Chapter 11: Leading an Ethical Organization: Corporate Governance, Corporate Ethics, and Social Responsibility

11.1 Introduction

11.2 Doing Well by Doing Good

11.3 Corporate Governance

11.4 Corporate Ethics and Social Responsibility

11.5 Contemporary Questions of Corporate Ethics

11.6 Conclusion

Learning Objectives

After reading this chapter, you should be able to understand and articulate answers to the following questions:

1. What is the role of the firm's board of directors as it relates to ethical behavior of the firm?
2. What is corporate social responsibility and its strategic role for a firm?
3. What are the implications of the contemporary ethical questions and issues facing companies?

11.1 Introduction

Today, more than ever, stakeholders are placing a variety of ethical and socially responsible demands on firms across industries. Subsequently, strategic management will be unsuccessful if it is performed in an ethical vacuum. Strategy development and implementation must reflect the firm's mission, vision, and values. Ethical assessments of the external and internal environments must be performed using accurate information and transparent processes even in competitive environments. When firms attempt to gain a competitive advantage, many companies engage in legitimate and accepted competitive tactics, but sometimes firms cross the line and enter unethical, and perhaps illegal, space in their quest. The potential costs of unethical corporate business practice is born by the perpetrator—if they are "caught." However, in many cases, like environmental dumping or

exploitative labor practices, society and its members may pay the costs years before the firm does. Minimally, business level, corporate level, and international strategy development should always occur within acceptable practices in the industry and in light of the firm's own code of ethics and compliance. As firms move from "doing right" to "doing good," and endorse corporate social responsibility philosophies and activities, employees, managers, customers, and other stakeholders take pride and satisfaction in the impact their company has on improving the society. Further, as contemporary societal expectations have shifted, firms have witnessed new opportunities to turn corporate values and ethical decision-making into a competitive advantage within their marketplace.

TOMS Shoes: Doing Business with Soul

Figure 11.1: Under the business model used by TOMS Shoes, a pair of their signature alpargata footwear is donated for every pair sold.

In 2002 Blake Mycoskie competed with his sister Paige on *The Amazing Race*—a reality show where groups of two people with existing relationships engage in a global race to win valuable prizes, with the winner receiving a coveted grand prize. Although Blake's team finished third in the second season of the show, the experience afforded him the opportunity to visit Argentina, where he returned in 2006 and developed the idea to build a company around the alpargata—a popular style of shoe in that region.

The premise of the company Blake started was a unique one. For every shoe sold, a pair will be given to someone in need. This simple business model was the basis for TOMS Shoes, which has now given away more than one million pairs of shoes to those in need in more than 20 countries worldwide (Oloffson, 2010). The rise of TOMS Shoes has inspired other companies that have adopted the "buy-one-give-one" philosophy. For example, the Good Little Company donates a meal for every package purchased (Nicolas, 2011). This business model has also been successfully applied to selling (and donating) other items such as glasses and books.

The social initiatives that drive TOMS Shoes stand in stark contrast to the criticisms that plagued Nike Corporation, where claims of human rights violations, ranging from the use of sweatshops and child labor to lack of compliance with minimum wage laws, were rampant in the 1990s (McCall, 1998). While Nike struggled to win back confidence in buyers that were concerned with their business practices, TOMS social initiatives are a source of excellent publicity in pride in those who purchase their products. As further testament to their popularity, TOMS has engaged in partnerships with Nordstrom, Disney, and Element Skateboards.

Although the idea of social entrepreneurship and the birth of firms such as TOMS Shoes are relatively new, a push toward social initiatives has been the source of debate for executives for decades. Issues that have sparked particularly fierce debate include CEO pay and the role of today's modern corporation. More than a quarter of a century ago, famed economist Milton Friedman argued, "The social responsibility of business is to increase

its profits." This notion is now being challenged by firms such as TOMS and their entrepreneurial CEO, who argue that serving other stakeholders beyond the owners and shareholders can be a powerful, inspiring, and successful motivation for growing business.

This chapter discusses some of the key issues and decisions relevant to understanding corporate and business ethics. These issues include how to govern large corporations in an effective and ethical manner, what behaviors are considered best practices in regard to corporate social performance, and how different generational perspectives and biases may hold a powerful influence on important decisions. Understanding these issues may provide knowledge that can encourage effective organizational leadership like that of TOMS Shoes and discourage the criticisms of many firms associated with the corporate scandals of the late 1990s and early 2000s.

References

McCall, W. (1998). Nike battles backlash from overseas sweatshops. *Marketing News*, 9, 14.

Nicolas, S. (2011, February). The great giveaway. *Director*, 64, 37–39.

Oloffson, K. (2010, September 29). In Toms' shoes: Start-up copy "one-for-one" model. *Wall Street Journal*. https://www.wsj.com/articles/SB10001424052748704116004575522251507063936.

Image Credits

Figure 11.1: Ladd, Parke. "Quinn's new Toms." CC BY 2.0. Retrieved from https://flic.kr/p/9dh984.

11.2 Doing Well by Doing Good

Corporate Scandals and Sarbanes-Oxley Act

Celebrity scandals often create "buzz" and actually make celebrities richer. But scandals in the business world often lead to the forfeiture of millions of dollars as well as prison sentences. We illustrate some notable corporate scandals below.

Table 11.1 Corporate Scandals

Notable Corporate Scandals		
Ponzi schemes are named after Charles Ponzi, who in the 1920s paid returns to investors using money from new investors rather than firm profits. Inevitably this kind of scheme falls apart because it becomes impossible to attract enough new investors to pay existing ones.	Enron executives used accounting loopholes to create shell companies to hide billions in debt from failed deals and projects. Although these smug executives thought they were always "the smartest guys in the room," the loss of $11 billion in stock value and the prison time served by many of them proves otherwise.	Corruption was a family affair at Adelphia Communications Corporation, which was named after the Greek word for brothers. Adelphia was the fifth largest cable company in the United States until father and son team John and Timothy Rigas were found guilty on securities violations tied to their theft of $100 million. Another Rigas son, Michael, pled guilty to falsifying financial reports.
After two crashes that took hundreds of lives, Boeing grounded their 737 Super Max airliner. Their $20 million fine was small compared to the financial losses related to loss of confidence and loss of future sales, as it was discovered that Boeing had failed in several ways with FAA rules, inspections, and training pilots on its software changes.	Although Chiquita Brands sells healthy snacks, their corporate actions upset many stomachs in 2007 when they were fined $25 million by the US Justice Department for having ties to a Colombia paramilitary group on the department's list of foreign terrorists organizations.	The Madoff investment scandal that broke in 2008 provided a modern twist on the classic Ponzi scheme. NASDAQ chairman Bernard Madoff pled guilty to eleven federal crimes that constituted the largest investor fraud ever committed by an individual. Madoff was sentenced to 150 years in prison.

In the 1990s and early 2000s, several corporate scandals were revealed in the United States that showed a lack of board vigilance. Perhaps the most famous involves Enron, whose executive antics were documented in the film *The Smartest Guys in the Room*. Enron used accounting loopholes to hide billions of dollars in failed deals. When their scandal was discovered, top management cashed out millions in stock options while preventing lower-level employees from selling their stock. The collective acts of Enron led many employees to lose all their retirement holdings and their jobs, stockholders lost $74 billion, and many Enron execs were sentenced to prison. This scandal also caused the dissolution of Enron's outside accounting firm, Arthur Anderson, one of the five largest accounting firms in the world at the time.

