

Chapter 2

Corporate Social Responsibility and Business Ethics

1. What Is Ethics?

- Explain how both individuals and institutions can be viewed as ethical or unethical.
- Explain how law and ethics are different, and why a good reputation can be more important than legal compliance.

Section Outline

- People generally have similar reactions about what actions or conduct can rightly be called ethical or moral.
- As humans, we need and value ethical people and want to be around them.
- Saying that someone or some organization is law-abiding does not mean the same as saying a person or company is ethical.
- For individuals, it is far from easy to recognize an ethical problem, have a clear and usable decision-making process to deal it, and then have the moral courage to do what's right.
 - All of that is even more difficult within a business organization, where corporate employees vary in their motivations, loyalties, commitments, and character.
- What is legal is not necessarily ethical. Conversely, what is ethical is not necessarily legal.
- Good ethics is good business. In the long run, businesses that pay attention to ethics as well as law do better; they are viewed more favorably by customers.

Key Takeaway

Legal compliance is not the same as acting ethically. Your reputation, individually or corporately, depends on how others regard your actions. Goodwill is hard to measure or quantify, but it is real nonetheless and can best be protected by acting ethically.

Exercises**Section 1 – What Is Ethics?**

1. Think of a person who did something morally wrong, at least to your way of thinking. What was it? Explain to a friend of yours—or a classmate—why you think it was wrong. Does your friend agree? Why or why not? What is the basic principle that forms the basis for your judgment that it was wrong?

Answer: Student answers will vary. For many undergraduate students and even for graduate students, this is an important process. People tend to judge other people's actions more harshly than their own actions. Once moral relativism is set aside (that is, the belief that anyone's moral opinions are as good as anyone else's or that there can be no rational discussion of right and wrong), students will typically come up with values, principles, or operative norms in the community or in society generally that can form the basis for further discussion.

2. Think of a person who did something morally right, at least to your way of thinking. (This is not a matter of finding something they did well, like efficiently changing a tire, but something good.) What was it? Explain to a friend of yours—or a classmate—why you think it was right. Does your friend agree? Why or why not? What is the basic principle that forms the basis for your judgment that it was right?

Answer: Students answers will vary.

3. Think of an action by a business organization (sole proprietor, partnership, or corporation) that was legal but still strikes you as wrong. What was it? Why do you think it was wrong?

Answer: Student answers will vary.

4. Think of an act by an individual or a corporation that is ethical but not legal.

Compare your answer with those of your classmates: were you more likely to find an example from individual action or corporate action? Do you have any thoughts as to why?

Answer: Student answers will vary.

Teaching Suggestions

1. Before starting this section, the instructor may give the following examples to the students and ask them to judge whether the situations are ethical, unethical, legal, or illegal:

- a. Stopping at a red light at a deserted intersection, out in the country, where you can see that there are no cars for miles, and then proceeding through the red light.
- b. An auto mechanic not telling you that he can save you some money by installing a rebuilt alternator or distributor, or some other expensive part, instead of a new one.
- c. A business that sends spam out, even after you repeatedly “unsubscribe.”
- d. A social media site that collects mega-data on all of its users without fully disclosing the uses of that data or how the media company monetizes that data.

Suggested Activities

1. The instructor can ask the students to illustrate with examples; situations that they think are ethical but illegal, and legal but unethical. For example, some students may find that using a morning after pill to avoid conception is legal but wrong, or that any form of gambling, even the legal, is morally wrong. Some students may say that the 20-year-old who obtains alcohol and gauges and “responsible drinking” is not acting unethically. Students could easily argue over whether Edward Snowden or Julian Assange (WikiLeaks) is acting ethically even though their actions are “against the law.”

2. Major Ethical Perspectives

- Describe the various major theories about ethics in human decision making.
- Begin considering how the major theories about ethics apply to difficult choices in life and business.

