Sixteenth Edition

Business *and* Society

Stakeholders, Ethics, Public Policy

Anne T. Lawrence | James Weber

Business and Society

Stakeholders, Ethics, Public Policy

Sixteenth Edition

Anne T. Lawrence
San José State University

James Weber
Duquesne University

BUSINESS AND SOCIETY: STAKEHOLDERS, ETHICS, PUBLIC POLICY, SIXTEENTH EDITION

Published by McGraw-Hill Education, 2 Penn Plaza, New York, NY 10121. Copyright © 2020 by McGraw-Hill Education. All rights reserved. Printed in the United States of America. Previous editions © 2017, 2014, and 2011. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of McGraw-Hill Education, including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

Some ancillaries, including electronic and print components, may not be available to customers outside the United States.

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 LWI 21 20 19

ISBN 978-1-260-04366-2 (bound edition)
MHID 1-260-04366-5 (bound edition)
ISBN 978-1-260-14049-1 (loose-leaf edition)
MHID 1-260-14049-0 (loose-leaf edition)

Portfolio Manager: *Laura Hurst Spell*
Marketing Manager: *Lisa Granger*
Content Project Managers: *Jeni McAtee, Katie Reuter*
Buyer: *Susan K. Culbertson*
Design: *Jessica Cuevas*
Content Licensing Specialist: *Traci Vaske*
Cover Image: ©*View Apart/Shutterstock*
Compositor: *SPi Global*

All credits appearing on page or at the end of the book are considered to be an extension of the copyright page.

Library of Congress Cataloging-in-Publication Data

Names: Lawrence, Anne T., author. | Weber, James (Business ethics professor), author.
Title: Business and society: stakeholders, ethics, public policy / Anne T. Lawrence, San Jose State University, James Weber, Duquesne University.
Description: Sixteenth edition. | New York, NY : McGraw-Hill Education, [2020]
Identifiers: LCCN 2018052591 | ISBN 9781260043662 (alk. paper) | ISBN 1260043665 (bound edition) | ISBN 9781260140491 (loose-leaf edition) | ISBN 1260140490 (loose-leaf edition)
Subjects: LCSH: Social responsibility of business.
Classification: LCC HD60 .F72 2020 | DDC 658.4/08—dc23 LC record available at https://lccn.loc.gov/2018052591

The Internet addresses listed in the text were accurate at the time of publication. The inclusion of a website does not indicate an endorsement by the authors or McGraw-Hill Education, and McGraw-Hill Education does not guarantee the accuracy of the information presented at these sites.

mheducation.com/highered

About the Authors

Anne T. Lawrence *San José State University*

Anne T. Lawrence is professor of management emerita at San José State University. She holds a Ph.D. from the University of California, Berkeley, and completed two years of post-doctoral study at Stanford University. Her articles, cases, and reviews have appeared in many journals, including the *Academy of Management Review, Administrative Science Quarterly, Case Research Journal, Journal of Management Education, California Management Review, Business and Society Review, Research in Corporate Social Performance and Policy, and Journal of Corporate Citizenship.* Her cases in business and society have been reprinted in many textbooks and anthologies. She has served as guest editor of the *Case Research Journal.* She served as president of both the North American Case Research Association (NACRA) and of the Western Casewriters Association and is a Fellow of NACRA, from which she received a Distinguished Contributor Award in 2014. She received the Emerson Center Award for Outstanding Case in Business Ethics (2004) and the Curtis E. Tate Award for Outstanding Case of the Year (1998, 2009, and 2015). At San José State University, she was named Outstanding Professor of the Year in 2005. In 2015, she received a Master Teacher in Ethics Award from The Wheatley Institution at Brigham Young University. She currently serves as chair of the board of the Case Research Foundation.

James Weber *Duquesne University*

James Weber is a professor of management and business ethics at Duquesne University, where he also serves as the managing director of the Institute for Ethics in Business. He holds a Ph.D. from the University of Pittsburgh and has taught at the University of San Francisco, University of Pittsburgh, and Marquette University. His areas of interest and research include personal, managerial, and organizational values and cognitive moral reasoning. His work has appeared in *Organization Science, Human Relations, Business & Society, Journal of Business Ethics, and Business Ethics Quarterly.* He received the SIM Sumner Marcus Award for lifetime contribution to the Social Issues in Management division of the Academy of Management in 2013 and the Best Reviewer Award from *Business & Society* in 2015. He was recognized by the Social Issues in Management division with the Best Paper Award in 1989 and 1994 and received the Best Article Award from the International Association for Business and Society in 1998. He has served as division and program chair of the Social Issues in Management division of the Academy of Management. He has also served as president and program chair of the International Association of Business and Society (IABS).