Around the same time as Enron, other corporate scandals created colossal damage. WorldCom, a telecommunications firm, inflated its assets. When discovered, shareholders lost $180 billion and 30,000 employees lost their jobs. Another famous one is Tyco, where the CEO and CFO stole $150 million and inflated the company revenues by $500 million. Before being discovered, the CEO threw a birthday party for his wife on a Mediterranean island that cost $2 million, paid with company funds. The CEO and CFO both went to prison.

In response to notable corporate scandals at Enron, WorldCom, Tyco, and other firms, Congress passed

sweeping new legislation with the hopes of restoring investor confidence while preventing future scandals (Table 11.1). Signed into law by President George W. Bush in 2002, **the Sarbanes-Oxley Act** contained 11 aspects that represented some of the most far-reaching reforms since the presidency of Franklin Roosevelt. These reforms create improved standards that affect all publicly traded firms in the United States. The key elements of each aspect of the act are summarized as follows:

1. Because accounting firms were implicated in corporate scandals, an oversight board was created to oversee auditing activities.
2. Standards now exist to ensure auditors are truly independent and not subject to conflicts of interest in regard to the companies they represent.
3. Enron executives claimed that they had no idea what was going on in their company, but the Sarbanes-Oxley Act requires senior executives to take personal responsibility for the accuracy of financial statements.
4. Enhanced reporting is now required to create more transparency in regard to a firm's financial condition.
5. Securities analysts must disclose potential conflicts of interest.
6. To prevent CEOs from claiming tax fraud is present at their firms, CEOs must personally sign the firm's tax return.
7. The Securities and Exchange Commission (SEC) now has expanded authority to censor or bar securities analysts from acting as brokers, advisers, or dealers.
8. Reports from the comptroller general are required to monitor any consolidations among public accounting firms, the role of credit agencies in securities market operations, securities violations, and enforcement actions.
9. Criminal penalties now exist for altering or destroying financial records.
10. Significant criminal penalties now exist for white-collar crimes.
11. The SEC can freeze unusually large transactions if fraud is suspected.

The changes that encouraged the creation of the Sarbanes-Oxley Act were so sweeping that comedian Jon Stewart quipped, "Did Wall Street have any rules before this? Can you just shoot a guy for looking at you wrong?" Despite the considerable merits of the Sarbanes-Oxley Act, no legislation can provide a cure-all for corporate scandal (Table 11.2). As evidence, the scandal by Bernard Madoff that broke in 2008 represented the largest investor fraud ever committed by an individual. But in contrast to some previous scandals that resulted in relatively minor punishments for their perpetrators, Madoff was sentenced to 150 years in prison.

In the early 2000s, highly publicized fraud at Enron, WorldCom, Tyco, and other firms revealed significant issues including conflicts of interest by auditors and securities analysts, boardroom failures, and inadequate funding of the Securities and Exchange Commission. In response, Senator Paul Sarbanes and Representative Michael Oxley sponsored legislation that contained what former President George. W. Bush called "the most far-reaching reforms of American business practices since the time of Franklin D. Roosevelt." We outline the 11 key aspects of the law below.

Table 11.2 Sarbanes-Oxley Act of 2002 (SOX)

11 Key Aspects of the Sarbanes-Oxley Act of 2002	
Accounting firms were complicit in some fraudulent events. In response, SOX created a board to oversee auditing activities within these firms.	To restore investor confidence in securities analysts, SOX expands the SEC's authority to censure or bar them from acting as a broker, advisor, or dealer.
Concerns about conflicts of interests arising from accounting firms acting as consultants and auditors for the same firm led SOX to establish standards to ensure that auditors would be truly independent.	The comptroller general and the SEC are now required to carefully monitor any consolidation among public accounting firms, the role of credit agencies in securities market operations, securities violations, and enforcement actions.
Senior executives must take individual responsibility for the accuracy of their firms' financial reports and they must forfeit the benefits arising from any non-compliance.	To preserve potentially incriminating documents, SOX creates criminal penalties for altering or destroying financial records.
To create more transparency, SOX enhances reporting standards for off-balance-sheet transactions and requires timely reporting of material changes in a firm's financial condition.	In the past, white-collar crimes often received a proverbial slap on the wrist. SOX significantly increased the penalties associated with white-collar crimes and conspiracies.
Securities analysts must disclose any conflicts of interest involving a firm.	In response to past fraud and records tampering, the SEC can temporarily freeze transactions deemed unusually large.
The CEO is required to sign his/her firm's tax return. This may prevent CEOs from claiming that they did not know tax fraud was occurring within their firms.	

Did the Sarbanes-Oxley Act help reduce corporate scandals? Maybe, but unfortunately they have continued. Some more notable ones are HealthSouth (2003), Freddie Mac (2004), American Insurance Group AIG (2005), Lehman Brothers (2008), Bernie Madoff (2008). Accounting and financial misdeeds are not the only type or corporate scandals that still plague the corporate environment. Sadly, more recent scandals involved Volkswagen (emissions fraud), Uber (sexual harassment), Apple (deliberately slowing devices), Facebook (data harvesting without consent), Boeing (skirting FAA rules), and various pharmaceutical companies that unethically pushed sales of opiate medications, increasing the opioid epidemic. As noted, not all corporate scandals are financial in nature, but typically are driven by greed and provide a financial benefit for individuals or companies.

Section Video

The ethics of business. Where and why it can go wrong [10:55]

This video explains the ethics of business, and where and why it can go wrong.

You can view this video here: https://youtu.be/vAtu_iBbknY.

Ethics and CSR as Corporate Strategy

One positive outcome of the corporate scandals has been an increased focus by firms on corporate ethics. Many companies now have an Ethics and Compliance Officer and a detailed Ethics and Compliance Code. For example, Walmart's Global Ethics and Compliance Program is provided online for the public and has numerous pages (Walmart, n.d.). Many firms provide annual training to all its employees on their company's ethics and compliance standards.

Here is the Table of Contents for Facebook's Code of Conduct. Although this is a typical approach to a Code of Conduct, it doesn't mean a company is necessarily perceived as ethical. This is particularly true lately as Facebook contends with pressure to change its commitments to "free speech" with accusations of promoting hate speech.

Table 11.3 Table of Contents for Facebook's Code of Conduct

Table of Contents
1. Introduction
2. Conflicts of Interest
3. Harassment
4. Communications
5. Public Disclosures
6. Financial Integrity and Responsibility
7. Confidential Information
8. Protection of User Data and Personnel Data
9. Protection and Use of Facebook Assets
10. Compliance with Laws
11. Reporting Violations
12. Policy Prohibiting Retaliation
13. Training
14. Amendment and Waivers

Another form of regulation designed to prevent corporate misbehavior are "whistleblower" laws and policies. Many firms intentionally encourage employees to report any suspected misconduct by the firm, its managers, or employees. A "whistleblower" hotline is often provided where suspected violations can be reported anonymously. Anti-retaliation policies encourage employees to come forward to report misconduct without fear of retaliation or losing their job. Although all these measures are helpful, unfortunately, fraud and misconduct still occur.