Section Outline

- **Jeremy Bentham** is often considered the founder of utilitarianism, though **John Stuart Mill** (who wrote **On Liberty** and **Utilitarianism**) and others promoted it as a guide to what is good.
 - **Utilitarianism** emphasizes not rules but results.
 - An action (or set of actions) is generally deemed good or right if it maximizes happiness or pleasure throughout society.
 - The utilitarian principle holds that an action is right if and only if the sum of utilities produced by that action is greater than the sum of utilities from any other possible act. This statement describes “**act utilitarianism**”—which action among various options will deliver the greatest good to society?
 - “**Rule utilitarianism**” is a slightly different version; it asks, what rule or principle, if followed regularly, will create the greatest good?
 - In management, people often employ a form of utility reasoning by projecting costs and benefits for plan X versus plan Y.
 - The following are some frequent mistakes that people make in applying what they think are utilitarian principles in justifying their chosen course of action:
 - Failing to come up with lots of options that seem reasonable and then choosing the one that has the greatest benefit for the greatest number.
 - Assuming that the greatest good for you or your company is in fact the greatest good for all—that is, looking at situations subjectively or with your own interests primarily in mind.

- Underestimating the costs of a certain decision to you or your company.
 - Underestimating the cost or harm of a certain decision to someone else or some other group of people.
 - Favoring short-term benefits, even though the long-term costs are greater.
 - Assuming that all values can be reduced to money.
- The **Deontological** view presented in the writings of **Immanuel Kant** purports that having a moral intent and following the right rules is a better path to ethical conduct than achieving the right results.
 - “**Universalizing**” is a form of rational thought in ethics that assumes the inherent equality of all human beings.
 - It considers all humans as equal, not in the physical, social, or economic sense, but equal before God, whether they are male, female, Pygmy, Eskimoan, Islamic, Christian, gay, straight, healthy, sick, young, or old.
 - For **Kant**, the basic principle of equality means that we should be able to universalize any particular law or action to determine whether it is ethical.
 - There are **two tests for a rule of action to be universal: consistency and reversibility**.
 - **Reversibility:** If you make a decision as though you didn’t know what role or position you would have after the decision, you would more likely make an impartial one—you would more likely choose a course of action that would be most fair to all concerned, not just you.
 - **Consistency:** A **deontologist** would say that since you know you are telling a lie, you must be willing to say that lying, as a general rule, universal phenomenon, is acceptable.
 - **Deontology** requires that we put duty first, act rationally, and give moral weight to the inherent equality of all human beings.
 - The **Golden Rule**, “Do unto others as you would have them do unto you,” emphasizes **reversibility**.

- **Social justice theorists** worry about “**distributive justice**”—that is, what is the fair way to distribute goods among a group of people.
 - **Marxist** thought emphasizes that members of society should be given goods according to their needs. But this redistribution would require a governing power to decide who gets what and when.
 - **Capitalist** thought takes a different approach, rejecting any giving that is not voluntary.
 - Certain economists, such as the late **Milton Friedman** also reject the notion that a corporation has a duty to give to unmet needs in society, believing that the government should play that role.
 - Even the most dedicated **free-market capitalist** admit the need for some government and some forms of welfare.
 - People who do not see the need for public goods (including laws, court systems, and the government goods and services just cited) often question why there needs to be a government at all.
 - **Thomas Hobbes** believed that people in a “state of nature” would rationally choose to have some form of government.
 - He called this the **social contract**, where people give up certain rights to government in exchange for security and common benefits.
 - **Modern social contract theorists**, such as **Thomas Donaldson** and **Thomas Dunfee** (**Ties that Bind**, 1999), observe that various communities, not just nations, make rules for the common good.
 - **Donaldson** and **Dunfee’s** integrative social contracts theory stresses the importance of studying the rules of smaller communities along with the larger social contracts made in states (such as Michigan or California) and nation-states (such as the United States or Germany).
 - A **social contract** can be changed by the participants in a community, just as the US Constitution can be amended.

