

Business Ethics

P13601



DR. 'ALIM J. BEVERIDGE

LECTURE 3



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The Role of the Corporation



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The Debate over CSR



- What is the corporation's purpose and what are its responsibilities?

**Maximize
Shareholder
Value
(Exclusively)**

Vs.

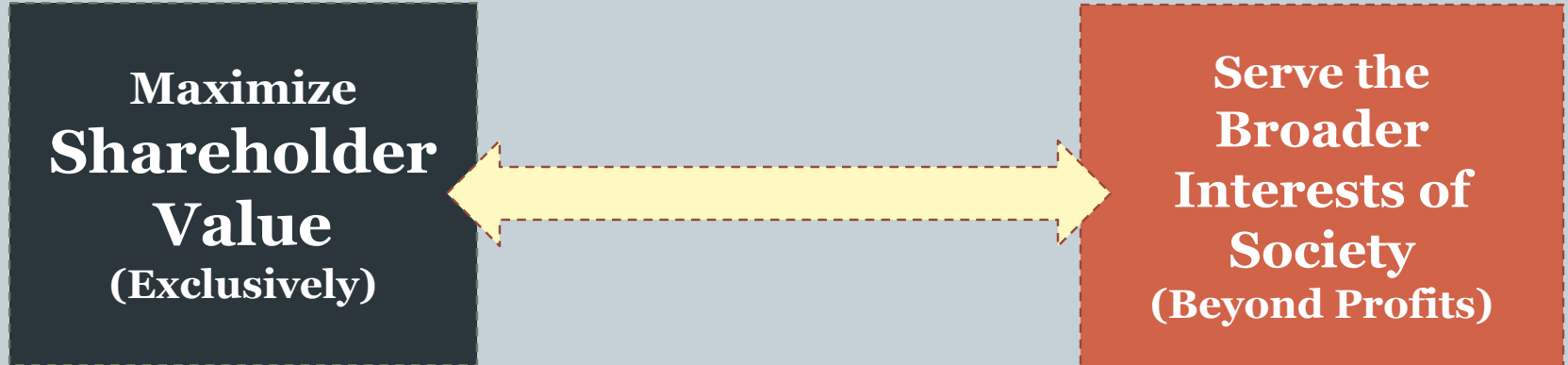
**Serve the
Broader
Interests of
Society
(Beyond Profits)**

- This question was hotly debated for decades.
- The Economist (2005/2008): “The CSR movement [has] won the battle of ideas... Clearly CSR has arrived.”

The Debate over CSR Today



- What is the corporation's purpose and what are its responsibilities?

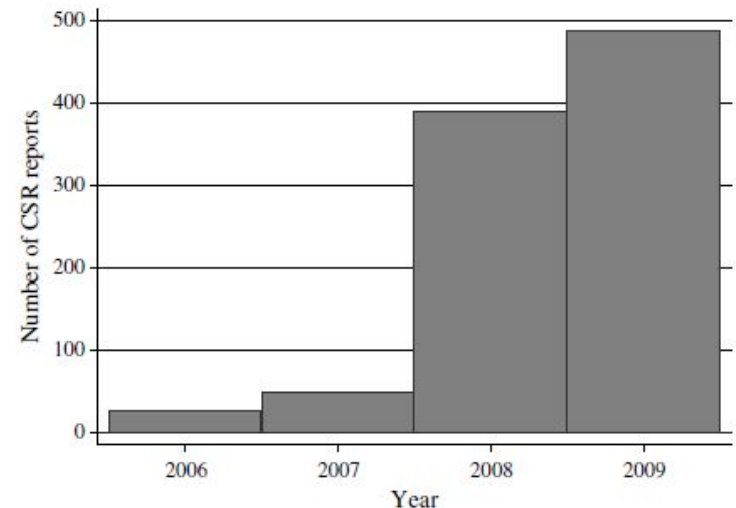


- From a dichotomy to a continuum.
- The question now is not “Whether” but “How?” (or “How much?”) (Smith, 2003)

The Debate over CSR Today

- World-wide diffusion: From a mostly US-based debate to a global concern.
- Chinese government/CPC signals importance of CSR beginning in 2006.
- Largest SOEs encouraged to publish annual SOE reports since 2008.
- Shanghai and Shenzhen stock exchanges make it mandatory for some firms.

Figure 2 Number of CSR Reports Issued by Chinese Publicly Listed Firms, 2006–2009



Corporate Social Responsibility



- What is CSR?
- How has the concept evolved over time?
- How and why have conceptualizations of CSR and attitudes toward it changed over time?
- Why do companies engage in it?

Definitions



Corporate social responsibility:

- “The firm’s consideration of, and response to, issues beyond the narrow economic, technical, and legal requirements of the firm.” (Davis, 1973)
- “Actions that appear to further some social good, beyond the interests of the firm and that which is required by law.” (McWilliam & Siegel, 2001)
- “Includes the economic, legal, ethical and philanthropic expectations placed on organizations by society at a given point in time.” (Carroll & Buchholtz, 2009)

Corporate Social Responsibility



● Five key elements

1. Corporations have responsibilities that go beyond the production of goods and services at a profit.
2. These responsibilities involve helping to solve important social problems, especially those they have helped create.
3. Corporations have a broader constituency than stockholders alone.
4. Corporations have impacts that go beyond simple marketplace transactions.
5. Corporations serve a wider range of human values than can be captured by a sole focus on economic values. (Buchholtz, 1991)

Early Conceptualization



- The **social responsibility of business**
“refers to the obligations of businessmen to pursue those politics, to make those decisions, or to follow those lines of actions which are desirable in terms of the objectives and values of society.” (Bowen, 1953)
- Focus on business and businessmen
- Emphasis on philanthropy and community relations
- Focus on social responsibility of the firm (corporation) emerges about 1967 in the US

What is a Corporation?



1. A legal entity - an “artificial” rather than “natural” person – having rights and duties
For example: it can own property, buy and sell, sue and be sued, employ people.
2. Owned by shareholders (e.g., in England, the US, and Australia). Can be publicly traded or privately held.
3. Often managed by “agents” (managers) who have a fiduciary duty to fulfil the goals and mission given them by its “principals” (owners).

What is its Purpose?



- Should it exclusively focus on maximizing profits?
- Or be more “broadly” concerned with social and environmental issues (e.g. adopt sustainability as a key framework, integrate the Triple Bottom Line into business decisions)?
- Depends on the country: different national business systems (which include legal systems and national cultural values) provide different answers

What is its Purpose?



- US & UK (Anglo-American model): shareholder value maximization (shareholder primacy) view dominant since 1980's; emphasis on profits
- In Continental Europe, Scandinavia and East Asia, corporations have a broader mandate
- Germany, Netherlands & France: firm's purpose includes furthering the welfare of employees and general society
- China: Well-being of the state is a priority

The US Case



- US law privileges the interests of shareholders, but not exclusively.
- Culturally there is a tension:
- “Libertarian” position advocates for minimalist responsibility of corporations
- “Egalitarian” position advocates for broader responsibilities (but not necessarily through expansion of law or regulation)
- This tension gave rise to the CSR debate and has shaped its evolution

Carroll's Four-Part Model: The Pyramid of CSR



**Do
Good**

**Philanthropic
Responsibilities**

Desired by society

**Do No
Harm**

Expected by society

**Required by
society**

**Required by
society**



Why should firms engage in CSR?



1. **Moral** arguments: pro-CSR arguments based on the view that corporations have moral obligations (“It’s the right thing to do”)

Other terms:

- Normative view: “based on what is considered to be the usual or correct way of doing something”; “conforming to or based on norms” (Merriam-Webster)
- The “Broad CSR” position (Schwartz & Saia)

Why should firms engage in CSR?