In response to persistent "rule-breaking" by corporate actors, Corporate Social Responsibility (CSR) emerged in the 1970s to assert that a "social contract" exists between business and society. At its base is the assumption that businesses thrive when the society it relies on thrives, and therefore, firms have a duty to provide more than profit back to its environment. It is a business model that attempts to "give back" to the members of the

community or society that help the firm succeed through the purchasing of its products or services. The goal of CSR is to enhance the success of a business by enhancing the society in which the organization operates. It can take the form of philanthropy or donating funds to causes it believes are important to its stakeholders. Some forms of CSR include corporate volunteerism, such as asking company employees to volunteer to build a Habitat for Humanity house on a Saturday. Improving environmental sustainability is one of the most recognized recent forms of CSR.

Many firms adopt the Triple Bottom Line approach to guide their CSR philosophy. In the triple bottom line, the company focuses on the three P's; profit, planet, and people. CSR is discussed in more detail later in this chapter.

Section Videos

What is business ethics? [04:08]

The video for this lesson explains personal business ethics.

You can view this video here: https://youtu.be/IEmUag1ri6U.

What is Ethics? What is Business Ethics? [04:35]

This second video for the lesson focuses on business ethics.

You can view this video here: https://youtu.be/vmVu66Fpd9U.

Key Takeaway

- Firms can have a positive or negative impact on society. Corporate scandals have caused tremendous losses for shareholders, employees, and other stakeholders. The government has passed various regulations such as the Sarbanes-Oxley Act in attempts to thwart unethical and illegal company behavior, yet this behavior continues. Company boards of directors have the ultimate responsibility of ensuring ethical behavior on the part of the organization and its CEO. Senior management may be tempted to act in their own interest instead of the best interests of the firm, which is called the agency problem. On the positive side, many firms have adopted the philosophy and activities of corporate social responsibility or creating shared value. Ethical issues will confront firms and their leadership teams. Adhering to the companies' core values and keeping the best interests of the firm as the priority will help guide leaders to the best decisions.

Exercises

1. Divide into groups of 4 or 8, and discuss actions boards of directors can take to help ensure ethical behavior is maintained by the company leadership and the employees. Come up with several ideas to share with the class.
2. You work for Deloitte in Tyson's Corner in Northern Virginia. You have been selected to serve on a team to come up with ideas on how your office can implement corporate social responsibility. What specific CSR ideas will you share with the team?

References

Table 11.3 Facebook. (2019, June 10). Adapted from "Code of Conduct" https://s21.q4cdn.com/399680738/files/doc_downloads/governance_documents/2019/Code-of-Conduct-(June-10-2019).pdf.

Walmart. (n.d.) Global Ethics & Compliance. https://corporate.walmart.com/our-story/global-ethics-compliance.

Video Credits

Cranfield School of Management. (2010, July 13). *The ethics of business. Where and why it can go wrong* [Video]. YouTube. https://youtu.be/vAtu_iBbknY.

Global Ethics Solutions. (2019, November 1). *What is business ethics?* [Video]. https://youtu.be/IEmUag1ri6U.

Markkula Center for Applied Ethics. (2010, October 1). *What is ethics? What is business ethics?* [Video]. https://youtu.be/vmVu66Fpd9U.

11.3 Corporate Governance

The Many Roles of Boards of Directors

"You're fired!" is a commonly used phrase most closely associated with Donald Trump as he dismissed candidates on his reality show, *The Apprentice*. But who would have the power to utter these words to today's CEOs, whose paychecks are on par with many of the top celebrities and athletes in the world? This honor belongs to the board of directors—a group of individuals that oversees the activities of an organization or corporation.

Potentially firing or hiring a CEO is one of many roles played by the board of directors in their charge to provide effective corporate governance for the firm. An effective board plays many roles, ranging from the approval of financial objectives, advising on strategic issues, making the firm aware of relevant laws, and representing stakeholders who have an interest in the long-term performance of the firm (Table 11.1 "Board Roles"). Effective boards may help bring prestige and important resources to the organization. For example, General Electric's board often has included the CEOs of other firms as well as former senators and prestigious academics. Blake Mycoskie of TOMS Shoes was touted as an ideal candidate for an "all-star" board of directors because of his ability to fulfill his company's mission "to show how together we can create a better tomorrow by taking compassionate action today" (Bunting, 2011).

One of the key stakeholders of a corporation is generally agreed to be the shareholders of the company's stock. Most large, publicly traded firms in the United States are made up of thousands of shareholders. While 5% ownership in many ventures may seem modest, this amount is considerable in publicly traded companies, where such ownership is generally limited to other companies, and ownership in this amount could result in representation on the board of directors.

The possibility of **conflicts of interest** is considerable in public corporations. A conflict of interest exists when a person could receive personal benefit from decisions they make in their official capacity. For example, if a firm's purchasing agent's husband owns an office supply company that could sell products to the firm, the purchasing agent has a conflict of interest, On the one hand, CEOs favor large salaries and job stability, and these desires are often accompanied by a tendency to make decisions that would benefit the firm (and their salaries) in the short term at the expense of decisions considered over a longer time horizon. In contrast, shareholders prefer decisions that will grow the value of their stock in the long term. This separation of interest creates an **agency problem** wherein the interests of the individuals that manage the company (agents such as the CEO) may not align with the interest of the owners (such as stockholders).

The Ethisphere® Institute presents an annual listing of the #WorldsMostEthicalCompanies at
https://www.worldsmostethicalcompanies.com/honorees.

The composition of the board is critical because the dynamics of the board play an important part in resolving the agency problem. However, who exactly should be on the board is an issue that has been subject to fierce debate. CEOs often favor the use of board insiders who often have intimate knowledge of the firm's business

affairs. In contrast, many institutional investors such as mutual funds and pension funds that hold large blocks of stock in the firm often prefer significant representation by board outsiders that provide a fresh, unbiased perspective concerning a firm's actions.

One particularly controversial issue in regard to board composition is the potential for CEO duality, a situation in which the CEO is also the chairman of the board of directors. This has also been known to create a bitter divide within a corporation.

For example, during the 1990s, The Walt Disney Company was often listed in BusinessWeek's rankings for having one of the worst board of directors (Lavelle, 2002). In 2005, Disney's board forced the separation of then CEO (and chairman of the board) Michael Eisner's dual roles. Eisner retained the role of CEO but later stepped down from Disney entirely. Disney's story reflects a changing reality that boards are acting with considerably more influence than in previous decades when they were viewed largely as rubber stamps that generally folded to the whims of the CEO.

William Shakespeare once wrote, "All the world's a stage, and the men and women merely players." This analogy applies well to boards of directors. When the performance of board members is impressive, the company is able to put on a dynamic show. But if a board member phones in their role, failure may soon follow. Discussed below are the different roles board members may play.

Table 11.4 Board Roles

Roles of Board Members	
Accountant	Board members may, at times, approve financial objectives.
Lawyer	Ensuring the firm complies with applicable laws is a key role.
Advisor	Providing advice on strategic issues is a critical role that is overlooked by less effective boards.
Activist	Boards must ensure the rights and interests of stakeholders (especially stockholders) are represented.
Human Resource Manager	Boards must monitor the CEO and engage in hiring, firing, and the administration of CEO compensation.
Agent	Because board members may serve in powerful positions at other companies, a well-networked board member may be able to bring new connections to the firm.