- **Social contract theory** is thus **dynamic**—it allows for structural and organic changes.
- The rights that people have—in positive law—come from whatever social contract exists in the society.
- This view differs from that of the deontologists and that of the natural-law thinkers such as Gandhi, Jesus, or Martin Luther King Jr., who believed that rights come from God or, in less religious terms, from some transcendent moral order.
- **Communitarians** emphasize that rights carry with them corresponding duties; that is, there cannot be a right without a duty.
- The relationship between rights and duties—in both law and ethics—calls for some explanations:
 - If you have a right of free expression, the government has a duty to respect that right but can put reasonable limits on it.
 - Rights and duties exist not only between people and their governments but also between individuals.
 - Your right in legal terms is only as good as your community's willingness to provide relief within the legal system.
 - **Basic rights** include fundamental elements as food, water, shelter, and physical safety.
 - **Positive rights** include the right to bear arms, the right to vote, the right of privacy, etc.
 - The right to be free from unreasonable searches and seizures, and the right to be free of cruel or unusual punishments are examples of **negative rights**.
 - **Economic or social rights** include adequate food, work, and environment.
 - **Political or civic rights** include the right to vote, the right to equal protection of the laws, the right to due process, etc.
- **Virtue theory**, or virtue ethics, emphasizes the value of virtuous qualities rather than formal rules or useful results.

- **Aristotle** is often recognized as the first philosopher to advocate the ethical value of certain qualities, or virtues, in a person's character.
- He named fourteen virtues: (1) courage, particularly in battle; (2) temperance, or moderation in eating and drinking; (3) liberality, or spending money well; (4) magnificence, or living well; (5) pride, or taking pleasure in accomplishments and stature; (6) high-mindedness, or concern with the noble rather than the petty; (7) unnamed virtue, which is halfway between ambition and total lack of effort; (8) gentleness, or concern for others; (9) truthfulness; (10) wit, or pleasure in group discussions; (11) friendliness, or pleasure in personal conduct; (12) modesty, or pleasure in personal conduct; (13) righteous indignation, or getting angry at the right things and in the right amounts; and (14) justice.
- **Josephson**, a noted American ethicist, believes that a current set of core values has been identified and that the values can be meaningfully applied to a variety of personal and corporate decisions.
- **Studies** from the **Josephson Institute of Ethics** in Marina del Rey, California have identified six core values in our society, values that almost everyone agrees are important to them: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

Key Takeaway

Throughout history, people have pondered what it means “to do what is right.” Some of the main answers have come from the differing perspectives of utilitarian thought; duty-based, or deontological, thought; social contract theory; and virtue ethics.

Exercises

Section 2 – Major Ethical Perspectives

XYZ Motor Corporation begins to get customer complaints about two models of its automobiles. Customers have had near-death experiences from sudden acceleration; they would be driving along a highway at normal speed when suddenly the car would begin to accelerate, and efforts to stop the acceleration by braking fail to work. Drivers could turn

off the ignition and come to a safe stop, but XYZ does not instruct buyers of its cars to do so, nor is this a common reaction among drivers who experience sudden acceleration.

Internal investigations of half a dozen accidents in US locations come to the conclusion that the accidents are not being caused by drivers who mistake the gas pedal for the brake pedal. In fact, there appears to be a possible flaw in both models, perhaps in a semiconductor chip, that makes sudden acceleration happen. Interference by floor mats and poorly designed gas pedals do not seem to be the problem.

It is voluntary to report these incidents to the National Highway Traffic and Safety Administration (NHTSA), but the company decides that it will wait awhile and see if there are more complaints. Recalling the two models so that local dealers and their mechanics could examine them is also an option, but it would be extremely costly. Company executives are aware that quarterly and annual profit-and-loss statements, on which their bonuses depend, could be decisively worse with a recall. They decide that on a cost-benefit basis, it makes more sense to wait until there are more accidents and more data. After a hundred or more accidents and nearly fifteen fatalities, the company institutes a selective recall, still not notifying NHTSA, which has its own experts and the authority to order XYZ to do a full recall of all affected models.

Experts have advised XYZ that standard failure-analysis methodology requires that the company obtain absolutely every XYZ vehicle that has experienced sudden acceleration, using microscopic analysis of all critical components of the electronic system. The company does not wish to take that advice, as it would be—as one top executive put it—”too time-consuming and expensive.”

1. Can XYZ’s approach to this problem be justified under utilitarian theory? If so, how? If not, why not?

Answer: XYZ’s approach to this problem cannot be justified under the utilitarian theory. Utilitarianism is the theory that says that the “right” moral act is the one that produces the greatest good for society. The firm’s managers are calculating costs and benefits in terms of their own bonuses and the firm’s annual earnings, not based on the greatest good for society.