- 2. Instrumental** arguments: based on claims that CSR leads to desirable outcomes, specifically increased profits, for firms (“It’s the profitable thing to do”)

Similar terms:

- The business case for CSR
- Enlightened self-interest
- Pragmatic view
- Strategic CSR or “profit-maximizing” CSR

Moral Arguments for CSR



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Historical Causes



1969 Cuyahoga River Fire, Cleveland, Ohio, USA

Birth of the U.S. Environmental Movement



- 1970's - Consequences of the modern U.S. environmental movement:
 1. New legislation (Clean Water Act)
 2. New governmental agency: Environmental Protection Agency (EPA)
 3. New expectations of firms
- Public concern gave impetus to CSR movement
- Similar phenomenon in many industrialized or industrializing countries in intervening years

A Polluted River



Moral Arguments for CSR



- “It’s the right thing to do”
- Focus on responsibility, obligation, accountability
- Driven by growing concern over dwindling natural resources and environmental degradation:
Pollution, water contamination, over-population, deforestation, climate change, etc.
- And concern over social issues:
Poverty, inequality, slavery, forced labor, starvation, health, human rights

Moral Arguments 1



- Firms have the responsibility to respond to social and environmental issues because:
 1. They helped create these problems.
- Accountability



Moral Arguments 2



2. Firms have prospered and should give back to society

- Reciprocity, philanthropy



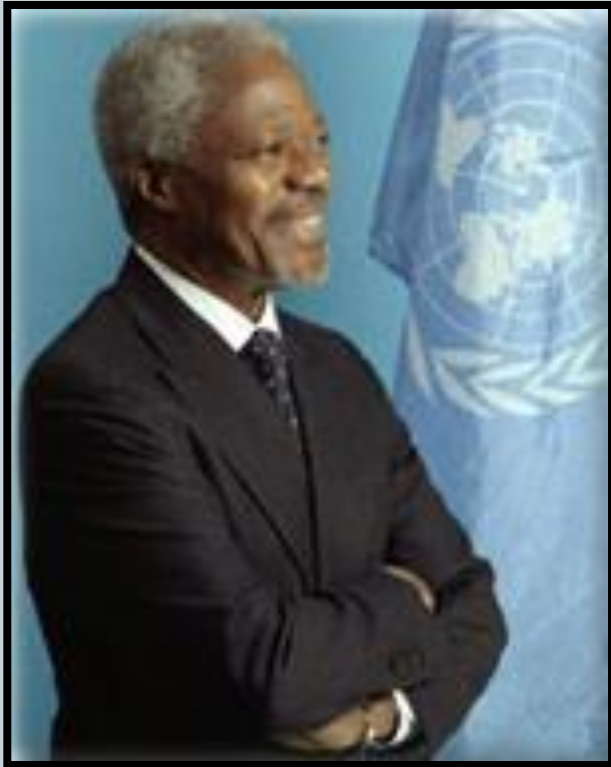
Moral Arguments 3

3. The issues are too large for governments (or NGOs)
OR
Firms have power and resources and “With great power comes great responsibility”

- Obligation



The Power of Corporations



“The sheer magnitude of problems, from malnutrition and HIV to illiteracy and homelessness, inspires a turn toward all available sources of aid, most notably corporations.”

UN Secretary General Kofi Annan

Moral Arguments 4

4. Firms are members of society and have to do their part

- Social contract



Who is Responsible?

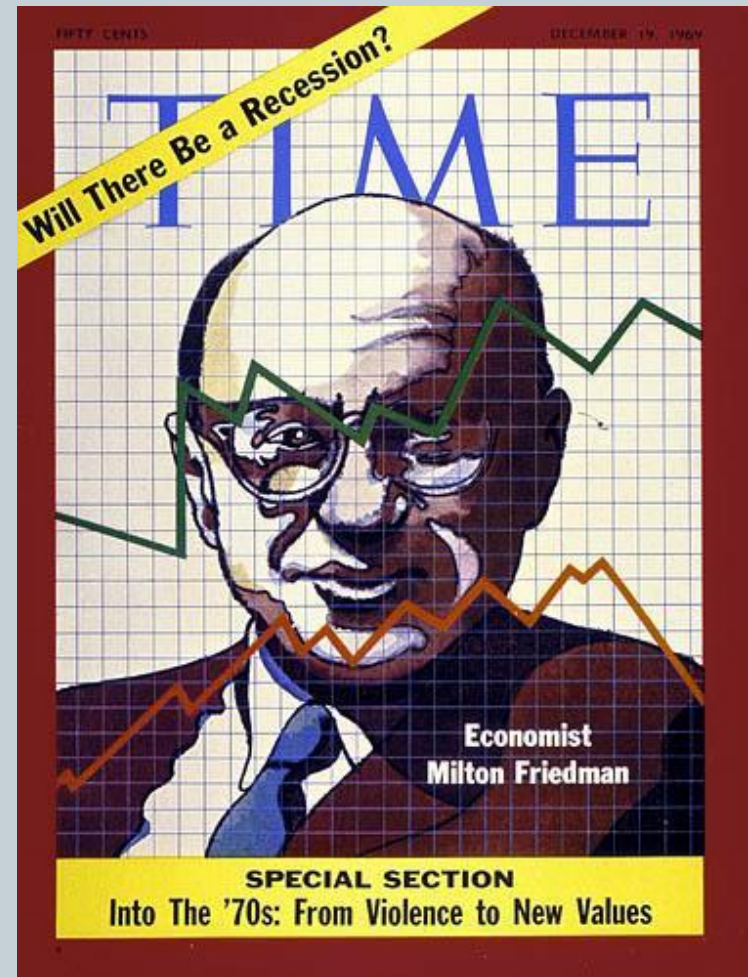
- Are moral arguments directed toward all firms equally?
- No.
- Generally the focus is on larger, more “visible” (high profile), more prosperous and multinational corporations.
- Also on firms or industries that are seen to do more damage (oil industry, Walmart, etc.)



Critique of Moral Arguments for CSR

Three arguments against CSR

- **1.** The only responsibility of business is maximizing profits while (1) obeying the law, (2) conforming to “ethical custom”; and (3) acting “without deception or fraud.”



Friedman's Critique



- 2.** Managers (agents) are employed by shareholders (principals) and have the obligation to pursue the latter's goals
- Managers who engage in CSR are illicitly spending the money of shareholders (or imposing a “tax”)

Friedman's Critique



3. Managers don't have the know-how or the right to decide how to solve social and environmental issues.
- It is the job of democratically elected politicians to pursue and/or protect the social good and to set the “rules of the game” to guide firm behaviour towards achieving the social good.