Managing CEO Compensation

One of the most visible roles of boards of directors is setting CEO pay. The valuation of the human capital associated with the rare talent possessed by some CEOs can be illustrated in a story of an encounter one tourist had with the legendary artist Pablo Picasso. As the story goes, Picasso was once spotted by a woman sketching. Overwhelmed with excitement at the serendipitous meeting, the tourist offered Picasso fair market value if he would render a quick sketch of her image. After completing his commission, she was shocked when he asked for five thousand francs, responding, "But it only took you a few minutes." Undeterred, Picasso retorted, "No, it took me all my life" (Kay, 1999).

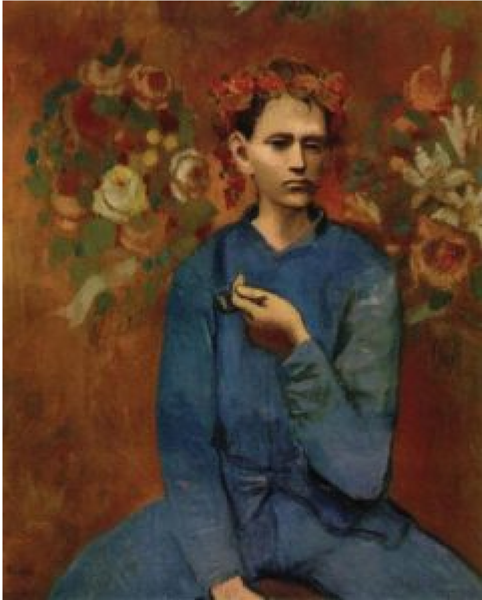

Figure 11.2: Picasso's Garçon á la pipe was one of the most expensive works ever sold at more than $100 million.

This story illustrates the complexity associated with managing CEO compensation. On the one hand, large corporations must pay competitive wages for the scarce talent that is needed to manage billion-dollar corporations. In addition, like celebrities and sport stars, CEO pay is much more than a function of a day's work for a day's pay. CEO compensation is a market driven function of the competitive wages that other corporations would offer for a potential CEO's services.

On the other hand, boards will face considerable scrutiny from investors if CEO pay is out of line with industry norms. From the year 1980 to 2000, the gap between CEO pay and worker pay grew from 42 to 1 to 475 to 1 (Blumenthal, 2000). Although efforts to close this gap have been made, as recently as 2019 reports indicate the ratio continues to be as high as 278 to 1. This is much higher than other countries, for example, Germany's is half the US ratio (Cox, 2019). Meanwhile, shareholders need to be aware that research studies have found that CEO pay is positively correlated with the size of firms—the bigger the firm, the higher the CEO's compensation (Tosi et al., 2000). Consequently, when a CEO tries to grow a company, such as by acquiring a rival firm, shareholders should question whether such growth is in the company's best interest or whether it is simply an effort by the CEO to get a pay raise.

Within American firms, the average CEO is paid over 200 times what the typical worker makes—one of the highest ratios in the world. Many CEOs also receive perks that the average employee could only dream possible. Such perks are trouble to the extent that they reflect the board's lack of vigilance in monitoring CEO spending. We illustrate a few examples below.

Table 11.5 CEO Perks

Perks of Being a CEO
Former Tyco CEO Dennis Koslowski—now a convicted felon—threw a week-long $2 million birthday bash for his wife that included an ice-sculpture of Michelangelo's David that dispensed vokda—top shelf, of course!
A pint-sized matter compared to the lavish perks of many executives, the sweet tooth should be satisfied for former Ben & Jerry's CEO Robert Holland Jr., who will receive free ice cream for life.
Golden parachutes where CEOs receive large cash settlements if fired are common in publicly traded companies. Less common is the "golden coffin" that provides big settlements if an executive passes away in office. Abercrombie & Fitch CEO Michael Jefferies was offered $6 million for his loyalty to the company…dead or alive.
Foreclosure! Countrywide Financial, now owned by Bank of America, paid nearly $1 million for their executives' country club memberships between 2003 through 2006.
Although Don Tyson of Tyson Foods retired in 2001, Tyson employees mowed his yard and cleaned his house to keep things tidy post retirement.

In most publicly traded firms, CEO compensation generally includes guaranteed salary, cash bonus, and stock options. But perks provide another valuable source of CEO compensation (Table 11.4 "CEO Perks"). In addition to the controversy surrounding CEO pay, such perks associated with holding the position of CEO have also

come under considerable scrutiny. The term perks, derived from perquisite, refers to special privileges, or rights, as a function of one's position. CEO perks have ranged in magnitude from the sweet benefit of ice cream for life given to former Ben & Jerry's CEO Robert Holland, to much more extreme benefits that raise the ears of investors while outraging employees. One such perk was provided to John Thain who, as former head of NYSE Euronext, received more than $1 million to renovate his office. While such perks may provide powerful incentives to stay with a company, they may result in considerable negative press and serve only to motivate vigilant investors wary of the value of such investments to shop elsewhere.

As noted earlier in this chapter, sometimes CEOs get involved in corporate scandals, seeking their own self interest instead of the best interests of the company. But this problem can be much more subtle than creating a scandal, and not limited to CEOs. An agency problem exists whenever an "agent" of the company, typically senior management, acts in their own self interest at the expense of the best interests of the firm. For example, a CEO may push for the acquisition of another company to enhance his or her salary and legacy when that acquisition is not a wise move. They may decide to expand into Spain instead of the United Kingdom because they prefer to travel to sunny Spain with its great food instead of the rainy United Kingdom, even though the United Kingdom is the better choice. Selfish or self-centered motives can influence decision making in ways that are difficult to detect. At times, the decision maker may feel justified in the decision and not realize their impure motives behind the decision. The board of directors and the decision makers themselves need to recognize that the agency problem exists and guard against it in their organization. The agency problem also exists in politics, and at times politicians are accused of making decisions that benefit themselves over their constituents.

The Market for Corporate Governance

The terms associated with mergers, acquisitions, and the actions used by executives to block these moves often sound like material from the latest war movie. We explain important terms below.

Table 11.6 Takeover Terms

While a pirate raids a competitor's vessel looking to loot valuable treasures, a **corporate raider** invades a firm by purchasing its stock.	**Hostile takeover** refers to an attempt to purchase a company that is strongly resisted by the target firm's CEO and/or board.
Defenses against takeovers are often referred to as **shark repellent**. We illustrate a few below.	
A **golden parachute** is a financial package (often including stock options and bonuses worth millions of dollars) given to executives likely to lose their jobs after a takeover. These parachutes make taking over a firm more costly and thus less attractive.	When executives are desperate to avoid a takeover they may be forced to swallow a **poison pill.** This involves making the firm's stock unattractive to raiders by letting shareholders buy stock at a discount.
A firm that rescues a target firm by offering a friendly takeover as an alternative to a hostile one is known as a **white knight**.	In contrast to blackmail, where information is withheld unless a demand is met, **greenmail** occurs when an unfriendly firm forces a target company to repurchase a large block of stock at a premium to thwart a takeover attempt.

An old investment cliché encourages individuals to buy low and sell high. When a publicly traded firm loses value, often due to lack of vigilance on the part of the CEO and/or board, a company may become a target of a takeover wherein another firm or set of individuals purchases the company. Generally, the top management team is charged with revitalizing the firm and maximizing its assets.