2. What would Kant advise XYZ to do? Explain.

Answer: Kant would have asked XYZ to put duty first, act rationally, and give moral weight to the inherent equality of all human beings. He would have wanted XYZ to judge if whatever it did was universally acceptable. He would have prompted XYZ to apply the Golden Rule (Do unto others as you would have them do unto you). In this case, following a duty not to intentionally harm others would take precedence over a duty to deliver profitability to any one set of managers or shareholders. Students may think that there is a universalizable duty to deliver maximum value to shareholders, but (1) the more general duty is the more universalizable one, and (2) some shareholders may also be customers!

3. What would the “virtuous” approach be for XYZ in this situation?

Answer: The virtuous approach for XYZ in this situation would be to report the incidents to NHTSA, issue a public apology, recall all its affected models, rework them, and reimburse customers who faced a loss because of the affected models. Doing so, in Josephson’s core values terms, would be the most trustworthy, caring, and responsible action. It is also the fairest thing to do and upholds the corporation’s duties as a citizen. It is worth noting students that because of organizational pressures and other well-known temptations of corporate life, and the findings of behavioral psychologists, that corporations are unlikely to consistently ask, “What is the virtuous action here?”

Teaching Suggestions

The instructor could start with a brief introduction of Jeremy Bentham, Immanuel Kant, and Aristotle.

3. An Ethical Decision Model

- Understand one model for ethical decision making: a process to arrive at the most ethical option for an individual or a business organization, using a virtue ethics approach combined with some elements of stakeholder analysis and utilitarianism.

Section Outline

- **Josephson** would first have you ask as many questions as are necessary to get a full background on relevant facts in a case. Assuming you have all the needed information, the decision process is as follows:
 - Identify the stakeholders.
 - Identify several likely or reasonable decisions that could be made.
 - Consider which stakeholders gain or lose with each decision.
 - Determine which decision satisfies the greatest number of core values.
 - If there is no decision that satisfies the greatest number of core values, try to determine which decision delivers the greatest good to the various stakeholders.
- When individuals and organizations confront ethical problems, the core values decision model offered by Josephson generally works well (1) to clarify the gains and losses of the various stakeholders, which then raises ethical awareness on the part of the decision maker and (2) to provide a fairly reliable guide as to what the most ethical decision would be.

Key Takeaway

Having a step-by-step process to analyze difficult moral dilemmas is useful. One such process is offered here, based on the core values of trustworthiness, caring, respect, fairness, responsibility, and citizenship. This does not mean that actually following this or any other rational process of ethical decision making will be easy to do, either individually or corporately.

Exercises

Section 3 – An Ethical Decision Model

1. Consider XYZ in the exercises for Section 2.2 and use the core values decision-making model. What are XYZ's options when they first notice that two of their models are causing sudden acceleration incidents that put their customers at risk? Who are the stakeholders? What options most clearly meet the criteria for each of the core values?

Answer: XYZ can issue an immediate recall, which would be expensive. Or it could “wait and see” while doing further testing, or “wait and see” while doing no further

testing and just “hope for the best.” At the same time and in conjunction with each of the above options it must choose whether to notify NHTSA, and whether to fully disclose what they know.

The stakeholders are the usual ones: shareholders, employees, customers, suppliers, and in this case, the governmental agency (NHTSA). Management guru Peter Drucker would point out that potential customers should be considered, as well (why taint your brand with unethical, illegal actions?).

According to the core values decision-making model, XYZ should recall all the models that are putting its customers at risk and fully and promptly notify NHTSA. Keeping all the core values in mind XYZ should accept that there is a fault in its models, report it to the NHTSA, and apologize to its customers. XYZ should take responsibility and be accountable for the consequences. XYZ should care for its customers and do what is right for them. XYZ should follow all the rules and laws. Scandals such as GM’s failure to correct faulty ignition switches (2001 – 2014) or Volkswagen’s use of software to evade emissions testing (2015) were illegal, to be sure, but stem from a failure to seriously consider ethics in their decision making processes.

Teaching Suggestions

1. The instructor could find a current “ethics scandal” in almost any quarter or semester that would illustrate the tension between ethical values and perspectives and business firm conduct. Specifically identifying the absence of one or more “core values” could be illuminating.

