monitor employee communications provided employees have given their consent. According to the Society for Human Resource Management, the ECPA definition of electronic communication applies to the electronic transmission of communications but not to their electronic storage. Therefore, courts have distinguished between monitoring electronic communications such as e-mail during transmission and viewing e-mails in storage. Viewing emails during transmission is broadly allowed, whereas viewing stored e-mail is considered similar to searching an employee's private papers and thus is not routinely allowed under the ECPA unless certain circumstances apply (e.g., the e-mails are stored in the employer's computer systems).[3]

In general, it is legal for a company to monitor the use of its own property, including but not limited to computers, laptops, and cell phones. According to the ECPA, an employer-provided computer system is the property of the employer, and when the employer provides employees with a laptop they can take home, it likely violates no laws when it monitors everything employees do with that computer, whether business-related or personal. The same is true of an employer-provided cell phone or tablet, and always true when an employer gives employees notice of a written policy regarding electronic monitoring of equipment supplied by the company. Generally, the same is not true of equipment owned by the employee, such as a personal cell phone.

However, an important distinction is based on the issue of consent. The consent provision in the ECPA is not limited to business communications only; therefore, a company might be able to assert the right to monitor personal electronic communications if it can show employee consent (although this is very likely to worry employees, as discussed in the next section). Another consideration is whose e-mail server is being used. The ECPA and some state laws generally make it illegal for employers to intercept private e-mail by using an employee's personal log-on/user ID/password information.

Although the ECPA and National Labor Relations Act are both federal laws, individual states are free to pass laws that impose greater limitations, and several states have done so. Some require employers to provide employees advance written notice that specifies the types or methods of monitoring to which they will be subjected. Examples of state laws creating some degree of protection for workers include laws in California and Pennsylvania that require consent of both parties before any conversation can be monitored or recorded.

Employees can bring common law privacy claims to challenge employer monitoring. (Common laws are those based on prior court decisions rather than on legislatively enacted statutes.) To prevail on a common law claim of invasion of privacy, which is a tort, the employee must demonstrate a right to privacy with respect to the information being monitored. Several state constitutions, such as those in Louisiana, Florida, South Carolina, and California, expressly provide citizens a right to privacy, which may protect employees with respect to monitoring of their personal electronic information and personal communication in the workplace.

One additional regulatory consideration applicable to electronic monitoring is whether the company's workforce is unionized. The National Labor Relations Board, the federal labor law agency, has ruled that the video surveillance of any portion of the workplace is a condition of employment subject to collective bargaining and must be agreed to by the union before implementation, so employees have notice. If a workplace is not unionized (the majority are not), then this federal regulation requiring notice does not apply, and as stated previously in this chapter, if there is any protection at all, it would have to be given by state regulation (which is rare in the private [nongovernmental] sector).

What Constitutes a Reasonable Monitoring Policy?

Many employees generally are not be familiar with the specific details of the law. They may feel offended by monitoring, especially of their own equipment. Companies must also consider the effect on workplace morale if everyone feels spied upon, and the risk that some high-performing employees may decide to look elsewhere for career opportunities. Employers should develop a clear, specific, and reasonable monitoring policy. The policy should limit monitoring to that which is directly work related. For example, if a company is concerned about productivity and the goal of monitoring is to keep tabs on employee performance, then neither keystroke logging nor screenshot recording is necessary; software designed to show idle time or personal Internet use would be more helpful in identifying wasted time, which is the ultimate goal.

Employers should always remember their business goals when monitoring employees. It is not only a matter of treating employees ethically; it also makes good business sense to ensure that monitoring pertains only to business matters and does not unnecessarily intrude into the privacy of employees. Perhaps most importantly, in the interest of fairness, the monitoring policy must be communicated to the employees. When, if ever, is it acceptable to monitor without notice to the employee and without his or her knowledge?

LINK TO LEARNING

This notice by the State of Connecticut mandates that all employers inform employees of the kinds of electronic monitoring of their activities and communications that may be undertaken at work, and the responsibilities of an employer. Read the notice and decide whether you think it is a reasonable policy. Would it make sense to the average worker? Do you think it is unfair to either party?

The Connecticut policy in the preceding Link to Learning applies to all employers (i.e., in state and in private sector workplaces). However, many states have policies that apply only to employees who work for the government. State employees hold a special status that conveys certain state constitutional rights with regard to due process, reasonable searches, and related legal doctrines. The same is true for federal government employees and the U.S. Constitution, which means the government has a duty of fairness in employee surveillance. It does not mean, however, that the government cannot monitor its employees at all, as demonstrated by an incident involving a California police officer. In a unanimous decision in Ontario v. Quon,[4] the U.S. Supreme Court in 2010 ruled in favor of a police chief in Ontario, California, who read nearly five hundred text messages sent by one of his sergeants on a police-issued pager. Many of the text messages were personal and some were sexually explicit. Only a few dozen were work related. The justices agreed that constitutional limits on unreasonable searches by public employers (under the Fourth Amendment) were minimal given a work-related purpose.

This decision creates precedent for more than 25 million employees of federal, state, and local governments and limits their expectation of privacy when using employer-issued tools. "Because the search [by the police chief] was motivated by a legitimate work-related purpose and because it was not excessive in scope, the search was reasonable," said Justice Anthony M. Kennedy.

In the private sector, where employees are not working for the government and the constitutional prohibition on unreasonable searches and seizures has very little applicability, if any, employers have even more latitude in terms of employee monitoring than in a government setting. The Ontario v. Quon case in all likelihood would never even make it to court if the employer were a private-sector company, because the issue of whether getting the text message was a reasonable search and seizure under the Fourth Amendment does not apply in a nongovernment employment setting. The Constitution acts to limit government intrusions but does not generally restrict private companies in this type of situation. However, ethical considerations may encourage private-sector employers to treat their workers respectfully, even if not required by law.

WHAT WOULD YOU DO?

Security versus Privacy

You manage a large, high-end jewelry store with an international clientele. Your workforce of 150 is demographically diverse, and your employees are trustworthy as a rule. However, you have experienced some unexplained loss of inventory and suspect a couple of employees are stealing valuable pieces, removing them from backroom storage safes and handing them off to another person somewhere in the store who leaves with them or to a third person pretending to be a customer. To prevent this, your assistant managers are urging you to place discreet cameras in the restrooms and break rooms, where these exchanges are likely occurring. Some managers might be concerned about using cameras at all due to privacy issues; others might want to use them without notifying employees or putting up signs because they do not want to tip off the suspects or deal with the negative reaction of the workforce (although that brings up invasion of privacy issues). You are weighing the pros of catching the thieves against the possible loss of other employees' trust.

Critical Thinking

- **What issues must you confront as you decide whether you will take the recommendation of your assistant managers?**
- **What, ultimately, will you do? Explain your decision.**

Drug Testing in the Workplace

Key issues that arise about a drug testing or monitoring program begin with whether an employer wants or needs to do it. Is it required by law for a particular job, under state or local regulations? Is it for pre-employment clearance? Does the employer need employees' permission? Does a failed test require mandatory termination? With the exception of employers in industries regulated by the federal government, such as airlines, trucking companies, rail lines, and national security-related firms, federal law is not controlling on the issue of drug testing in the workplace; it is largely a state issue. At the federal level, the Department of

Transportation does mandate drug testing for workers such as airline crews and railway conductors and has a specific procedure that must be followed. However, for the most part, drug testing is not mandatory and depends on whether the employer wants to do it. Multiple states do regulate drug testing, but to varying degrees, and there is no common standard to be followed.

Testing of job applicants is the most common form of drug testing. State laws typically allow it, but the employer must follow state rules, if they exist, about providing notice and following standard procedures intended to prevent inaccurate samples. Testing current employees is much less common, primarily due to cost; however, companies that do use drug testing include some in the pharmaceutical and financial services industries. Some states put legal constraints on drug testing of private-sector employees. For example, in a few states. the job must include the possibility of property damage or injury to others, or the employer must believe the employee is using drugs.

Challenging a drug test is difficult because tests are considered highly accurate. An applicant or employee can refuse to take the test, but that often means not being hired or losing the job, assuming the worker is an employee at will. The concept of employment at willaffirms that either the employee or the employer may dissolve an employment arrangement at will (i.e., without cause and at any time unless an employment contract is in effect that stipulates differently). Most workers are considered employees at will because neither the employer nor employee is obligated to the other; the worker can quit or be fired at any time for any reason because there is no contractual obligation. In some states, the employee risks not only job loss but also the denial of unemployment benefits if fired for refusing to take a drug test. Thus, the key concept that makes drug testing possible is employment at will, which covers approximately 85 percent of the employees in the private sector (unionized workers and top executives have contracts and thus are not at will, nor are government employees who have due process rights). The only legal limitation is that, in some states, the drug testing procedure must be fair, accurate, and designed to minimize errors and false-positive results.

The drug testing process, however, raises some difficult privacy issues. Employers want and are allowed to protect against specimen tampering by taking such steps as requiring subjects to wear a hospital gown. Some employers use test monitors who check the temperature of the urine and/or listen as a urine sample is collected. According to the Cornell University Law School Legal Information Institute, some state courts (e.g., Georgia, Louisiana, Hawaii) have found it an unreasonable invasion of privacy for the monitor to watch an employee in the restroom; however, in other states (e.g., Texas, Nevada), this is allowed.[5]

Case examples abound of challenges based on privacy concerns. In an article in the Harvard Journal of Law and Technology, University of Houston Law School professor Mark Rothstein, who is director of the Health Law and Policy Institute, summarized examples of legal challenges.[6] In one case, the court ruled that an employer engaged in unlawful retaliation as defined by the Mine Safety and Health Act. The employer dismissed two employees who were required to urinate in the presence of others but found themselves unable to do so. In a different case, $125,000 in tort damages was awarded to a worker for invasion of privacy and negligent infliction of emotional distress as a consequence of his being forced to submit a urine sample as he was being directly observed.

21. Loyalty to the Company

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Define employees' responsibilities to the company for which they work**
- **Describe a non-compete agreement**
- **Explain how confidentiality applies to trade secrets, intellectual property, and customer data**

The relationship between employee and employer is changing, especially our understanding of commitment and loyalty. An ethical employee owes the company a good day's work and his or her best effort, whether the work is stimulating or dull. A duty of loyalty and our best effort are our primary obligations as employees, but what they mean can change. A manager who expects a twentieth-century concept of loyalty in the twenty-first century may be surprised when workers express a sense of entitlement, ask for a raise after six months, or leave for a new job after twelve months. This chapter will explore a wide range of issues from the perspective of what and how employees contribute to the overall success of a business enterprise.

A Duty of Loyalty

Hard work and our best effort likely make sense as obligations we owe an employer. However, loyalty is more abstract and less easily defined. Most workers do not have employment contracts, so there may not be a specific agreement between the two parties detailing their mutual responsibilities. Instead, the common law (case law) of agency in each state is often the source of the rules governing an employment relationship. The usual depiction of duty in common law is the duty of loyalty, which, in all fifty states, requires that an employee refrain from acting in a manner contrary to the employer's interest. This duty creates some basic rules employees must follow on the job and provides employers with enforceable rights against employees who violate them.

In general terms, the duty of loyalty means an employee is obligated to render "loyal and faithful" service to the employer, to act with "good faith," and not to compete with but rather to advance the employer's interests.[1] The employee must not act in a way that benefits him- or herself (or any other third party), especially when doing so would create a conflict of interest with the employer.[2] The common law of most states holds as a general rule that, without asking for and receiving the employer's consent, an employee cannot hold a second job if it would compete or conflict with the first job. Thus, although the precise boundaries of this aspect of the duty of loyalty are unclear, an employee who works in the graphic design department of a large advertising agency in all likelihood cannot moonlight on the weekend for a friend's small web design business. However, employers often grant permission for employees to work in positions that do not compete or interfere with their principal jobs. The graphic designer might work for a friend's catering business, for example, or perhaps as a wedding photographer or editor of a blog for a public interest community group.

LINK TO LEARNING

Moonlighting has become such a common phenomenon that the website Glassdoor now has a section reserved for such jobs. The Glassdoor website has a number of postings for different moonlighting opportunities to explore.

What is clear is that it is wrong for employees to make work decisions primarily for their own personal gain, rather than doing what is in the employer's best interest. An employee might have the authority to decide which other companies the employer will do business with, for example, such as service vendors that maintain the copiers or clean the offices. What if the employee owned stock in one of those companies or had a relative who worked there? That gives him or her an incentive to encourage doing business with that particular company, whether it would be best for the employer or not.

The degree to which the duty of loyalty exists is usually related to the degree of responsibility or trust an employer places in an employee. More trust equals a stronger duty. For example, when an employee has very extensive authority or access to confidential information, the duty can rise to its highest level, called a fiduciary duty, which is discussed in an earlier chapter.

Differing Concepts of Loyalty

There is no generally agreed-upon definition of an employee's duty of loyalty to his or her employer. One indicator that our understanding of the term is changing is that millennials are three times more likely than older generations to change jobs, according to a Forbes Human Resources Council survey (Figure 22.1).[3] About nine in ten millennials (91 percent) say they do not expect to stay with their current job longer than three years, compared with older workers who often anticipated spending ten years or even an entire career with one employer, relying on an implicit social contract between employer and employee that rewarded lifetime employment.

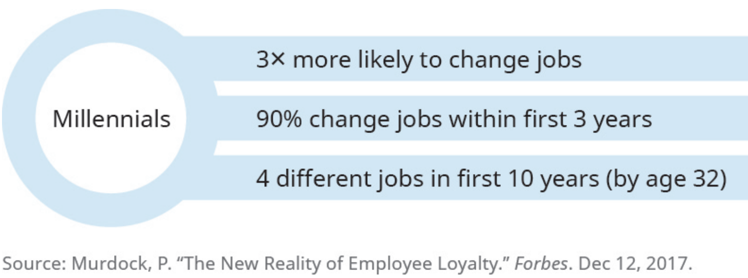


Figure 22.1 The data on millennials and job mobility indicate that millennials are more likely to "job hop" than their predecessors. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The Loyalty Research Center, a consulting firm, defines loyal employees as "being committed to the success of the organization. They believe that working for this organization is their best option . . . and loyal employees do not actively search for alternative employment and are not responsive to offers."[4] Likewise, Wharton School, University of Pennsylvania, professor Matthew Bidwell says there are two halves to the term: "One piece is having the employer's best interests at heart. The other piece is remaining with the same employer rather than moving on." Bidwell goes on to acknowledge, "There is less a sense that your organization is going to look after you in the way that it used to, which would lead [us] to expect a reduction in loyalty."[5]

Why are employees less likely to feel a duty of loyalty to their companies? One reason is that loyalty is a two-way street, a feeling developed through the enactment of mutual obligations and responsibilities. However, most employers do not want to be obligated to their workers in a legal sense; they usually require that almost all workers are employees "at will," that is, without any long-term employment contract. Neither state nor federal law mandates an employment contract, so when a company says an employee is employed at will, it is sending a message that management is not making a long-term commitment to the employee. Employees may naturally feel less loyalty to an organization from which they believe they can be let go at any time and for any legal reason (which is essentially what at-will employment means). Of course, at-will employment also means the employee can also quit at any time. However, freedom to move is a benefit only if the employee has mobility and a skill set he or she can sell to the highest bidder. Otherwise, for most workers, at-will employment usually works to the employer's advantage, not the employee's.

Another reason the concept of loyalty to an organization seems to be changing at all levels is the important role money plays in career decisions. When they see chief executive officers (CEOs) and other managers leaving to work for the highest bidder, subordinates quickly conclude that they, too, ought to look out for themselves, just as their bosses do, rather than trying to build up seniority with the company. Switching jobs can often be a way for employees to improve their salaries. Consider professional sports. For decades professional athletes were tied to one team and could not sell their services to the highest bidder, meaning that their salaries were effectively capped. Finally, after several court decisions (including the Curt Flood reserve clause case involving the St. Louis Cardinals and Major League Baseball),[6] players achieved some degree of freedom and can now switch employers frequently in an effort to maximize their earning potential.

The same evolution occurred in the entertainment industry. In the early years of the movie business, actors were tied to studios by contracts that prevented them from making movies for any other studio, effectively limiting their earning power. Then the entertainment industry changed as actors gained the freedom to sell their services to the highest bidder, becoming much more highly compensated in the process. Employees in any industry, not just sports and entertainment, benefit from being able to change jobs if their salary at their current job stagnates or falls below the market rate.

Another economic phenomenon affecting loyalty in the private sector was the switch from defined-benefit to defined-contribution retirement plans. In the former, often called a pension, employee benefits are usually sponsored (paid) fully by the employer and calculated using a formula based on length of employment, salary history, and other factors. The employer administers the plan and manages the investment risk, promising the employee a set payout upon retirement. In the defined-contribution plan, however, the employee invests a certain percentage of his or her salary in a retirement fund, often a 401(k) or 403(b) plan, where it is sometimes matched (partially or wholly) by the employer. (These savings plans with their seemingly strange designations are part of the U.S. Internal Revenue Code, and the letter/number combinations indicate subsections of the Code. 401(k) Plans typically are featured in for-profit employment settings and 403(b) plans in nonprofit environments.) Defined-benefit plans reward longevity in the firm, whereas defined-contribution plans reward high earnings over seniority. Thus, with the growth of defined-contribution plans, some reasons for staying with the same employer over time are no longer applicable.

According to PayScale's Compensation Best Practices Report, the two leading motivators people give for leaving their job are first, higher pay, and second, personal reasons (e.g., family, health, marriage, spousal relocation).[7] Of course, beyond money, workers seek meaning in their work, and it is largely true that money alone does not motivate employees to higher performance. However, it is a mistake for managers to think money is not a central factor influencing employees' job satisfaction. Money matters because if employees are not making enough money to meet their financial obligations or goals, they will likely be looking to for a higher-paying job. And, of course, increasing salary or other benefits can be a way of demonstrating both the company's loyalty to its employees and the role it believes employees' best interests play in its mission—navigating the aforementioned two-way street. For some employees, simply being acknowledged and thanked for their service and good work can go a long way toward sparking their loyalty; for others, more concrete rewards may be necessary.

Finally, many people work for themselves as freelance or contract workers in the new "gig" economy. They may take assignments from one or more companies at a time and are not employees in the traditional sense of the word. Therefore, it seems more reasonable that they would approach work in the same way a certified public accountant or attorney would—as completing a professional job for a client, after which they move on the next client, always keeping their independent status. We would not expect gig workers to demonstrate employer loyalty when they are not employees.

WHAT WOULD YOU DO?

The Ties That Bind

If building employee loyalty is a challenge for managers and they see their workers leaving for better opportunities, what can they do to change the situation? Some companies focus on team-building activities, company picnics, rock-climbing walls, or zip lines, but do these actually make workers decide to stay with their company for less salary? The answer is usually no. The reality is that salary plays an important role in an employee's decision to move to a new job. Therefore, retention bonuses are a popular and perhaps more successful technique for instilling loyalty. The company provides a payment to an employee contingent on his or her committing to remain at the company for a specific period.

According to a Glassdoor study,[8] when changing jobs, employees earn an average increase of more than 5 percent in salary alone, not including benefits. Thus, the offer of a salary increase and/or a retention or performance bonus can help turn many would-be former employees into newly loyal ones. The same study found that a 10 percent increase in pay upped the odds that an employee would stay at the company. According to Dr. Andrew Chamberlain, chief economist of

Glassdoor, “While it is important to provide upward career paths for workers, a simple job title promotion may not be enough. Maintaining competitive pay is an important part of reducing turnover.”[9]

Of course, a retention bonus may not be enough to keep someone at a job he or she hates, but it might help someone who likes the job to decide to stay. The Society for Human Resource Management believes retention plans should be part of an overall pay strategy, not merely giveaways for tenure.[10] Imagine that your colleague is considering leaving your firm for another company: Your manager has offered him a retention bonus to stay and your colleague is seeking your advice about what to do. What would you advise?

Critical Thinking

- **What questions would you ask your colleague to better determine the advice you should give him or her?**
- **Consider your summer jobs, part-time employment, work-study hours on campus, and internships. What meant more to you–the salary you made or the extent to which you were treated as a real contributor and not just a line on a payroll ledger? Or a combination of both?**
- **What lessons do you now draw about reciprocal loyalty between companies and their workers?**

Confidentiality

In the competitive world of business, many employees encounter information in their day-to-day work that their employers reasonably expect they will keep confidential. Proprietary (private) information, the details of patents and copyrights, employee records and salary histories, and customer-related data are valued company assets that must remain in-house, not in the hands of competitors, trade publications, or the news media. Employers are well within their rights to expect employees to honor their duty of confidentiality and maintain the secrecy of such proprietary material. Sometimes the duty of confidentiality originates specifically from an employment contract, if there is one, and if not, the duty still exists in most situations under the common law of agency.

Most companies do not consider U.S. common law on confidentiality sufficient protection, so they often adopt employment agreements or contracts with employees that set forth the conditions of confidentiality. (Note that such contracts define a one-way obligation, from the employee to the employer, so they do not protect the at-will employee from being terminated without cause.) Typically, an employment agreement will list a variety of requirements. For example, although in most situations the law would already hold that the employer owns copyrightable works created by employees within the scope of their employment (known as works for hire), a contract usually also contains a specific clause stating that the company owns any and all such works and assigning ownership of them to the company. The agreement will also contain a patent assignment provision, stating that all inventions created within the scope of employment are owned by or assigned to the company.

LINK TO LEARNING

If one day you might be a freelancer, gig worker, or contractor, watch this video showing how a nondisclosure agreement can help you protect your ideas to learn more.

Employers also want to protect their trade secrets, that is, information that has economic value because it is not generally known to the public and is kept secret by reasonable means. Trade secrets might include technical or design information, advertising and marketing plans, and research and development data that would be useful to competitors. Often nondisclosure agreements are used to protect against the theft of all such information, most of which is normally protected only by the company's requirement of secrecy, not by federal intellectual property law. Federal law generally protects registered trademarks (commercial identifications such as words, designs, logos, slogans, symbols, and trade dress, which is product appearance or packaging) and grants creators copyrights (to protect original literary and artistic expressions such as books, paintings, music, records, plays, movies, and software) and patents (to protect new and useful inventions and configurations of useful articles) (Figure 22.2).