In some cases, the takeover is in the form of a leveraged buyout (LBO) in which a publicly traded company is purchased with sizable debt and then taken off the stock market. One of the most famous LBOs was of RJR Nabisco, which inspired the book (and later film) *Barbarians at the Gate*. LBOs are historically associated with reduction in workforces to streamline processes and decrease costs. The managers who instigate buyouts generally bring a more entrepreneurial mind-set to the firm with the hopes of creating a turnaround from the same fate that made the company an attractive takeover target (recent poor performance) (Wright et al., 2001).

Many takeover attempts increase shareholder value. However, because most takeovers are associated with the dismissal of previous management, the terminology associated with change of ownership has a decidedly negative slant against the acquiring firm's management team. For example, individuals or firms that hope to conduct a takeover are often referred to as corporate raiders. An unsolicited takeover attempt is often dubbed a hostile takeover, with shark repellent as one of the potential defenses against such attempts. Although the poor management of a targeted firm is often the reason such businesses are potential takeover targets, when another firm that may be more favorable to existing management enters the picture as an alternative buyer, a white knight is said to have entered the picture (Table 11.3 "Takeover Terms").

The negative tone of takeover terminology also extends to the potential target firm. CEOs as well as board members are likely to lose their positions after a successful takeover occurs, and a number of anti-takeover tactics have been used by boards to deter a corporate raid. For example, many firms are said to pay greenmail by repurchasing large blocks of stock at a premium to avoid a potential takeover. Firms may threaten to take a poison pill where additional stock is sold to existing shareholders, increasing the shares needed for a viable takeover. Even if the takeover is successful and the previous CEO is dismissed, a golden parachute that includes a lucrative financial settlement is likely to provide a soft landing for the ousted executive.

Section Video

Role of the Board in Creating an Ethical Corporate Culture [06:48]

The video for this lesson describes the role of the board in creating an ethical corporate culture.

You can view this video here: https://youtu.be/kOm8SC8qI4w.

Key Takeaway

- Firms can benefit from superior corporate governance mechanisms such as an active board that monitors CEO actions, provides strategic advice, and helps to network to other useful resources. When such mechanisms are not in place, CEO excess may go unchecked, resulting in negative publicity, poor firm performance, and the potential for a takeover by other firms. An agency problem exists when the CEO acts in their own best interest instead of the best interest of the firm.

Exercises

1. Divide the class into teams and see who can find the most egregious CEO perk in the last year.
2. Find a listing of members of a board of directors for a Fortune 500 firm. Does the board seem to be composed of individuals who are likely to fulfill all the board roles effectively?
3. Research a hostile takeover in the past five years and examine the long-term impact on the firm's stock market performance. Was the takeover beneficial or harmful for shareholders?
4. Examine the AFL-CIO Executive Paywatch website https://aflcio.org/paywatch and select a company of interest to see how many years you would need to work to earn a year's pay enjoyed by the firm's CEO.

References

Blumenthal, R. G. (2000, September 4). The pay gap between workers and chiefs looks like a chasm. *Barron's*, 10.

Bunting, C. (2011, February 23). Board of dreams: Fantasy board of directors. *Business News Daily*. http://www.businessnewsdaily.com/681-board-of-directors-fantasy-picks-small-business.html.

Cox, J. (2019, August 16). CEOs see pay grow 1,000% in the last 40 years, now make 278 times the average worker. CNBC. https://www.cnbc.com/2019/08/16/ceos-see-pay-grow-1000percent-and-now-make-278-times-the-average-worker.html.

Kenton, W. (2020). *Sarbanes-Oxley* (SOX) *Act of* 2002. Investopedia. https://www.investopedia.com/terms/s/sarbanesoxleyact.asp.

Kay, I. (1999). Don't devalue human capital. *Wall Street Journal—Eastern Edition*, 233, A18.

Lavelle, L. (2002, October 7). The best and worst boards: How corporate scandals are sparking a revolution in governance. *BusinessWeek*, 104.

Tosi, H. L., Werner, S., Katz., J. P., & Gomez-Mejia, L. R. (2000). How much does performance matter? A meta-analysis of CEO pay studies. *Journal of Management*, 26, 301–339.

Wright, M., Hoskisson, R. E., & Busenitz, L. W. (2001). Firm rebirth: Buyouts as facilitators of strategic growth and entrepreneurship. *Academy of Management Executive*, 15, 111–125.

Image Credits

Figure 11.2: Picasso, Pablo. "Garçon à la Pipe." Public Domain. Retrieved from https://en.wikipedia.org/wiki/File:Garçon_à_la_pipe.jpg.

Video Credits

Markkula Center for Applied Ethics. 2013, November 26. Role of the Board in Creating an Ethical Corporate Culture. Retrieved from https://youtu.be/kOm8SC8qI4w.

11.4 Corporate Ethics and Social Responsibility

What Is Corporate Social Responsibility?

As introduced early in this chapter, **Corporate Social Responsibility** (CSR) "is a self-regulating business model that helps a company be socially accountable—to itself, its stakeholders, and the public. By practicing corporate social responsibility, also referred to simply as social responsibility, companies can be conscious of the kind of impact they are having on all aspects of society, including economic, social, and environmental" (Chen, 2020). Philanthropy is the simplest form of CSR, where a firm donates funds to a nonprofit organization such as the local volunteer rescue squad or the American Cancer Society. However, CSR can take many forms, with the end result that society benefits in some way. Environmental efforts in CSR might include reducing the company's pollution or helping to clean up the plastic that washes up on beaches. Supporting the local literacy volunteers by encouraging employees to participate to help adults learn to read and write provides a social benefit.

Figure 11.3: The CSR Pyramid shown illustrates the ever-increasing responsibilities of a firm that engages in a CSR philosophy and the associated activities.

The CSR approach is not without controversy. When CSR was introduced, the famous economist Milton Friedman opposed CSR on philosophical grounds. He believed, as some others did, that no profits should be diverted for CSR activities. The logic was that company investors and stockholders took a risk when they invested in the company, and therefore the company's first obligation is to them. On the other hand, many who practice CSR believe that CSR activities ultimately do benefit the company investors and stockholders. The belief is that having a CSR strategy provides good public relations for the firm and enhances their brand image, creating loyalty and more sales long term. For example, some consumers may specifically shop for TOMS shoes because of the firm's Buy One, Give One model, where the consumer feels their purchase is providing a positive social impact.

Some examples of CSR efforts are:

- Reducing their carbon footprint—Coca Cola
- Ensuring contract manufacturers pay a living wage—Patagonia
- Improving sustainable manufacturing—BMW
- Matches employees' donations to nonprofits—Microsoft and Google
- Reducing carbon emissions—United Airlines
- Promoting literacy among children—Twitter

- Eliminating foam cups–Dunkin'
- Donating employees' hours to children's tutoring–Salesforce

One criticism of CSR is that it is seen as an "add on" endeavor for firms. Often, CSR is not an ingrained component of the firm's philosophy and operations. In response to this criticism, a rather new movement emerged in an attempt to remedy this deficiency. Michael Porter and Mark Kramer suggest that instead of CSR, wise corporations are shifting to a **Creating Shared Value (CSV)** model that argues that firms should address social issues by creating shared value, which is fundamentally focused on expanding the total pool of social and economic resources (Porter & Kramer, 2006; Porter & Kramer, 2011). Porter and Kramer re-frame the business proposition by trying to recognize that "societal needs, not just conventional economic needs, define markets, and social harms can create internal costs for firms" (Porter & Kramer, 2011).