Instrumental Arguments for CSR

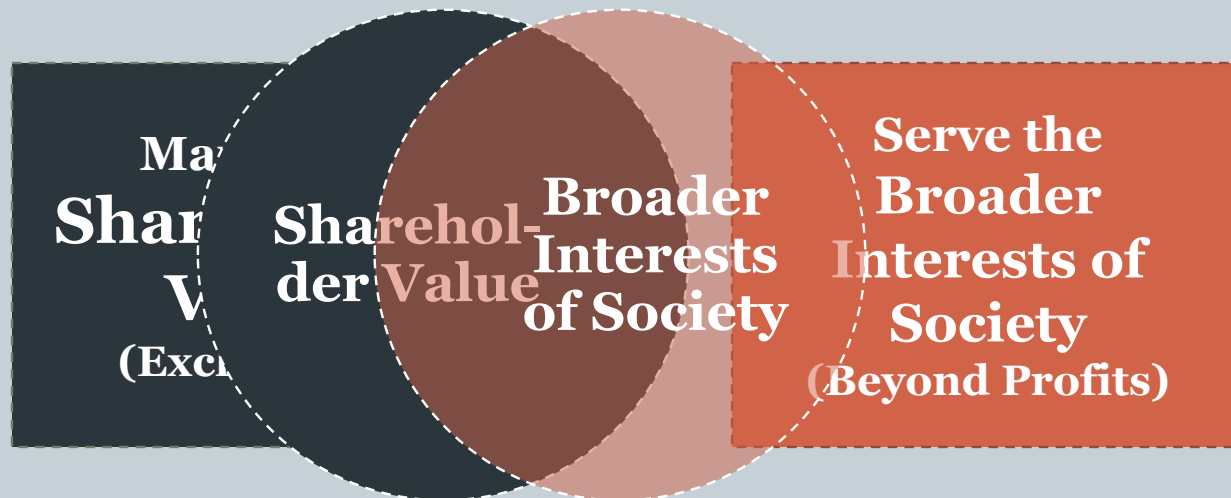


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Instrumental Arguments for CSR

- There is no tension between pursuing shareholder wealth (Friedman/libertarian position) and responding to “broader” interests of society and environment
- Because: “It’s good for business” (or bad to ignore it)



Instrumental Arguments for CSR

Reasons:

- Changing expectations & radical transparency (cf. Lecture 1), resources dwindling
- Growing “conscious consumer” & LOHAS (Lifestyles of Health and Sustainability) segments
- Focus on cost reduction, risk management, opportunity, reputation



LOHAS in China



- “17% of consumers in China’s top five cities – a combined population of more than 60 million – describe themselves as LOHAS-focused, versus 19% of American consumers, despite the significant head start of the US market’s LOHAS consciousness.”
- “And China’s LOHAS consumers are not price sensitive – nine out of ten consumers would be willing to pay 20% more on average for sustainable products, and are looking for increased product choices and availability.”



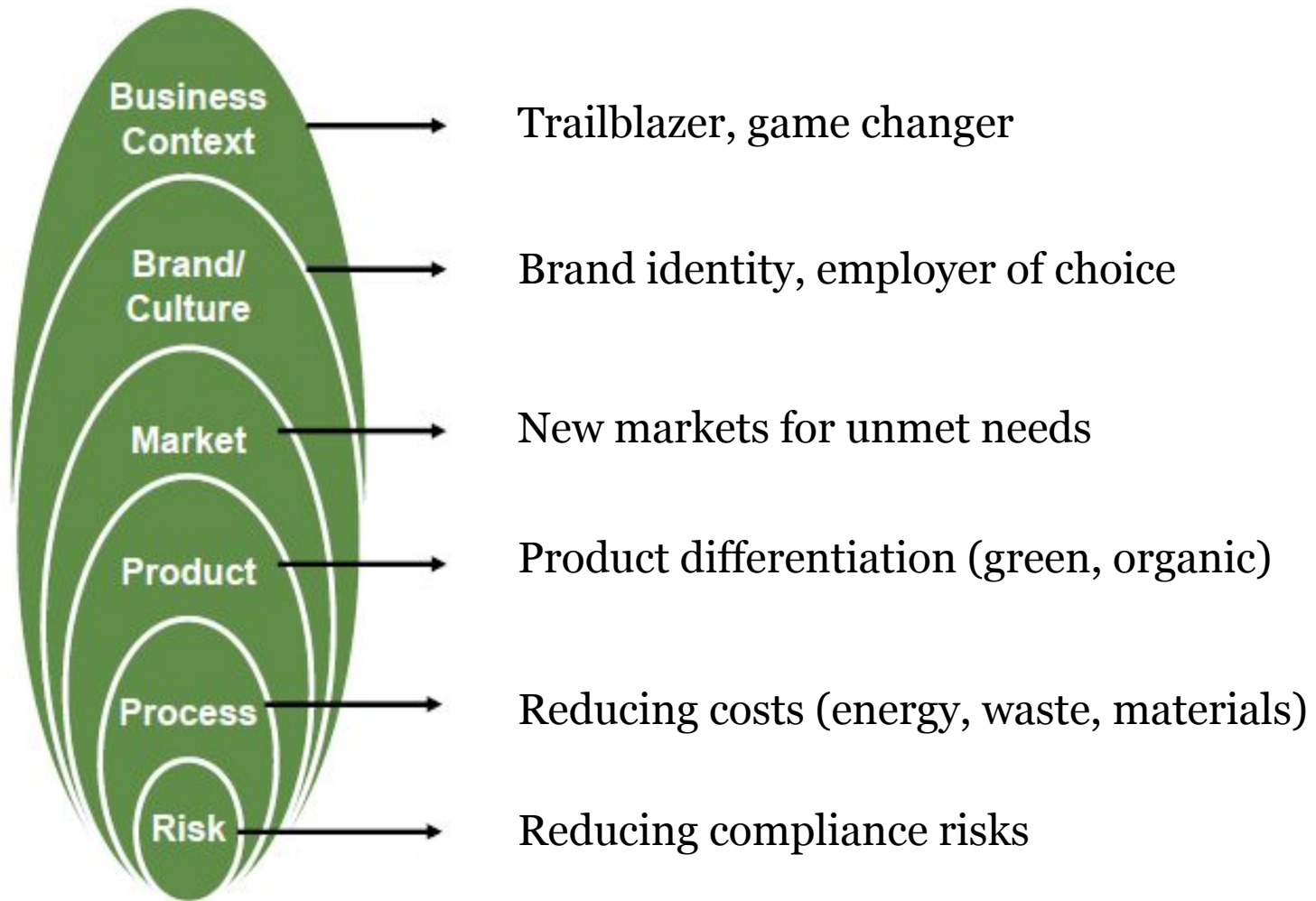
<http://blog.lohas.com>

Good Reputation



- CSR rankings: Reputation Institute *RepTrak*, Newsweek's *Top Green Companies*
- CSR makes corporations more attractive to employees and prospective employees (“Employer of Choice”)
- CSR makes corporations more attractive to investors
- CSR helps corporation maintain good relations with government (Less monitoring, oversight and regulation)
- CSR makes suppliers more attractive
- Good reputation = Good relations

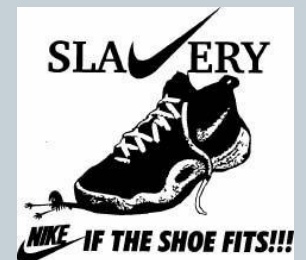
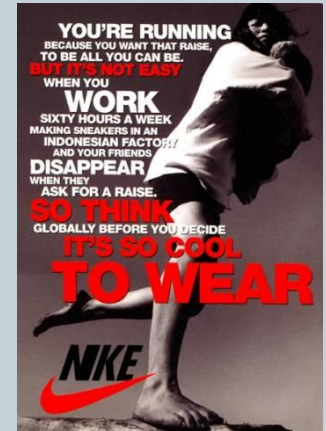
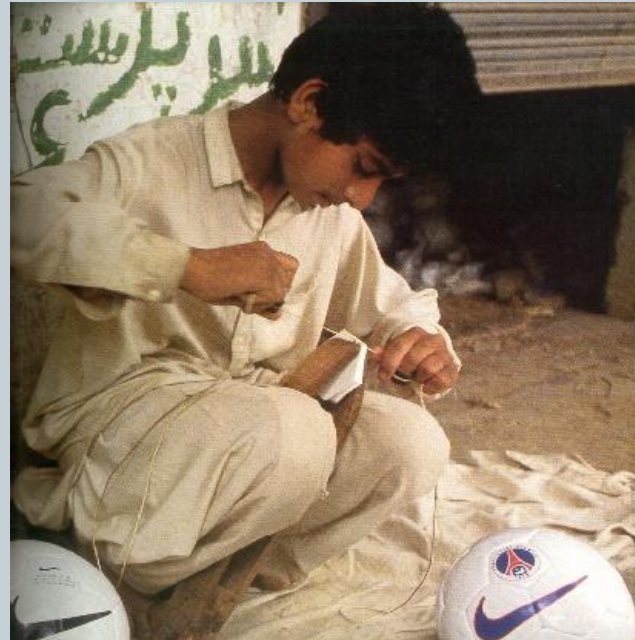
Types of Instrumental Focus