Preface

In a world economy that is becoming increasingly integrated and interdependent, the relationship between business and society is becoming ever more complex. The globalization of business, the emergence of civil society organizations in many nations, and rapidly changing government regulations and international agreements have significantly altered the job of managers and the nature of strategic decision making within the firm.

At no time has business faced greater public scrutiny or more urgent demands to act in an ethical and socially responsible manner than at the present. Consider the following:

- The rise of populist and nationalist political leaders in the United States and parts of Europe and the Middle East have led to renewed debates on the proper role of government in regulating business and protecting stakeholders. As environmental, financial, employment, and consumer regulations have been rolled back, particularly in the United States, businesses have had to choose whether to take advantage of loosened rules or to follow a strategy of voluntary corporate responsibility. Long-standing trade relationships have been upended by tariffs and other barriers on imports, helping some businesses and hurting others. Changing immigration policy has required firms to rethink their policies toward their foreign-born workers, including so-called Dreamers brought to the United States illegally as children. In this rapidly changing environment, business firms have been challenged to manage in a way that remains consistent with their values.
- A host of new technologies have become part of the everyday lives of billions of the world's people. Advances in the basic sciences are stimulating extraordinary changes in agriculture, telecommunications, transportation, and pharmaceuticals, which have the potential to enhance peoples' health and quality of life. Artificial intelligence can be used to drive vehicles, diagnose illnesses, and manage investments. Technology has changed how we interact with others, bringing people closer together through social networking, instant messaging, and photo and video sharing. These innovations hold great promise. But they also raise serious ethical issues, such as those associated with the use of the Internet to exploit or defraud others, censor free expression, or invade individuals' privacy. Businesses must learn to harness powerful technologies for good, while acting responsibly and ethically toward their many stakeholders.
- Businesses in the United States and other nations are transforming the employment relationship, abandoning practices that once provided job security and guaranteed pensions in favor of highly flexible but less secure forms of employment. The rise of the "gig" economy has transformed many workers into self-employed contractors. Many jobs, including those in the service sector, are being outsourced to the emerging economies of China, India, and other nations. As jobs shift abroad, multinational corporations are challenged to address their obligations to workers in far-flung locations with very different cultures and to respond to initiatives, like the Responsible Business Alliance Code of Conduct, which call for voluntary commitment to enlightened labor standards and human rights. The #MeToo movement has focused a spotlight on sexual harassment and abusive behavior in the workplace, and led to the fall of well-known executives and media personalities and calls for change in workplace culture.
- Severe weather events—hurricanes, floods, and wildfires—have urgently focused attention on the human impact on natural systems, prompting both businesses and

governments to act. An emerging consensus about the causes and risks of climate change is leading many companies to adopt new practices, and once again the nations of the world have experimented with public policies designed to limit the emissions of greenhouse gases, most notably in the Paris Agreement. Many businesses have cut air pollution, curbed solid waste, and designed products and buildings to be more energy-efficient, saving money in the process. A better understanding of how human activities affect natural resources is producing a growing understanding that economic growth must be achieved in balance with environmental protection if development is to be sustainable.

- Many regions of the world and its nations are developing at an extraordinary rate. Yet, the prosperity that accompanies economic growth is not shared equally. Access to health care, adequate nutrition, and education remain unevenly distributed among and within the world's nations, and inequalities of wealth and income have become greater than they have been in many years. These trends have challenged businesses to consider the impact of their compensation, recruitment, and professional development practices on the persistent—and in some cases, growing—gap between the haves and the have-nots. Big corporate tax cuts in the United States have required companies to decide whether to distribute their windfalls to their executives, shareholders, employees, or customers; to invest in new jobs; or to buy back stock.
- The opioid epidemic has focused attention on the role of drug companies, distributors, and pharmacies—as well as government regulators—in contributing to the scourge of addiction, disability, and death caused by narcotics. The continuing pandemic of AIDS in sub-Saharan Africa and the threat of a swine or avian flu, the Zika virus, or another Ebola outbreak have compelled drug makers to rethink both their pricing policies and their research priorities. Many businesses must consider the delicate balance between their intellectual property rights and the urgent demands of public health, particularly in the developing world.
- In many nations, legislators have questioned business's influence on politics. Business has a legitimate role to play in the public policy process, but it has on occasion shaded over into undue influence and even corruption. Technology offers candidates and political parties new ways to reach out and inform potential voters, but it has also created new opportunities for manipulation of the electoral process through deceptive messaging. Businesses the world over are challenged to determine their legitimate scope of influence and how to voice their interests most effectively in the public policy process.