Creating shared value (CSV) is a business strategy that creates a direct link between the success of the firm and the improvement of society. Generally, CSV can be considered to be a particular strategic approach within the more general CSR landscape. A key differentiating detail is the explicit focus of CSV in generating positive economic outcomes through its strategic investments. As a company prospers economically, so do those it impacts. However, CSV and CSR both take a longer-term, rather than a short-term, approach to measuring impact. For example, Whole Foods was one of the most high profile companies to adopt CSV as a guiding strategy. This strategy translated into investing in local schools to ensure a well prepared work force and supporting local agricultural communities so it could reliably source produce from local vendors. While one traditional view of "business as usual" is that when a company prospers, it is at the expense of the consumer and society. CSV and CSR flip this view.

Section Videos

Business Ethics: Corporate Social Responsibility [02:56]

The video for this lesson further explains corporate social responsibility.

You can view this video here: https://youtu.be/xoE8XlcDUI8.

Insight: Ideas for Change–Michael Porter–Creating Shared Value [14:09]

The video for this lesson focuses on the differences between CSR and CSV.

You can view this video here: https://youtu.be/xuG-1wYHOjY.

Measuring Corporate Social Performance

TOMS Shoes' commitment to donating a pair of shoes for every pair sold illustrates the concept of social entrepreneurship, in which a business is created with a goal of improving both business and society (Schectman, 2010). Using a CSR model, firms such as TOMS exemplify a desire to improve **corporate social performance** (CSP) in which a commitment to individuals, communities, and the natural environment is valued alongside the goal of creating economic value. Although determining the level of a firm's social responsibility is subjective, this challenge has been addressed by other organizations that rate firms on a number of stakeholder-related issues with the goal of measuring CSP. They conduct ongoing research on social, governance, and environmental performance metrics of publicly traded firms and reports such statistics to institutional investors. For example, the KLD database provides ratings on numerous "strengths" and "concerns" for each firm along a number of dimensions associated with corporate social performance (Table 11.6 "Measuring Corporate Social Performance"). The results of their assessment are used to develop the Domini social investments fund, which has performed at levels roughly equivalent to the S&P 500. Some rating firms use an ESG framework for evaluating a firm. ESG stands for Environmental, Social, and Governance, and measures within each of these three dimensions are used to score a company.

Corporate social performance is defined as the degree to which a firm's actions honor ethical values that respect individuals, communities, and the natural environment. Determining whether a firm is socially responsible is somewhat subjective, but one popular approach has been developed by KLD Research & Analytics. Their work tracks "strengths" and "concerns" for hundreds of firms over time. KLD's findings are used by investors to screen socially responsible firms and by scholars who are interested in explaining corporate social performance. We illustrate the six key dimensions tracked by KLD below.

Table 11.7 Measuring Corporate Social Performance

Corporate Social Performance		
Community strengths include engagement in charitable giving, while involvement in tax controversies exemplifies a community concern.	Product quality/safety strengths include actions such as the establishment of a well-developed quality program, while concerns arise if a firm receives fines related to product quality and/or safety.	Diversity strengths include progressive programs for the employment of people with disabilities, whereas fines or civil penalties that result from an affirmative action constitute a concern.
A no-layoff policy is a strength in regard to employee relations, while poor union relations are a concern.	Environmental strengths include engaging in recycling, while concerns arise when penalties for air or water violations are documented.	Corporate governance strengths include equitable levels of compensation for top management and board members, while concerns are raised if controversies related to accounting, transparency, or political accountability are discovered.

Assessing the community dimension of CSP is accomplished by assessing community strengths, such as charitable or innovative giving that supports housing, education, or relations with indigenous peoples, as well as charitable efforts worldwide, such as volunteer efforts or in-kind giving. A firm's CSP rating is lowered when a firm is involved in tax controversies or other negative actions that affect the community, such as plant closings that can negatively affect property values.

CSP diversity strengths are scored positively when the company is known for promoting women and minorities, especially for board membership and the CEO position. Employment of people with disabilities and the presence of family benefits such as child or elder care would also result in a positive score by KLD. Diversity concerns include fines or civil penalties in conjunction with an affirmative action or other diversity-related controversy. Lack of representation by women on top management positions—suggesting that a glass ceiling is present at a company—would also negatively impact scoring on this dimension.

Figure 11.4: Chick-fil-A encourages education through their program that has provided more than $92 million in financial aid to more than sixty thousand employees since 1970. [Photo used under Fair Use]

The employee relations dimension of CSP gauges potential strengths such as notable union relations, profit sharing and employee stock-option plans, favorable retirement benefits, and positive health and safety programs noted by the US Occupational Health and Safety Administration. Employee relations concerns would be evident in poor union relations, as well as fines paid due to violations of health and safety standards. Substantial workforce reductions as well as concerns about adequate funding of pension plans also warrant concern for this dimension.

The environmental dimension records strengths by examining engagement in recycling, preventing pollution, or using alternative energies. KLD would also score a firm positively if profits derived from environmental products or services were a part of the company's business. Environmental concerns such as penalties for hazardous waste, air, water, or other violations or actions such as the production of goods or services that could negatively impact the environment would reduce a firm's CSP score.

Product quality/safety strengths exist when a firm has an established and/or recognized quality program; product quality safety concerns are evident when fines related to product quality and/or safety have been discovered or when a firm has been engaged in questionable marketing practices or paid fines related to antitrust practices or price fixing.

Corporate governance strengths are evident when lower levels of compensation for top management and board members exist, or when the firm owns considerable interest in another company rated favorably by KLD; corporate governance concerns arise when executive compensation is high or when controversies related to accounting, transparency, or political accountability exist.

Key Takeaway

- Many companies have adopted a Corporate Social Responsibility (CSR) philosophy to make improvements in the communities and society they operate. CSR is evolving to a Creating Shared Value (CSV) model which integrates the profit motive with solving social issues. Firms such as KLD provide objective measures of both positive and negative actions related to corporate social performance.

Exercises

1. How would your college or university fare if rated on the dimensions of CSR? Of CSV?
2. Do you believe that executives behave more ethically as a result of legislation such as the Sarbanes-Oxley Act? Why or why not?

References

Chen, J. (2020, February 22). *Corporate Social Responsibility* (CSR). Investopedia. https://www.investopedia.com/terms/c/corp-social-responsibility.asp.

Porter, M. E., & Kramer, M. R. (2006). Strategy and society: The Link Between Competitive Advantage and Corporate Social Responsibility. *Harvard Business Review*, 84(12), 78-92.

Porter, M. E., & Kramer, M. R. (2011). Creating Shared Value. *Harvard Business Review*.

Schectman, J. (2010). Good Business. *Newsweek*, 156, 50.

Image Credits

Figure 11.3: Kindred Grey (2020). "Business responsibilities." CC BY-SA 4.0. Retrieved from: https://commons.wikimedia.org/wiki/File:Business_responsibilities.png.

Figure 11.4: Chick-fil A. (2020). Photo used under Fair Use. Scholarship winners. Retrieved from

https://thechickenwire.chick-fil-a.com/news/chick-fil-a-to-award-17-million-in-team-member-scholarships-in-2020.

Video Credits

Study.com. (2013, December 31). Business Ethics: Corporate Social Responsibility. Retrieved from https://youtu.be/xoE8XlcDUI8.

World Economic Forum. (2012, September 6). Insight: Ideas for Change-Michael Porter-Creating Shared Value. Retrieved from https://youtu.be/xuG-1wYHOjY.