Figure 22.2 Registered trademarks and content covered by patents and copyrights are protected by law, but trade secrets have no official status and so do not enjoy the same level of federal protection. Thus, companies generally protect trade secrets internally, usually with employment agreements or contracts. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

U.S. companies have long used non-compete agreements as a way to provide another layer of confidentiality, ensuring that employees with access to sensitive information will not compete with the company during or for some period after their employment there. The stated purpose of such agreements is to protect the company's intellectual property, which is the manifestation of original ideas protected by legal means such as patent, copyright, or trademark. To be enforceable, non-compete agreements are usually limited by time and distance (i.e., they are in effect for a certain number of months or years and within a certain radius of the employer's operations). However, some companies have begun requiring these agreements even from mid- and lower-level workers in an attempt to prevent them from changing jobs, including those who have no access to any confidential intellectual property. About 20 percent of the U.S. private-sector workforce, and about one in six people in jobs earning less than $40,000 a year, are now covered by non-compete agreements.[11] The increased use of such agreements has left many employees feeling trapped by their limited mobility.

LINK TO LEARNING

A template for a typical non-compete agreement can be found at PandaDoc.

An ethical question arises regarding whether this practice is in the best interests of society and its workers, and some states are responding. California enacted a law in 2017 saying that most non-compete agreements are void, holding that although an employee may owe the employer a responsibility not to compete while employed, that duty ceases upon termination of employment.[12] In other words, an employee does not “belong” to a company forever. In California, therefore, a non-compete arrangement that limits employment after leaving the employer is now unenforceable. Does this law reflect the approach that most states will now take? A California company may still legally prohibit its employees from moonlighting during the term of their employment, particularly for a competitor.

CASES FROM THE REAL WORLD

Non-Compete Agreements

After an investigation by then–New York attorney general Eric Schneiderman, fast-food franchisor Jimmy John's announced in 2016 that it would not enforce non-compete agreements signed by low-wage employees that prohibited them from working at other sandwich shops, and it agreed to stop using the agreements in the future. Jimmy John's non-compete agreement had prohibited all workers, regardless of position, from working during their employment and for two years after at any other business that sold "submarine, hero-type, deli-style, pita, and/or wrapped or rolled sandwiches" in a geographic area within two miles of any Jimmy John's shop anywhere in the United States.[13]

Schneiderman said of the agreements, "They limit mobility and opportunity for vulnerable workers and bully them into staying with the threat of being sued." Illinois Attorney General Lisa Madigan had also initiated action, filing a lawsuit that asked the court to strike down such clauses. "Preventing employees from seeking employment with a competitor is unfair to Illinois workers and bad for Illinois businesses," Madigan said. "By locking low-wage workers into their jobs and prohibiting them from seeking better paying jobs elsewhere, the companies have no reason to increase their wages or benefits."[14]

Jimmy John's has more than 2,500 franchises in forty-six states, so its agreement meant it would be difficult for a former worker to get a job in a sandwich shop in almost any big city in the United States.

Critical Thinking

- **Other than being punitive, what purpose do non-compete agreements serve when low-level employees are required to sign them?**
- **Suppose an executive chef or vice president of marketing or operations at Jimmy John's or any large sandwich franchise leaves the firm with knowledge of trade secrets and competitive strategies. Should he or she be compelled to wait a negotiated period of time before working for a competitor? Why or why not?**
- **What is fair to all parties when high-level managers possess unique, sensitive information about their former employer?**

Employers may also insert a nonsolicitation clause, which protects a business from an employee who leaves for another job and then attempts to lure customers or former colleagues into following. Though these clauses have limitations, they can be effective tools to protect an employer's interest in retaining its employees and customers. However, they are particularly difficult for employees to comply with in relatively closed markets. Sample language for all the clauses we have discussed is found in Figure 22.3.

Non-Compete Clause
The Employee agrees that for a period of one year after the Employee no longer works for the Company, the Employee will not engage in the same or similar activities as were performed for the Company in any business within a 100-mile radius of the Company.

Nonsolicitation of Customers/Employees Clause
The Employee agrees that for a period of two years after the Employee no longer works for the Company, the Employee will not solicit customer, clients, and/or employees of the Company.

Confidentiality/ Non-Disclosure Clause
Employee agrees that during employment with the Company and following the termination of such employment for an unlimited term, the Employee shall not misappropriate, divulge, disclose, or make use of any confidential information, intellectual property, or trade secrets.

Figure 22.3 Common clauses found in employment contracts include those restricting competition and solicitation upon termination of the contract, as well as requiring confidentiality during and after employment. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

A final clause an employee might be required to sign is a nondisparagement clause, which prohibits defaming or deliberately running down the reputation of the former employer.

22. Loyalty to the Brand and to Customers

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Describe how employees help build and sustain a brand**
- **Discuss how employees' customer service can help or hurt a business**

A good employment relationship is beneficial to both management and employees. When a company's products or services are legitimate and safe and its employment policies are fair and compassionate, managers should be able to rely on their employees' dedication to those products or services and to their customers. Although no employee should be called upon to lie or cover up a misstep on the part of the firm, every employee should be willing to make a sincere commitment to an ethical employer.

Respecting the Brand

Every company puts time, effort, and money into developing a brand, that is, a product or service marketed by a particular company under a particular name. As Apple, Coca-Cola, Amazon, BMW, McDonald's, and creators of other coveted brands know, branding—creating, differentiating, and maintaining a brand's image or reputation—is an important way to build company value, sell products and services, and expand corporate goodwill. In the sense discussed here, the term "brand" encompasses an image, reputation, logo, tagline, or specific color scheme that is trademarked, meaning the company owns it and must give permission to others who would legally use it (such as Tiffany's unique shade of blue).

Companies want and expect employees to help in their branding endeavors. For example, according to the head of training at American Express, the company's brand is its product, and its mantra has always been, "Happy employees make happy customers."[1] American Express places significant emphasis on employee satisfaction because it is convinced this strategy helps protect and advance its brand. One company that uses positive employee involvement in branding is the technology conglomerate Cisco, which started a branding program on social media that reaches out to employees (Figure 23.1). Employees are encouraged to be creative in their brand-boosting posts in the program. The benefit is that prospective job candidates get a peek into Cisco life, and current employees feel the company trusts and values their ideas.[2]

Figure 23.1 These Cisco employees, part of a newly formed Virtual Customer Success team in India, help promote the brand and perhaps promote change as well. Women have been underrepresented in STEM careers (science, technology, engineering, math), and this group takes pride in the fact that they are part of a gender-balanced team. This photo was submitted as part of the annual #WeAreCisco #LoveWhereYouWork contest, with the hashtag #womenintech and the photo caption "Sorry, we're busy making a difference." (credit: modification of work by Shojana Ravi/Cisco, CC BY 4.0, used with the permission of https://thenetwork.cisco.com)

LINK TO LEARNING

Watch this video explaining the concept of brand loyalty to learn more.

However, protecting the brand can be a special challenge today, thanks to the ease with which customers and even employees can post negative information about the brand on the Internet and social media. Consider these examples in the fast-food industry. A photo posted on Taco Bell's Facebook page showed an employee licking a row of tacos. A Domino's Pizza employee can be seen in a YouTube video spitting on food, putting cheese into his nose and then putting that cheese into a sandwich, and rubbing a sponge used for dish washing on his groin area.[3] On Twitter, a Burger King employee in Japan posted a photo of himself lying on hamburger buns while on duty.

The companies all responded swiftly. A Taco Bell spokesperson said the food was not served to customers and the employee in the photo was fired. The two Domino's employees behind the videos were fired and faced felony charges and a civil lawsuit; Domino's said the tainted food was never delivered. According to a Burger King news release, the buns in the photo were waste material because of an ordering mistake and were promptly discarded after the photo was taken; the employee in the photo was fired.

These examples demonstrate how much damage disloyal or disgruntled employees can create, especially on social media. All three companies experienced financial and goodwill losses after the incidents and struggled to restore public trust in their products. The immediate and long-term costs of such incidents are the reason companies invest in developing brand loyalty among their employees.

According to a Harvard Business Review interview with Colin Mitchell, global vice president, McDonald's Brand, McDonald's, good branding requires that a business think of marketing not just to its customers but also to its employees, because they are the "very people who can make the brand come alive for your customers".[4] The process of getting employees to believe in the product, to commit to the idea that the company is selling something worth buying, and even to think about buying it, is called internal marketing. Of course, some employees may not want to be the equivalent of a company spokesperson. Is it reasonable to expect an employee to be a kind of roving ambassador for the company, even when off the clock and interacting with friends and neighbors? Suppose employers offer employees substantial discounts on their products or services. Is this an equitable way to sustain reciprocal loyalty between managers and workers? Why or why not?

Internal marketing is an important part of the solution to the problem of employees who act as if they do not care about the company. It helps employees make a personal connection to the products and services the business sells, without which they might be more likely to undermine the company's expectations, as in the three fast-food examples cited in this section. In those cases, it is clear the employees did not believe in the brand and felt hostile toward the company. The most common problem is usually not as extreme. More often it is a lack of effort or "slacking" on the job. Employees are more likely to develop some degree of brand loyalty when they share a common sense of purpose and identity with the company.

LINK TO LEARNING

The Working Advantage website offers corporate discounts to check out. Companies sometimes offer employees significant discounts to encourage them to buy, and support, their products.

Obligations to Customers

As the public's first point of contact with a company, employees are obliged to assist the firm in forming a positive relationship with customers. How well or poorly they do so contributes a great deal to customers' impression of the company. And customers' perceptions affect not only the company but all the employees who depend on its success for their livelihood. Thus, the ethical obligations of an employee also extend to interactions with customers, whom they should treat with respect. Employers can encourage positive behavior toward customers by empowering employees to use their best judgment when working with them.

LINK TO LEARNING

Watch this video giving a light-hearted take on bad customer service to learn more.

It may take only one bad customer interaction with a less-than-engaged or committed employee to sour brand loyalty, no matter how hard a company has worked to build it. In the same way, just one good experience can build up good will.

CASES FROM THE REAL WORLD

Redefining Customers

Sometimes engaged employees go above and beyond in the interest of customer service, even if they have no "customers" to speak of. Kathy Fryman is one such employee. Fryman was a custodian for three decades at a one hundred-year-old school in the Augusta (KY) Independent School District. She was not just taking care of the school building, she was also taking care of the people inside.[5]

Fryman fixed doors that would not close, phones that would not ring, and alarms that did not sound when they should. She kept track of keys and swept up dirty floors before Parents' Night. That was all part of the job of custodian, but she did much more.

Fryman would often ask the nurse how an ill student was doing. She would check with a teacher about a kid who was going through tough times at home. If a teacher mentioned needing something, the next day it would show up on his or her desk. A student who needed something for class would suddenly find it in his or her backpack. Speaking of Fryman, district superintendent Lisa McCrane said, "She just has a unique way of making others feel nurtured, comforted, and cared for." According to Fryman, "I need to be doing something for somebody."

Fryman's customers were not there to buy a product on which she would make a commission. Her customers were students and teachers, parents and taxpayers. Yet she provided the kind of service that all employers would be proud of, the kind that makes a difference to people every day.

Critical Thinking

- **Is there a way for a manager to find, develop, and encourage the next Fryman, or is the desire to "do something good for somebody" an inherent trait in some employees that is missing in others?**
- **What is the appropriate means to reward a worker with Fryman's level of commitment? Her salary was fixed by school district pay schedules. Should she have been given an extra stipend for service above and beyond the expected? Additional time off with pay? Some other reward?**
- **Employees who display Fryman's zeal often do so for their own internal rewards. Others may simply want to be recognized and appreciated for their effort. If you were the superintendent in her district, how would you recognize Fryman? Could she, for example, be invited to speak to new hires about opportunities to render exceptional service?**

Employees who treat customers well are assets to the company and deserve to be treated as such. Sometimes, however, customers are rude or disrespectful, creating a challenge for an employee who wants to do a good job. This problem is best addressed by management and the employee working together. In the Pizza Hut case that follows, an employee was placed in a bad situation by customers.

CASES FROM THE REAL WORLD

Is the Customer Always Right?

At an independently owned Pizza Hut franchise in Oklahoma,[6] two regular customers made sexually offensive remarks to a female employee named Lockard, who then told her boss she did not like waiting on them. One evening, these customers again entered the restaurant, and her boss instructed Lockard to wait on them. She did, but this time the customers became physically abusive. Although it is the employee's duty to provide good customer service, that does not mean accepting harassment.

Lockard sued her employer, the owner of the franchise, for failing to take her complaints seriously and for making her continue to suffer sexual harassment and assault by customers. The jury ruled in her favor, awarding her $360,000, and an appeals court upheld the judgment.

Critical Thinking

- **Clearly, no employee should expect to be physically assaulted, but how far should an employee be expected to go in the name of customer service? Is taking verbal taunts expected? Why or why not?**
- **Just as every employee should treat customers and clients with respect, so every employer is ethically—and often legally—obligated to safeguard employees on the job. This includes establishing a workplace atmosphere that is safe and secure for workers. If you were the owner of this Pizza Hut franchise, what protections might you put in place for your employees?**

23. Contributing to a Positive Work Atmosphere

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Explain employees' responsibility to treat their peers with respect**
- **Describe employees' duty to follow company policy and the code of conduct**
- **Discuss types of workplace violence**

You may spend more time with your coworkers than you spend with anyone else, including your family and friends. Thus, your ability to get along with work colleagues can have a significant impact on your life, as well as your attitude toward your job and your employer. All sorts of personalities populate our workplaces, but regardless of their working style, preferences, or quirks, employees owe one another courtesy and respect. That does not mean always agreeing with them, because evaluating a diversity of perspectives on business problems and opportunities is often essential for finding solutions. At the same time, however, we are responsible for limiting our arguments to principles, not personalities. This is what we owe to one another as human beings, as well as to the firm, so worksite arguments do not inflict lasting harm on the people who work there or on the company itself.

Getting Along with Coworkers

An employee who gets along with coworkers can help the company perform better. What can employees do to help create a more harmonious workplace with a positive atmosphere?

One thing you can do is to keep an open mind. You may be wondering as you start a new job whether you will get along with your colleagues as well as you did at your old job. Or, if you did not get along with the people there and were looking for a change, you might fear things will be the same at the new job. Do not make any prejudgments. Get to know a bit about your new coworkers. Accept, or extend, lunch invitations, join weekend activities and office social events, and perhaps join those office traditions that bind long-serving employees and newcomers together in a collaborative spirit.

Another thing you can do it to remember to be kind. Everyone has a bad day every now and then, and if you spot a coworker having one, performing a random act of kindness may make that person's day better. You do not need to be extravagant. Offer to stay late to help the person meet a tight deadline, or bring coffee or a healthy snack to someone working on particularly difficult tasks. Remember the adage, "It's nice to be important, but it's more important to be nice."

For any relationship to succeed, including the relationship between coworkers, the parties must respect each other—and show it. Avoid doing things that might offend others. For example, do not take credit for someone else's work. Do not be narrow minded;

when someone brings up a topic such as politics or religion, be willing to listen and tolerate differing points of view.

A related directive is to avoid sexual jokes, stories, anecdotes, and innuendos. You might think it is okay to talk about anything and everything at work, but it is not. Others may not find the topic funny and feel offended, and you may make yourself vulnerable to action by management if such behavior is reported. Your coworkers might be a captive audience, but you should never place them in an awkward position.

Make an effort to get along with everyone, even difficult people. You did not choose your coworkers, and some may be hard to get along with. But professionalism requires that we attempt to establish the best working relationships we can on the job, no matter the opinions we might have about our colleagues. Normally, we might like some of them very much, be neutral about some others, and genuinely dislike still others. Yet our responsibility in the workplace is to respect and act at least civilly toward all of them. We likely will feel better about ourselves as professionals and also live up to our commitments to our companies.

Finally, do no use social media to gossip. Gossiping at work can cause problems anywhere, perhaps especially on social media, so resist the urge to vent online about your coworkers. It makes you appear petty, small, and untrustworthy, and colleagues may stop communicating with you. You may also run afoul of your employer's social media policy and risk disciplinary action or dismissal.

Understanding Personalities

Understanding the various personalities at work can be a complex task, but it is a vital one for developing a sense of collegiality. One technique that may be helpful is to develop your own emotional intelligence, which is the capacity to recognize other people's emotions and also to know and manage your own. One aspect of using emotional intelligence is showing empathy, the willingness to step into someone else's shoes.

LINK TO LEARNING

Do you think you know yourself? Take this free online personality test from IDR Labs; it may tell you something you did not know that you can use to your benefit at work.

All of us have different workplace personalities, which express the way we think and act on the job. There are many such personalities, and none is superior or inferior to another, but they are a way in which we exhibit our uniqueness on the job (Figure 24.1). Some of us lead with our brains and emphasize logic and reason. Others lead with our hearts, always emphasizing mercy over justice in our relationships with others.

Figure 24.1 Which type of personality are you? (credit: Jackson Ceszyk/Flickr, CC BY 4.0)

Employees can also have very different work styles, the way in which we are most comfortable accomplishing our tasks at work. Some of us gravitate toward independence and jobs or tasks we can accomplish alone. Others prefer team or project work, bringing us into touch with different personalities. Still others seek a mix of these environments. Some prioritize getting the job done as efficiently as possible, whereas others value the journey of working on the project with others and the shared experiences it brings. There is no right or wrong style, but it benefits any worker to know his or her preferences and something about the work personalities of colleagues. When in the office, the point for any of us individually is to appreciate what motivates our greatest success and happiness on the job.

WHAT WOULD YOU DO?

Personality Test

Imagine you are a department director with twenty-five employees reporting directly to you. Two of them are experts in their fields: You like and respect them individually, as do the others in your department, but they simply cannot get along with each other and so never work together.

How do you resolve this personality clash? You cannot simply insist that the two colleagues cooperate, because personalities do not change. Still, you have to do your best to establish an atmosphere in which they can least collaborate civilly. Even though managers have no power to change human nature or the personality conflicts that inevitably occur, part of their responsibility is to establish a harmonious working environment, and others will judge you on the harmony you cultivate in your department.

Critical Thinking

Working relationships are extremely important to an employee's job satisfaction. What options would you use to foster a cooperative working relationship in your department?

Reducing Workplace Violence

As recent incidents have shown—for example, the April 2018 shooting at YouTube headquarters in San Bruno, California[21]—workplace violence is a reality, and all employees play a role in helping make work a safe, as well as harmonious place. Employees, in fact, have a legal and ethical duty not to be violent at work, and managers have a duty to prevent or stop violence. The National Institute for Occupational Safety and Health reports that violence at work usually fits into one of four categories: traditional criminal intent, violence by one worker against another, violence stemming from a personal relationship, and violence by a customer.[22]

In violence based on traditional criminal intent, the perpetrator has no legitimate relationship to the business or its employees, and often the violence is part of a crime such as robbery or shoplifting. Violence between coworkers occurs when a current or former employee attacks another employee in the workplace. Worker-on-worker deaths account for approximately 15 percent of all workplace homicides. All companies are at risk for this type of violence, and contributing factors include failure to conduct a criminal background check as part of the hiring process.

When the violence arises from problems in a personal relationship, the perpetrator often has a direct relationship not with the business but with the victim, who is an employee. This category of violence accounts for slightly less than 10 percent of all workplace homicides. Women are at higher risk of being victims of this type of violence than men. In the fourth scenario, the violent person has a legitimate relationship with the business, perhaps as a customer or patient, and becomes violent while on the premises. A large portion of customer incidents occur in the nightclub, restaurant, and health care industries. In 2014, about one-fifth of all workplace homicides resulted from this type of violence.[23]

Codes of Conduct

Companies have a right to insist that their employees, including managers, engage in ethical decision-making. To help achieve this goal, most businesses provide a written code of ethics or code of conduct for all employees to follow. These cover a wide variety of topics, from workplace romance and sexual harassment to hiring and termination policies, client and customer entertainment, bribery and gifts, personal trading of company shares in any way that hints of acting on insider knowledge of the company's fortunes, outside employment, and dozens of others. A typical code of conduct, regardless of the company or the industry, will also contain a variety of standard clauses, often blending legal compliance and ethical considerations (Table 24.2).

(Table 24.2) Sample Code of Conduct

Compliance with all laws	Employees must comply with all laws, including bribery, fraud, securities, environmental, safety, and employment laws.
Corruption and fraud	Employees must not accept certain types of gifts and hospitality from clients, vendors, or partners. Bribery is prohibited in all circumstances.
Conflict of interest	Employees must disclose and/or avoid any personal, financial, or other interests that might influence their ability to perform their job duties.
Company property	Employees must treat the company's property with respect and care, not misuse it, and protect company facilities and other material property.
Cybersecurity and digital devices policy	Employees must not use company computer equipment to transfer illegal, offensive, or pirated material, or to visit potentially dangerous websites that might compromise the safety of the company network or servers; employees must respect their duty of confidentiality in all Internet interactions.
Social media policy	Employees may [or may not] access personal social media accounts at work but are expected to act responsibly, follow company policies, and maintain productivity.
Sexual harassment	Employees must not engage in unwelcome or unwanted sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature. Behaviors such as conditioning promotions, awards, training, or other job benefits upon acceptance of unwelcome actions of a sexual nature are always wrong.[24]
Workplace respect	Employees must show respect for their colleagues at every level. Neither inappropriate nor illegal behavior will be tolerated.

LINK TO LEARNING

Exxon Mobil's Code of Conduct is typical of that of most large companies. Read Exxon Mobil's code of conduct on their website, and note that it demands ethical conduct at every level of the organization. Exxon expects its leadership team to model appropriate behavior for all employees. Decide whether, if you were an Exxon employee, you would find the code understandable and clear regarding what is allowed and what is not. Still thinking as an employee, identify the section of the code you think is most important for you, and explain why.

Two areas that deserve special mention are cybersecurity and harassment. Recent news stories have highlighted the hacking of electronic tools such as computers and databases, and employees and managers can indirectly contribute to such data breaches through unauthorized web surfing, sloppy e-mail usage, and other careless actions. Large companies such as Equifax, LinkedIn, Sony, Facebook, and JP Morgan Chase have suffered the theft of customer information, leading to loss of consumer confidence; sometimes large fines have been levied on companies. Employees play a part in preventing such breaches by strictly following company guidelines about data privacy and confidentiality, the use and storage of passwords, and other safeguards that limit access to only authorized users.

LINK TO LEARNING

For more on recent data breaches, watch a couple of videos. Watch this video about how J.P. Morgan Chase's $13 billion fine was the largest in history from CBS Evening News. Also watch this video about how the Sony PlayStation was hacked and data was stolen from 77 million users from CBS Early.

We are also witnessing an increased level of public awareness about harassment in the workplace, particularly because of the #MeToo movement that followed revelations in 2017 and 2018 of years of sexual predation by powerful men in Hollywood and Washington, DC, as well as across workplaces of all kinds, including in sports and the arts. A victim of sexual harassment can be a man or a woman, and/or the same sex as the harasser. The harasser can be a supervisor, coworker, other employee, officer/director, intern, consultant, or nonemployee. Whatever the situation, harassing and threatening behavior is wrong (and sometimes criminal) and should always be reported.