The new Sixteenth Edition of *Business and Society* addresses this complex agenda of issues and their impact on business and its stakeholders. It is designed to be the required textbook in an undergraduate or graduate course in Business and Society; Business, Government, and Society; Social Issues in Management; or the Environment of Business. It may also be used, in whole or in part, in courses in Business Ethics and Public Affairs Management. This new edition of the text is also appropriate for an undergraduate sociology course that focuses on the role of business in society or on contemporary issues in business.

The core argument of *Business and Society* is that corporations serve a broad public purpose: to create value for society. All companies must make a profit for their owners. Indeed, if they did not, they would not long survive. However, corporations create many other kinds of value as well. They are responsible for professional development for their employees, innovative new products for their customers, and generosity to their communities. They must partner with a wide range of individuals and groups in society to advance collaborative goals. In our view, corporations have multiple obligations, and all stakeholders' interests must be considered.

A Tradition of Excellence

Since the 1960s, when Professors Keith Davis and Robert Blomstrom wrote the first edition of this book, *Business and Society* has maintained a position of leadership by discussing central issues of corporate social performance in a form that students and faculty have found engaging and stimulating. The leadership of the two founding authors, and later of Professors William C. Frederick and James E. Post, helped *Business and Society* to achieve a consistently high standard of quality and market acceptance. Thanks to these authors' remarkable eye for the emerging issues that shape the organizational, social, and public policy environments in which students will soon live and work, the book has added value to the business education of many thousands of students.

Business and Society has continued through several successive author teams to be the market leader in its field. The current authors bring a broad background of business and society research, teaching, consulting, and case development to the ongoing evolution of the text. The new Sixteenth Edition of *Business and Society* builds on its legacy of market leadership by reexamining such central issues as the role of business in society, the nature of corporate responsibility and global citizenship, business ethics practices, and the complex roles of government and business in a global community.

For Instructors

For instructors, this textbook offers a complete set of supplements.

Instructor Library

The Connect Management Instructor Library is a repository for additional resources to improve student engagement in and out of class. The instructor can select and use any asset that enhances their lecture. The Connect Instructor Library includes an extensive instructor's resource manual—fully revised for this edition—with lecture outlines, discussion case questions and answers, tips from experienced instructors, and extensive case teaching notes. A computerized test bank and power point slides for every chapter are also provided.

Create

With McGraw-Hill Create, **create.mheducation.com**, the instructor can easily rearrange chapters, combine material from other content sources, and quickly upload self-developed content such as a course syllabus or teaching notes. Content may be drawn from any of the thousands of leading McGraw-Hill textbooks and arranged to fit a specific class or teaching approach. Create even allows an instructor to personalize the book's appearance by selecting the cover and adding the instructor's name, school, and course information and to select a print or eBook format.

For Students

Business and Society has long been popular with students because of its lively writing, up-to-date examples, and clear explanations of theory. This textbook has benefited greatly from feedback over the years from thousands of students who have used the material in the authors' own classrooms. Its strengths are in many ways a testimony to the students who have used earlier generations of *Business and Society.*

The new Sixteenth Edition of the text is designed to be as student-friendly as always. Each chapter opens with a list of key learning objectives to help focus student reading and study. Numerous figures, exhibits, and real-world business examples (set as blocks of colored type) illustrate and elaborate the main points. A glossary at the end of the book provides definitions for bold-faced and other important terms. Internet references and a full section-by-section bibliography guide students who wish to do further research on topics of their choice, and subject and name indexes help students locate items in the book.

Students—study more efficiently, retain more and achieve better outcomes. Instructors—focus on what you love—teaching.

SUCCESSFUL SEMESTERS INCLUDE CONNECT

For Instructors

You're in the driver's seat.

Want to build your own course? No problem. Prefer to use our turnkey, prebuilt course? Easy. Want to make changes throughout the semester? Sure. And you'll save time with Connect's auto-grading too.

65%

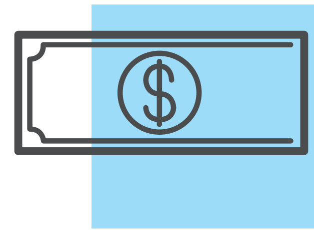
Less Time Grading

They'll thank you for it.