Source: Chris Lazslo The Sustainable Company

Risk Management

- Nike, 1996
- 48% decline in stock price over 19 months, destroying \$12.2 billion in market value
- Reaction, Defense
- Accommodation: protect reputation, avoid government intervention
- Prevention focus



Cost and Waste Reduction

- Walmart , 2000's
- Prevention focus, proactive



Fleet of Class 8 trucks
25% more fuel efficient



Existing stores 20% more
efficient; new stores 25-45%

Differentiation

- Nike vs. Adidas, 2008
- Promotion focus, proactive
- Strategic CSR



Game Changers

- Promotion focus, proactive
- Strategic CSR



Tennant Company



Toyota Prius

Are Instrumental CSR Claims True?



- Does CSR increase firm financial performance?
- A recent meta-analysis found that:
The overall effect is positive but small (mean $r=.13$, median $r=.08$)

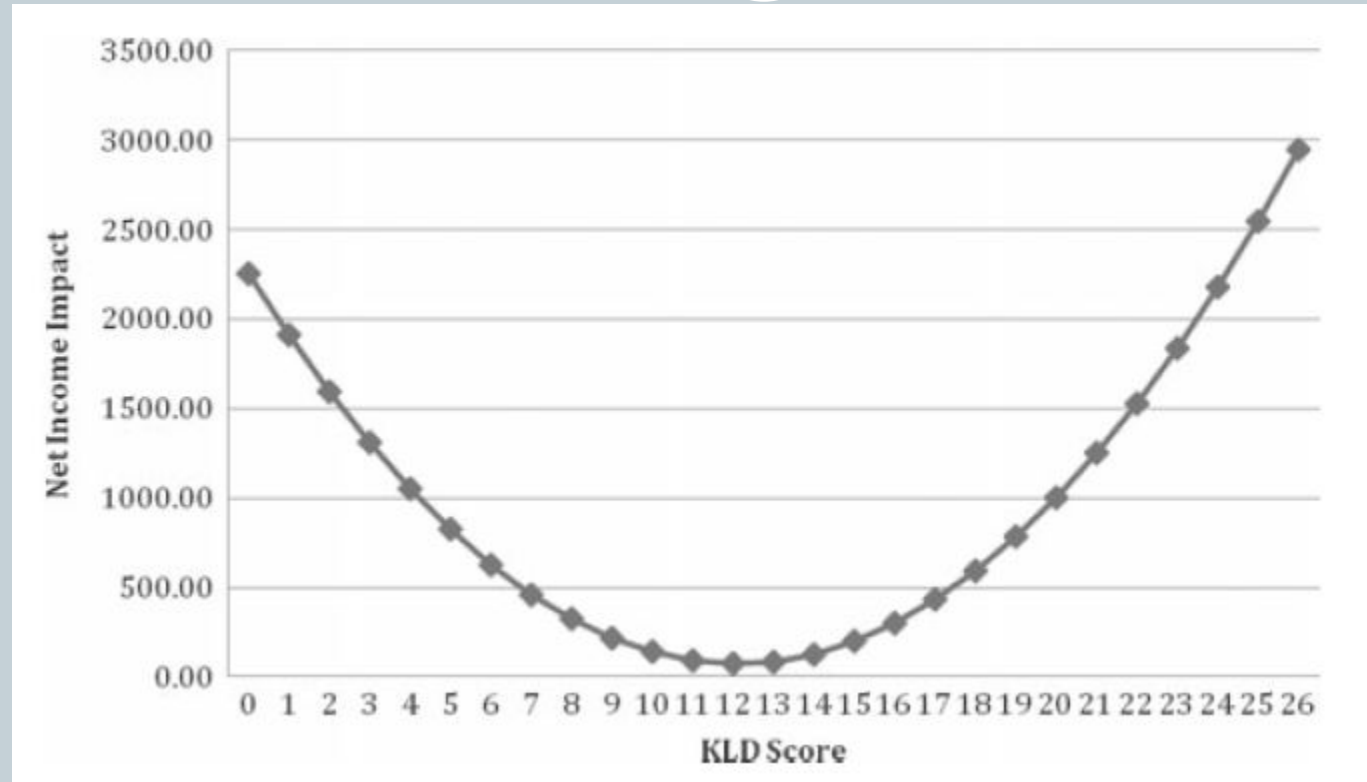
Possible Contingencies



Firms that are more likely to reap benefits:

- Consumer-facing (as opposed to B2B)
- Employ highly educated workforce
- Have a differentiation strategy
- Sell experience goods (as opposed to search goods)
- Are in industries with poor reputation or heavily regulated industries
- Know how to improve stakeholder relationships through CSR

Recent Evidence



- Barnett & Salomon (2012) analysis of US firms

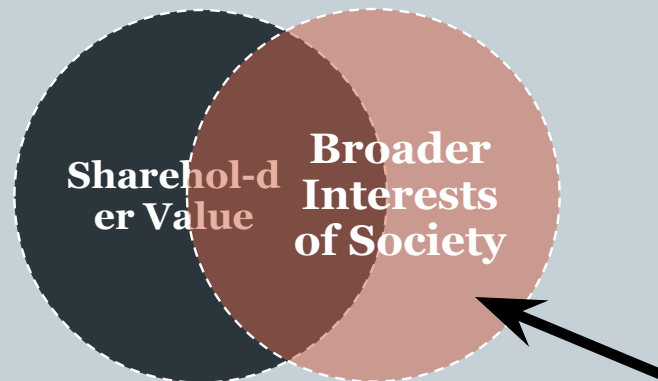
Critiques of Instrumental Arguments



- Continues to prioritize profits above all
- It is deceptive, not genuine (Friedman: firms shouldn't call it CSR)
- Can lead to superficial CSR initiatives focused on appearances while business as usual e.g. (pollution, exploitation of labor, etc.) continues
“Window-dressing”
- Can be used by irresponsible companies to make themselves look good
“Greenwashing”

Critiques of Instrumental Arguments

- What if there is no “Market for Virtue”? What happens when there is a real conflict between profits and the broader interests of society? (e.g., Ford Pinto case)



How Companies View CSR



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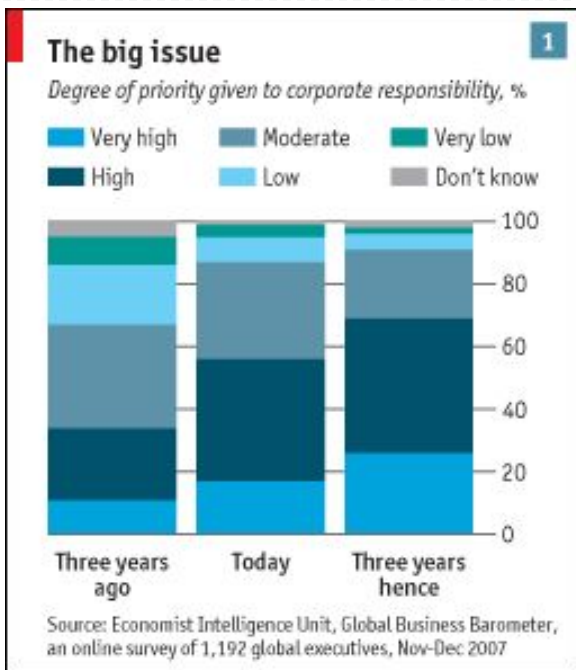
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Corporate Social Responsiveness