24. Financial Integrity

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Describe an employee's responsibilities to the employer in financial matters**
- **Define insider trading**
- **Discuss bribery and its legal and ethical consequences**

Employees may face ethical dilemmas in the area of finance, especially in situations such as bribery and insider trading in securities. Such dubious "profit opportunities" can offer the chance of realizing thousands or millions of dollars, creating serious temptation for an employee. However, insider trading and bribery are serious violations of the law that can result in incarceration and large fines.

Insider Trading

The buying or selling of stocks, bonds, or other investments based on nonpublic information that is likely to affect the price of the security being traded is called insider trading. For example, someone who is privy to information that a company is about to be taken over, which will cause its stock price to rise when the information becomes public, may buy the stock before it goes up in order to sell it later for an enhanced profit. Likewise, someone with inside information about a coming drop in share price may sell all his or her holdings at the current price before the information is announced, avoiding the loss other shareholders will suffer when the price falls. Although insider trading can be difficult to prove, it is essentially cheating. It is illegal, unethical, and unfair, and it often injures other investors, as well as undermining public confidence in the stock market.

Insider trading laws are somewhat complex. They have developed through federal court interpretations of Section 10(b)5 of the Securities Exchange Act of 1934, as well as through actions by the U.S. Securities and Exchange Commission (SEC). The laws identify several kinds of violations. These include trading by an insider (generally someone who performs work for the company) who possesses significant confidential information relevant to the valuation of the company's stock, and trading by someone outside of the company who is given this sort of information by an insider or who obtains it inappropriately. Even being the messenger (the one communicating material nonpublic information to others on behalf of someone else) can be a legal violation.

The concept of an "insider" is broad and includes officers, directors, and employees of a company issuing securities. A person can even constitute what is called a "temporary insider" if he or she temporarily assumes a unique confidential relationship with a firm and, in doing so, acquires confidential information centered on the firm's financial and operational affairs. Temporary insiders can be investment bankers, brokers, attorneys, accountants, or other professionals typically thought of as outsiders, such as newspaper and television reporters.

A famous case of insider trading, Securities and Exchange Commission v. Texas Gulf Sulphur Co. (1968), began with the discovery of the Kidd Mine and implicated the employees of Texas mining company.[1] When first notified of the discovery of a large and very valuable copper deposit, mine employees bought stock in the company while keeping the information secret. When the information was released to the public, the price of the stock went up and the employees sold their stock, making a significant amount of money. The SEC and the Department of Justice prosecuted the employees for insider trading and won a conviction; the employees had to give back all the money they had made on their trades. Insider trading cases are often highly publicized, especially when charges are brought against high-profile figures.

ETHICS ACROSS TIME AND CULTURES

Insider Trading and Fiduciary Duty

One of the most famous cases of insider trading implicated Michael Milken, Dennis Levine, and Martin Siegel, all executives of Drexel Burnham Lambert (DBL), and the company itself.[2] Ivan Boesky, also accused, was an arbitrageur, an outside investor who bet on corporate takeovers and appeared to be able to uncannily anticipate takeover targets, buy their stock ahead of time, and earn huge profits. Everyone wondered how; the answer was that he cheated. Boesky went to the source—the major investment banks—to get insider information. He paid Levine and Siegel to give him pretakeover details, an illegal action, and he profited enormously from nearly every major deal in the merger-crazy 1980s, including huge deals involving oil companies such as Texaco, Getty, Gulf, and Chevron.

The SEC started to become suspicious after receiving a tip that someone was leaking information. Investigators discovered Levine's secret Swiss bank account, with all the money Boesky had paid him. Levine then gave up Boesky in a plea deal; the SEC started watching Boesky and subsequently caught Siegel and Milken.

The penalties were the most severe ever given at the time. Milken, the biggest catch of all, agreed to pay $200 million in government fines, $400 million to investors who had been hurt by his actions, and $500 million to DBL clients—for a grand total of $1.1 billion. He was sentenced to ten years in prison and banned for life from any involvement in the securities industry. Boesky received a prison sentence of 3.5 years, was fined $100 million, and was permanently barred from working with securities. Levine agreed to pay $11.5 million and $2 million more in back taxes; he too was given a lifetime ban and was sentenced to two years in prison.

Milken and Levine violated their financial duties to their employer and the company's clients. Not only does insider trading create a public relations nightmare, it also subjects the company to legal liability. DBL ended up being held liable in civil lawsuits due to the actions of its employees, and it was also charged with violations of the Racketeer Influenced and Corrupt Organizations (RICO) Act) and ultimately failed, going bankrupt in 1990.

(As a note of interest regarding the aftermath of all of this for Milken, he has tried to redeem his image since his incarceration. He resolutely advises others to avoid his criminal acts and has endowed some worthy causes in Los Angeles.)

Critical Thinking

- **Employers in financial services must have stringent codes of professional behavior for their employees to observe. Even given such a code, how should employees honor their fiduciary duty to safeguard the firm's assets and treat clients equitably? What mechanisms would you suggest for keeping employees in banking, equities trading, and financial advising within the limits of the law and ethical behavior?**
- **This case dominated the headlines in the 1980s and the accused in this case were all severely fined and received prison sentences. How do you think this case might be treated today?**
- **Should employees in these industries be encouraged or even required to receive ethical certification from the state or from professional associations? Why or why not?**

Bribery and the Foreign Corrupt Practices Act

Another temptation that may present itself to employees is the offer of a bribe. A bribe is a payment in some material form (cash or noncash) for an act that runs counter to the legal or ethical culture of the work environment. Bribery constitutes a violation of the law in all fifty U.S. states, as well as of a federal law that prohibits bribery in international transactions, the Foreign Corrupt Practices Act. Bribery generally injures not only individuals but also competitors, the government, and the free-market system as a whole. Of course, often the bribe is somewhat less obvious than an envelope full of money. It is important, therefore, to understand what constitutes a bribe.

Numerous factors help establish the ethics (and legality) of gift giving and receiving: the value of the gift, its purpose, the circumstances under which it is given, the position of the person receiving it, company policy, and the law. Assuming an employee has decision-making authority, the company wants and has the right to expect him or her to make choices in its best interest, not the employee's own self-interest. For example, assume an employee has the authority to buy a copy machine for the company. The employer wants to get the best copy machine for the best price, taking into account quality, service, warranties, and other factors. But what if the employee accepts a valuable gift card from a vendor who sells a copy machine with higher operating and maintenance charges, and then places the order with that vendor. This is clearly not in the best interests of the employer. It constitutes a failure on the part of the employee to follow ethical and legal rules, and, in all likelihood, company policy as well. If a company wants its employees always to do the right thing, it must have policies and procedures that ensure the employees know what the rules are and the consequences for breaking them.

A gift may be only a well-intentioned token of appreciation, but the potential for violating company rules (and the law) is still present. A well-written and effectively communicated gift policy provides guidance to company employees about what is and is not appropriate to accept from a customer or vendor and when. This policy should clearly state whether employees are allowed to accept gifts on or outside the work premises and who may give or accept them. If gifts are allowed, the gift policy should define the acceptable value and type, and the circumstances under which an employee may accept a gift.

When in doubt about whether the size or value of a gift renders it impossible for an employee to accept it, workers should be advised to check with the appropriate officer or department within their company. Be it an “ethics hotline” or simply the human resources department, wise firms provide an easy protocol for employees to follow in determining what falls within and without the protocols for accepting gifts.

As an example of a gift policy, consider the federal government’s strict rules.[3] A federal employee may not give or solicit a contribution for a gift to an official superior and may not accept a gift from an employee receiving less pay if that employee is a subordinate. On annual occasions when gifts are traditionally given, such as birthdays and holidays, an employee may give a superior a gift valued at less than $10. An employee may not solicit or accept a gift given because of his or her official position, or from a prohibited source, including anyone who has or seeks official action or business with the agency. In special circumstances such as holidays, and unless the frequency of the gifts would appear to be improper, an employee generally may accept gifts of less than $20. Gifts of entertainment, such as expensive restaurant meals, are also restricted. Finally, gifts must be reported when their total value from one source exceeds $390 in a calendar year. Some companies in the private sector follow similar rules.

Bribery presents a particular ethical challenge for employees in the international business arenas. Although every company wants to land lucrative contracts around the world, most expect their employees to follow both the law and company policy when attempting to consummate such deals. The U.S. law prohibiting bribery in international business dealings is the Foreign Corrupt Practices Act(FCPA), which is an amendment to the Securities and Exchange Act of 1934, one of the most important laws promoting transparency in corporate governance. The FCPA dates to 1977 and was amended in 1988 and 1998. Its main purpose is to make it illegal for companies and their managers to influence or bribe foreign officials with monetary payments or rewards of any kind in an attempt to get or keep business opportunities outside the United States. The FCPA is enforced through the joint efforts of the SEC and the Department of Justice.[4] It applies to any act by U.S. businesses, their representatives, foreign corporations whose stock is traded in U.S. markets, and all U.S. citizens, nationals, or residents acting in furtherance of a foreign corrupt practice, whether they are physically present in the United States or not (this is called the nationality principle). Antibribery law is a serious issue for companies with overseas business and cross-border sales. Any companies or individuals convicted of these activities may pay significant fines, and individuals can face prison time.

The FCPA prohibits an agent of any company incorporated in the United States from extending a bribe to a foreign government official to achieve a business advantage in that country, but it does not specifically prohibit the extension of a bribe to a private officer of a nongovernmental company in a foreign country. The definition of a foreign government official can be expansive; it includes not only those working directly for the government but also company officials if the company is owned or operated by the government. An exception is made for "facilitating or grease payments," small amounts of money paid to low-level government workers in an effort to speed routine tasks like processing paperwork or turning on electricity, but not to influence the granting of a contract.

Illegal payments need not be cash; they can include anything of value such as gifts and trips. For example, BHP Billiton, a U.S. energy company, and GlaxoSmithKline, a U.K. pharmaceutical company, were each fined $25 million for buying foreign officials tickets to the 2008 Olympic Games in Beijing, China.[5] Fines for violations like these can be large and can include civil penalties as well as forfeited profits. For example, Telia, a Swedish telecommunications provider whose shares are traded on Nasdaq, recently agreed to pay nearly a billion dollars ($965 million) in a settlement to resolve

FCPA violations that consisted of using bribery to win business in Uzbekistan.[6]

LINK TO LEARNING

The SEC website provides an interactive list of the SEC's FCPA enforcement actions by calendar year and company namefor more information. Click on Telia to read more details on the case cited in the preceding paragraph. Do you think the penalty was too harsh, or not harsh enough? Why?

The potential effect of laws such as the FCPA that impose ethical duties on employees and the companies they work for is often debated. Although some believe the FCPA disadvantages U.S. firms competing in foreign markets, others say it is the backbone of an ethical free enterprise system. The argument against strong enforcement of the FCPA has some merit according to managers in the field, and there is a general sense that illegal or unethical conduct is sometimes necessary for success. An attorney for energy-related company Cinergy summed up the feelings of many executives: "Shame on the Justice Department's myopic view and inability to understand the realities of the world."[7] Some nations consider business bribery to be culturally acceptable and turn a blind eye to such activities.

The argument in favor of FCPA enforcement has its supporters as well, who assert that the law not only covers the activities of U.S. companies but also levels the playing field because of its broad jurisdiction over foreign enterprises and their officials. The fact is that since the United States passed the FCPA, other nations have followed suit. The 1997 Organization for Economic Cooperation and Development (OECD) Anti-Bribery Convention has been instrumental in getting its signatories (the United Kingdom and most European Union nations) to enact stricter antibribery laws. The United Kingdom adopted the Bribery Act in 2010, Canada adopted the Corruption of Foreign Officials Act of 1999, and European Union nations have done the same. There is also the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which has forty-three signatories, including all thirty-five OECD countries and eight other countries.

Companies and employees engaging in transactions in foreign markets face an increased level of regulatory scrutiny and are well served if they put ethics policies in place and enforce them. Companies must train employees at all levels to follow compliance guidelines and rules, rather than engaging in illegal conduct such as “under the table” and “off the books” payments (Figure 25.1).

Figure 25.1 “Under the table” and “off the books” are terms applied to payments that are really bribes. (credit: modification of “Graft for Everyone!” by Chris Potter/Flickr, CC BY 2.0)

Ethical Leadership

Of course, bribery is just one of many ethical dilemmas an employee might face in the workplace. Not all such dilemmas are governed by the clear-cut rules generally laid out for illegal acts such as bribery. Employees may find themselves being asked to do something that is legal but not considered ethical. For example, an employee might receive confidential proprietary knowledge about another firm that would give his or her firm an unfair competitive advantage. Should the employee act on this information?

WHAT WOULD YOU DO?

Should You Act on Information If You Have Doubts?

Assume you are a partner in a successful computer consulting firm bidding for a contract with a large insurance company. Your chief rival is a firm that has usually offered services and prices similar to yours. However, from a new employee who used to work for that firm, you learn that it is unveiling a new competitive price structure and accelerated delivery dates, which will undercut the terms you had been prepared to offer the insurance company. Assume you have verified that the new employee is not in violation of any non-compete or nondisclosure agreement and therefore the information was not given to you illegally.

Critical Thinking

Would you change prices and delivery dates to beat your rival? Or would you inform both your rival and potential customer of what you have learned? Why?

Most companies say they want all employees to obey the law and make ethical decisions. But employees typically should not be expected to make ethical decisions based just on gut instinct; they need guidance, training, and leadership to help them navigate the maze of grey areas that present themselves daily in business. This guidance can be provided by the company through standard setting and the development of ethical codes of conduct and policies. Senior managers modeling ethical behavior and so leading by direct example also provide significant direction.

25. Criticism of the Company and Whistleblowing

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Outline the rules and laws that govern employees' criticism of the employer**
- **Identify situations in which an employee becomes a whistleblower**

This chapter has explained the many responsibilities employees owe their employers. But workers are not robots. They have minds of their own and the freedom to criticize their bosses and firms, even if managers and companies do not always welcome such criticism. What kind of criticism is fair and ethical, what is legal, and how should a whistleblowing employee be treated?

Limiting Pay Secrecy

For decades, most U.S. companies enforced pay secrecy, a policy that prohibits employees from disclosing or discussing salaries among themselves. The reason was obvious: Companies did not want to be scrutinized for their salary decisions. They knew that if workers were aware of what each was paid, they would question the inequities that pay secrecy kept hidden from them.

Recently, the situation has begun to change. Ten states have enacted new laws banning employers from imposing pay secrecy rules: California, Colorado, Illinois, Louisiana, Maine, Michigan, Minnesota, New Hampshire, New Jersey, and Vermont.[1] The real game changer came in 2012, when multiple decisions by the National Labor Relations Board (NLRB) and various federal courts made it clear that most pay secrecy policies are unenforceable and violate federal labor law (National Labor Relations Act, 29 U.S.C. § 157-158).[2] Generally speaking, labor law lends employees the right to engage in collective activities, including that of discussing with each other the specifics of their individual employment arrangements, which includes how much they are paid. Moreover, the applicable sections of the 1935 National Labor Relations Act (NLRA) apply to union and non-union employees, so there is no exception made for companies whose employees are non-unionized, meaning the law protects all workers. In 2014, President Barack Obama issued an executive order banning companies that engaged in federal contracting from prohibiting such salary discussions.[3]

Opening up the discussion of pay acknowledges the growing desire of employees to be well informed and to have the freedom to question or criticize their company. If employees cannot talk about something at work because they think it will make their boss angry, where do they go instead? Social media can be a likely answer. Protections generally extend to salary discussions on Facebook or Twitter or Instagram; Section 7 of the NRLA protects two or more employees who act together or discuss improving their terms and conditions of employment in person or online, just as it does in other settings.

Speaking Out on Social Media

Does the First Amendment protect employees at work who criticize their boss or their company? Generally, no. That answer may surprise those who believe that the First Amendment protects all speech. It does not. The Bill of Rights was created to protect citizens from an overreaching government, not from their employer. The First Amendment reads as follows:

"Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances."

The key words are "Congress shall make no law," meaning the content of speech is something the government and politicians cannot control with laws or policies. However, this right of free speech is generally not applicable to the private sector workplace and does not cover criticism of your employer.

Does that mean an employee can be fired for criticizing the company or boss? Yes, under most circumstances. Therefore, if someone posts a message on social media that says, "My boss is a jerk" or "My company is a terrible place to work," the likelihood is that the person can be fired without any recourse, assuming he or she is an employee at will (see the discussion of at-will employment earlier in this chapter). Unless the act of firing constitutes a violation under federal law, such as Title VII of the Civil Rights Act of 1964, the speech is not protected speech, and thus the speaker (the employee) is not protected.

At some point, all of us may get angry with our companies or supervisors, but we still have a duty to keep our disputes in-house and not make public any situations we are attempting to resolve internally. Employers typically are prohibited from discussing human resource matters relating to any specific employees.

Employees, too, should keep complaints confidential unless and until crimes are charged or civil suits are filed.

CASES FROM THE REAL WORLD

Adrian Duane and IXL Learning

Adrian Duane had worked for IXL, a Silicon Valley educational technology company,[4] for about a year when he got into a dispute with his supervisor over Duane's ability to work flexible hours after he returned from medical leave following transgender surgery.

Duane posted a critical comment on Glassdoor.com after he said his supervisor refused to accommodate a scheduling request. Duane's critique said, in part: "If you're not a family-oriented white or Asian straight or mainstream gay person with 1.7 kids who really likes softball—then you're likely to find yourself on the outside. . . . Most management do not know what the word 'discrimination' means, nor do they seem to think it matters."[5]

According to court documents, Paul Mishkin, IXL's CEO, confronted Duane with a printout of the Glassdoor review during a meeting about his complaints, at which time IXL terminated Duane. IXL claimed the derogatory post showed "poor judgment and ethical values." Security had already cleared out Duane's desk and boxed his personal effects, and he was escorted from the premises. According to IXL, the company had granted Duane's requests for time off or modified work schedules and welcomes all individuals equally regardless of gender identity.

The NLRB heard Duane's case. Judge Gerald M. Etchingham said he did not believe the post was part of a concerted or group action among Duane's fellow employees at the company, and therefore it was not protected under the NLRA, because it was not an attempt to improve collective terms and conditions of employment. Furthermore, Etchingham said Duane's post was more like "a tantrum" and "childish ridicule" of his employer rather than speech protected under Section 7 of the NLRA. In other words, this was not an attempt to stimulate discussion but rather an anonymous one-way (and one-time) post. "Here, Duane's posting on Glassdoor.com was not a social media posting like Facebook or Twitter. Instead, Glassdoor.com is a website used by respondent and prospective employees as a recruiting tool to recruit prospective employees."[6]

The NLRB decision is an interesting step in the development of the law as the NLRB tries to apply the NLRA's protections to employee use of social media. Duane has a pending Equal Employment Opportunity Commission lawsuit alleging employment discrimination under Title VII of the Civil Rights Act of 1964.

Critical Thinking

- **What ethical and legal obligations do**

employees have to refrain from badmouthing their employers in a fit of pique, especially on the firm's own website?

- **Should management allow employees to criticize the company without fear of retaliation? Could management benefit from allowing such criticism? Why or why not?**

The rules related to social media are evolving, but applicable laws do not generally distinguish between sites or locations in which someone might criticize an employer, so criticism of the boss remains largely unprotected speech. As discussed earlier, employees can go online and post information about wages, hours, and working conditions, and that speech is protected by federal statute. So, although some general complaints against employers are not protected under the First Amendment, they may be protected under the NLRA (because arguably they may be related to terms and conditions of employment). However, most courts agree that statements personally critical of the boss or the company on a basis other than wages and working conditions are not protected. Obviously, there is no protection when employees post false or misleading information on social media in an attempt to harm the company's reputation or that of management.

Whistleblowing: Risks and Rewards

The act of whistleblowing—going to an official government agency and disclosing an employer's violation of the law—is different from everyday criticism. In fact, whistleblowing is largely viewed as a public service because it helps society reduce bad workplace behavior. Being a whistleblower is not easy, however, and someone inclined to act as one should expect many hurdles. If a whistleblower's identity becomes known, his or her revelations may amount to career suicide. Even if they keep their job, whistleblowers often are not promoted, and they may face resentment not only from management but also from rank-and-file workers who fear the loss of their own jobs. Whistleblowers may also be blacklisted, making it difficult for them to get a job at a different firm, and all as a result of doing what is ethical.

Blowing the whistle on your employer is thus a big decision with significant ramifications. However, most employees do not want to cover up unethical or illegal conduct, nor should they. When should employees decide to blow the whistle on their boss or company? Ethicists say it should be done with an appropriate motive—to get the company to comply with the law or to protect potential victims—and not to get revenge on a boss at whom you are angry. Of course, even if an employee has a personal revenge motive, if the company actively is breaking the law, it is still important that the wrongdoing be reported. In any case, knowing when and how to blow the whistle is a challenge for an employee wanting to do the right thing.

The employee should usually try internal reporting channels first, to disclose the problem to management before going public. Sometimes workers mistakenly identify something as wrongdoing that was not wrongdoing after all. Internal reporting gives management a chance to start an investigation and attempt to rectify the situation. The employee who goes to the government should also have some kind of hard evidence that wrongful actions have occurred; the violation should be serious, and blowing the whistle should have some likelihood of stopping the wrongful act.

Under many federal laws, an employer cannot retaliate by firing, demoting, or taking any other adverse action against workers who report injuries, concerns, or other protected activity. One of the first laws with a specific whistleblower protection provision was the Occupational Safety and Health Act of 1970. Since passage of that law, Congress has expanded whistleblower authority to protect workers who report violations of more than twenty different federal laws across various topics. (There is no all-purpose whistleblower protection; it must be granted by individual statutes.)

A sample of the specific laws under which whistleblowing employees are protected can be found in the environmental area, where it is in the public interest for employees to report violations of the law to the authorities, which, in turn, helps the average citizen concerned about clean air and water. The Clean Air Act protects any employee reporting air emission violations from area, stationary, and mobile sources from any retaliation for such reporting. The Water Pollution Control Act similarly protects from retaliation any employee who reports alleged violations relating to discharge of pollutants into water.

Without the help of employees who are "on the ground" and see the violations occur, it could be difficult for government regulators to always find the source of pollution. Even when whistleblowers are not acting completely altruistically, their revelations may still be true and worthy of being brought to the public's attention. Thus, in such situations, the responsible employee becomes a steward of the public interest, and we all should want whistleblowers to come forward. Yet not all whistleblowers are white knights, and not all their firms are evil dragons worthy of being slain.