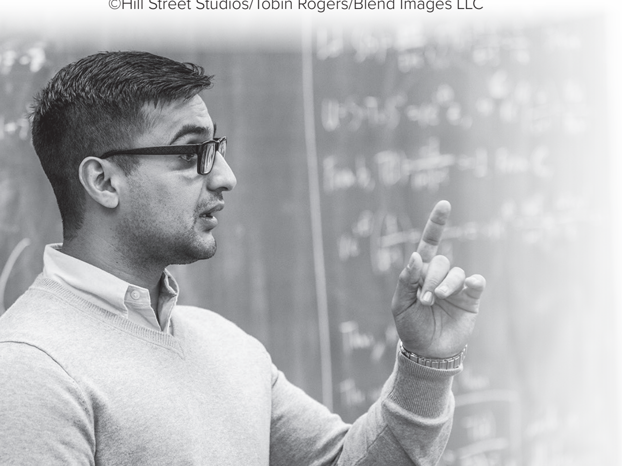
Adaptive study resources like SmartBook® help your students be better prepared in less time. You can transform your class time from dull definitions to dynamic debates. Hear from your peers about the benefits of Connect at **www.mheducation.com/highered/connect**

Make it simple, make it affordable.

Connect makes it easy with seamless integration using any of the major Learning Management Systems—Blackboard®, Canvas, and D2L, among others—to let you organize your course in one convenient location. Give your students access to digital materials at a discount with our inclusive access program. Ask your McGraw-Hill representative for more information.



©Hill Street Studios/Tobin Rogers/Blend Images LLC



Solutions for your challenges.

A product isn't a solution. Real solutions are affordable, reliable, and come with training and ongoing support when you need it and how you want it. Our Customer Experience Group can also help you troubleshoot tech problems—although Connect's 99% uptime means you might not need to call them. See for yourself at **status.mheducation.com**

For Students

©Shutterstock/wavebreakmedia

Effective, efficient studying.

Connect helps you be more productive with your study time and get better grades using tools like SmartBook, which highlights key concepts and creates a personalized study plan. Connect sets you up for success, so you walk into class with confidence and walk out with better grades.

"I really liked this app—it made it easy to study when you don't have your text-book in front of you."

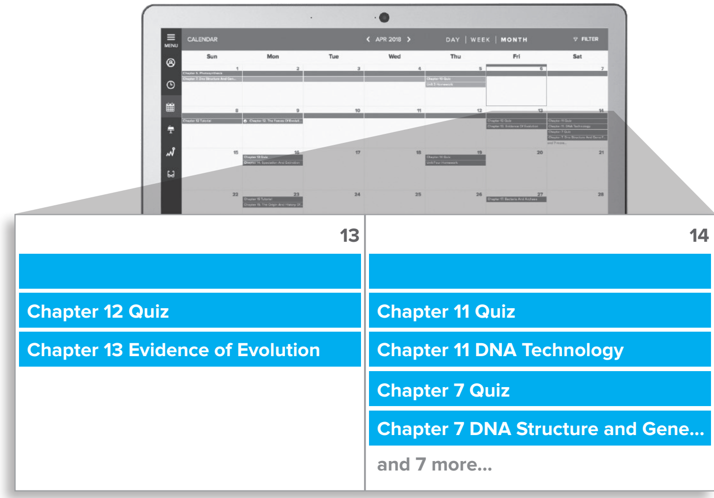
- Jordan Cunningham,
Eastern Washington University

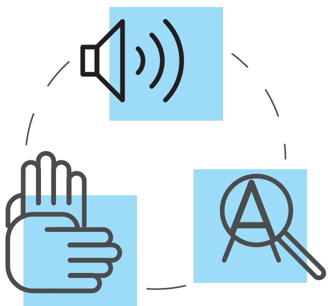
Study anytime, anywhere.

Download the free ReadAnywhere app and access your online eBook when it's convenient, even if you're offline. And since the app automatically syncs with your eBook in Connect, all of your notes are available every time you open it. Find out more at **www.mheducation.com/readanywhere**

No surprises.

The Connect Calendar and Reports tools keep you on track with the work you need to get done and your assignment scores. Life gets busy; Connect tools help you keep learning through it all.





Learning for everyone.

McGraw-Hill works directly with Accessibility Services Departments and faculty to meet the learning needs of all students. Please contact your Accessibility Services office and ask them to email accessibility@mheducation.com, or visit **www.mheducation.com/about/accessibility.html** for more information.