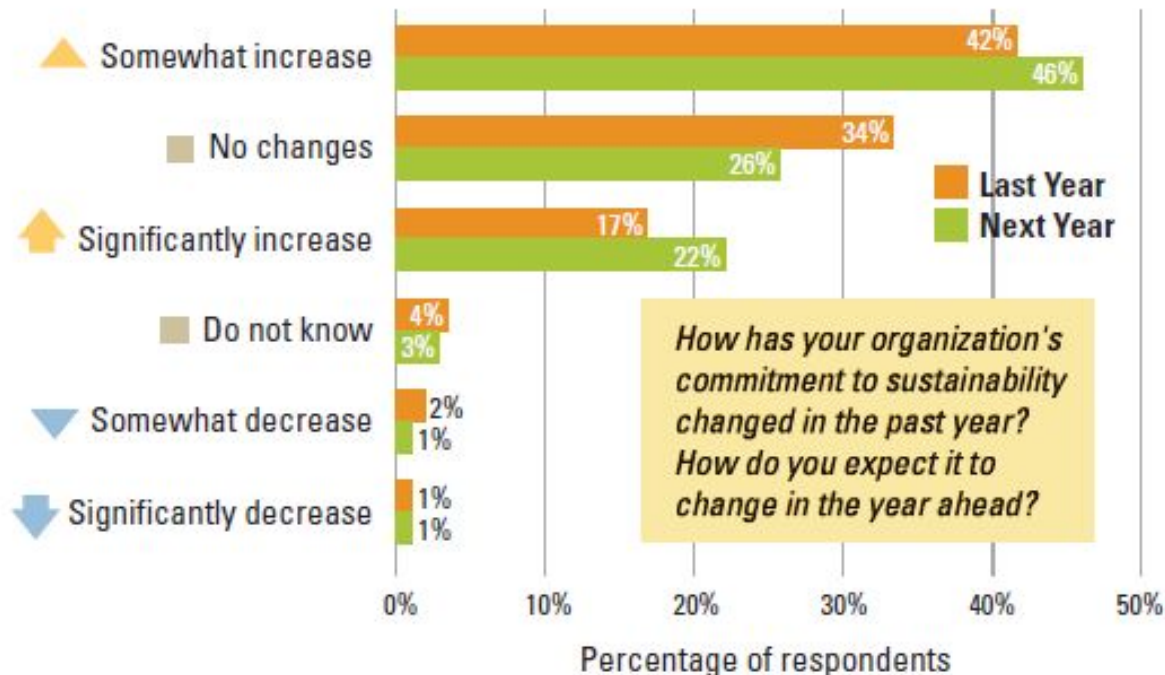


- How do companies respond to social or environmental issues or demands?
- Theoretically four responses are possible:
 1. **Reactive** – denial, pass responsibility to others
 2. **Defensive** – doing the least required, superficial response, subterfuge
 3. **Accommodative** – doing what is demanded
 4. **Proactive** – going beyond expectations, anticipating future demand
- (Carroll, 1979, 1991; Wartick & Cochran, 1985)
- Generally CSR activity has been increasing the world over

Importance to Firms

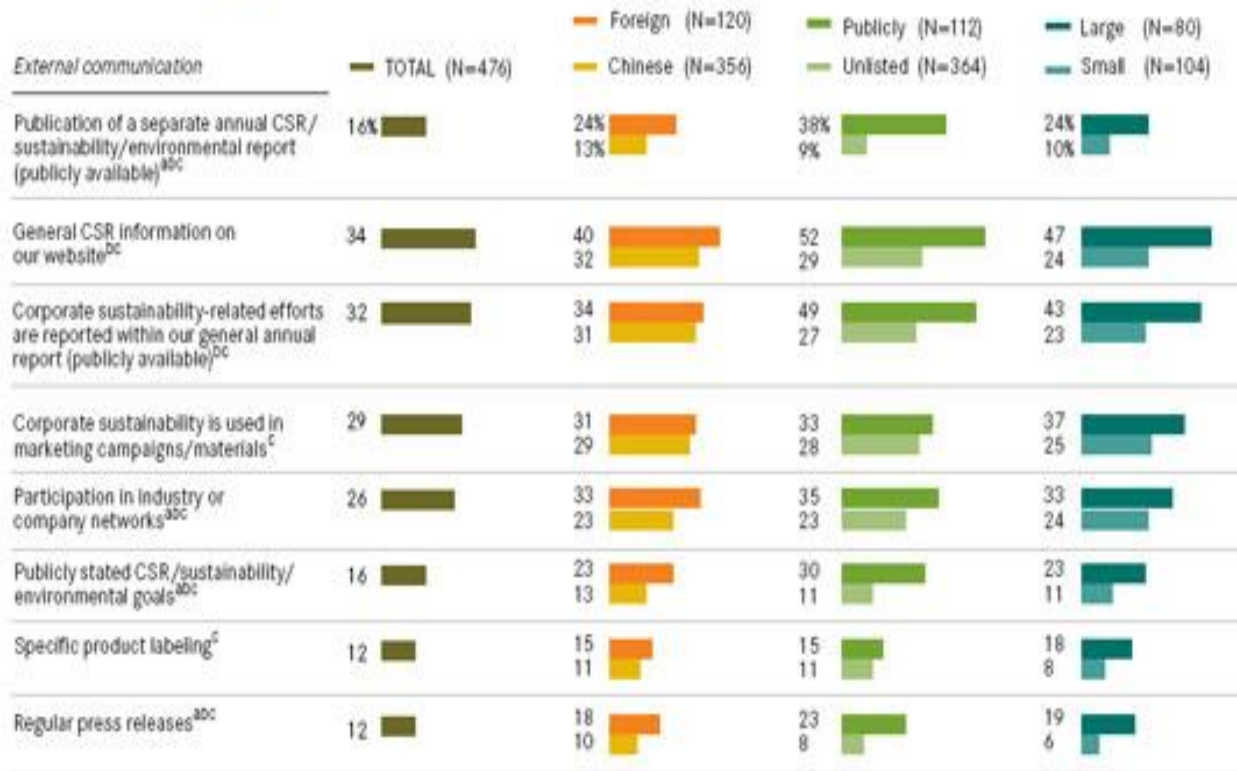


The Economist, 2008



CSR in China

Sustainability-related communication in China



^a The difference between Chinese and foreign companies is significant at the 95% level.

^b The difference between publicly listed and unlisted companies is significant at the 95% level.

^c The difference between large companies and SMEs is significant at the 95% level.

Notes: Multiple answers possible.

Source: The Conference Board 2010 China Corporate Sustainability Survey.