LINK TO LEARNING

Go to this U.S. Department of Labor website that lists all the laws under which whistleblowers have protection to learn more.

Blowing the whistle may bring the employee more than just intrinsic ethical rewards; it may also result in cash. The most lucrative law under which employees can blow the whistle is the False Claims Act (FCA), 31 U.S.C. §§ 3729–3733. This legislation was enacted in 1863, during the American Civil War, because Congress was worried that suppliers of goods to the Union Army might cheat the government. The FCA has been amended many times since then, and today it serves as a leading example of a statutory law that remains important after more than 150 years. The FCA provides that any person who knowingly submits false claims to the government must pay a civil penalty for each false claim, plus triple the amount of the government's damages. The amount of this basic civil penalty is regularly adjusted by the cost of living, and the current penalty range is from $5500 to $11,000.

More importantly for our discussion, the qui tam provision of the law allows private persons (called relators) to file lawsuits for violations of the FCA on behalf of the government and to receive part of any penalty imposed. The person bringing the action is a type of a whistleblower, but one who initiates legal action on his or her own rather than simply reporting it to a government agency. If the government believes it is a worthwhile case and intervenes in the lawsuit, then the relator (whistleblower) is entitled to receive between 15 and 25 percent of the amount the government recovers. If the government thinks winning is a long shot and declines to intervene in the lawsuit, the relator's share increases to 25 to 30 percent.

A few whistleblowers have become rich (and famous, thanks to an ABC News story), with awards ranging in the neighborhood of $100 million.[7] In 2012, a single whistleblower, Bradley Birkenfeld, a former

UBS employee, was awarded $104 million by the Internal Revenue Service (IRS), making him the most highly rewarded whistleblower in history. Birkenfeld also spent time in prison for participating in the tax fraud he reported. In 2009, ten former Pfizer employees were awarded $102 million for exposing an illegal promotion of prescription medications. John Kopchinski, the original whistleblower and one of the ten, received $50 million. In another case involving the health care company HCA, two employees who blew the whistle on Medicare fraud ended up receiving a combined total of $100 million.

It is not just the size of the reward that should get your attention but also the amount of money these employees saved taxpayers and/or shareholders. They turned in companies that were cheating the Centers for Medicare and Medicaid Services (affecting taxpayers), the IRS (affecting government revenues), and private health insurance (affecting premiums). The public saved far more than the reward paid to the whistleblowers.

Incredibly high rewards such as the aforementioned are somewhat unusual, but according to National Whistleblower Center director Stephen Kohn, "Birkenfeld's and Eckard's rewards act like advertisements for the U.S. government's whistleblower programs, which make hundreds of rewards every year."[8] The FCA is one of four laws under which whistleblowers can receive a reward; the others are administered by the IRS, the SEC, and the Commodity Futures Trading Commission. Most whistleblowers do not get paid until the lawsuit and all appeals have concluded and the full amount of any monetary penalty has been paid to the government. Many complex cases of business fraud can go on for several years before a verdict is rendered and appealed (or a settlement is reached). An employee whose identity has been disclosed and who has been unofficially blacklisted may not see any reward money for several years.

CASES FROM THE REAL WORLD

Sherron Watkins and Enron

Enron is one of the most infamous examples of corporate fraud in U.S. history. The scandal that destroyed the company resulted in approximately $60 billion in lost shareholder value. Sherron Watkins, an officer of the company, discovered the fraud and first went to her boss and mentor, founder and chairperson Ken Lay, to report the suspected accounting and financial irregularities. She was ignored more than once and eventually went to the press with her story. Because she did not go directly to the SEC, Watkins received no whistleblower protection. (The Sarbanes-Oxley Act was not passed until after the Enron scandal. In fact, it was Watkins's circumstance and Enron's misdeeds that helped convince Congress to pass the law.[9])

Now a respected national speaker on the topic of ethics and employees' responsibility, Watkins talks about how an employee should handle such situations. "When you're faced with something that really matters, if you're silent, you're starting on the wrong path . . . go against the crowd if need be," she said in a speech to the National Character and Leadership Symposium, (a seminar to instill leadership and moral qualities in young men and women).

Watkins talks openly about the risk of being an honest employee, something employees should consider when evaluating what they owe their company, the public, and themselves. "I will never have a job in corporate America again. The minute you speak truth to power and you're not heard, your career is never the same again."

Enron's corporate leaders dealt with the looming crisis by a combination of blaming others and leaving their employees to fend for themselves. According to Watkins, "Within two weeks of me finding this fraud, [Enron president] Jeff Skilling quit. We did feel like we were on a battleship, and things were not going well, and the captain had just taken a helicopter home. The fall of 2001 was just the bleakest time in my life, because everything I thought was secure was no longer secure."

Critical Thinking

- **Did Watkins owe an ethical duty to Enron, to its shareholders, or to the investing public to go public with her suspicions? Explain your answer.**
- **How big a price is it fair to ask a whistleblowing employee to pay?**

LINK TO LEARNING

Visit the National Whistleblower Center website and learn more about some of the individuals discussed in this chapter who became whistleblowers.

Watch this video about one of the most famous whistleblowers, Sherron Watkins, former vice president of Enron to learn more.

Sometimes employees, including managers, face an ethical dilemma that they seek to address from within rather than becoming a whistleblower. The risk is that they may be ignored or that their speaking up will be held against them. However, companies should want and expect employees to step forward and report wrongdoing to their superiors, and they should support that decision, not punish it. Sallie Krawcheck, a financial industry executive, was not a whistleblower in either the classical or the legal sense. She went to her boss with her discovery of wrongdoing at work, which means she had no legal protection under whistleblower statutes. Read her story in the following box.

CASES FROM THE REAL WORLD

Sallie Krawcheck and Merrill Lynch

Shortly after Sallie Krawcheck took over as chief of Merrill Lynch's wealth management division at Bank of America, she discovered that a mutual fund called the Stable Value Fund, a financial product Merrill had sold to customers as an investment for their 401k plans, was not as stable as its name implied. The team at Merrill had made a mistake by managing the fund in a way that assumed a higher risk than was acceptable to its investors, and the fund ended up losing much of its value. Unfortunately, because it was supposed to be a low-risk fund, the people who had invested in it, and who would suffer most from Merrill's mistakes, were earners of relatively modest incomes, including Walmart employees, who made up the largest group.

According to Krawcheck, she had two options. Option one was to say tough luck to the Stable Value Fund's investors, including the Walmart employees, explaining that all investments carry some degree of risk. Option two was to bail out the investors by pouring money into the fund to increase its value. Krawcheck had already been burned once by trying to be ethical. She had been head of CitiGroup's wealth management division (Smith Barney); in that capacity, she had made a decision to reimburse clients for some of their losses she felt were due to company mistakes. Rather than supporting her decision, however, CitiGroup terminated her, in large part for making the ethical decision rather than the profitable one. Now she was in the same predicament with a new company. Should Krawcheck risk her job again by choosing the ethical act, or should she make a purely financial decision and tell the 401k investors they would have to take the loss?

Krawcheck began talking to people inside and outside the company to see what they thought. Most told her to just keep her head down and do nothing. One "industry titan" told her there was nothing to be done, that everyone knows stable-value funds are not really stable. Unconvinced, Krawcheck took the problem to Bank of America's CEO. He agreed to back her up and put company money into the depleted stable-value funds to prop them up.

Krawcheck opted to be honest and ethical by helping the small investors and felt good about it. "I thought, ethical business was good business," she says. "It came down to my sense of purpose as well as my sense of my industry's purpose; it wasn't about some abstract ethical theorem . . . the answer wasn't that I got into the business simply to make a lot of money. It was because it was a business that I knew could have a positive impact on clients' lives."[10]

But the story does not really have a happy ending. Krawcheck writes that she thought at the time she had done the right thing and still had her job, a win/win outcome of a very tough ethical dilemma. However, speaking out did come at a cost. Krawcheck lost some important and powerful allies within the company, and although she did not lose her job at that time, she writes "the political damage was done; when that CEO retired, the clock began ticking down on my time at Bank of America, and before long I was 'reorganized out' of that role."[11]

Critical Thinking

- **Could you do what Sallie Krawcheck did and risk being fired a second time? Why or why not?**
- **Krawcheck went on to start her own firm, Ellevest, specializing in investments for female clients. Why do you think she chose this route rather than moving to another large Wall Street firm?**

WHAT WOULD YOU DO?

Underestimating and Overcharging

Suppose you are a supervising engineer at a small defense contractor of about one hundred employees. Your firm had barely been breaking even, but the recent award of a federal contract has dramatically turned the situation around. Midway through the new project, though, you realize that the principal partners in your firm have been overcharging the Department of Defense for services provided and components purchased. (You discovered this accidentally, and it would be difficult for anyone else to find it out.) You take this information to one of the principals, whom you know well and respect. He tells you apologetically that the overcharges became necessary when the firm seriously underestimated total project costs in its bid on the contract. If the overcharges do not continue, the firm will again be perilously close to bankruptcy.

You know the firm has long struggled to remain financially viable. Furthermore, you have great confidence in the quality of the work your team is providing the government. Finally, you feel a special kinship with nearly all the employees and particularly with the founding partners, so you are loath to take your evidence to the government.

Critical Thinking

What are you going to do? Will you swallow your discomfort because making the overcharges public may very well put your job and those of one hundred friends and colleagues at risk? Would the overall quality of the firm's work on the contract persuade you it is worth what it is charging? Or would you decide that fraud is never permissible, even if its disclosure comes at the cost of the survivability of the

firm and the friendships you have within it? Explain your reasoning.

26. Diversity and Inclusion in the Workforce

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Explain the benefits of employee diversity in the workplace**
- **Discuss the challenges presented by workplace diversity**

Diversity is not simply a box to be checked; rather, it is an approach to business that unites ethical management and high performance. Business leaders in the global economy recognize the benefits of a diverse workforce and see it as an organizational strength, not as a mere slogan or a form of regulatory compliance with the law. They recognize that diversity can enhance performance and drive innovation; conversely, adhering to the traditional business practices of the past can cost them talented employees and loyal customers.

A study by global management consulting firm McKinsey & Company indicates that businesses with gender and ethnic diversity outperform others. According to Mike Dillon, chief diversity and inclusion officer for PwC in San Francisco, “attracting, retaining and developing a diverse group of professionals stirs innovation and drives growth.”[1] Living this goal means not only recruiting, hiring, and training talent from a wide demographic spectrum but also including all employees in every aspect of the organization.

Workplace Diversity

The twenty-first century workplace features much greater diversity than was common even a couple of generations ago. Individuals who might once have faced employment challenges because of religious beliefs, ability differences, or sexual orientation now regularly join their peers in interview pools and on the job. Each may bring a new outlook and different information to the table; employees can no longer take for granted that their coworkers think the same way they do. This pushes them to question their own assumptions, expand their understanding, and appreciate alternate viewpoints. The result is more creative ideas, approaches, and solutions. Thus, diversity may also enhance corporate decision-making.

Communicating with those who differ from us may require us to make an extra effort and even change our viewpoint, but it leads to better collaboration and more favorable outcomes overall, according to David Rock, director of the Neuro-Leadership Institute in New York City, who says diverse coworkers “challenge their own and others’ thinking.”[2] According to the Society for Human Resource Management (SHRM), organizational diversity now includes more than just racial, gender, and religious differences. It also encompasses different thinking styles and personality types, as well as other factors such as physical and cognitive abilities and sexual orientation, all of which influence the way people perceive the world. “Finding the right mix of individuals to work on teams, and creating the conditions in which they can excel, are key business goals for today’s leaders, given that collaboration has become a paradigm of the twenty-first century workplace,” according to an SHRM article.[3]

Attracting workers who are not all alike is an important first step in the process of achieving greater diversity. However, managers cannot stop there. Their goals must also encompass inclusion, or the engagement of all employees in the corporate culture. “The far bigger challenge is how people interact with each other once they’re on the job,” says Howard J. Ross, founder and chief learning officer at Cook Ross, a consulting firm specializing in diversity. “Diversity is being invited to the party; inclusion is being asked to dance. Diversity is about the ingredients, the mix of people and perspectives. Inclusion is about the container—the place that allows employees to feel they belong, to feel both accepted and different.”[4]

Workplace diversity is not a new policy idea; its origins date back to at least the passage of the Civil Rights Act of 1964 (CRA) or before. Census figures show that women made up less than 29 percent of the civilian workforce when Congress passed Title VII of the CRA prohibiting workplace discrimination. After passage of the law, gender diversity in the workplace expanded significantly. According to the U.S. Bureau of Labor Statistics (BLS), the percentage of women in the labor force increased from 48 percent in 1977 to a peak of 60 percent in 1999. Over the last five years, the percentage has held relatively steady at 57 percent. Over the past forty years, the total number of women in the labor force has risen from 41 million in 1977 to 71 million in 2017.[5] The BLS projects that the number of women in the U.S. labor force will reach 92 million in 2050 (an increase that far outstrips population growth).

The statistical data show a similar trend for African American, Asian American, and Hispanic workers (Figure 27.1). Just before passage of the CRA in 1964, the percentages of minorities in the official on-the-books workforce were relatively small compared with their representation in the total population. In 1966, Asians accounted for just 0.5 percent of private-sector employment, with Hispanics at 2.5 percent and African Americans at 8.2 percent.[6] However, Hispanic employment numbers have significantly increased since the CRA became law; they are expected to more than double from 15 percent in 2010 to 30 percent of the labor force in 2050. Similarly, Asian Americans are projected to increase their share from 5 to 8 percent between 2010 and 2050.

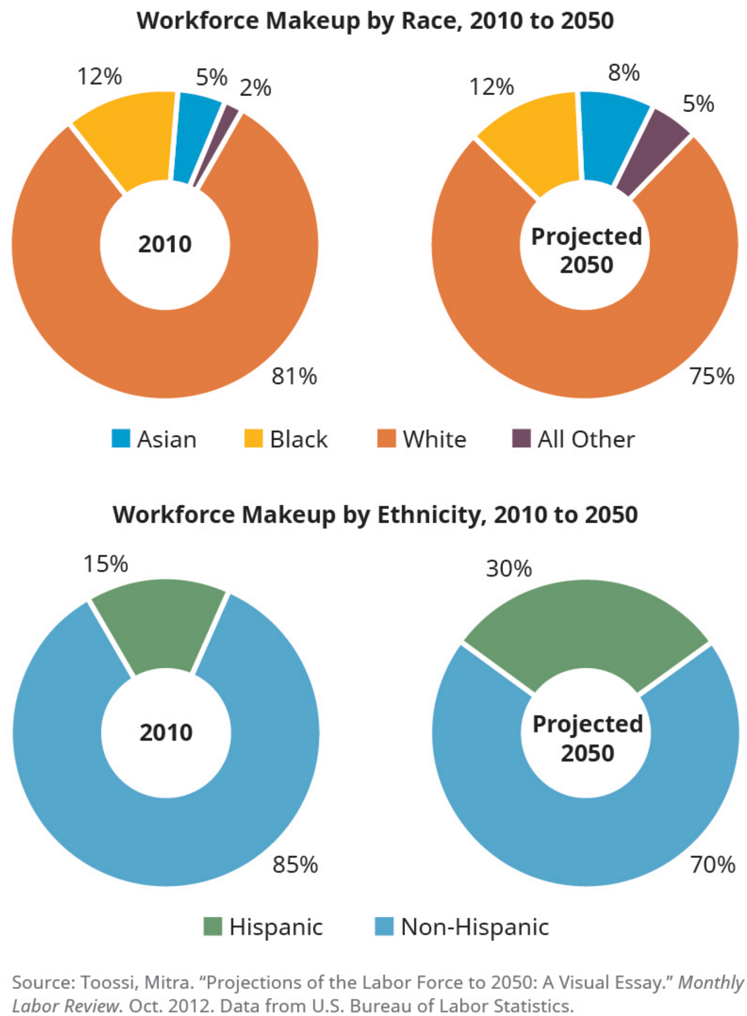


Figure 27.1 There is a distinct contrast in workforce demographics between 2010 and projected numbers for 2050. (credit: attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Much more progress remains to be made, however. For example, many people think of the technology sector as the workplace of open-minded millennials. Yet Google, as one example of a large and successful company, revealed in its latest diversity statistics that its progress toward a more inclusive workforce may be steady but it is very slow. Men still account for the great majority of employees at the corporation; only about 30 percent are women, and women fill fewer than 20 percent of Google's technical roles (Figure 27.2). The company has shown a similar lack of gender diversity in leadership roles, where women hold fewer than 25 percent of positions. Despite modest progress, an ocean-sized gap remains to be narrowed. When it comes to ethnicity, approximately 56 percent of Google employees are white. About 35 percent are Asian, 3.5 percent are Latino, and 2.4 percent are black, and of the company's management and leadership roles, 68 percent are held by whites.[7]

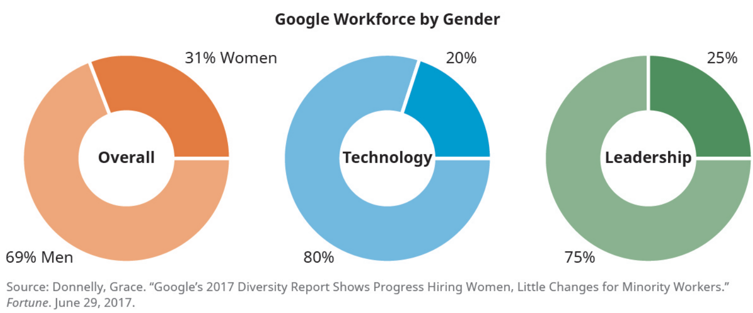


Figure 27.2 Google is emblematic of the technology sector, and this graphic shows just how far from equality and diversity the industry remains. (credit: attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Google is not alone in coming up short on diversity. Recruiting and hiring a diverse workforce has been a challenge for most major technology companies, including Facebook, Apple, and Yahoo (now owned by Verizon); all have reported gender and ethnic shortfalls in their workforces.

The Equal Employment Opportunity Commission (EEOC) has made available 2014 data comparing the participation of women and minorities in the high-technology sector with their participation in U.S. private-sector employment overall, and the results show the technology sector still lags.[8] Compared with all private-sector industries, the high-technology industry employs a larger share of whites (68.5%), Asian Americans (14%), and men (64%), and a smaller share of African Americans (7.4%), Latinos (8%), and women (36%). Whites also represent a much higher share of those in the executive category (83.3%), whereas other groups hold a significantly lower share, including African Americans (2%), Latinos (3.1%), and Asian Americans (10.6%). In addition, and perhaps not surprisingly, 80 percent of executives are men and only 20 percent are women. This compares negatively with all other private-sector industries, in which 70 percent of executives are men and 30 percent women.

Technology companies are generally not trying to hide the problem. Many have been publicly releasing diversity statistics since 2014, and they have been vocal about their intentions to close diversity gaps. More than thirty technology companies, including Intel, Spotify, Lyft, Airbnb, and Pinterest, each signed a written pledge to increase workforce diversity and inclusion, and Google pledged to spend more than $100 million to address diversity issues.[9]

Diversity and inclusion are positive steps for business organizations, and despite their sometimes slow pace, the majority are moving in the right direction. Diversity strengthens the company's internal relationships with employees and improves employee morale, as well as its external relationships with customer groups. Communication, a core value of most successful businesses, becomes more effective with a diverse workforce. Performance improves for multiple reasons, not the least of which is that acknowledging diversity and respecting differences is the ethical thing to do.[10]

Adding Value through Diversity

Diversity need not be a financial drag on a company, measured as a cost of compliance with no return on the investment. A recent McKinsey & Company study concluded that companies that adopt diversity policies do well financially, realizing what is sometimes called a diversity dividend. The study results demonstrated a statistically significant relationship of better financial performance from companies with a more diverse leadership team, as indicated in Figure 27.3. Companies in the top 25 percent in terms of gender diversity were 15 percent more likely to post financial returns above their industry median in the United States. Likewise, companies in the top 25 percent of racial and/or ethnic diversity were 35 percent more likely to show returns exceeding their respective industry median.[11]

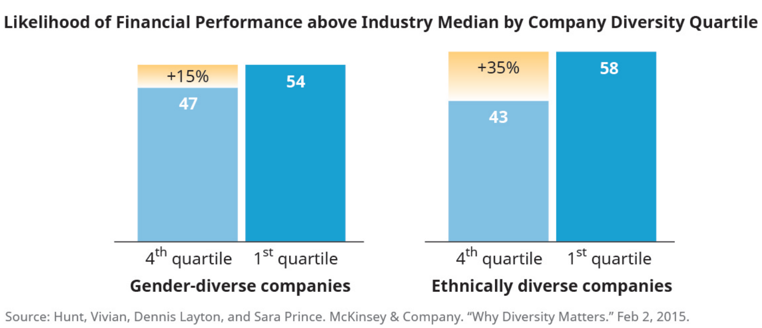


Figure 27.3 Companies with gender and ethnic diversity generally outperform those without it. (credit: attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

These results demonstrate a positive correlation between diversity and performance, rebutting any claim that affirmative action and other such programs are social engineering that constitutes a financial drag on earnings. In fact, the results reveal a negative correlation between performance and lack of diversity, with companies in the bottom 25 percent for gender and ethnicity or race proving to be statistically less likely to achieve above-average financial returns than the average companies. Non-diverse companies were not leaders in performance indicators. Positive correlations do not equal causation, of course, and greater gender and ethnic diversity do not automatically translate into profit. Rather, as this chapter shows, they enhance creativity and decision-making, employee satisfaction, an ethical work environment, and customer goodwill, all of which, in turn, improve operations and boost performance.

Diversity is not a concept that matters only for the rank-and-file workforce; it makes a difference at all levels of an organization. The McKinsey & Company study, which examined twenty thousand firms in ninety countries, also found that companies in the top 25 percent for executive and/or board diversity had returns on equity more than 50 percent higher than those companies that ranked in the lowest 25 percent. Companies with a higher percentage of female executives tended to be more profitable.[12]

LINK TO LEARNING

Read the working paper "Is Gender Diversity Profitable? Evidence from a Global Survey," from the Peterson Institute for International Economics for a closer look at the profitability of gender

Achieving equal representation in employment based on demographic data is the ethical thing to do because it represents the essential American ideal of equal opportunity for all. It is a basic assumption of an egalitarian society that all have the same chance without being hindered by immutable characteristics. However, there are also directly relevant business reasons to do it. More diverse companies perform better, as we saw earlier in this chapter, but why? The reasons are intriguing and complex. Among them are that diversity improves a company's chances of attracting top talent and that considering all points of view may lead to better decision-making. Diversity also improves customer experience and employee satisfaction.