New for the Sixteenth Edition

Over the years, the issues addressed by *Business and Society* have changed as the environment of business itself has been transformed. This Sixteenth Edition is no exception, as readers will discover. Some issues have become less compelling and others have taken their place on the business agenda, while others have endured through the years.

The Sixteenth Edition has been thoroughly revised and updated to reflect the latest theoretical work in the field and statistical data, as well as recent events. Among the new additions are:

- New discussion of theoretical advances in stakeholder theory, corporate citizenship, public affairs management, public and private regulation, corporate governance, social and environmental auditing, social investing, reputation management, business partnerships, supply chain codes of conduct, social entrepreneurship, and corporate philanthropy.
- Treatment of practical issues, such as social networking, artificial intelligence and robotics, gender diversity, political advertising and campaign contributions, public and media relations, well as the latest developments in the regulatory environment in which businesses operate.
- New discussion cases and full-length cases on such timely topics as the role of business in the unfolding opioid crisis, Wells Fargo's unauthorized consumer accounts, the Volkswagen diesel emissions scandal, the aftermath of the BP disaster in the Gulf of Mexico, the massive Equifax data breach, the consumer boycott of Stoli vodka, the business response to the movement for school safety, LaFarge's dealings in the Syrian war zone, the potential regulation of Facebook in the United States and Europe, political action by the U.S. steel industry on the issue of tariffs, the rise of autonomous vehicles, law enforcement access to mobile phone data, executive misconduct at Wynn Resorts, business response to the threat to "Dreamers," IKEA's sustainable supply chain, Salesforce's integrated philanthropy, and social media criticism of United Airlines.

Finally, this is a book with a vision. It is not simply a compendium of information and ideas. The new edition of *Business and Society* articulates the view that in a global community, where traditional buffers no longer protect business from external change, managers can create strategies that integrate stakeholder interests, respect personal values, support community development, and are implemented fairly. Most important, businesses can achieve these goals while also being economically successful. Indeed, this may be the *only* way to achieve economic success over the long term.

Anne T. Lawrence
James Weber

Acknowledgments

We are grateful for the assistance of many colleagues at universities in the United States and abroad who over the years have helped shape this book with their excellent suggestions and ideas. We also note the feedback from students in our classes and at other colleges and universities that has helped make this book as user-friendly as possible.

We especially wish to thank two esteemed colleagues who made special contributions to this edition. David M. Wasieleski, professor of management and business ethics at Duquesne University, led the revisions of Chapters 5 and 6, to which he contributed his knowledge of ethics theory and organizational practice. Vanessa D. Hill, associate professor of management at the University of Louisiana at Lafayette, generously shared with us her expertise on the employment relationship and workplace diversity and inclusion. She was the lead author of Chapters 15 and 16, which have greatly benefited from her insights. For these contributions, we are most grateful.

We also wish to express our appreciation for the colleagues who provided detailed reviews for this edition. These reviewers were Hossein Bidgoli, California State University, Bakersfield; Ryan Fehr, Foster School of Business, University of Washington, Seattle; Scott Jeffrey, Monmouth University; Eun-Hee Kim, Gabelli School of Business, Fordham University; Jet Mboga, William Paterson University; Stephen P. Preacher, Southern Wesleyan University; and A. J. Stagliano, Saint Joseph's University. Their insights helped guide our revision.

Thanks are also due Daniel Jacobs of Loyola Marymount University; Samir Kumar Barua of the Indian Institute of Management Ahmedabad and Mahendra R. Gurarathi of Bentley University; Grishma Shah, Janet Rovenpor, and Musa Jafar of Manhattan College; Robyn Linde of Rhode Island College and H. Richard Eisenbeis of the University of Southern Colorado Pueblo (retired); Cynthia E. Clark of Bentley University; and Debra M. Staab, a freelance writer and researcher, who contributed cases to this edition.

We are grateful to several individuals have made specific research contributions to this project. Denise Kleinrichert, of the Center for Ethical and Sustainable Business Management at San Francisco State University, provided new material on B Corporations and social entrepreneurship for Chapter 3, which we appreciate. Natalie Hanna and Kelsey Aemi of Duquesne University provided able research assistance. Thanks are due also to Carolyn Roose Eagle, Ben Eagle, and Nate Marsh for research support. Emily Marsh, of Colorbox Industries, provided graphic design services.