11.5 Contemporary Questions of Corporate Ethics

The subject of corporate ethics is an ever-evolving theme. Sometimes companies and the individuals in those companies cross the line and commit acts that are unethical, immoral, or illegal. Society has attempted to erect barriers to prevent these activities from happening by passing laws and regulations, expecting a strict code of ethics and conduct, and providing measures of a firm's social contribution. Depending on which party is in power in Washington, laws and regulations are relaxed because they are "bad for business," or they are strengthened to "protect the people." Unfortunately, whatever the legal climate, violations of society's standards and expectations continue to occur, and it is critical to recognize that laws represent the minimum ethical standard tolerated by a society.

Firms committed to ethical business practices must start by recognizing that just because an action is legal, it does not mean it is ethical. Strategists understand the importance of this distinction because it will be the organization's stakeholders, and not the legal system, that will decide if the firm is satisfactorily ethical. For example, the 2020 boycott by advertisers of Facebook was a reaction to Facebook's failure to take a more active position on hate speech, but Facebook's decisions did not break any laws. (Fung, 2020).

This leads to questions about contemporary corporate ethics. In a global economy, where US companies are competing against cell phones from South Korean companies and Belgian chocolates, ethical questions arise as to the best path for a company to follow. Will companies stick to their core values statements when ethical decision making gets tough? Some of these questions are explored below.

Stakeholder Considerations

Bottom of the Pyramid Mini Case

In 2017, 8.6% of the world population controlled 86.3% of global wealth. This disparity continues to increase. This left about 3.5 billion people at the "bottom of the pyramid" (BOP) making $10,000 or less annually. This group has largely been ignored by business, assuming they did not have the means to purchase goods other than subsistence items (Prahalad, 2019).

Some companies are recognizing that this market of nearly half the world's population may be a viable market and in doing so, provide the world's poor with access to low-cost products that would improve the quality of their daily lives. There are three factors causing the increased interest in this market:

- The rise in income of this group in the last several decades.
- The widespread use of cell phone technology among the world's poor, lowering the cost of communication and learning. Banking is even done by cell phone in some poor countries.
- The rise of corporate social responsibility and creating shared value philosophies among companies in richer nations (Prahalad, 2019).

Companies entering this market have used the strategy of "low price, low margins, high volumes" in attempts to gain profitability, but this strategy required appropriately 30% market penetration to be successful. Proctor and Gamble launched its PUR(R) water purification powder on a large scale with this strategy but failed, not achieving sufficient penetration and volumes. Dupont attempted the same strategy selling protein powder packets to fortify foods, but failed for the same reason (Simanis, 2012).

There are criticisms of BOP strategies that extend beyond their failure to achieve market penetration. These BOP critics argue that the targeted marketing of the world's poorest people is exploitative and will systematically keep the poor in poverty by pushing out local suppliers and failing to provide sustainable structures for local employment in their place. Pointedly, they suggest that this approach perpetuates the conditions it is trying to improve.

What can firms like P&G and Dupont do to be successful in the market? How do they need to change their strategy? How can this be a win-win for the company and those at the bottom of the pyramid, or can it? Should firms be engaging in this strategy at all?

Offshoring

As US wages increased, and with improvements in communications and transportation, many US companies offshored their activities. Often, manufacturing operations were closed down in the United States and performed in a country where the labor costs were much cheaper. The result has been the loss of thousands

of jobs in the US, with plants closed down and communities left devastated. Another aspect of offshoring has been in the service sector, with US firms setting up their call centers abroad, along with IT services and even accounting services. Importantly, offshoring impacts the working conditions of people around the world, generally in the poorest economies with the least labor protections. Workers in agricultural and garment industries are particularly vulnerable to labor exploitation in the global supply chain (British Standards Institution, 2019), and global concerns about child labor are well documented (Moulds, n.d.).

The ethical question is, "Is offshoring ethical?" Justifications can be made on both sides of the issue. US companies compete in a global marketplace, and the dominant argument has been that if they had to pay US wages, they could not compete internationally. Also, in 2019 before the COVID-19 pandemic, the United States had record low unemployment, so the need to return jobs to the United States was questionable. Conversely, the loss of good jobs and the resulting blight of closed facilities in communities across the country are just not worth the advantage of offshoring, in the opinion of some. As of 2018, efforts are being made by the federal government to encourage manufacturers to return to the United States, which include imposing additional tariffs on some goods made abroad. One outcome of the COVID-19 pandemic was the realization that the United States depends on foreign countries for many essential products, such as pharmaceuticals and face masks. This dependency, especially on China, a political adversary, gave more merit to the argument of reducing offshoring.

Of course, other countries besides the United States pursue cheap labor costs. Sometimes, this can lead to increased labor exploitation abroad, as foreign manufacturers compete against each other on price. This can even lead to labor exploitation at home, with the threat of offshoring to reduce wages and benefits. Conversely, ethical companies have produced the opposite effect abroad, making their suppliers pay fair wages if they want their business. Child labor has been reduced in developing countries because US firms required their suppliers to not use child labor. In an interesting twist, some industries are turning to the American South for cheap manufacturing labor. (Roberts, 2018)

Offshoring is a complicated strategic question, and without considering the full context of the questions facing the firm within its external environment, a strategist could easily make a short-sighted decision.

Environment/Climate Change/Sustainability

Another debate involving multiple world-wide stakeholders relates to environmental sustainability and global warming. As in offshoring, there are opposing forces that tip the scale one way or the other. On one side is the health of the economy and business environment. The opposing side is the health of the planet and its inhabitants; people, animals, and plant life. As environmental forces gain traction and laws and regulations are implemented by governments, some believe this hurts the economy, businesses, and employment. On the flip side, as regulations are loosened, others believe it contributes to increased pollution, poorer human health, and global warming with all its implications for drought, rising sea levels, and loss of animal and plant species.

These arguments have been going on since the early 1970's with the passage of the Clean Air Act and Clean Water Act by Congress. Some take the position that the dichotomy of opposing forces does not have to exist,

that movements toward clean renewable energy sources or reducing pollution are overall good for the business environment, stimulating innovation, efficiency, and job creation. Even though it may cost a manufacturer millions of dollars to retrofit their plant to reduce pollution, these costs can be made up and the overall impact is positive. The pendulum swings back and forth on this issue, often depending on who is in power in Washington. European countries have taken the lead in sustainability, with significant conversion to wind power for electricity generation. Others, including China, India, and emerging economies lag behind.

Global Economic Inequality

In 1990, approximately 36% of the world's population lived in extreme poverty. The World Bank defines extreme poverty as living on less than $1.90 per day. Fortunately, this rate has been consistently declining about one percentage point annually, and in 2015 the percentage of people world wide living in extreme poverty was 10%. Approximately 68 million people are no longer considered in extreme poverty (The World Bank, 2018). China is a prime example of poor people moving to cities to take manufacturing jobs, with the result of millions elevating into the middle class.

What created such a drop in those living in extreme poverty? These people have benefited from the increase in global business and foreign direct investment that have impacted developing countries in Asia, Latin America, and Africa. Offshoring to low wage countries, although controversial, has helped millions move from an agrarian lifestyle of poverty to a steady job with steady income. The increase in global trade, particularly in commodities produced by poorer countries, helped in this effort. Likewise, the corporate social responsibility efforts of companies manufacturing in poorer countries insisted on their partners and supply chains to pay a living wage, pay men and women equally, and eliminate child labor, which meant more children received an education.