To achieve improved results, companies need to expand their definition of diversity beyond race and gender. For example, differences in age, experience, and country of residence may result in a more refined global mind-set and cultural fluency, which can help companies succeed in international business. A salesperson may know the language of customers or potential customers from a specific region or country, for example, or a customer service representative may understand the norms of another culture. Diverse product-development teams can grasp what a group of customers may want that is not currently being offered.

Resorting to the same approaches repeatedly is not likely to result in breakthrough solutions. Diversity, however, provides usefully divergent perspectives on the business challenges companies face. New ideas help solve old problems—another way diversity makes a positive contribution to the bottom line.

The Challenges of a Diverse Workforce

Diversity is not always an instant success; it can sometimes introduce workplace tensions and lead to significant challenges for a business to address. Some employees simply are slow to come around to a greater appreciation of the value of diversity because they may never have considered this perspective before. Others may be prejudiced and consequently attempt to undermine the success of diversity initiatives in general. In 2017, for example, a senior software engineer's memo criticizing Google's diversity initiatives was leaked, creating significant protests on social media and adverse publicity in national news outlets.[13] The memo asserted "biological causes" and "men's higher drive for status" to account for women's unequal representation in Google's technology departments and leadership.

Google's response was quick. The engineer was fired, and statements were released emphasizing the company's commitment to diversity.[14] Although Google was applauded for its quick response, however, some argued that an employee should be free to express personal opinions without punishment (despite the fact that there is no right of free speech while at work in the private sector).

In the latest development, the fired engineer and a coworker filed a class-action lawsuit against Google on behalf of three specific groups of employees who claim they have been discriminated against by Google: whites, conservatives, and men.[15] This is not just the standard "reverse discrimination" lawsuit; it goes to the heart of the culture of diversity and one of its greatest challenges for management—the backlash against change.

In February 2018, the National Labor Relations Board ruled that Google's termination of the engineer did not violate federal labor law[16] and that Google had discharged the employee only for inappropriate but unprotected conduct or speech that demeaned women and had no relationship to any terms of employment. Although this ruling settles the administrative labor law aspect of the case, it has no effect on the private wrongful termination lawsuit filed by the engineer, which is still proceeding.

Yet other employees are resistant to change in whatever form it takes. As inclusion initiatives and considerations of diversity become more prominent in employment practices, wise leaders should be prepared to fully explain the advantages to the company of greater diversity in the workforce as well as making the appropriate accommodations to support it. Accommodations can take various forms. For example, if you hire more women, should you change the way you run meetings so everyone has a chance to be heard? Have you recognized that women returning to work after childrearing may bring improved skills such as time management or the ability to work well under pressure? If you are hiring more people of different faiths, should you set aside a prayer room? Should you give out tickets to football games as incentives? Or build team spirit with trips to a local bar? Your managers may need to accept that these initiatives may not suit everyone. Adherents of some faiths may abstain from alcohol, and some people prefer cultural events to sports. Many might welcome a menu of perquisites ("perks") from which to choose, and these will not necessarily be the ones that were valued in the past. Mentoring new and diverse peers can help erase bias and overcome preconceptions about others. However, all levels of a company must be engaged in achieving diversity, and all must work together to overcome resistance.

LINK TO LEARNING

Read this article for strategies on overcoming gendered meeting dynamics in the workplace from the Harvard Business Review.

CASES FROM THE REAL WORLD

Companies with Diverse Workforces

Texas Health Resources, a Dallas-area healthcare and hospital company, ranked No. 1 among Fortune's Best Workplaces for Diversity and No. 2 for Best Workplaces for African Americans.[17] Texas Health employs a diverse workforce that is about 75 percent female and 40 percent minority. The company goes above and beyond by offering English classes for Hispanic workers and hosting several dozen social and professional events each year to support networking and connections among peers with different backgrounds. It also offers same-sex partner benefits; approximately 3 percent of its workforce identifies as LGBTQ (lesbian, gay, bisexual, transgender, queer or questioning).

Another company receiving recognition is Marriott International, ranked No. 6 among Best Workplaces for Diversity and No. 7 among Best Workplaces for African Americans and for Latinos. African American, Latino, and other ethnic minorities account for about 65 percent of Marriott's 100,000 employees, and 15 percent of its executives are minorities. Marriott's president and CEO, Arne Sorenson, is recognized as an advocate for LGBTQ equality in the workplace, published an open letter on LinkedIn expressing his support for diversity and entreating then president-elect Donald Trump to use his position to advocate for inclusiveness. “Everyone, no matter their sexual orientation or identity, gender, race, religion disability or ethnicity should have an equal opportunity to get a job, start a business or be served by a business,” Sorenson wrote. “Use your leadership to minimize divisiveness around these areas by letting people live their lives and by ensuring that they are treated equally in the public square.”[18]

Critical Thinking

Is it possible that Texas Health and Marriott rank highly for diversity because the hospitality and healthcare industries tend to hire more women and minorities in general? Why or why not?

27. Accommodating Different Abilities and Faiths

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Identify workplace accommodations often provided for persons with differing abilities**
- **Describe workplace accommodations made for religious reasons**

The traditional definition of diversity is broad, encompassing not only race, ethnicity, and gender but also religious beliefs, national origin, and cognitive and physical abilities as well as sexual preference or orientation. This section examines two of these categories, religion and ability, looking at how an ethical manager handles them as part of an overall diversity policy. In both cases, the concept of reasonable accommodation means an employer must try to allow for differences among the workforce.

Protections for People with Disabilities

In the United States, the Americans with Disabilities Act (ADA), passed in 1990, stipulates that a person has a disability if he or she has a physical or mental impairment that reduces participation in “a major life activity,” such as work. An employer may not discriminate in offering employment to an individual who is diagnosed as having such a disability. Furthermore, if employment is offered, the employer is obliged to make reasonable accommodations to enable him or her to carry out normal job tasks. Making reasonable accommodations may include altering the physical workplace so it is readily accessible, restructuring a job, providing or modifying equipment or devices, or offering part-time or modified work schedules. Other accommodations could include providing readers, interpreters, or other necessary forms of assistance such as an assistive animal (Figure 28.1). The ADA also prohibits discriminating against individuals with disabilities in providing access to government services, public accommodations, transportation, telecommunications, and other essential services. [1]

Figure 28.1 A person with a service dog can usually perform all the essential function of the job, with some assistance. (credit: "DSC_004" by Aberdeen Proving Ground/Flickr, CC BY 2.0)

Access and accommodation for employees with physical or mental disabilities are good for business because they expand the potential pool of good workers. It is also ethical to have compassion for those who want to work and be contributing members of society. This principle holds for customers as well as employees. Recognizing the need for protection in this area, the federal government has enacted several laws to provide it. The Disability Rights Division of the U.S. Department of Justice lists ten different federal laws protecting people with disabilities, including not only the ADA but also laws such as the Rehabilitation Act, the Air Carrier Access Act, and the Architectural Barriers Act.

LINK TO LEARNING

The EEOC is the primary federal agency responsible for enforcing the ADA (as well as Title VII of the Civil Rights Act of 1964, mentioned earlier in the chapter). It hears complaints, tries to settle cases through administrative action, and, if cases cannot be settled, works with the Department of Justice to file lawsuits against violators. Visit the EEOC website to learn more.

A key part of complying with the law is understanding and applying the concept of reasonableness: "An employer is required to provide a reasonable accommodation to a qualified applicant or employee with a disability unless the employer can show that the accommodation would be an undue hardship—that is, that it would require significant difficulty or expense."[2]

The law does not require an employee to refer to the ADA or to "disability" or "reasonable accommodation" when requesting some type of assistance. Managers need to be able to recognize the variety of ways in which a request for an accommodation is communicated. For example, an employee might not specifically say, "I need a reasonable accommodation for my disability" but rather, "I'm having a hard time getting to work on time because of the medical treatments I'm undergoing." This example demonstrates a challenge employers may face under the ADA in properly identifying requests for accommodation.

CASES FROM THE REAL WORLD

The ADA and Verizon Attendance Policy

Managers are usually sticklers about attendance, but Verizon recently learned an expensive lesson about its mandatory attendance policies from a 2011 class action lawsuit by employees and the EEOC. The suit asserted that Verizon denied reasonable accommodations to several hundred employees, disciplining or firing them for missing too many days of work and refusing to make exceptions for those whose absences were caused by their disabilities. According to the EEOC, Verizon violated the ADA because its no-fault attendance policy was an inflexible and “unreasonable” one-size-fits-all rule.

The EEOC required Verizon to pay $20 million to settle the suit, the largest single disability discrimination settlement in the agency’s history. The settlement also forced Verizon to change its attendance policy to include reasonable accommodations for persons with disabilities. A third requirement was that Verizon provide regular training on ADA requirements to all mangers responsible for administering attendance policies.

Critical Thinking

- **What are some specific rules that would fit within a fair and reasonable attendance policy?**
- **How would you decide whether an employee was taking advantage of an absenteeism policy?**

Managing Religious Diversity in the Workplace

Title VII of the CRA, which governs nondiscrimination, applies the same rules to the religious beliefs (or nonbeliefs) of employees and job applicants as it does to race, gender, and other categories. The essence of the law mandates four tenets that all employers should follow: nondiscrimination, nonharassment, non-retaliation, and reasonable accommodation.

Regulations require that an employee notify the employer of a bonafide religious belief for which he or she wants protection, but the employee need not expressly request a specific accommodation. The employer must consider all possible accommodations that do not require violating the individual's beliefs and/or practices, such as allowing time off (Figure 28.2). However, the accommodation need not pose undue hardship on the firm, in terms of either scheduling or financial sacrifice. The employer must present proof of hardship if it decides it cannot offer an accommodation.

Figure 28.2 This calendar shows the significant number of holidays and observances an employer must consider with regard to time-off policies, including holidays of the three major religions, secular days, and other traditional days off. It may be a challenge to give everyone all preferred days off. (credit: modification of "2019 Calendar" by "Firkin"/openclipart, Public Domain)

Some cases of accommodation are based on cultural heritage rather than religion.

WHAT WOULD YOU DO?

Can Everyone's Wishes Be Accommodated?

You are a manager in a large Texas-based oil and gas company planning an annual summer company picnic and barbecue on the weekend of June 19. The oil industry has a long tradition of outdoor barbecues, and this one is a big morale-building event. However, June 19 is "Juneteenth," the day on which news of the Emancipation Proclamation reached slaves in Texas in 1865. Several African American employees always attend the barbecue event and are looking forward to it, but they also want to celebrate Emancipation Day, rich in history and culture and accompanied by its own official event. The picnic date cannot be easily rescheduled because of all the catering arrangements that had to be made.

Critical Thinking

- **Is there a way to permit some employees to celebrate both occasions without inconveniencing others who will be attending only one?**
- **What would you do as the manager, keeping in mind that you do not want to offend anyone?**

Reasonable accommodation may require more than just a couple of hours off to go to weekly worship or to celebrate a holiday. It may extend to dress and uniform requirements, grooming rules, work rules and responsibilities, religious expression and displays, prayer or meditation rooms, and dietary issues.

LINK TO LEARNING

The Sikh faith dates to roughly the fourteenth century in India. Its practitioners have made their way to many Western nations, including the United Kingdom, Canada, Italy, and the United States. Sikhs in the West have experienced discrimination due to the distinctive turbans adult males wear, which are sometimes mistaken for Islamic apparel. Men are also required to wear a dagger called a 'kirpan.' California law permits religious observers to wear a sheathed dagger openly, but not hidden away. Watch this video showing a San Joaquin County Sheriff's sergeant explaining the accommodation given to Sikhs to wear a kirpan in public to learn more. How comfortable are you with permitting daggers to be carried openly in the workplace?

The law also protects those who do not have traditional beliefs. In Welsh v. United States (1970), the Supreme Court ruled that any belief occupying "a place parallel to that filled by the God of those admittedly qualifying for the exception" is covered by the law.[3] A nontheistic value system consisting of personal, moral, or ethical beliefs that is sincerely held with the strength of traditional religious views is deserving of protection. Protected individuals need not have a religion; indeed, if atheist or agnostic, they may have no religion at all.

Religion has become a hot-button issue for some political groups in the United States. Religious tolerance is the official national policy enshrined in the Constitution, but it has come under attack by some who want to label the United States an exclusively Christian nation.

CASES FROM THE REAL WORLD

The Abercrombie & Fitch Religious Discrimination Case

The U.S. Supreme Court, in a 2015 case involving Abercrombie & Fitch, ruled that that "an employer may not refuse to hire an applicant for work if the employer was motivated by avoiding the need to accommodate a religious practice," and that doing so violates the prohibition against religious discrimination contained in the CRA of 1964, Title VII. According to the EEOC general counsel David Lopez, "This case is about defending the American principles of religious freedom and tolerance. This decision is a victory for our increasingly diverse society."[4]

The case arose when, as part of her Muslim faith, a teenage girl named Samantha Elauf wore a hijab (headscarf) to a job interview with Abercrombie & Fitch. Elauf was denied a job because she did not conform to the company's "Look Policy," which Abercrombie claimed banned head coverings. Elauf filed a complaint with the EEOC alleging religious discrimination, and the EEOC, in turn, filed suit against Abercrombie & Fitch, alleging it refused to hire Elauf because of her religious beliefs and failed to accommodate her by making an exception to its "Look Policy."

"I was a teenager who loved fashion and was eager to work for Abercrombie & Fitch," said Elauf. "Observance of my faith should not have prevented me from getting a job. I am glad that I stood up for my rights, and happy that the EEOC was there for me and took my complaint to the courts. I am grateful to the Supreme Court for the decision and hope that other people realize that this type of discrimination is wrong and the EEOC is there to help."[5]

Critical Thinking

- **Does a retail clothing store have an interest in employee appearance that it can justify in terms of customer sales?**
- **Does it matter to you what a sales associate looks like when you shop for clothes? Why or why not?**

28. Sexual Identification and Orientation

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Explain how sexual identification and orientation are protected by law**
- **Discuss the ethical issues raised in the workplace by differences in sexual identification and orientation**

As society expands its understanding and appreciation of sexual orientation and identity, companies and managers must adopt a more inclusive perspective that keeps pace with evolving norms. Successful managers are those who willing to create a more welcoming work environment for all employees, given the wide array of sexual orientations and identities evident today.

Legal Protections

Workplace discrimination in this area means treating someone differently solely because of his or her sexual identification or sexual orientation, which can include, but is not limited to, identification as gay or lesbian (homosexual), bisexual, transsexual, or straight (heterosexual). Discrimination may also be based on an individual's association with someone of a different sexual orientation. Forms that such discrimination may take in the workplace include denial of opportunities, termination, and sexual assault, as well as the use of offensive terms, stereotyping, and other harassment.

Although the U.S. Supreme Court ruled in United States v. Windsor (2013) that Section 3 of the 1996 Defense of Marriage Act (which had restricted the federal interpretations of "marriage" and "spouse" to opposite-sex unions) was unconstitutional, and guaranteed same-sex couples the right to marry in Obergefell v. Hodges (2015),[1] marital status has little or no direct applicability to the circumstances of someone's employment. In terms of legal protections at work, the LGBTQ community is at a disadvantage because Title VII of the CRA does not address sexual orientation and federal law does not prohibit discrimination based on this characteristic. As of January 2018, twenty states prohibit sexual orientation discrimination in private and public workplaces and five more states prohibit sexual orientation discrimination only in public workplaces, not private (Figure 29.1).[2]

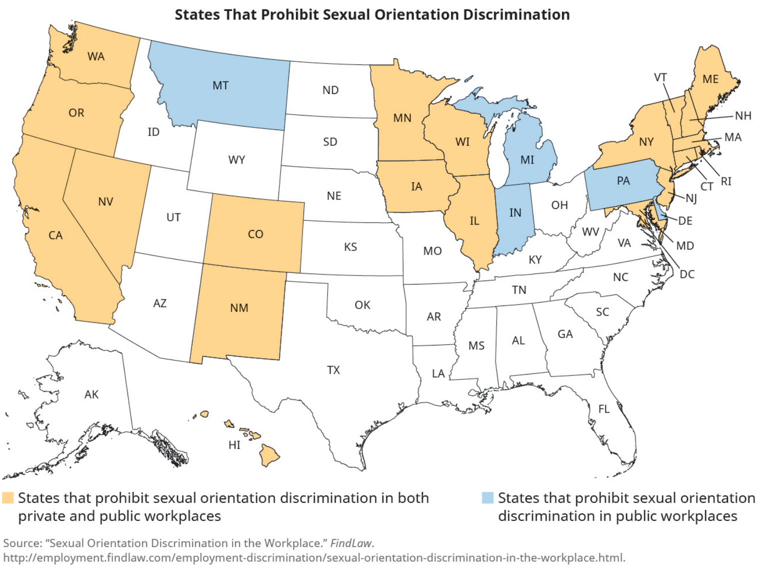


Figure 29.1 State law in the United States varies in terms of protections and guarantees extended to LGBTQ employees of private companies. The geographic locations granting protection are clustered around the states that tend to vote for the Democratic party in national elections, with very little protection in the Great Plains or South. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

In those states that do not have applicable state laws, employees risk adverse employment action simply for their LGBTQ status or for being married to a same-sex partner. Although legislation to address these circumstances has been introduced in Congress in previous sessions, none of the bills has yet passed. For example, a proposed law named the Equality Act is a federal LGBTQ nondiscrimination bill that would provide protections for LGBTQ individuals in employment, housing, credit, and education. But unless and until it passes, it remains up to the business community to provide protections consistent with those provided under federal law for other employees or applicants.

Ethical Considerations

In the absence of a specific law, LGBTQ issues present a unique opportunity for ethical leadership. Many companies choose to do the ethically and socially responsible thing and treat all workers equally, for example, by extending the same benefits to same-sex partners that they extend to heterosexual spouses. Ethical leaders are also willing to listen and be considerate when dealing with employees who may still be coming to an understanding of their sexual identification.

Financial and performance-related considerations come into play as well. Denver Investments recently analyzed the stock performance of companies before and after their adoption of LGBTQ-inclusive workplace policies.[3] The number of companies outperforming their peers in various industries increased after companies adopted LGBTQ-inclusive workplace policies. Once again, being ethical does not mean losing money or performing poorly.

In fact, states that have passed legislation considered anti-LGBTQ by the wider U.S. community, such as the Religious Freedom Restoration Act in Indiana or North Carolina's H.B. 2, the infamous "bathroom bill" that would require transgender individuals to use the restroom corresponding with their birth certificate, have experienced significant economic pushback. These states have seen statewide and targeted boycotts by consumers, major corporations, national organizations such as the National Collegiate Athletic Association, and even other cities and states.[4] In 2016, in response to H.B. 2, nearly seventy large U.S. companies, including American Airlines, Apple, DuPont, General Electric, IBM, Morgan Stanley, and Wal-Mart, signed an amicus ("friend of the court") brief in opposition to the unpopular North Carolina bill.[5] Indiana's Religious Freedom Restoration Act evoked a similar backlash in 2015 and public criticism from U.S. businesses.

To assess LGBTQ equality policies at a corporate level, the Human

Rights Campaign foundation publishes an annual Corporate Equality Index (CEI) of approximately one thousand large U.S. companies and scores each on a scale of 0 to 100 on the basis of how LGBTW-friendly its benefits and employment policies are (Figure 29.2). More than six hundred companies recently earned a perfect score in the 2018 CEI, including such household names as AT&T, Boeing, Coca-Cola, Gap Inc., General Motors, Johnson & Johnson, Kellogg, United Parcel Service, and Xerox.[6]

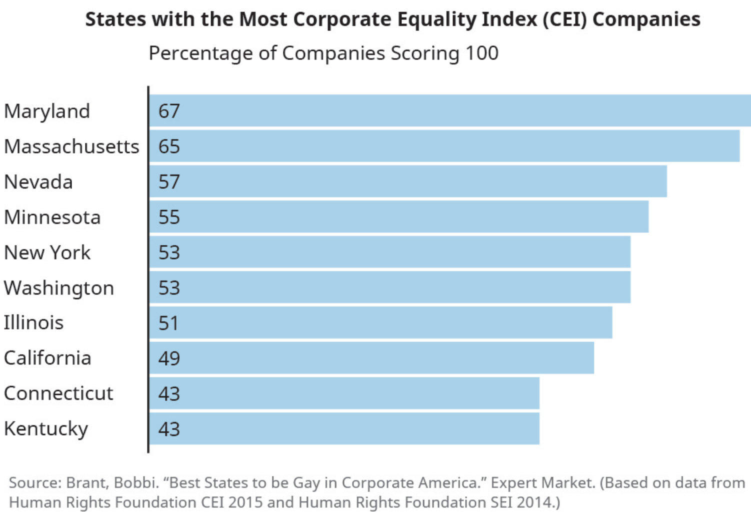


Figure 29.2 The Human Rights Campaign Foundation publishes an annual Corporate Equality Index to assess the LGBTQ equality policies of major U.S. corporations. A perfect score on the index is 100. These are the ten states with the highest percentages of "100 score" companies as of 2014–2015. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

LINK TO LEARNING

Read the Human Rights Campaign's 2018 report for more on the Human Rights Campaign's CEI and its criteria.

Another organization tracking LGBTQ equality and inclusion in the workplace is the National LGBT Chamber of Commerce, which issues third-party certification for businesses that are majority-owned by LGBT individuals. There are currently more than one thousand LGBT-certified business enterprises across the country, although California, New York, Texas, Florida, and Georgia account for approximately 50 percent of them. Although these are all top-ranked states for new business startups in general, they are also home to multiple Fortune 500 companies whose diversity programs encourage LGBT-certified businesses to become part of their supply chains. Examples of large LGBT-friendly companies with headquarters in these states are American Airlines, JPMorgan Chase, SunTrust Bank, and Pacific Gas & Electric.