Debra M. Staab, in addition to authoring a case, provided research assistance and undertook the complex task of preparing the instructor's resource manual, test bank, and other ancillary materials. Her contributions have been invaluable.

In addition, we are grateful to the many colleagues who over the years have generously shared with us their insights into the theory and pedagogy of business and society. In particular, we would like to thank Cynthia E. Clark and Jill Brown of Bentley University; Shawn Berman, Harry J. Van Buren III, Natalia Vidal, and Garima Sharma of the University of New Mexico; Anke Arnaud of Embry Riddle Aeronautical University; Jennifer J. Griffin of Loyola University of Chicago; Ronald M. Roman, Asbjorn Osland, Thomas Altura, and Matthew Maguire of San José State University; Heather Elms of American University; Joseph A. Petrick of Wright State University; Kathleen

Rehbein of Marquette University; Judith Schrempf-Stirling of the University of Geneva; Michelle Westermann-Behaylo of the University of Amsterdam; Diane Swanson and Bernie Hayen of Kansas State University; Cynthia M. Orms of Georgia College & State University; Ali Al-Kazemi of Kuwait University; Sandra Waddock of Boston College; Mary C. Gentile of the University of Virginia Darden School of Business; Michael E. Johnson-Cramer and Jamie Hendry of Bucknell University; John Mahon and Stephanie Welcomer of the University of Maine; Bradley Agle of Brigham Young University; Gina Vega of Merrimack College; Craig Dunn and Brian Burton of Western Washington University; Lori V. Ryan of San Diego State University; Bryan W. Husted of EGADE Business School Monterrey; Sharon Livesey of Fordham University; Barry Mitnick of the University of Pittsburgh; Virginia Gerde of Furman University; Matthew Drake of Duquesne University; Robbin Derry of the University of Lethbridge; Jerry Calton of the University of Hawaii-Hilo; Linda Klebe Treviño of Pennsylvania State University; Mary Meisenhelter of York College of Pennsylvania; Amy Hillman and Gerald Keim of Arizona State University; Barbara Altman of Texas A&M University Central Texas; Randall Harris of Texas A&M University Corpus Christi; Richard Wokutch of Virginia Tech University; Dawn Elm of University of St. Thomas; Lynda Brown of the University of Montana; Kathleen A. Getz of Loyola University – Maryland; Gordon P. Rands of Western Illinois University; Paul S. Adler of the University of Southern California; Linda C. Rodriguez of the University of South Carolina Aiken; Emmanuel Raufflet of HEC Montreal; Bruce Paton of Menlo College; Smita Trivedi, Tom E. Thomas, Geoffrey Desa, and Murray Silverman (retired), of San Francisco State University; Jacob Park of Green Mountain College; Armand Gilinsky of Sonoma State University; and Tara Ceranic Salinas of the University of San Diego.

These scholars' dedication to the creative teaching of business and society has been a continuing inspiration to us.

We wish to express our appreciation to James E. Post, a former author of this book, who has continued to offer valuable intellectual guidance to this project. We also wish to note, with sadness and gratitude, the passing of our mentor and a former author of this book, William C. Frederick, in 2018. His ideas live on in this book.

We continue to be grateful to the excellent editorial and production team at McGraw-Hill. We offer special thanks to Laura Hurst Spell, our associate portfolio manager, for her skillful leadership of this project. We also wish to recognize the able assistance of Marla Sussman, executive editor, and of Jeni McAtee, content project manager, whose ability to keep us on track and on time has been critical. Lisa Granger headed the excellent marketing team. Katie Reuter, content project manager (assessment); Susan K. Culbertson, buyer; Richard Wright, copy editor; Traci Vaske, content licensing specialist; and Jessica Cuevas, who designed the book cover, also played key roles. Each of these people has provided professional contributions that we deeply value and appreciate.

As always, we are profoundly grateful for the ongoing support of our spouses, Paul Roose and Sharon Green.