Gao, 2009

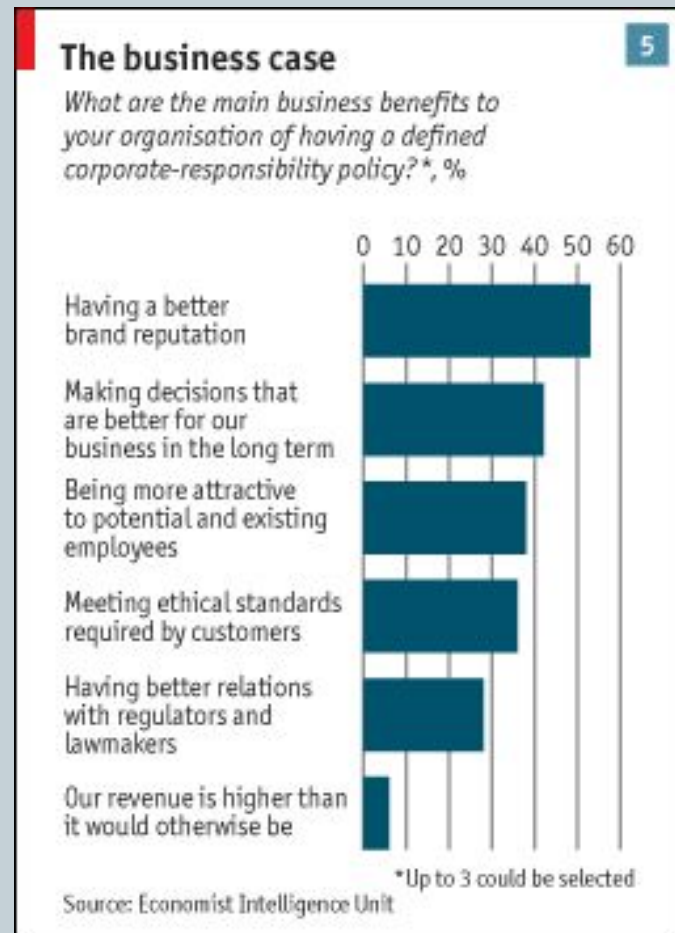
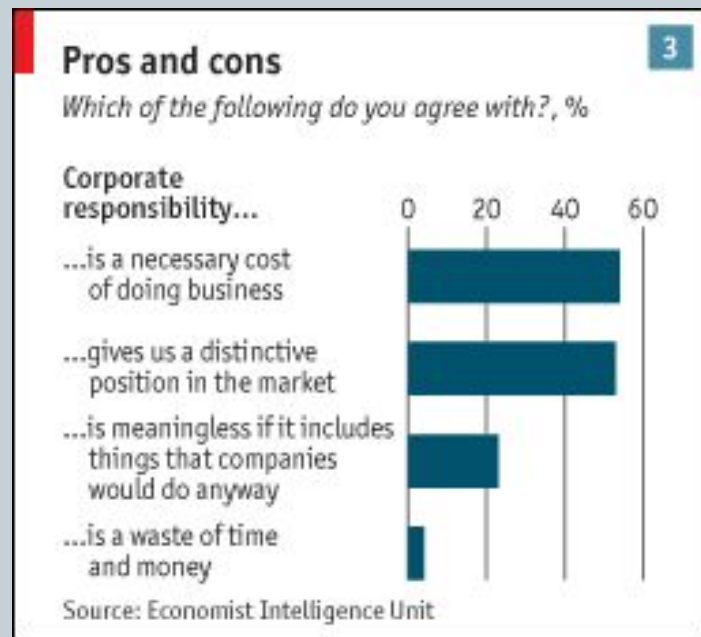
Why Do Firms Do It?



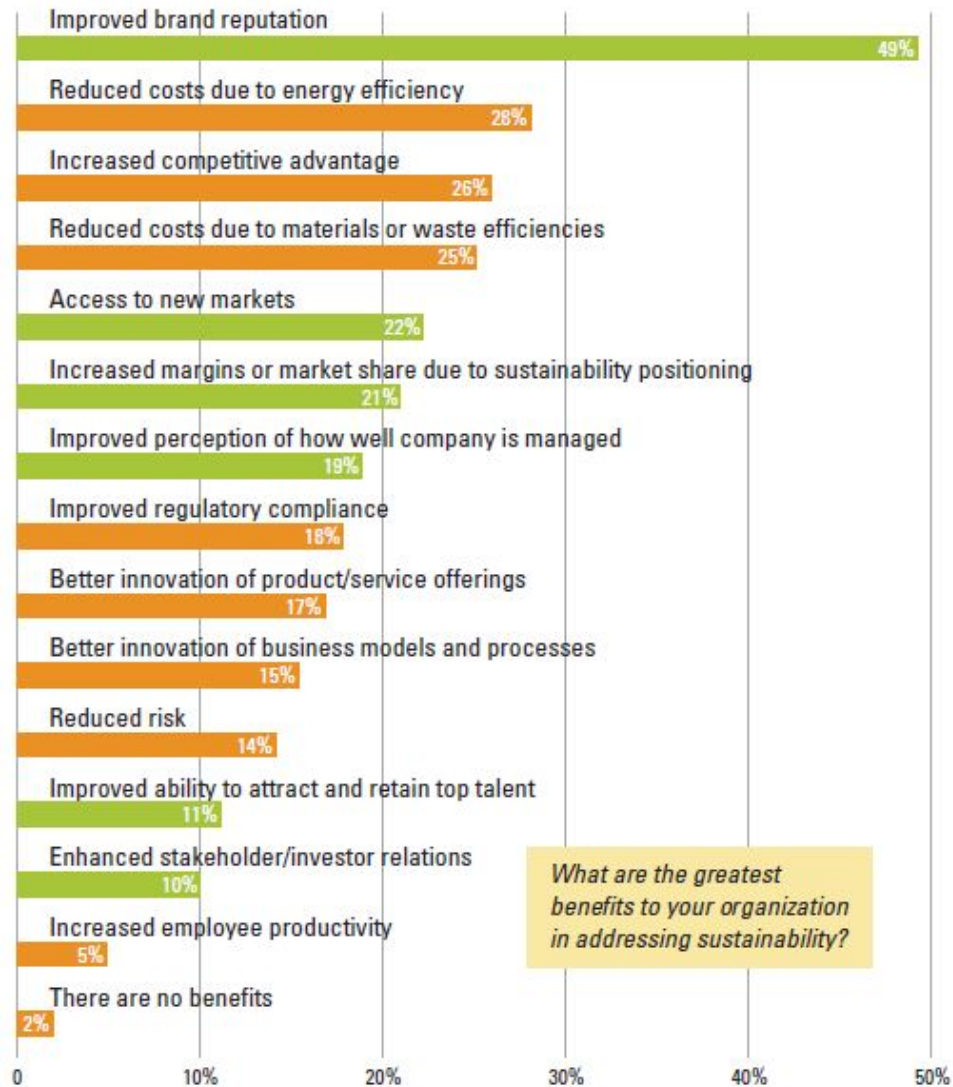
Three explanations:

- Competitiveness: Consumer demands, cut costs, increase profits, differentiate
- Legitimacy: Reputation, survival, conformity
- Ethics: Social and ecological responsibility
(Bansal & Roth, 2000)

Why Do Firms Do It?



Perceived Benefits



Why Has CSR Spread?

- Globalization, especially global supply chains
- Spread of “good” management ideas, emulation of most admired companies
- Internationalization (access to international markets), CSR as a signal of quality
- Rise of the Anglo-American model; CSR as a way of signaling that corporations can self-govern or self-regulate
- Changing Global Business Context (Lecture 1): public concern over dwindling resources, pollution, etc.

The Challenge



- What exactly are a firm's social and environmental responsibilities?
- Whose needs, interests & demands should it pay attention to?