29. Income Inequalities

LEARNING OBJECTIVES

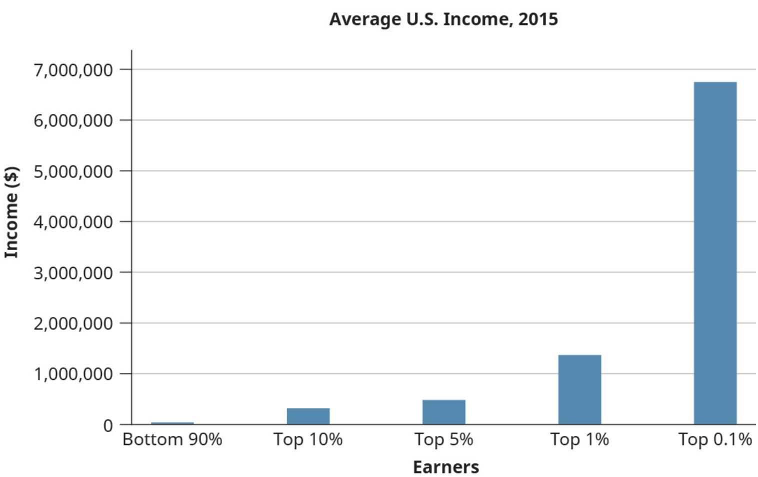
By the end of this section, you will be able to:

- **Explain why income inequality is a problem for the United States and the world**
- **Analyze the effects of income inequality on the middle class**
- **Describe possible solutions to the problem of income inequality**

The gap in earnings between the United States' affluent upper class and the rest of the country continues to grow every year. The imbalance in the distribution of income among the participants of an economy, or income inequality, is an enormous challenge for U.S. businesses and for society. The middle class, often called the engine of growth and prosperity, is shrinking, and new ethical, cultural, and economic problems are following from that change. Some identify income inequality as an ethical problem, some as an economic problem. Perhaps it is both. This section will address income inequality and the way it affects U.S. businesses and consumers.

The Middle Class in the United States

Data collected by economic researchers at the University of California show that income disparities have become more pronounced over the past thirty-five years, with the top 10 percent of income earners averaging ten times as much income as the bottom 90 percent, and the top 1 percent making more than forty times what the bottom 90 percent does.[1] The percentage of total U.S. income earned by the top 1 percent increased from 8 percent to 22 percent during this period. Figure 30.1 indicates the disparity as of 2015.



Source: Saez, Emmanuel. "Income and Wealth Inequality: Evidence and Policy Implications." *Contemporary Economic Policy* 35, no. 1 (Jan 2017): 7–25.

Figure 30.1 The 2015 data show the significant income disparity existing in the United States today—a gap that has increased significantly since 1980. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The U.S. economy was built largely on the premise of an expanding and prosperous middle class to which everyone had a chance of belonging. This ideal set the United States apart from other countries, in its own eyes and those of the world. In the years after World War II, the GI Bill and returning prosperity provided veterans with money for education, home mortgages, and even small businesses, all of which helped the economy grow. For the first time, many people could afford homes of their own, and residential home construction reached record rates. Families bought cars and opened credit card accounts. The culture of the middle class with picket fences, backyard barbecues, and black-and-white televisions had arrived. Television shows such as Leave it to Beaver and Father Knows Best reflected the "good life" desired by many in this newly emerging group. By the mid-1960s, middle-class wage earners were fast becoming the engine of the world's largest economy.

The middle class is not a homogenous group, however. For example, split fairly evenly between Democratic and Republican parties, the middle class helped elect Republican George W. Bush in 2004 and Democrat Barack Obama in 2008 and 2012. And, of course, a suburban house with a white picket fence represents a consumption economy, which is not everyone's idea of utopia, nor should it be. More importantly, not everyone had equal access to this ideal. But one thing almost everyone agrees on is that a shrinking middle class is not good for the economy. Data from the International Monetary Fund indicate the U.S. middle class is going in the wrong direction.[2] Only one-quarter of 1 percent of all U.S. households have moved up from the middle- to the upper-income bracket since 2000, while twelve times that many have slid to the lower-income bracket. That is a complete reversal from the period between 1970 and 2000, when middle-income households were more likely to move up than down. According to Business Insider, the U.S. middle class is "hollowing out, and it's hurting U.S. economic growth."[3]

Not only has the total wealth of middle-income families remained flat (Figure 30.2) but the overall percentage of middle-income households in the United States has shrunk from almost 60 percent in 1970 to only 47 percent in 2014, a very significant drop. Because consumers of comfortable means are a huge driver of the U.S.

economy, with their household consumption of goods and services like food, energy, and education making up more than two-thirds of the nation's gross domestic product (GDP), the downward trend is an economic challenge for corporate America and the government. Business must be part of the solution. But exactly what can U.S. companies do to help address income inequality?

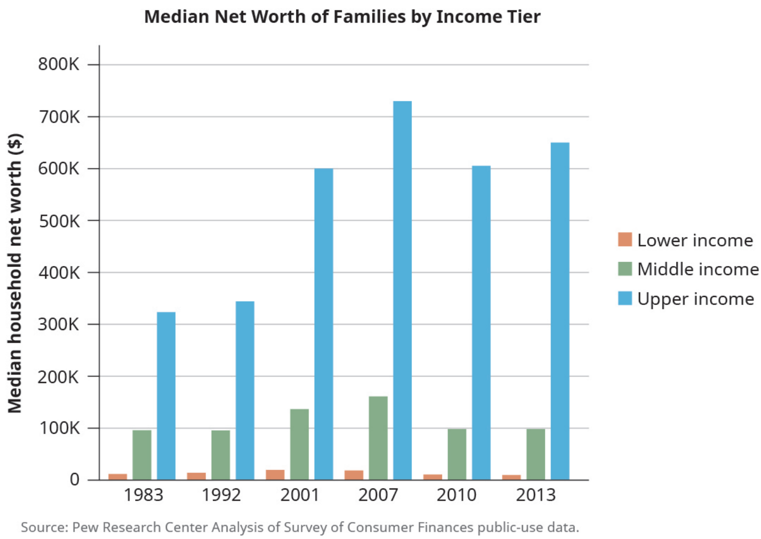


Figure 30.2 Lower- and middle-class wealth has remained stagnant or shrunk for the past thirty-five years while upper-class wealth has doubled. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Addressing Income Inequality

Robert Reich was U.S. Secretary of Labor from 1993 to 1997 and served in the administrations of three presidents (Gerald Ford, Jimmy Carter, and Bill Clinton). He is one of the nation's leading experts on the labor market and the economy and is currently the chancellor's professor of Public Policy at University of California, Berkeley, and a senior fellow at the Blum Center for Developing Economies. Reich recently told this story: "I was visited in my office by the chairman of one of the country's biggest high-tech firms. He wanted to talk about the causes and consequences of widening inequality and the shrinking middle class, and what to do about it." Reich asked the chairman why he was concerned. "Because the American middle class is the core of our customer base. If they can't afford our products in the years ahead, we're in deep trouble."[4]

Reich is hearing a similar concern from a growing number of business leaders, who see an economy that is leaving out too many people. Business leaders know the U.S. economy cannot grow when wages are declining, nor can their businesses succeed over the long term without a growing or at least a stable middle class. Other business leaders, such as Lloyd Blankfein, CEO of Goldman Sachs, have also said that income inequality is a negative development. Reich quoted Blankfein: "It is destabilizing the nation and is responsible for the divisions in the country . . . too much of the GDP over the last generation has gone to too few of the people."[5]

Some business leaders, such as Bill Gross, chair of the world's largest bond-trading firm, suggest raising the federal minimum wage, currently $7.25 per hour for all employers doing any type of business in interstate commerce (e.g., sending or receiving mail out of state) or for any company with more than $500,000 in sales. Many business leaders and economists agree that a higher minimum wage would help address at least part of the problem of income inequality; industrialized economies function best when income inequality is minimal, according to Gross and others who advocate for policies that bring the power of workers and corporations back into balance.[6] A hike in the minimum wage affects middle-class workers in two ways. First, it is a direct help to those who are part of a two-earner family at the lower end of the middle class, giving them more income to spend on necessities. Second, many higher-paid workers earn a wage that is tied to the minimum wage. Their salaries would increase as well.

Without congressional action to raise the minimum wage, states have taken the lead, along with businesses that are voluntarily raising their own minimum wage. Twenty-nine states have minimum wages that exceed the federal rate of $7.25 per hour. Costco, T.J. Maxx, Marshalls, Ikea, Starbucks, Gap, In-and-Out Burger, Whole Foods, Ben & Jerry's, Shake Shack, and McDonalds have also raised minimum wages in the past two years. Target recently announced a rise in its minimum wage to eleven dollars per hour, and banks, including Wells Fargo, PNC Financial Services, and Fifth Third Bank, announced a fifteen-dollar minimum wage.[7]

LINK TO LEARNING

Go to the National Conference of State Legislatures website for information about various laws in each state and to look up the minimum wage law in your state.

The American Sustainable Business Council, in conjunction with Business for a Fair Wage, surveyed more than five hundred small businesses, and the results were surprising. A clear majority (58%–66%, depending on region) supported raising the minimum wage to at least ten dollars per hour.[8] Business owners were not simply being ethical; most understand that their business would benefit from an increase in consumers' purchasing power, and that this, in turn, would help the general economy. Frank Knapp, CEO of the South Carolina Small Business Chamber of Commerce representing five thousand business owners, said a higher minimum wage "will put more money in the hands of 300,000 South Carolinians who make less than ten dollars per hour and they will spend it here in our local economies. This minimum wage increase will also benefit another 150,000 employees who will have their wages adjusted. The resulting net $500 million increase in state GDP will be good for small businesses and good for the economy of South Carolina."[9]

In addition to paying a higher wage, businesses can help workers move to, or stay in, the middle class in other ways. For decades, some companies have hired many full-time workers as independent contractors because it saves them money on a variety of employee benefits they do not have to offer as a result. However, that practice shifts the burden to the workers, who now have to pay the full cost of their health insurance, workers' compensation, unemployment benefits, time off, and payroll taxes. A recent Department of Labor study indicates that employer costs for employee compensation averaged $35.64 per hour worked in September 2017; wages and salaries averaged $24.33 per hour worked and accounted for 68 percent of these costs, whereas benefit costs averaged $11.31 and accounted for the remaining 32 percent.[10] That means if employees on the payroll were paid as independent contractors, their pay would effectively be about one-third less, assuming they purchased benefits on their own. The 30 percent difference companies save by hiring independent contractors is often the margin between being in the middle class and falling below it.

ETHICS ACROSS TIME AND CULTURES

Falling Out of the Middle Class

Imagine a child living in a house with no power for lights, heat, or cooking, embarrassed to invite friends over to play or study, and not understanding what happened to a once-normal life. This is a story many middle-class families in the United States think could happen only to someone else, never to them. However, an HBO documentary entitled American Winter suggests the opposite is true; many seemingly solid middle-class families can slip all too easily into the lower class, into poverty, in houses that are dark with empty refrigerators.

The film, set in Portland, Oregon, tells the story of an economic tragedy. Families that were once financially stable are now barely keeping their heads above water. A needed job was outsourced or given to an independent contractor, or a raise failed to come even as necessities kept getting more expensive. The families had to try to pay for healthcare or make a mortgage payment when their bank account was overdrawn. Once-proud middle-class workers talk about the shame of having to ask friends for help or turn to public assistance as a last resort. The fall of the U.S. middle class is more than a line on an economic chart; it is a cold reality for many families who never saw it coming.

Critical Thinking

- **Does a company have an ethical duty to find a balance between remaining profitable and paying all workers a decent living wage? Why or why not? Who decides what constitutes a fair wage?**
- **How would you explain to a board of directors your decision to pay entry-level workers a higher wage than required by law?**

Yet sympathy for raising the minimum wage at either the federal or state level to sustain the middle class or reduce poverty in general has not been unanimous. Indeed, some economists have questioned whether a positive correlation exists between greater wages and a lowering of the poverty rate. Representative of such thought is the work of David Neumark, an economist at the University of California, Irvine, and William L. Wascher, a long-time economic researcher on the staff of the Board of Governors of the Federal Reserve System. They argue that, however well-meaning such efforts might be, simply raising the minimum wage can be counterproductive to driving down poverty. Rather, they maintain, the right calculus for achieving this goal is much more complex. As they put it, "we are hard-pressed to imagine a compelling argument for a higher minimum wage when it neither helps low-income families nor reduces poverty." Instead, the federal and state governments should consider a series of steps, such as the Earned Income Tax Credit, that would be more effective in mitigating poverty.[11]

Pay Equity as a Corollary of Income Equality

The issue of income inequality is of particular significance as it relates to women. According to the World Economic Forum (WEF), gender inequality is strongly associated with income inequality.[12] The WEF studied the association between the two phenomena in 140 countries over the past twenty years and discovered they are linked virtually everywhere, not only in developing nations. The issue of pay discrimination is addressed elsewhere in this textbook; however, the issue merits mention here as a part of the bigger picture of equality in the workplace. Adding to the disparity in income between men and women is the reality that many women are single mothers with dependent children and sometimes grandchildren. Hence, any reduction in their earning power has direct implications for their dependents, too, constituting injustice to multiple generations.

According to multiple studies, including those by the American Association of University Women and the Pew Research Center, on average, women are paid approximately 80 percent of what men are paid.[13] Laws that attempt to address this issue have not eradicated the problem. A recent trend is to take legislative action at the state rather than the federal level. A New Jersey law, for example, was named the Diane B. Allen Equal Pay Act to honor a retired state senator who experienced pay discrimination.[14] It will be the strongest such law in the country, allowing victims of discrimination to seek redress for up to six years of underpayment, and monetary damages for a prevailing plaintiff will be tripled.

The most significant part of the law, however, is a seemingly small change in wording that will have a big impact. Rather than requiring "equal pay for equal work," as does the federal law and most state laws aimed at the gender wage gap, the Diane B. Allen Equal Pay Act will require "equal pay for substantially similar work." This means that if a New Jersey woman has a different title than her male colleague but performs the same kinds of tasks and has the same level of responsibility, she must be paid the same. The new law recognizes that slight differences in job titles are sometimes used to justify pay differences but in reality are often arbitrary.

Minnesota recently passed a similar law, but it applies only to state government employees, not private-sector workers. It mandates that women be paid the same for comparable jobs and analyzes the work performed on the basis of how much knowledge, problem solving, and responsibility is required, and on working conditions rather than merely on job titles.

Ethical business managers will see this trend as an effort to address an ethical issue that has existed for well over a century and will follow the lead of states such as New Jersey and Minnesota. A company can help solve this problem by changing the way it uses job titles and creating a compensation system built on the ideas behind these two laws, which focus on job characteristics and not titles.

30. Robotics, Artificial Intelligence, and the Workplace of the Future

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- **Discuss the application of robotics and the workplace changes it will bring**
- **Identify artificial intelligence applications in the workplace**
- **Explain the ethical challenges presented by the use of artificial intelligence**

As we have seen earlier in this chapter, general advances in computer technology have already enabled significant changes in the workplace. In this module, we will look at how future workforce demographics may be affected by existing and emerging technologies. The combination of automation and robotics has already changed not only the workplace but everyday life as well. It also comes with a host of ethical and legal issues, not least being where humans will fit in the workplace of tomorrow. Managers of the future may ask, “Does my company or society benefit from having a human do a job rather than a robot, or is it all about efficiency and cost?"

Robotics and Automation in the Workplace

Advances in the field of robotics—a combination of computer science, mechanical and electronics engineering, and science—have meant that machines or related forms of automation now do the work of humans in a wide variety of settings, such as medicine, where robots perform surgeries previously done by the surgeon's hand. Robots have made it easier and cheaper for employers to get work done. The downside, however, is that some reasonably well-paying jobs that provided middle-class employment for humans have become the province of machines.

A McKinsey Global Institute study of eight hundred occupations in nearly fifty countries showed that more than 800 million jobs, or 20 percent of the global workforce, could be lost to robotics by the year 2030.[1] The effects could be even more pronounced in wealthy industrialized nations, such as the United States and Germany, where researchers expect that up to one-third of the workforce will be affected. By 2030, the report estimates that 39 million to 73 million jobs may be eliminated in the United States. Given that the level of employment in the United States in mid-2018 is approaching 150 million workers, this potential loss of jobs represents roughly one-quarter to one-half of total current employment (but a smaller share of employment in 2030 because of future population and employment growth).

The big question, then, is what will happen to all these displaced workers. The McKinsey report estimates that about twenty million of them will be able to transfer easily to other industries for employment. But this still leaves between twenty million and more than fifty million displaced workers who will need new employment. Occupational retraining is likely to be a path taken by some, but older workers, as well as geographically immobile workers, are unlikely to opt for such training and may endure job loss for protracted periods.

In developing countries, the report predicts that the number of jobs requiring less education will shrink. Furthermore, robotics will have less impact in poorer countries because these nations' workers are already paid so little that employers will save less on labor costs by automating. According to the report, for example, by the same date of 2030, India is expected to lose only about 9 percent of its jobs to emerging technology.

Which occupations will be most heavily affected? Not surprisingly, the McKinsey report concludes that machine operators, factory workers, and food workers will be hit hardest, because robots can do their jobs more precisely and efficiently. "It's cheaper to buy a $35,000 robotic arm than it is to hire an employee who's inefficiently making $15 an hour bagging French fries," said a former McDonald's CEO in another article about the consequences of robots in the labor market.[2] He estimated that automation has already cut the number of people working in a McDonald's by half since the 1960s and that this trend will continue. Other hard-hit jobs will include mortgage brokers, paralegals, accountants, some office staff, cashiers, toll booth operators, and car and truck drivers. The Bureau of Labor Statistics (BLS) estimates that eighty thousand fast-food jobs will disappear by 2024. As growing numbers of retail stores like Walmart, CVS, and McDonald's provide automated self-checkout options, it has been estimated that 7.5 million retail jobs are at risk over the course of the next decade. Furthermore, it has been estimated that as self-driving cars and trucks replace automobile and truck drivers, five million jobs will be lost in the early 2020s.

Jobs requiring human interaction are typically at low risk for being replaced by automation. These include nurses and most physicians, lawyers, teachers, and bartenders, as well as social workers (estimated by the BLS to grow by 19 percent by 2024), hairstylists and cosmetologists, youth sports coaches, and songwriters. McKinsey also anticipates that specialized lower-wage jobs like gardening, plumbing, and care work will be less affected by automation.

The challenge to the economy, then, will be how to address the prospect of substantial job loss; about twenty million to fifty million people will not be able to easily find new jobs. The McKinsey report notes that new technology, as in the past, will generate new types of jobs. But this is unlikely to help more than a small fraction of those confronting unemployment. So the United States will likely face some combination of rapidly rising unemployment, an urgent need to retrain twenty million or more workers, and recourse to policies whereby the government serves as an employer of last resort.

ETHICS ACROSS TIME AND CULTURES

Advances in Robotics in Japan

Japan has long maintained its position as the world's top exporter of robots, selling nearly 50 percent of the global market share in terms of both units and dollar value. At first, Japan's robots were found mainly in factories making automobiles and electronic equipment, performing simple jobs such as assembling parts. Now Japan is poised to take the lead by putting robots in diverse areas including aeronautics, medicine, disaster mitigation, and search and rescue, performing jobs that human either cannot or, for safety reasons (such as defusing a bomb), should not do. Leading universities such as the University of Tokyo offer advanced programs to teach students not only how to create robots but also how to understand the way robot technology is transforming Japanese society. Universities, research institutions, corporations, and government entities are collaborating to implement the country's next generation of advanced artificial intelligence robot technology, because Japan truly sees the rise of robotics as the "Fourth Industrial Revolution."

New uses of robots include hazardous cleanup in the wake of the 2011 earthquake and tsunami disaster that destroyed the Fukushima Daiichi nuclear power plant. After those events, Japan accelerated its development and application of disaster-response robots to go into radioactive areas and handle remediation.

In the laboratory at the University of Tokyo School of Engineering, advances are also being made in technology that mimics the capabilities of the human eye. One application allows scientists a clear field of vision in extreme weather conditions that are otherwise difficult or impossible for humans to study.

Japanese researchers are also developing a surgical robotic system with a three-dimensional endoscope to conduct high-risk surgery in remote mountainous regions with no specialized doctors. This system is in use in operating rooms in the United States as well, but Japan is taking it a step further by using it in teletherapy, where the patient is hundreds of miles away from the doctor actually performing the surgery. In Japan's manufacturing culture, robots are viewed not as threats but as solutions to many of the nation's most critical problems. Indeed, with Japan's below-replacement fertility since the mid-1970s, Japan's work force has been aging quite rapidly; in fact, beginning in the period from 2010 to 2015, the Japanese population started shrinking. Clearly, robots are potentially quite important as a means to offset prospective adverse consequences of a diminishing labor force.

Critical Thinking

- **Does using robots cause a loss of jobs, a shifting of jobs, or both? How should society respond?**
- **How might the use of robots add to the increasing inequality in the U.S. economy?**
- **Do companies have an ethical responsibility to their workers to training or other support to workers displaced by automation?**

Artificial Intelligence

Although some robots are remotely controlled by a human operator or a computer program written by a human, robots can also learn to work without human intervention, and often faster, more efficiently, and more cheaply than humans can. The branch of science that uses computer algorithms to replicate human intelligent behavior by machines with minimal human intervention is called artificial intelligence (AI). Related professions in which the implementation of AI might have particular impact are banking, financial advising, and the sales of securities and managing of stock portfolios.

According to global consulting giant Accenture, AI is "a collection of advanced technologies that allows machines to sense, comprehend, act and learn." Accenture contends that AI will be the next great advance in the workplace: "It is set to transform business in ways we have not seen since the Industrial Revolution; fundamentally reinventing how businesses run, compete and thrive. When implemented holistically, these technologies help improve productivity and lower costs, unlocking more creative jobs and creating new growth opportunities."[3] Accenture looked at twelve of the world's most developed countries, which account for more than half of world economic output, to assess the impact of AI in sixteen specific industries. According to its report, AI has the potential to significantly increase corporate profitability, double rates of economic growth by 2035, increase labor productivity by as much as 40 percent, and boost gross value added by $14 trillion by 2035, based on an almost 40 percent increase in rates of return.[4] Even news articles have begun to be written by robots.[5]

LINK TO LEARNING

Read this article about AI and its applications and watch this video about how automation and AI are changing the accounting profession to learn more. Also, read this article about how some startups are creating new AI-related technology and products to automate accounting systems to learn more.

A report by KPMG, another global consulting and accounting firm, indicates that almost 50 percent of the activities people perform in the workplace today could be automated, most often by using AI and automation technology that already exist. The ethical question facing the business community, and all of us on a broader level, is about the type of society in which we all want to live and the role automation will play in it. The answer is not simply about efficiency; a company should consider many variables as it moves toward increased automation (Figure 31.1).