Anne T. Lawrence

James Weber

Brief Contents

PART ONE
Business in Society 1

1. The Corporation and Its Stakeholders 2
2. Managing Public Issues and Stakeholder Relationships 25
3. Corporate Social Responsibility and Citizenship 47
4. Business in a Globalized World 71

PART TWO
Business and Ethics 93

5. Ethics and Ethical Reasoning 94
6. Organizational Ethics 115

PART THREE
Business and Public Policy 137

7. Business–Government Relations 138
8. Influencing the Political Environment 161

PART FOUR
Business and the Natural Environment 187

9. Sustainable Development and Global Business 188
10. Managing for Sustainability 211

PART FIVE
Business and Technology 237

11. The Role of Technology 238
12. Regulating and Managing Technology 261

PART SIX
Business and Its Stakeholders 281

13. Shareholder Rights and Corporate Governance 282
14. Consumer Protection 305
15. Employees and the Corporation 327
16. Managing a Diverse Workforce 350
17. Business and Its Suppliers 374
18. The Community and the Corporation 396
19. Managing the Public and the Corporate Reputation 419

CASES IN BUSINESS AND SOCIETY 441

1. Profiting from Pain: Business and the U.S. Opioid Epidemic 442
2. Wells Fargo's Unauthorized Customer Accounts 453
3. The Carlson Company and Protecting Children in the Global Tourism Industry 462
4. BP Blowout: The Aftermath of the Gulf Oil Disaster 471
5. Google and the Right to Be Forgotten 480
6. General Motors and the Ignition Switch Recalls 490
7. The Upper Big Branch Mine Disaster 500
8. After Rana Plaza 510
9. The Boycott of Stoli Vodka 521

GLOSSARY 529

BIBLIOGRAPHY 542

INDEXES

Name 547

Subject 550

Contents

PART ONE
BUSINESS IN SOCIETY 1

CHAPTER 1
The Corporation and Its Stakeholders 2

Business and Society 4
A Systems Perspective 5
The Stakeholder Theory of the Firm 6
The Stakeholder Concept 8
Different Kinds of Stakeholders 9
Stakeholder Analysis 11
Stakeholder Interests 12
Stakeholder Power 13
Stakeholder Coalitions 15
Stakeholder Mapping 16
The Corporation's Boundary-Spanning Departments 19
The Dynamic Environment of Business 20
Creating Value in a Dynamic Environment 22
Summary 22
Key Terms 23
Internet Resources 23
Discussion Case: Insuring Uber's App-On Gap 23

CHAPTER 2
Managing Public Issues and Stakeholder Relationships 25

Public Issues 26
Environmental Analysis 28
Competitive Intelligence 31
Stakeholder Materiality 32
The Issue Management Process 33
Identify Issue 33
Analyze Issue 34
Generate Options 35
Take Action 35
Evaluate Results 35
Organizing for Effective Issue Management 36
Stakeholder Engagement 38
Stages in the Business–Stakeholder Relationship 38
Drivers of Stakeholder Engagement 39
The Role of Social Media in Stakeholder Engagement 40
Stakeholder Dialogue 41
Stakeholder Networks 41
The Benefits of Engagement 42
Summary 43
Key Terms 44
Internet Resources 44
Discussion Case: Businesses Respond to the Movement for School Safety 44

CHAPTER 3
Corporate Social Responsibility and Citizenship 47

Corporate Power and Responsibility 49
Corporate Social Responsibility and Citizenship 51
The Origins of Corporate Social Responsibility 51
Balancing Social, Economic, and Legal Responsibilities 53
The Corporate Social Responsibility Question 53
Support for Corporate Social Responsibility 53
Concerns about Corporate Social Responsibility 57
Social Entrepreneurs and B Corporations 59
Management Systems for Corporate Social Responsibility and Citizenship 60
Stages of Corporate Citizenship 62
Assessing and Reporting Social Performance 64
Social Audit Standards 65
Social Reporting 65
Summary 67
Key Terms 68
Internet Resources 68
Discussion Case: Corporate Social Responsibility at Gravity Payments 69

CHAPTER 4
Business in a Globalized World 71

The Process of Globalization 72
Major Multinational Enterprises 73
International Financial and Trade Institutions 75
The Benefits and Costs of Globalization 78
Benefits of Globalization 78
Costs of Globalization 79
Doing Business in a Diverse World 81
Comparative Political and Economic Systems 82

Global Inequality and the Bottom of the Pyramid *84*
Collaborative Partnerships for Global Problem Solving 86
A Three-Sector World *87*
Summary 89
Key Terms 89
Internet Resources 89
Discussion Case: Intel and Conflict Minerals 90