Stakeholder Theory



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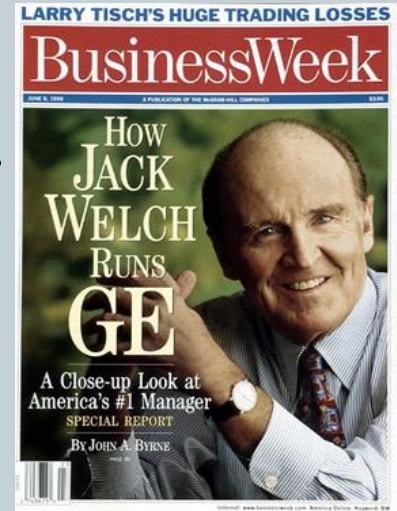
Stakeholder Theory of the Firm

- First proposed by Ed Freeman (1984)
- A response to the **shareholder** maximization view championed during the 1980's
- 1980's: Reagan, Thatcher, deregulation, privatization, neo-liberalism, neo-classical economics



Critique of Shareholder Value

- US: The law does not actually dictate that corporations must prioritize it at all times.
- Not a good way to manage. Instead focus should be on customers, sound strategy.
- Can lead to an obsession with short-term earnings and great harm (eg, GFC).
- Shareholders have no commitment to the firm, may own for minutes or seconds with no interest in its fortunes. Employees, suppliers, customers, communities are in it for the long run (long-term).



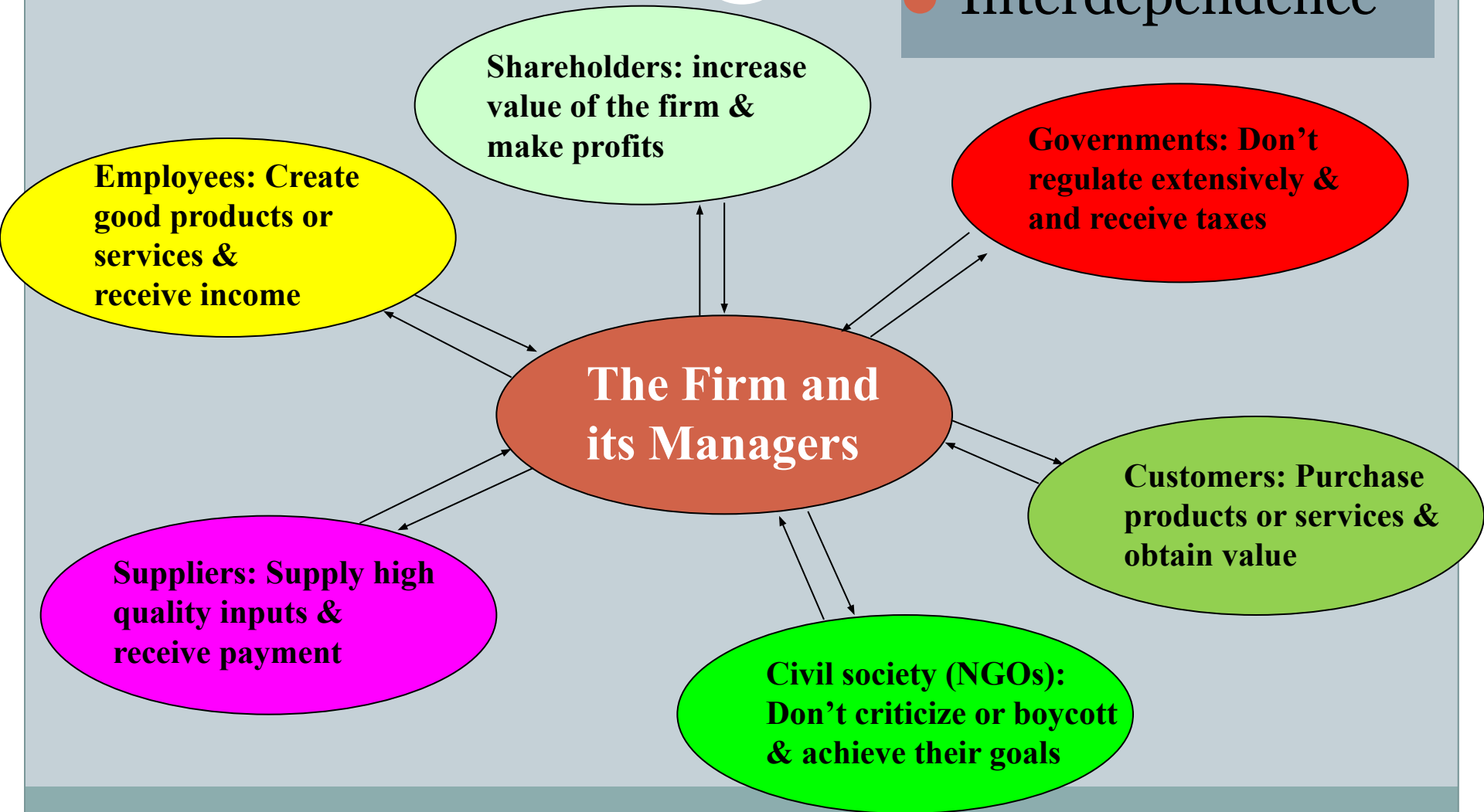
Definition of Stakeholders



- “A stakeholder is any group or individual who can affect or is affected by the achievement of the organization’s objectives” (Freeman)
- “The stakeholders in a firm are individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and who are therefore its potential beneficiaries and/or risk bearers” (Post, Preston, & Sachs)

Stakeholder Relations

● Interdependence



Types of Stakeholders



- Which of all of these stakeholders should managers pay attention to?

Stakeholder Analysis



- The process of identifying stakeholders and determining which are the most important.

Primary Stakeholders



- “A **primary stakeholder** group is one without whose continuing participation the corporation cannot survive as a going concern. Primary stakeholder groups typically are comprised of shareholders and investors, employees, customers, and suppliers, together with what is defined as the public stakeholder group: the governments and communities that provide infrastructures and markets, whose laws and regulations must be obeyed, and to whom taxes and other obligations may be due. There is a high level of interdependence between the corporation and its primary stakeholder groups.”
(Clarkson, 1995)