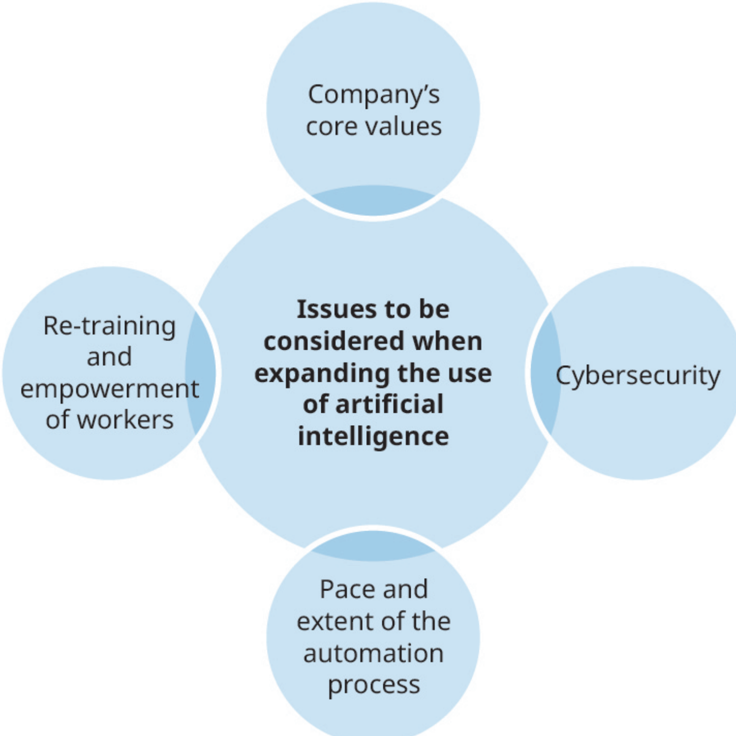


Figure 31.1 Managers should balance multiple variables as the workplace moves toward increased use of artificial intelligence, automation, and robotics. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 *license)*

For example, as AI programs become better able to interact with humans, especially online, should a company be required to inform its customers if and when they are dealing with any form of AI and not a person? If people cannot tell when they are communicating with an AI program and not a human being, has an AI-controlled computer or robot reached a form personhood? Why or why not? Although traditional business ethics can provide us with a starting place to answer such questions, we will also need a philosophical approach, because we also need to decide whether it is necessary to have consciousness to be considered a person. This issue is further muddied when a human employee largely is tapping AI i to serve customers or clients. Should this combination of human and AI assistance be made patently clear?

Another issue in AI and all forms of automation is liability. According to Reuters News, “lawmakers in Europe have agreed on the need for [European Union]-wide legislation that would regulate robots and their use, including an ethical framework for their development and deployment, as well as the establishment of liability for the actions of robots, including self-driving cars.”[6] The legal and ethical questions in assigning liability for decisions made by robots and AI are not only fascinating to debate but also an important legal matter society must resolve. The answers will one day directly affect the day-to-day lives of billions of people.

31. Corporations and their Social Responsibility

Understanding Corporations and CSR

The subject of this book is *corporate social responsibility* (CSR), a broad term that refers generally to the ethical role of the corporation in society. Before we define CSR more precisely and before we explore in depth a number of case studies that illustrate aspects of the ethical role of corporations, we first need to understand exactly what corporations are, why they exist, and why they have become so powerful.

Today, the global role of corporations rivals that of national or local governments. In 2000, it was reported that, of the 100 largest economic organizations in the world, 51 were corporations and 49 were countries.[1] General Motors, Walmart, Exxon, and Daimler Chrysler all ranked higher than the nations of Poland, Norway, Finland and Thailand (in terms of economic size, comparing corporate revenues with national gross domestic product, or GDP). This trend has continued, and for the past decade, 40 to 50 of the world's 100 largest economic organizations have been corporations, with the rest being national economies. In 2012, Walmart was the twenty-fifth largest economic organization in the world, putting it ahead of 157 countries.[2]

For corporate employees, as for citizens living in communities dominated by large corporations, the corporation is arguably the most important form of social organization. For people such as corporate executives and shareholders, whose lives depend directly on corporations, it is not surprising that company politics often are considered more relevant than national or local politics.

Corporations are also a major part of the daily lives of the world's citizens and consumers. For devoted fans of iconic brands like Nike, Apple, Mercedes, or Louis Vuitton, the corporation can occupy a psychological niche very much like that of a member of the family. Indeed, if many teenagers today were forced to choose between an iPhone and a memorable night out celebrating their parents' anniversary, the parents would likely celebrate alone. Similarly, those parents might also be loath to part with their cherished products. Dad would not easily say goodbye to his Chevrolet Corvette or Bose stereo, and Mom might not be easily persuaded to part with her Yamaha piano or Rossignol skis.

At the opposite extreme, for citizens who have been harmed physically or financially by corporations—like the Louisiana or Alaska residents whose beaches were fouled by massive oil spills, or the thousands of small investors who found their life savings wiped out by the Ponzi schemes of Bernie Madoff's investment company—the corporation can seem as dangerous as an invading army, or as destructive as an earthquake.

Despite their vast social role, corporations remain poorly understood by the world's citizens. While school children everywhere are expected to study the structure and history of their nation's government, they are not similarly taught to appreciate the functions, motivations, and inner workings of corporations. Let us begin with a brief review of the nature of corporations.

Fire fighter ships spray water onto a burning oil rig

BP oil rig explosion, photo by United States Coast Guard (2010, public domain). Figure 1.1 The 2010 explosion of a British Petroleum (BP) oil rig off the coast of Louisiana, the cause of the worst environmental disaster in U.S. history.

Why Do Corporations Exist?

There were no corporations in ancient Egypt, Greece, or Rome; or in imperial China or Japan; or among the precolonial kingdoms of the Zulu or Ashanti. The Aztecs and Incas had no corporations, nor did the Sioux, Cherokee, or Navajo. It is true that in some classical and traditional societies there were certain forms of communal and religious organizations that anticipated the organizational capacities of corporations, but strictly speaking, they were not corporations.

Corporations are a relatively modern social innovation, with the first great corporations dating from about 1600. Since then, the growth of corporations has been phenomenal. What explains it? Why has the corporate structure been so successful, profitable, and powerful? Here are a few of the distinguishing characteristics of corporations.

Corporations are Creatures of Law

The first point to make about corporations is that they are not informal organizations or assemblies. In order to exist at all, corporations must be authorized by state or national laws. In their daily operations, corporations are regulated by a specific set of laws. Every country has laws that stipulate how corporations can be created; how they must be managed; how they are taxed; how their ownership can be bought, sold, or transferred; and how they must treat their employees. Consequently, most large corporations have large legal and government affairs departments. Since the laws and rules that may constrain corporations are written and enforced by the government, most corporations consider it of vital importance to seek influence over governmental regulators and lawmakers. In most countries, the very largest corporations have privileged access to top decision makers. The extent and reach of corporate influence over governments is one of the most controversial aspects of corporate existence.

Corporations Raise Capital for Major Undertakings

The first great benefit of corporations is that they provide an organized vehicle for pooling cash and capital from a large number of investors so that they can undertake major enterprises. Thus, one great stimulus to the growth of corporations was the rapid growth of international trade between 1400 and 1700 CE. In that era, sending a large vessel across the oceans was a major financial and logistical undertaking, which was also extremely risky; ships were often lost in storms. These early commercial ventures required such large capital investments that, at first, funding them was only within the reach of royalty. American schoolchildren are taught that the legendary explorer Christopher Columbus needed the royal patronage of Queen Isabella of Spain to support the voyages that led to the "discovery" of the New World. However, as new ocean trading routes were established and the vast potential for profits from trading spices became known, the first modern corporations were formed: the English East India Company, chartered in 1600, and its archrival, the Dutch East India Company, chartered in 1602. These companies are considered the world's first multinational corporations, and they possessed most of the hallmarks of corporate structure that we see today.

Corporations and Other Business Structures

Not all businesses or companies are public corporations. For example, in the US, it is legal to operate a business in your own name (this is called a *sole proprietorship*) or with partners (a *partnership*). Corporations also come in a bewildering array of forms. Thus, in the US, we have C *corporations*, S *corporations*, *benefit corporations* (also B *corporations*), and *limited liability* *companies* (LLCs). In the UK, the term *company* is preferred to corporation, and we will notice that the names of most large UK companies followed by the designation *plc* or *PLC* (public limited company), as in Rolls-Royce plc, while smaller companies often have the designation *Ltd* (private limited company). In France, large companies are usually designated SA (société anonyme), while smaller ones may be known as *SARL*(société à responsabilité limité). In Germany, large companies are designated AG(Aktiengesellschaft), while smaller ones are known as *GmbH* (Gesellschaft mit beschränkter Haftung). In Japan, the corresponding terms are *KK* (kabushiki kaisha) and *YK* (yūgen kaisha).

All of these terms define two basic aspects of corporations: 1) their limited liability (which applies to all corporations), and 2) their status as a *public* or *private*company. Public companies are allowed to sell their shares on public stock markets and tend to be the larger type of company.

The Importance of Limited Liability

Why aren't all businesses sole proprietorships or partnerships, instead of corporations? The answer is found in the concept of *liability*, which refers to the risk of loss for debts incurred by the business, or for damages caused by the business.

If you start a business as a sole proprietor or via a partnership, you (and/or your partners) are *personally liable* for any debts or damage that can be attributed to the particular business. Let us say that you have $1 million in assets and your good friend has $2 million in assets. Together, you agree to invest $250,000 each in a pizza delivery business (the business will start with $500,000 worth of capital). Unfortunately, in the first month of operation, one of your drivers negligently causes a car accident and severely injures a family driving in another car. The family sues you for their injuries and they obtain a court judgment ordering you to pay $3 million in compensation. Even though you had intended to invest only $250,000 in the business, now your entire fortune and that of your friend are likely to be wiped out in satisfying that court judgment. The same sort of result could arise if your business ran up $3 million in debt that it was unable to pay back. Thus, the founder of a sole proprietorship exposes his/her entire personal assets to the risk that the assets will be seized to satisfy liabilities incurred by the business.

The result can be quite different for a corporation. One of the principal advantages of a corporation, from an investor's point of view, is that the corporation provides a legal a "shield" from liability. A shareholder of a corporation only risks the stock that the shareholder owns. The shareholder's personal assets are not in jeopardy. When a corporation suffers an adverse legal judgment and does not have sufficient funds to satisfy the judgment, the corporation simply goes bankrupt. The party or parties who have been injured cannot sue the owners—the shareholders—of the corporation because the corporation acts as a shield from liability.

Why does society allow the shareholders of a corporation to retreat behind the corporate shield, while we do not allow the same for owners of a so-called mom-and-pop business in the form of a sole proprietorship? The main purpose of the liability-shield is to encourage investment in corporations. People are more willing to invest in a corporation (by acquiring stock) because they need not fear that their personal assets can be seized to satisfy the business's debts or liabilities. The underlying implication is that corporations and corporate investment provide important benefits for society, which explains why governments have been willing to adopt laws that protect and encourage corporate ownership. As many U.S. states learned in the nineteenth century, it can make sound economic sense to attract large corporations because they often become major employers and taxpayers. Corporations may enhance the ability of the local economy to compete with foreign economies that are supported by the productivity of their own corporations.

In many instances the ability of corporations to retreat behind the corporate shield has been controversial. For example, several major airlines (notably American Airlines) have been accused of choosing to declare bankruptcy over finding a way to pay high wages to their pilots and cabin personnel.[3] The airlines were attacked by labor unions as having used the bankruptcy as a tactic to avoid meeting the union's demands for fair wages. Such corporations are able to benefit from an option provided by US bankruptcy law, known as *Chapter 11 reorganization*, which allows them to enter bankruptcy temporarily. The courts appoint a trustee to run the corporation, and the trustee is empowered to take any actions necessary to reduce the corporation's debts, including revoking labor agreements with employees. Such corporations can later "emerge" from bankruptcy with fewer employees or with employees earning lower salaries.

Corporations Permit Wealth Creation and Speculation in Stocks

While all corporations possess limited liability, not all of them are permitted to raise money in the stock market or have their shares traded in stock markets. Here, we find the important distinction between *public corporations*, which may have their shares traded on stock markets, and *private corporations*, which may not have their shares traded on stock markets.

As a rule, large corporations and multinational corporations choose to do business as public corporations because big companies have such enormous capital needs that they may best raise funds by placing stock for sale in public stock markets. However, this is not always the case; there are some very large corporations that choose to remain private, which means that they raise money directly from investors rather than from making stock available on stock markets.

On the whole, ownership of a corporate interest in the form of stocks is more freely and easily transferable than ownership of an interest in a sole proprietorship or partnership. If you want to sell a mom-and-pop store, you generally have to sell the whole business; you cannot sell a small portion when you need to raise money.

If you are one of the members of a partnership and you want to sell your share, you will generally have to get prior approval from the other partners; needing to do so may discourage possible investors because they may not want to go to the trouble of seeking approval from your partners. However, if you inherit a thousand shares of stock in Apple from your wealthy aunt (which, in 2013, would have had an approximate value of $420,000), and you find that you need extra money, you can sell one hundred shares (or about $42,000 worth). Such a transaction is easy because there are lots of investors eager to own Apple shares and you do not need anyone's approval. This ease of transferability also encourages people to invest in stock instead of in other businesses, because it is so easy to sell corporate stock as needed.

When a corporation grows and/or becomes more profitable, the shareholders benefit financially in two ways. First, the corporation will often distribute a portion of its profits to the shareholders in the form of *dividends*, a certain annual payment per share of stock. Second, if a corporation is growing rapidly and is expected to be very profitable in the future, more investors will want to own its stock and the price of that stock will increase. Thus, ownership of stock is an investment vehicle that provides many advantages over other types of investments. For one thing, you can own stock without having to personally take part in the management of the company. In addition, you can sell all or part of your ownership when you need the funds. Finally, if the corporation is very successful, it will not only pay a steady revenue stream—through dividends—but your shares will become more valuable over time.

The advantages of stock ownership as an investment vehicle explains the growth of the world's great stock exchanges, such as the New York Stock Exchange or the Hong Kong Stock Exchange. Stock exchanges are like enormous flea markets for stock, because you can either buy or sell stock there. Unlike the goods available in ordinary markets, though, the price of stocks fluctuates constantly, literally minute by minute. A stock that was worth $10 last year may now be worth as much as $1000 or as little as $0.10. Thus, stock markets are also somewhat like casinos or lotteries, because they allow investors to speculate on the future.

Speculation has its pros and cons. The potential for wealth creation through stock ownership has spawned an important industry that employs hundreds of thousands of people and generates vast profits: financial services. Stock brokerages, investment banks, and trading houses have arisen to provide expert guidance and services to investors.

American colleges and universities have developed a highly collaborative and perhaps even symbiotic relationship with the financial services industry. For one thing, since there are many jobs and professional occupations in financial services, virtually all universities offer courses and majors in finance or financial economics, and many also have graduate business schools that prepare students for careers in the financial services industry.

Perhaps equally importantly, most colleges and universities depend on private and charitable donations to help defray the cost of running the institution and, consequently, to keep tuition rates and fees lower (although many students will find it hard to imagine how tuition could be any higher). When wealthy individuals and corporations make donations or charitable contributions to colleges and universities, they often do so by giving corporate stock. Even when they make a cash donation, the university may find that it is most financially convenient to use that cash to acquire corporate stock. As a result, the largest universities have amassed vast holdings of corporate stock, among other investments. The financial resources of a university are often held in the form of a special trust known as an *endowment*. Universities prefer not to sell off parts of the endowment but rather seek to cover costs by using the interest and dividends generated by the endowment.

At times, the corporate holdings of universities have become quite controversial. For example, in the 1970s and 1980s, a growing student movement called on universities to *divest* (to sell all their stock) in any corporations that did business with the racist apartheid regime that controlled South Africa at that time. Many commentators believe that it was this pressure on corporations that led to the fall of the apartheid regime and the election of South Africa's first black president, Nelson Mandela.

Corporations Can Have Perpetual Existence

It is possible but rare for family-owned businesses to remain sole proprietorships for several generations; more commonly, they eventually become corporations, or they are sold or transferred to a new business operator. Very often, a small business is sold when the founder dies, because the founder's children or heirs either do not want to work in the family business or are not as gifted in that business as was the founder. Even in successful, family-owned businesses where a child or relative of the founder inherits the business, it still happens that after a generation or two, no further family members are qualified (or wish) to join the business, and the business must be sold.

However, corporations are structured from the outset to have a potentially perpetual existence, because corporations do business through their officers and executives rather than through their owners. Although it is possible for owners to have dual roles as shareholders and as executives, it is not necessary. One common scenario is for the founder of the corporation to act as its chief executive officer (CEO) until such time as the corporation becomes so large and successful that the shareholders prefer to transfer management responsibility to an executive with specific professional experience in running a large corporation.

Disadvantages of the Corporate Form

Separation of Ownership and Management Functions

One potential disadvantage of the corporate form (from the point of view of its founders) is that, as the corporation grows, the original founders may lose control and even be pushed out of the corporation by newcomers. This happened to Steve Jobs, the legendary cofounder of Apple, who was pushed out of his leadership role in 1985 by Apple's board of directors, only to return in the mid-1990s and retake his role as CEO. More recently, in 2013, George Zimmer, the founder of the apparel retailer Men's Wearhouse, was terminated as chairman of the board by his own board of directors. This situation can arise because, as a company grows, the founders may be tempted to part with some portion of their equity by selling stock to new investors. Corporations are ultimately controlled by the board of directors, who are voted into office by the shareholders. If a founder allows his or her share of corporate stock to drop beneath 50%, then the founder will no longer be able to elect a majority of the board of directors, and may become subject to termination as an officer by the board. The board of directors is thus a sort of committee that controls the fate of the corporation, and it does this principally by choosing a CEO and supervising the CEO's performance.

Dual Taxation

Although the tremendous growth in the number and size of corporations, and their ever-increasing social role, is due in part to their advantages as an investment vehicle, there are some financial disadvantages worth mentioning. One of the most important is so-called dual taxation, which refers to the practice in most countries of taxing corporate profits twice: once when the corporation declares a certain amount of profit, and again when the corporation distributes dividends to shareholders. The complexity of corporate tax regulations is such that even small corporations must frequently employ specialized accountants and attorneys to handle their tax returns.

Quarterly Financial Reporting for Publicly Traded Corporations

Another disadvantage applies only to publicly traded corporations. Although all corporations are subject to a number of government regulations, the highest degree of regulation applies to public corporations, which raise capital by selling stock in stock markets. Large corporations are often willing to submit to these burdensome regulations because there are strong benefits to being traded on a stock exchange, the most important of which is the ability to raise a great deal of initial funding when the stock is first made available for trade. This first public sale of stock is known in the US an *initial public offering* or IPO. In two famous recent examples, Google raised $1.67 billion with its IPO in 2004, and Facebook raised $18 billion with its IPO in 2012.

Red Toms shoes presented from the back

Source: Toms Shoes, photo by Vivianna Love (CC BY 2.0, 2009) *Figure 1.2 A well-worn pair of Toms Shoes; Toms gives away free shoes to a poor child for every pair it sells.*

Despite the allure of additional financing, a company that is traded on a stock market must make a great deal of financial information publicly available, usually on a quarterly basis, four times per year. This obligation can be quite onerous because it requires the corporation to employ a number of internal accountants as well as outside auditors. In addition, the information that is publicly revealed can be of strategic value to the corporation's competitors. Moreover, the need to make frequent quarterly reports on the company's ongoing profitability can have a negative impact on corporate strategy, because executives may become fixated on short-term goals while neglecting long-term goals. In light of these disadvantages, it is not surprising that some public corporations decide to take their shares off the stock markets in a process that is known as *going private*, which is the opposite of an IPO. Other corporations simply avoid going public in the first place. Thus, there are also some very large corporations, such as the multi–billion-dollar engineering firm Bechtel, which prefer to remain private even though they could raise investment capital with an IPO. Such companies prefer to raise capital by other means to avoid the requirements of quarterly earnings reports and therefore not revealing financial information to competitors.

Corporate Social Responsibility

In this book, we will make continual reference to the concept of corporate social responsibility, but it is important to realize that CSR is an evolving concept that can be analyzed from multiple perspectives. The term CSR may be used quite differently depending on whether a given speaker is looking at it from the point of view of a corporation, a government, a charity sponsored by the corporation, a citizen employed by the corporation, a citizen who has been harmed by the corporation, or an activist group protesting abuses of corporate power. Let us review key concepts and terms related to CSR, starting with CSR itself.

CSR: Definition

We define CSR simply and broadly as the ethical role of the corporation in society. Corporations themselves often use this term in a narrower, and less neutral, form. When corporations have a director of CSR or a committee in charge of CSR, or when they mention CSR prominently in their mission statements, they are invariably using the term to mean "corporate actions and policies that have a positive impact on society." Corporations refer most frequently to CSR when they speak of civic organizations they support, or to corporate environmental or social policies.

One related term here is corporate "compliance." Not only are large corporations subjected to a host of governmental regulations, many of which have social objectives (such as avoidance of discrimination, corruption, or environmental damage), but many corporations also have set up internal guidelines. In order to make sure that a corporation respects or complies with all these laws, regulations, and norms, both internal and external, corporations increasingly employ "compliance" officers or executives. For example, large fashion and apparel companies frequently place a specific executive in charge of "human rights compliance," to ensure that its clothing was manufactured in safe factories that respect labor laws and do not employ children.

Corporate Philanthropy

Corporate philanthropy refers to a corporation's gifts to charitable organizations. There is an implication that the corporation's donations have no strings attached, which is probably quite rare. At a minimum, most corporations expect that their donations will be publicly attributed to the corporation, thus generating positive public relations. When corporations make large cash gifts to universities or museums, they are usually rewarded with a plaque, or with a building or library named after the donor. Such attributions burnish the corporation's public image, and in such cases we are not dealing with true corporate philanthropy, strictly speaking, but something more in the nature of marketing or public relations.

Stakeholder Capitalism

Stakeholder capitalism refers to a conception of the corporation as a body that owes a duty not only to its *shareholders* (the predominant American view) but also to all of its *stakeholders*, defined as all those parties who have a stake in the performance and output of the corporation. Stakeholders include the company's employees, unions, suppliers, customers, local and national governments, and communities that may be affected by corporate activities such as construction, manufacturing, and pollution. Stakeholder capitalism is a concept that was largely developed in Europe and reflects the widespread European attitude toward corporate governance, which accepts a great degree of government and social oversight of the corporation. The American approach is often described, in contrast, as *laissez-faire* (meaning "leave alone"), in that corporations are granted more freedom of operation than in Europe. One example of a stakeholder approach is in the German practice known as *codetermination*, in which corporations are required to provide a seat on the corporation's board of directors for a union representative. This is intended to oblige the corporation to be more cognizant of worker needs and demands, and to ensure that corporate strategies are not concealed from workers.