It is important to understand that even though there has been significant improvements in the number of people world wide living in extreme poverty (less than $1.90 per day), nearly half of the world's population still lives in poverty. Approximately 46% (as of 2015) live on less than $5.50 per day, and 25% live on less than $3.20 per day. Progress has been made but there is still a long way to go. (Walton, 2019).

Since 2015, the rate of decrease in extreme poverty has slowed. The world goal of reaching 3% living in extreme poverty by 2030 is doubtful (The World Bank, 2020). Several more recent factors slow the decline even more. In 2018–2019 the United States implemented tariffs on many products being imported into the country. This had the effect of slowing international trade, lowering manufacturing volumes abroad, and impacting the job growth seen earlier in poorer countries. The trend of reversing offshoring by US companies, called onshoring, will slow the rate as jobs transition to the United States. Lower commodity prices also influenced the decline. The COVID-19 pandemic had a tremendous negative impact on the world economy with a long term effect of increasing the poverty rate. COVID-19 caused economic activity to decline world wide, and employment in poorer countries dropped off considerably.

COVID-19 Mini Case

The world wide pandemic created by the COVID-19 virus had tremendous impact on businesses domestically and globally. For some, sales increased dramatically, such as in the grocery and medical ventilator industries. For most, however, volumes shrunk as countries mandated stay at home orders and social distancing. Local and national economies across the world were devastated, creating vast numbers of unemployed. Governments were tempted to open the economy back up as soon as possible, and sometimes even when the incidence of infections and hospitalization were still on the rise. This conflicted decision was also deliberated by executives and owners of businesses large and small.

The pandemic created an ethical challenge for both political leaders and citizens: Open up to get the economy going and people back to work and school, but risk raising infection rates, or, continue to lock down to control and diminish the impact of the virus but keep people unemployed, or some balance in between.

(1) Suppose you are the governor of a state. Should lock down continue, at the cost of more unemployment over a longer time frame, or open the economy up at the expense of more coronavirus cases, hospitalizations, and even deaths? What do you do?

(2) Suppose you are the CEO of a 200 person company that makes specialized parts for airplanes. You outsource the manufacturing to another company in Mexico. With the coronavirus outbreak, you initially followed the governor's guidance, closed the office and had people work from home. Productivity is suffering, and you have a lab where 30 people work in two shifts who cannot work from home. You have paid them for the first 4 weeks anyway, but now you are running in the red with sales down. What do you do? Bring everyone back to the office, and risk them getting infected? Bring only the lab staff back, with the same risk? Lay off the lab staff? Furlough everyone to stop the bleeding until this passes? Continue paying everyone and risk bankrupting the company? Some combination of these options? Or is there another option you haven't thought of yet? What's your decision, CEO?

(3) In the midst of this chaos, there are strategic opportunities for those firms positioned to take advantage of the new environment. What might some of those opportunities be?

(4) Suppose you own Sharkey's in Blacksburg. Students are gone and your business has collapsed. Now you're closed per the governor's order, and all staff are furloughed. You tried to stay open for take-out only but it didn't work. The governor has announced that Phase 2 will start next week, and you can open with 25% capacity. It's July, there are a few students around, with many more expected in August. You have enough cash in the bank to stay closed and pay the bills until the semester starts. You'll lose even more money if you open now at 25% capacity and have to pay staff. They need their jobs, however, coming back also increases their risk of infection. What do you do? What's the best decision? You first decide that you hate these ethical dilemmas. Then what?

Section Video

What are the ethical issues facing business today? [02:25]

The video for this lesson explores the ethical issues that businesses face today.

You can view this video here: https://youtu.be/_pLh6bOKbQE.

Key Takeaway

- Living in the United States isolates and insulates its citizens from most of the extreme problems of the world; war, dire poverty, starvation, poor housing, lack of water for drinking, bathing, and cleaning, as well as toxic environments. Global business and economic activities over the last few decades have had a positive impact on the conditions of approximately half of the world's population that struggle financially. Foreign direct investment and offshoring by wealthy countries, as well as buying commodities from poorer countries have contributed to the rise in incomes in poorer nations. Ethical questions remain on how business can impact positively not only on the world's poor, but also on citizens at home, and on the health of the planet.

References

British Standards Institution. (2019). *Risk Factors for Labor Exploitation in Global Supply Chains.* https://www.bsigroup.com/en-US/blog/supply-chain-blog/risk-management/risk-factors-for-labor-exploitation-in-global-supply-chains/.

Fung, B. (2020). *Hundreds of brands are pulling advertisements from Facebook. Its largest advertisers aren't among them.* CNN Business. https://www.cnn.com/2020/07/01/tech/facebook-top-advertisers/index.html.

Moulds, J. (n.d.). *Child labour in the fashion supply chain*. The Guardian. https://labs.theguardian.com/unicef-child-labour.

Prahalad, D. (2019, January 2). *The new fortune at the bottom of the pyramid*. Strategy + Business. https://www.strategy-business.com/article/The-New-Fortune-at-the-Bottom-of-the-Pyramid?gko=c5f11.

Roberts, K. (2018, January 22). *Insult to injury: Foreign manufacturers now making more case in the U.S. than U.S. companies*. Forbes. https://www.forbes.com/sites/kenroberts/2018/01/22/insult-to-injury-foreign-manufacturers-now-making-more-cars-in-u-s-than-u-s-companies.

Simanis, E. (2012, January). *Reality Check at the Bottom of the Pyramid*. Harvard Business Review. https://hbr.org/2012/06/reality-check-at-the-bottom-of-the-pyramid.

Walton, D. (2019). *Poverty trends: global, regional, and national.* Development Initiatives. https://devinit.org/resources/poverty-trends-global-regional-and-national.

The World Bank. (2018). Decline of global extreme poverty continues but has slowed: World Bank. https://www.worldbank.org/en/news/press-release/2018/09/19/decline-of-global-extreme-poverty-continues-but-has-slowed-world-bank.

The World Bank. (2020). Poverty overview. https://www.worldbank.org/en/topic/poverty/overview.

Video Credits

Institute of Business Ethics. (2016, February 1). What are the ethical issues facing business today? Retrieved from https://youtu.be/__pLh6bOKbQE.

11.6 Conclusion

This chapter explains the role of boards of directors in the corporate governance of organizations such as large, publicly traded corporations. Wise boards work to manage the agency problem that creates a conflict of interest between top managers such as the CEO and other groups with a stake in the firm. When boards fail to do their duties, numerous scandals may ensue. Corporate scandals became so widespread that new legislation such as the Sarbanes-Oxley Act of 2002 has been developed with the hope of impeding future actions by executives associated with unethical or illegal behavior. Companies have adopted practices such as ethics and compliance codes and corporate social responsibility activities to improve their accountability to the communities and society they serve. Globally, business activities have lowered poverty rates, but ethical issues remain regarding balancing competing interests on many issues such as offshoring, pollution, sustainability, and economic inequality.

Exercises

1. Divide your class into four or eight groups, depending on the size of the class. Each group should select a different industry. Find positive and negative examples of corporate social performance based on the dimensions used by KLD.
2. This chapter discussed Blake Mycoskie and TOMS Shoes. What other opportunities exist to create new organizations that serve both social and financial goals?