Suggested Activities

1. The instructor could ask students to bring in everyday examples of conduct of others that brings a sense of “moral approval” or “moral disapproval.” Linking those with core values will be enlightening. This can be done anonymously, with students writing out examples of others’ conduct on a blank notecard and letting the instructor find the best examples for class discussion.

4. Corporations and Corporate Governance

- Explain the basic structure of the typical corporation and how the shareholders own the company and elect directors to run it.
 - Understand how the shareholder profit-maximization model is different from the stakeholder theory.
 - Discern and describe the ethical challenges for corporate cultures.
 - Explain what conscious capitalism is and how it differs from stakeholder theory.
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Section Outline

- In corporate legal structure, because the directors of a corporation do not meet that often, it is possible for officers to not be entirely honest with the directors.
 - Since the law does not require officers to be shareholders, their motivations may not align with the best interests of the company. This is the “**agency problem**” often discussed in corporate governance: how to get the managers’ interests well aligned with the shareholders’ interests.
- **Maximizing profits**—is the prevailing view among business managers and in business schools.
 - This view largely follows the idea of **Milton Friedman** that the only moral duty of a manager is to maximize return on investment to the owners.
- **Stakeholders** of a corporation include its employees, suppliers, customers, and the community.
 - A stakeholder is anyone who most would agree is significantly affected (positively or negatively) by the decision of another moral agent.
 - The corporation is a creation of the law.
 - Corporations enjoy the benefit of limited liability by virtue of which larger pools of capital could be aggregated for larger enterprises; shareholders could only lose their investments should the venture fail in any way, and there would be no personal liability and thus no potential loss of personal

- assets other than the value of the corporate stock.
 - In the late 1800s, New Jersey and Delaware changed their laws and allowed incorporation of companies “for any legal purpose,” rather than requiring some public purpose.
 - Thus it is government (and its laws) that makes limited liability happen through the corporate form.
 - According to **stakeholders theorists**, corporations (and other business organizations) must pay attention not only to the bottom line but also to their overall effect on the community.
 - Public perception of a company’s unfairness, uncaring, disrespect, or lack of trustworthiness often leads to long-term failure, whatever the short-term successes or profits may be.
 - A socially responsible corporation is likely to consider the impact of its decisions on a wide range of stakeholders, not just shareholders.
- A corporation is a “person” capable of suing, being sued, and having rights and duties in our legal system.
- Often, the culture of a corporation is more important in determining whether it is likely to break the law or commit serious ethical misdeeds.
- People in an organization tend to watch closely what the top managers do and say.
 - People at the top tend to set the target, the climate, the beliefs, and the expectations that fuel behavior.
- The manager is often an agent for himself or herself and will often act more in his or her self-interest than for the corporate interest.
- If unhappy employees call attention to problems that are being covered up by coworkers or supervisors, they become unpopular with those whose defalcations they report on and with the managers who don’t really want to hear the bad news.
 - In many organizations, “killing the messenger” solves the problem.
- Ethics codes have been put in place—partly in response to federal sentencing guidelines and partly to encourage feedback loops to top management.
 - The best ethics code are aspirational, or having an ideal to be pursued, not legalistic, or compliance driven.

- A code of ethics is only as important as top management is willing to make it.
- If the code is just a document that goes into a drawer or onto a shelf, it will not effectively encourage good conduct within the corporation.
- The federal sentencing guidelines were enacted in 1991.
 - The guidelines require judges to consider “aggravating and mitigating” factors in determining sentences and fines.
 - Companies have to show that they are following the guidelines by providing evidence that they have (1) a viable, active code of ethics; (2) a way for employees to report violations of law or the ethics code; and (3) an ethics ombudsman, or someone who oversees the code.
 - If a company can show that it has an ongoing process to root out wrongdoing at all levels of the company, the judge is allowed to consider this as a major mitigating factor in the fines the company will pay.
- If you manage by the numbers, there is a temptation to lie about those numbers based on the need to get stock price ever higher.
- Most of the time:
 - People generally choose short-term gains over potential long-term losses.
 - People often justify the harm to others as being minimal or “necessary” to achieve the desired sales quota or financial goal.
 - While working as a group, people often form an “us versus them” mentality.
 - The long-term losses are difficult to quantify, while the short-term gains are easy to measure and quite satisfying financially.
 - People in the organization think that the actions they take are necessary.
- Companies giving emphasis on doing whatever is necessary to win is understandable, but it is not ethical.
- One effort to integrate the two view points of stakeholder theory and shareholder primacy is the **conscious capitalism** movement.
 - Companies that practice conscious capitalism embrace the idea that profit and prosperity can and must go hand in hand with social justice and

environmental stewardship.