Cause-Related Marketing

Cause-related marketing (CRM) refers to a corporation's associating the sales of its products to a program of donations or support for a charitable or civic organization. An example is provided by the famous Red campaign, in which corporations such as Gap pledged to contribute profits from the sale of certain red-colored products to a program for African development and alleviation of AIDS-related social problems. The basic idea of cause-related marketing is that the corporation markets its brand at the same time that it promotes awareness of the given social problem or civic organization that addresses the social problem. Another well-known example is the pink ribbon symbol that promotes breast-cancer awareness and is used prominently in the marketing of special lines of products by many corporations, such as Estée Lauder, Avon, New Balance and Self Magazine. In addition to marketing products with the pink-ribbon symbol, Estee Lauder has made support for breast cancer awareness one of the defining features of its corporate philanthropy. Thus, Estee Lauder also frequently refers to such charitable contributions, currently on the order of $150 million, in its corporate communications and public relations documents.[4]

Sponsorship

Sponsorship refers to a corporation's financial support for sports, art, entertainment, and educational endeavors in a way that prominently attributes the support to the particular corporation. Sponsorship can be considered a form of marketing communications because it seeks to raise awareness and appreciation of the corporation in a given target audience. Arguably, of course, sponsorship benefits society, because society appreciates sports, art, and entertainment. However, in the case of sponsorship, as opposed to philanthropy, the sponsors expect a clear return. Indeed, many corporations carefully analyze the benefits of their sponsorship activities in the same way they measure the impact of their marketing and advertising.

Many prominent global sponsors are companies that find it difficult to advertise through other channels. For example, Philip Morris, the world's largest tobacco company and owner of the Marlboro brand, which finds its global advertising restricted due to a number of bans and limits on tobacco advertising, has invested heavily in sponsorship. Philip Morris has long been the number one sponsor of Formula 1 race car competitions, and it is impossible for a spectator to watch one of these races without observing, consciously or otherwise, huge billboards and banners featuring the famous red-and-white Marlboro logo. Similarly, since alcohol advertising is also increasingly scrutinized, it is not surprising that Budweiser has followed a similar tactic and become the principal sponsor of NASCAR racing. Pharmaceuticals have also become an area subjected to tight advertising and marketing controls; therefore, Pfizer, the world's largest pharmaceutical company, engages in scores of sponsorship activities, notably in its support for the Paralympics, an Olympic-style competition for physically-handicapped athletes.

Sustainability

Sustainability has become such an important concept that it is frequently confused with CSR. Indeed, for some companies it seems that CSR is sustainability. This is perhaps not surprising, given the growing media attention on issues related to sustainability.

Sustainability is a concept derived from environmentalism; it originally referred to the ability of a society or company to continue to operate without compromising the planet's environmental condition in the future. In other words, a sustainable corporation is one that can sustain its current activities without adding to the world's environmental problems. Sustainability is therefore a very challenging goal, and many environmentalists maintain that no corporation today operates sustainably, since all use energy (leading to the gradual depletion of fossil fuels while emitting greenhouse gases) and all produce waste products like garbage and industrial chemicals. Whether or not true sustainability will be attainable anytime in the near future, the development and promotion of sustainability strategies has become virtually an obsession of most large corporations today, as their websites will attest in their inevitable reference to the corporation's sincere commitment to sustainability and responsible environmental practices. No corporation or corporate executive today will be heard to say that they do not really care about the environment. However, if we observe their actions rather than their words, we may have cause for doubt.

We will explore specific cases related to sustainability in later chapters. For now, let us just note that CSR, strictly speaking, is broader than environmental sustainability because it also refers to a corporation's ethical relationship to its employees, shareholders, suppliers, competitors, customers, and local and foreign governments.

More recently, many people have been using the term *sustainability* also to refer to social and political sustainability, which brings the concept closer to that of CSR.

Greenwashing

Greenwashing refers to corporations that exaggerate or misstate the impact of their environmental actions. By the early 1990s a great number of consumer products were being promoted as "environmentally friendly," "eco-friendly," or "green," when in fact there was little or nothing to justify the claims. In 1991, an American Marketing Association study revealed that 58% of environmental ads contained at least one deceptive claim. As a result, many advertising regulatory bodies around the world adopted specific advertising codes to regulate the honesty and accuracy of environmental claims in advertising. For example, in the UK, a producer of a recycling bin advertised that it helped buyers “save the rainforests” by encouraging recycling of plastic and paper products. The advertisement was found to be misleading because most paper products sold in the UK were not made from wood in tropical rainforests, but from wood harvested on northern European tree farms.

In Norway, car manufacturers and dealers are prohibited from claiming that their cars are green, eco-friendly, etc., because in the view of the Norwegian Consumer Ombudsman, it is impossible for cars to be beneficial for the environment; the best they can do is reduce the environmental damage they cause.[5]

Greenwashing is not only a corporate practice but a political one as well, as politicians everywhere promise to undertake actions to improve the environment. Thus, the administration of former US President George W. Bush was widely criticized for promoting legislation under the name of the “Clear Skies Initiative,” when in fact the purpose of the legislation was to weaken antipollution measures.[6]

Social Entrepreneurship and Social Enterprise

Social entrepreneurship and social enterprise refer to the use of business organizations and techniques to attain laudable social goals. As we will discuss further in Chapter 6, Blake Mycoskie decided to create TOMS Shoes largely as a reaction to his travels in Argentina, which had exposed him to terrible poverty that left many school-age children without shoes. An important part of the corporate mission of TOMS Shoes lies in its pledge to give away a free pair of shoes for every pair purchased by a customer. TOMS Shoes' model has been imitated by many others, including the popular online eyewear brand, Warby Parker.

The difference between social entrepreneurship and CSR is that, with social entrepreneurship, the positive social impact is built into the mission of the company from its founding. Other examples of social entrepreneurship include The Body Shop, Ben & Jerry's ice cream, and Newman's Own. The Body Shop was founded by noted activist Anita Roddick who insisted that all products be derived from ingredients which were natural, organic, and responsibly sourced. Her employment policies famously allowed every employee to take off one day a month from work to engage in social or community projects. Similarly, Ben & Jerry's was founded to promote the use of organic, locally-produced food. The company's founders insisted on a policy that executives earn no more than seven times the salary of factory line-workers (although this policy was eventually relaxed when it became difficult to recruit a competent CEO at those wages). Ben & Jerry's engaged in a number of high-profile political activities in which they encouraged their employees to participate, such as protesting the building of the Seabrook nuclear power plant in Vermont. Newman's Own was founded by film actor Paul Newman and his friend A. E. Hotchner with the goal of selling wholesome products and giving away 100% of the profits to charitable ventures. To date, Newman's Own has given away over $200 million.

Social Marketing

Social marketing refers to the use of business marketing techniques in the pursuit of social goals. Often, governments and nonprofit organizations make use of social marketing to make their points more forcefully and effectively to a wide audience. Classic examples are the extremely powerful TV commercials warning of the dangers of unsafe driving or of failing to use seatbelts. Cinematic techniques are employed to portray dramatic, arresting images of crumpled cars and bodies, children and mothers crying. The source of social marketing advertisements is usually a local government or nonprofit organization.

Social marketing is usually used to try to convince citizens to drive more safely, eat better, report child and domestic abuse, and avoid various forms of criminality and drug use. As with ordinary advertising, social marketing can seem overdone or maudlin, and some social marketing ads have been mocked or considered silly. For example, former First Lady Nancy Reagan participated in a social marketing campaign that urged young people to "Just Say No" to drugs, an approach which was ridiculed as simplistic by many. Noted radical activist Abbie Hoffman said that telling drug users to "just say no" to drugs was like telling manic-depressives to "just cheer up." Despite that, drug use in America declined over the time period that the campaign was in progress, though there is no evidence that any part of this decline was due to the campaign.

Business Ethics

Mugshot of Former Enron Lawyer Ken Lay

Source: United States Marshals Service, 2004, public domain
Figure 1.3 The mug shot of former Enron top executive Ken Lay. Lay was eventually convicted on 10 counts of fraud; while awaiting sentencing of up to 100 years in prison he died of a heart attack in 2006.

Business ethics is an academic discipline closely related to CSR, but one that tends to use the tools of philosophy to formally analyze the ethical role of individuals and corporations. Although the terms are quite similar, there are differences of nuance. For example, although academics who study business ethics tend to focus on corporations, the term itself could also apply to the ethical dilemmas of sole proprietors or of individuals involved in commercial situations, such as a private party trying to sell a used car that he knows has a hidden mechanical flaw. While the term *CSR* tends to be used by corporations and social entrepreneurs in a way that assumes a positive connotation, *business ethics* is used in a more neutral and even critical fashion, as one might expect, given the perspective of writers who are not beholden to corporations. Indeed, when the media uses the term *business ethics*, it is often in a negative sense, to draw attention to instances of deception or fraud on the part of corporations or executives.[7]

White-Collar Crime

White-collar crime refers to fraudulent or financially-oriented criminal activities by high-status professionals or businesspeople. The term *white-collar crime* was coined by sociologist Edwin Sutherland, who defined it as a "crime committed by a person of respectability and high social status in the course of his occupation" in a 1939 speech entitled "The White Collar Criminal." Although the term applies to financial fraud committed by individuals who are not associated with corporations, there is a strong linkage to corporations in actual practice because corporate executives are often well-placed to commit crimes of fraud and corruption. However, a distinction should be drawn between white-collar crime and corporate crime, which refers to crimes for which the corporation itself is responsible. In many cases, such as in violations of US laws against bribing foreign government officials, it may be unclear whether the matter is better classified as white-collar crime or corporate crime. In the law, it may depend on whether the corporation's senior executives were aware of and supported the acts of criminality.

While there is a popular perception that punishments for wealthy white-collar criminals are less severe than for poor and middle-class criminals, the situation appears to have changed in light of the severe penalties for white-collar crime mandated by the 2002 Sarbanes–Oxley Act, which was adopted by the US Congress in the wake of the notorious Enron scandal. As a result, former Enron CEO Jeffrey Skilling, the architect of Enron's frauds, was sentenced to 24 years in prison. Bernie Ebbers, former CEO of WorldCom, was convicted of fraudulent misstating of billions of dollars of WorldCom earnings, resulting in a sentence of 25 years. More recently, Bernie Madoff, whose vast Ponzi scheme defrauded investors of up to $65 billion, was sentenced in 2009 to 150 years in prison for his crimes, effectively a life sentence without possibility of parole.

Topic for Debate: Regulation of Corporations

It is one of the basic premises of this book that we do not want you merely to read and assimilate the material. We want you to engage it personally in an effort to develop and refine your own opinions. Therefore, each chapter will feature a topic for debate (more detailed rules and suggestions for debate will be set forth in the next chapter). Most chapters will feature an in-depth case study based on a real-life business situation, or a fictionalized account of a real business situation or social controversy. In this chapter we will use what we will call a "mini-case study"—a sort of thought experiment, based on a simple set of facts as follows:

Mini-Case Study: The Case of the Undecided Voter

Your close friend, Jane Goodie, is a college student who has registered to vote in her first election. Jane's father has been a lifelong Republican voter and Jane's mother a lifelong Democrat. As Jane grew up, she often listened to her parents debating politics at the dinner table. More than once, Jane found herself disconcerted and discouraged by the appearance of biased thinking on the part of one or both of her parents; they rarely seemed to agree or listen to each other in their political debates. Sometimes, Jane even wondered to herself, "Why do they vote at all, since their votes obviously just cancel each other out?" However, since her parents have strongly urged her to vote as soon as she is old enough, and since they have also urged to make up her own mind about which candidate to choose, she is looking forward to expressing her own views at the ballot box. But first she must make up her mind.

Since this is not a presidential election year, the most important office up for election is that of Senator. Both senatorial candidates are very impressive and illustrious people: One is a graduate of Harvard Law School, the other of Yale Law School. The Democratic, or "liberal," candidate pursued an impressive career as an environmental lawyer before being elected to a position as mayor of one of the leading cities in your state. The Republican, or "conservative," candidate enjoyed an impressive career as an advisor to a number of successful start-up companies before also being elected to a position as a mayor of one of the leading cities in your state.

Both candidates appear to be exceptionally bright, eloquent, and dedicated to public service. In this particular campaign, they both espouse very similar views on foreign policy and social policy. In fact, the main difference between the candidates comes down to one thing: their attitude toward government regulation of business, and of large corporations in particular. The Democratic candidate, citing recent examples of fraud, pollution, and layoffs at major corporations, is calling for tighter regulation of corporations. The Republican candidate, citing the importance of the business sector as a major taxpayer and creator of jobs, calls for a loosening and reduction of government regulation of business.

Your friend does not know who to vote for, but believes that she should decide on the basis of the single issue on which the candidates differ: the regulation of business. Your friend asks for your advice.

You are therefore asked to develop the strongest reasons for supporting one of the following two possible responses:

Affirmative Position

Jane should vote for the Democratic candidate.

Possible Arguments:

- It is better to maintain tight regulation of businesses and corporations, given their propensity to cause or contribute to social harms.
- Corporations are able to lobby governments to shield themselves from regulation.
- Corporations are able to attain more power and influence than citizens.

Negative Position

Jane should vote for the Republican candidate.

Possible Arguments:

- It is better to liberate businesses and corporations from onerous and expensive government regulation.
- Corporations are major employers and job-creators.
- Corporations can undertake enormous projects beyond the scope of small business or individuals.
- Corporations stimulate research and innovation.

Readings

The readings below are meant only to stimulate your thinking about possible perspectives to take on corporations. Please supplement them with your own research.

1.1 The Corporation as a "Psychopathic" Creature

Bakan, Joel. "Business as Usual," in The Corporation: The Pathological Pursuit of Profit and Power, 28–59. *New York: Simon and Schuster,* 2004.

Bakan, Joel. "The Externalizing Machine," in The Corporation: The Pathological Pursuit of Profit and Power, 60–84. *New York: Simon and Schuster,* 2004.

Business leaders today say their companies care about more than profit or loss, that they feel responsible to society as a whole, not just to their shareholders. Corporate social responsibility is their new creed, a self-conscious corrective to earlier greed-inspired visions of the corporation. Despite this shift, the corporation itself has not changed. It remains, as it was at the time of its origins as a modern business institution in the middle of the nineteenth century, a legally designated "person" designed to valorize self-interest and invalidate moral concern. Most people would find its "personality" abhorrent, even psychopathic, in a human being, yet curiously we accept it in society's most powerful institution. The troubles on Wall Street today, beginning with Enron's spectacular crash, can be blamed in part on the corporation's flawed institutional character, but the company was not unique for having that character. Indeed, all publicly traded corporations have it, even the most respected and socially acceptable….

As a psychopathic creature, the corporation can neither recognize nor act upon moral reasons to refrain from harming others. Nothing in its legal makeup limits what it can do to others in pursuit of its selfish ends, and it is compelled to cause harm when the benefits of doing so outweigh the costs. Only pragmatic concern for its own interests and the laws of the land constrain the corporation's predatory instincts, and often that is not enough to stop it from destroying lives, damaging communities, and endangering the planet as a whole…. Far less exceptional in the world of the corporation are the routine and regular harms caused to others—workers, consumers, communities, the environment—by corporation's psychopathic tendencies. These tend to be viewed as inevitable and acceptable consequences of corporate activity—"externalities" in the coolly technical jargon of economics.

"An externality," says economist Milton Friedman, "is the effect of a transaction…on a third party who has not consented to or played any role in the carrying out of that transaction." All the bad things that happen to people and the environment as a result of corporations' relentless and legally compelled pursuit of self-interest are thus neatly categorized by economists as externalities—literally, other people's problems.

1.2 “EPA Costs US Economy $353 Billion per Year”

Young, Ryan. “EPA costs US economy $353 billion per year.” The Daily Caller. Last modified December 27, 2012. http://dailycaller.com/2012/12/27/epa-costs-us-economy-353-billion-per-year/.

Transparency is the lifeblood of democracy. Washington needs more of it, especially in the all-too-opaque world of regulation. The Environmental Protection Agency (EPA), for example, is the most expensive federal regulatory agency. Its annual budget is fairly modest in Beltway terms, at a little less than $11 billion, but that’s not where the vast majority of its costs come from. Complying with EPA regulations costs the US economy $353 billion per year—more than 30 times its budget—according to the best available estimate. By way of comparison, that is more than the entire 2011 national GDPs of Denmark ($332 billion) and Thailand ($345 billion)…

In the last edition of the Unified Agenda, the fall 2011 edition, the EPA had 318 rules at various stages of the regulatory process. Nobody outside the agency knows how many rules it currently has in the pipeline. All in all, 4,995 EPA rules appeared in the Winter Unified Agenda from 1999–2011. Over the same period, 7,161 EPA final rules were published in the *Federal Register*. That means more than 2,000 final rules, which have the force of law, came into effect without first appearing in the Unified Agenda. This could indicate an important transparency problem.

That’s just the EPA’s *annual* flow of regulations. The agency has existed for more than 40 years. How many total rules does it currently have in effect? Again, the answer doesn’t come from the agency. Earlier this year, the Mercatus Center’s Omar Al-Ubaydli and Patrick A. McLaughlin ran text searches through the entire *Code of Federal Regulations* (CFR) for terms such as “shall,” “must,” “prohibited,” and the like. The CFR Title covering environmental protection alone contains at least 88,852 specific regulatory restrictions. The number could be as high as 154,350….

Justice Louis Brandeis correctly believed that sunshine is the best disinfectant. With high regulatory costs contributing to a stagnant economic recovery, it is well past time to shine more light on regulatory agencies. Annual agency report cards would make a good start.

1.3 Press Release from the US Consumer Product Safety Commission

Consumer Product Safety Commission. "Port Surveillance News: CPSC Investigators Find, Stop Nearly 650,000 Unsafe Products at the Start of Fiscal Year 2012." News Release. April 5, 2012. https://www.cpsc.gov/en/Newsroom/News-Releases/2012/Port-Surveillance-News-CPSC-Investigators-Find-Stop-Nearly-650000-Unsafe-Products-at-the-Start-of-Fiscal-Year-2012/.

Investigators Stop Nearly 650,000 Unsafe Products

Investigators with the US Consumer Product Safety Commission (CPSC) prevented more than half a million violative and hazardous imported products from reaching the hands of consumers in the first quarter of fiscal year 2012.

Working with US Customs and Border Protection (CBP) agents, CPSC port investigators successfully identified consumer products that were in violation of US safety rules or found to be unsafe. CPSC and CBP teamed up to screen more than 2,900 imported shipments at ports of entry into the United States. As applicable, these screenings involved use and abuse testing or the use of an X-ray fluorescence (XRF) analyzer. Their efforts prevented more than 647,000 units of about 240 different non-complying products from reaching consumers, between October 1, 2011 and December 31, 2011.

Topping the list of products stopped were children's products containing levels of lead exceeding the federal limits, toys and other articles with small parts that present a choking hazard for children younger than 3 years old, and toys and child-care articles with banned phthalates.

In addition to violative toys and other children's products, items stopped at import included defective and dangerous hair dryers, lamps, and holiday lights.

"We mean business when it comes to enforcing some of the toughest requirements for children's products in the world. If an imported product fails to comply with our safety rules, then we work to stop it from coming into the United States," said Chairman Inez Tenenbaum. "Safer products at the ports means safer products in your home."

During fiscal year 2011, CPSC inspected more than 9,900 product shipments at the ports nationwide and stopped almost 4.5 million units of violative or hazardous consumer products from entering the stores and homes of US consumers.

CPSC has been screening products at ports since it began operating in 1973. In 2008, the agency intensified its efforts with the creation of an import surveillance division.

1.4 "Costs of Air Pollution in the U.S."

Taylor, Timothy. "Costs of Air Pollution in the U.S.," *Conversable Economist* (blog), November 7, 2011, http://conversableeconomist.blogspot.com/2011/11/costs-of-air-pollution-in-us.html.

What costs does air pollution impose on the U.S. economy? Nicholas Z. Muller, Robert Mendelsohn, and William Nordhaus tackle that question in the August 2011 issue of the *American Economic Review*. Total "gross external damages" the six "criterion" air pollutants in 2002—sulfur dioxide, nitrogen oxides, volatile organic compounds, ammonia, fine particulate matter, and coarse particulate matter—was $182 billion.

Since GDP was about $10.5 trillion in 2002, the cost of air pollution was a bit under 2% of the total. The effects included in the model calculations are adverse consequences for human health, decreased timber and agriculture yields, reduced visibility, accelerated depreciation of materials, and reductions in recreation services.

The sectors with the biggest air pollution costs measured in terms of "gross external damages" (GED) (counting the same six pollutants but again not counting carbon emissions) are utilities, agriculture/forestry, transportation, and manufacturing.

If one looks at the ratio of gross economic damages to value-added in the sector, agriculture/forestry and utilities lead the way by far with ratios above one-third. Manufacturing has fairly high gross external damages, but the GED/VA ratio for the sector as a whole is only 0.01.

To me, a lesson that emerges from these calculations is that the costs of air pollution and of burning fossil fuels are very high, both in absolute terms and compared to the value-added of certain industries, even without taking carbon emissions into account. Environmentalists who are discouraged by their inability to persuade more people of the risks of climate change might have more luck in reducing carbon emissions if they deemphasized that topic—and instead focused on the costs of these old-fashioned pollutants.

1.5 "Over-Regulated America"

"*Over-regulated America: The home of laissez-faire is being suffocated by excessive and badly written regulation.*" *The Economist.* *Last modified February 8,* 2012.http://www.economist.com/node/21547789.

Synthesis Questions

The most productive discussions and debates are those that open our eyes to different perspectives and different ways of thinking. While we may not change our initial opinions, we may emerge with an enhanced understanding of the perspectives of others, or of the complexity of a particular issue.

So we suggest that at the end of each chapter you answer a few questions in a way that allows you to "synthesize" your discussions and readings—by bringing together the strongest parts of each side of the argument—so as to arrive at a deeper, more nuanced understanding of the issues involved.

Clearly, the ethical role of corporations is a vast, complex topic and allows for a great diversity of opinions. Here are three initial synthesis questions for further reflection:

Synthesis Questions

1. **Are corporations on the whole good for society?**
2. **Do you personally like or distrust corporations? Why?**
3. **How should society regulate corporations?**

Endnotes

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4. "The Estee Lauder Companies Breast Cancer Awareness Campaign," accessed November 28, 2014, http://bcacampaign.com/.

5. "Norway Outlaws 'Green' Cars," *TerraPass*, September 11, 2007, accessed December 6, 2014, http://terrapass.com/politics/norway-outlaws/.

6. US Senator Patrick Leahy, "The Greenwashing of the Bush Anti-Environmental Record on the President's Earth Day Visits to Maine and Florida," (statement on the Senate floor, Washington, DC, April 26, 2004).

7. See Sebastian Bailey, "Business Leaders Beware: Ethical Drift Makes Standards Slip," *Forbes*, May 15, 2013, accessed December 6, 2014, http://www.forbes.com/sites/sebastianbailey/2013/05/15/business-leaders-beware-ethical-drift-makes-standards-slip/.