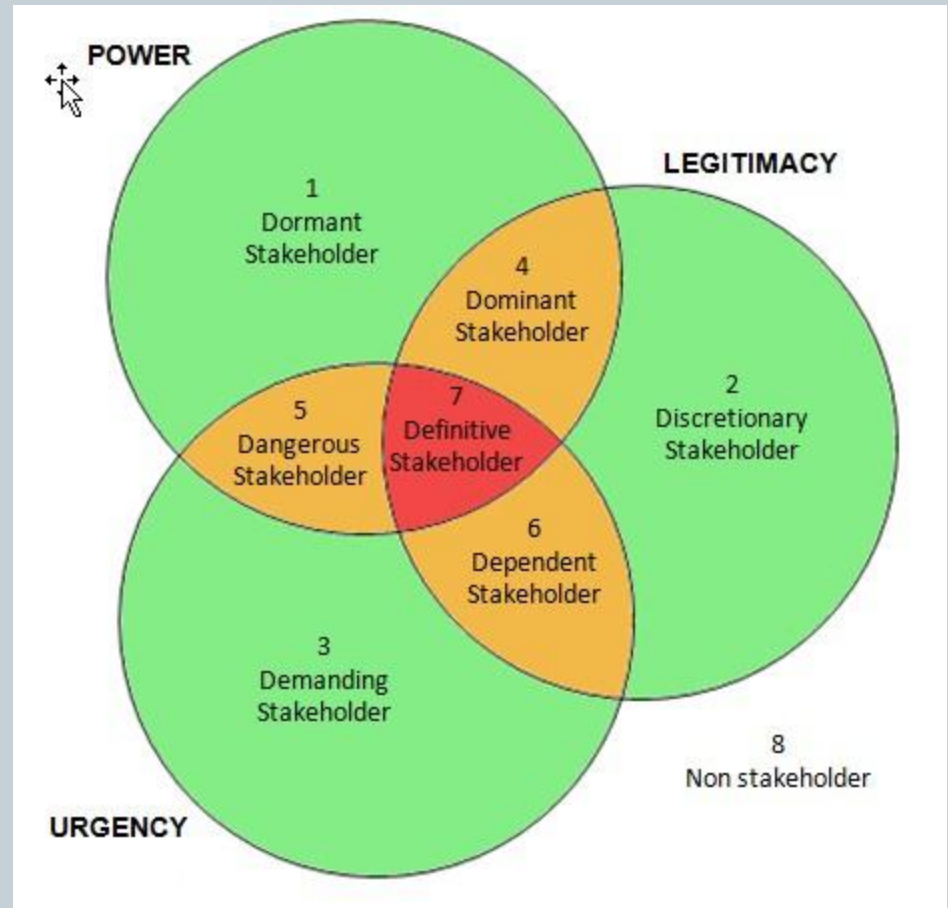
Secondary Stakeholders



- “**Secondary stakeholder** groups are defined as those who influence or affect, or are influenced or affected by, the corporation, but they are not engaged in transactions with the corporation and are not essential for its survival. The media and a wide range of special interest groups are considered as secondary stakeholders under this definition.”
- “The corporation is not dependent for its survival on secondary stakeholder groups.”
(Clarkson, 1995)

Stakeholder Salience

- Which stakeholders (should) matter depends on the situation
- Three factors influence salience: power, legitimacy, urgency



Mitchell, Agle & Wood, 1997

Ford Pinto



The Problem



Ford Pinto Case



- Recall & fix: Cost would be \$11 per vehicle, with 12.5 million vehicles needing to be recalled. The total cost would be **\$137.5 million** (and less trunk space).
- Do nothing: Predicted 180 people could die, 180 people could suffer serious burns, and 2,100 vehicles could be destroyed by fire. Based on estimates, total cost would be **\$49.5 million** (180 deaths x \$200,000 + 180 serious burns x \$67,000 + 2,100 vehicles x \$700)
(Schwartz & Saiia, 2012)

Discussion



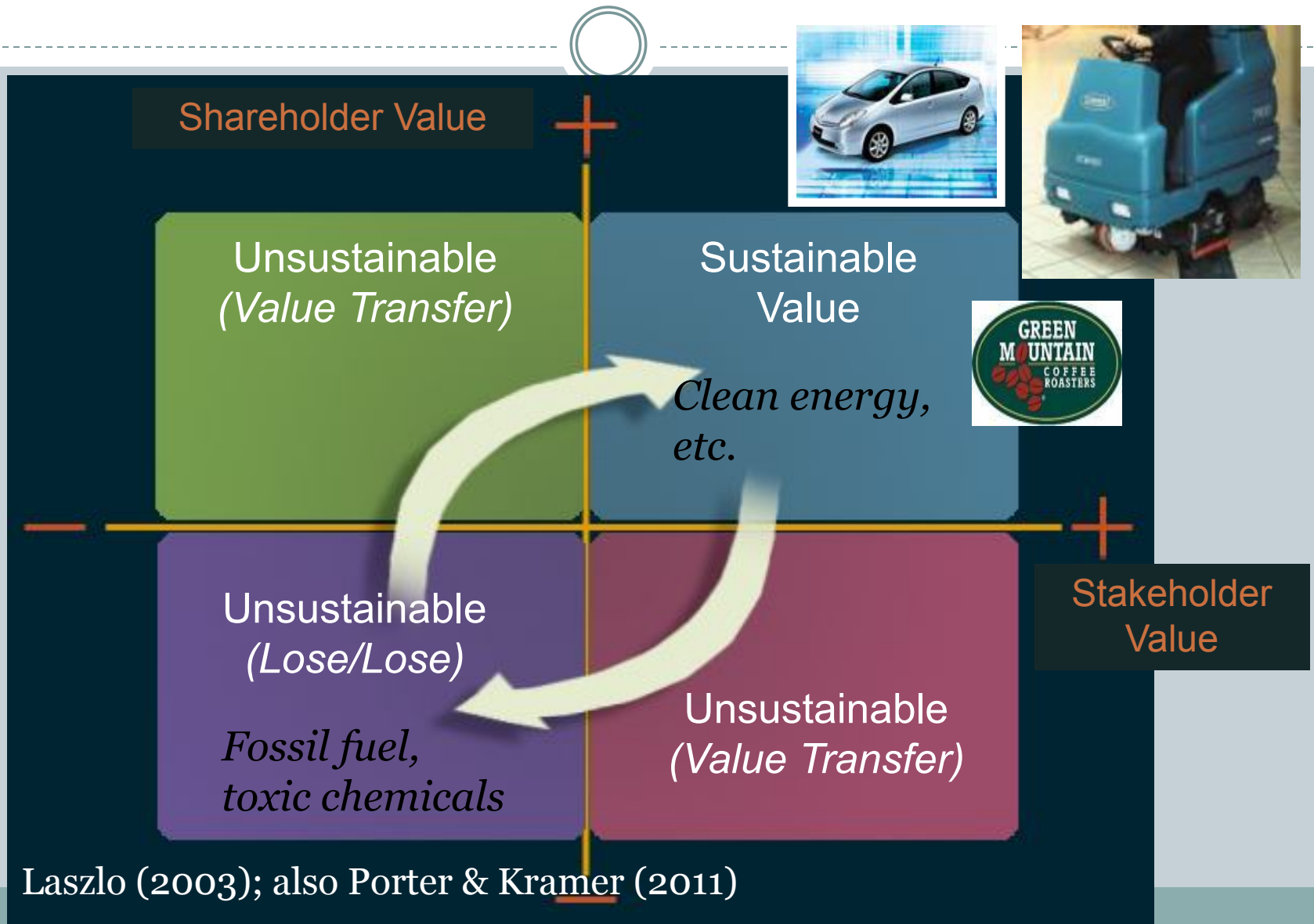
- Consider the Fort Pinto case
- Who are the most important stakeholders in this situation? What would their demands have been (had they been aware)?
- From an instrumental view, what should Ford do: recall the Pinto or not? Why?
- From a moral view, what should Ford do? Why?

Integration 1



- Using business acumen and innovation, create products or services that genuinely do good (or solve a social problem) and generate significant profits for companies at the same time
- Create new markets
- Shared value
- Sustainable value
- Doing well by doing good
- Base of the pyramid

Integration 1



Integration 2



Value Maximization Proposition:

- It is impossible to maximize more than one thing.
- Maximization of the long-run value of the firm should be the goal of all managers.
- Social welfare is maximized when all firms do this.
- Stakeholders' and shareholders' claims should be evaluated solely based on this criteria. Neither is necessarily more important than the other.

(Jensen, 2002)

Summary



- Debates regarding the role of the corporation in society largely relate to the profit maximization thesis, but some version of the validity of CSR is generally accepted
- On one side, there are the likes of Friedman who argue that corporate managers should be primarily concerned with maximizing profits
- On the other, there are claims that corporate managers should be more “broadly” concerned with the social good (for moral and/or instrumental reasons)
- Today’s lecture aimed to outline the various arguments, show their strengths and problems and their historical origins. Think about where you would place yourself between the two sides?

Next Lecture



- Note switch in Lectures 4 and 5
- Next time: Shareholders, Investors and Business Ethics
- Read textbook chapter 6
- Additional readings on Moodle

THANK YOU