- They operate with a holistic or systems view.
- They understand that all stakeholders are connected and interdependent.
- They reject false trade-offs between stakeholder interests and strive for creative ways to achieve win-win-win outcomes for all.
- It is designed to maximize profits but is focused more on its higher purpose and does not fixate solely on the bottom line.
- It focuses on delivering value to all its stakeholders, harmonizing as best it can the interests of consumers, partners, investors, the community, and the environment.
- This requires that company managers take a “servant leadership” role and focus on fulfilling the company’s purpose, delivering value to its stakeholders, and facilitating a harmony of interests, rather than on personal gain and self-aggrandizement.
- Having a culture of servant leadership is a much better way to see a company’s top management works to ensure a harmony of interests.

Teaching Suggestions

1. The instructor could invite students to consider current “ethics scandals” where companies fail to either follow the law or follow ethical custom (to use the language of Milton Friedman).
2. Find a major public company and your state or region, and ask the students to identify who the relevant stakeholders are and consider with stakeholders are most important to the continued success of the company, and why? To the best of the student’s knowledge, do the actions of this company meet the conditions laid out by Milton Friedman?.

Suggested Activities

1. The instructor could encourage the students to consider whether their favorite companies (Apple? Nike? Patagonia?) actually meet Mackey’s criteria for being “conscious capitalists.”

5. Summary and Exercises

Answers to exercises

1.a Student answers may vary. Friedman doesn't say, really. Consider, though: What if your business is in a country where bribery is "customary"?

1.b Friedman would say not; maximizing profits should be done within the law. Friedman actually assumes a fairly competent set of public laws and competent, non-corrupt public governance that will take care of general social and environmental needs. Since the time of his essay in 1970, however, a growing number of individuals and companies have engaged in "rent seeking" from government rather than consistent rules of law that uphold competitive fairness under free market principles, or protection of common natural resources for the general good.

1.c This question relates to what the law "is." Realist tradition for school of thought would say that in the situation, there was no effective law. Some economics and law commentators would recommend "breach and pay," meaning that the company should go ahead and break the law and be willing to pay. (Although the assumption here is that the law won't be enforced, so the actuality would be breaching and not paying!) See Mayer, "Legal Loopholes, Business Ethics, and Corporate Legal Strategy: A Reply to Professor Ostas," at <http://onlinelibrary.wiley.com/doi/10.1111/j.1744-1714.2011.01123.x/abstract>

2.a It is probably fair to conclude that Mr. Hardy did not empower his female employees, and thus had some less than fully productive female employees. While he might have just been "joking around," he wasn't doing his business any favors. The only utility from his "joking around" would be his own pleasure, not the well being of his employees or the firm generally.

2.b Although Mr. Hardy would probably say that he enjoys off-color humor and sexual innuendo and takes it in as happily as he gives it out, the more universal duty of respect for others (not using them as means to his own ends) would leave Kant in dutiful disapproval, regardless of what Mr. Hardy would say.

3. Lack of respect, caring, and fairness come to mind.
4. The Board, in cases where legality or illegality is not obvious (recall that the lower courts found no violation of Title VII) should nonetheless hold him to a high standard of personal behavior in the workplace. A warning might suffice, but stronger action would be needed if and when actual legal complaints are filed.
5. This question is wide open for discussion. Note that this is not about Hardy's personal activities during his time at home or away from the office. The activities directly affect the morale of the female employees. At least some students are likely to offer the opinion that if profits are healthy, don't do anything; if it makes Mr. Hardy "happy" to joke around (his terminology), then as long as the "bottom line" is good, don't "rock the boat." As the old saying goes, "If it ain't broke, don't fix it." Do students really agree with that? Why or why not?