PART TWO
BUSINESS AND ETHICS 93

CHAPTER 5
Ethics and Ethical Reasoning 94

The Meaning of Ethics 95
What Is Business Ethics? *96*
Why Should Business Be Ethical? *97*
Why Ethical Problems Occur in Business 101
Personal Gain and Selfish Interest *101*
Competitive Pressures on Profits *102*
Conflicts of Interest *102*
Cross-Cultural Contradictions *102*
The Core Elements of Ethical Character 103
Managers' Values *103*
Spirituality in the Workplace *104*
Managers' Moral Development *105*
Analyzing Ethical Problems in Business 106
Virtue Ethics: Pursuing a "Good" Life *107*
Utility: Comparing Benefits and Costs *108*
Rights: Determining and Protecting Entitlements *109*
Justice: Is It Fair? *110*
Applying Ethical Reasoning to Business Activities *110*
The Moral Intensity of an Ethical Issue 111
Summary 112
Key Terms 112
Internet Resources 113
Discussion Case: LafargeHolcim and ISIS in Syria 113

CHAPTER 6
Organizational Ethics 115

Corporate Ethical Climates 116
Business Ethics across Organizational Functions 118
Accounting Ethics *118*
Financial Ethics *119*
Marketing Ethics *120*
Information Technology Ethics *121*
Supply Chain Ethics *122*
Making Ethics Work in Corporations 123
Building Ethical Safeguards into the Company *123*
Ethics in a Global Economy 129
Efforts to Curtail Unethical Practices *130*
Summary 132
Key Terms 133
Internet Resources 133
Discussion Case: Equifax's Data Breach 133

PART THREE
BUSINESS AND PUBLIC POLICY 137

CHAPTER 7
Business–Government Relations 138

How Business and Government Relate 139
Seeking a Collaborative Partnership *139*
Working in Opposition to Government *140*
Legitimacy Issues *141*
Government's Public Policy Role 141
Elements of Public Policy *142*
Types of Public Policy *145*
Government Regulation of Business 147
Market Failure *147*
Negative Externalities *148*
Natural Monopolies *148*
Ethical Arguments *148*
Types of Regulation *149*
The Effects of Regulation *154*
Regulation in a Global Context 156
Summary 157
Key Terms 157
Internet Resources 157
Discussion Case: Should Facebook Be Regulated? 158

CHAPTER 8
Influencing the Political Environment 161

Participants in the Political Environment 163
Business as a Political Participant *163*
Influencing the Business–Government Relationship 164
Corporate Political Strategy *164*
Political Action Tactics 165
Promoting an Information Strategy *166*
Promoting a Financial-Incentive Strategy *170*
Promoting a Constituency-Building Strategy *175*

Levels of Political Involvement 178
Managing the Political Environment 179
Business Political Action: A Global Challenge 180
Summary 182
Key Terms 183
Internet Resources 183
Discussion Case: Political Action by the U.S. Steel Industry, 2015–2018 183

PART FOUR

BUSINESS AND THE NATURAL ENVIRONMENT 187

CHAPTER 9

Sustainable Development and Global Business 188

Business and Society in the Natural Environment 190
Sustainable Development 190
Threats to the Earth's Ecosystem 191
Forces of Change 192
The Earth's Carrying Capacity 194
Global Environmental Issues 196
Climate Change 196
Ozone Depletion 199
Resource Scarcity: Water and Land 199
Decline of Biodiversity 201
Threats to Marine Ecosystems 202
Response of the International Business Community 203
Codes of Environmental Conduct 206
Summary 207
Key Terms 208
Internet Resources 208
Discussion Case: Clean Cooking 208

CHAPTER 10

Managing for Sustainability 211

Role of Government 213
Major Areas of Environmental Regulation 213
Alternative Policy Approaches 218
Costs and Benefits of Environmental Regulation 222
Managing for Sustainability 224
Stages of Corporate Environmental Responsibility 224
The Ecologically Sustainable Organization 225
Sustainability Management in Practice 225
Environmental Auditing and Reporting 227
Environmental Partnerships 228
Sustainability Management as a Competitive Advantage 228
Cost Savings 229
Brand Differentiation 229
Technological Innovation 230
Reduction of Regulatory and Liability Risk 231
Strategic Planning 231
Summary 233
Key Terms 233
Internet Resources 234
Discussion Case: Hydraulic Fracturing—Can the Environmental Impacts Be Reduced? 234

PART FIVE

BUSINESS AND TECHNOLOGY 237

CHAPTER 11

The Role of Technology 238

Technology Defined 239
Phases of Technology in Society 240
The Role of Technology in Our Daily Lives 241
The Presence of the Internet 241
Unwanted Technology Threats 243
Public Access to and Use of Technology 245
The Digital Divide in the United States and Worldwide 245
Mobile Telephones 246
Social Networking 248
Ethical Challenges Involving Technology 250
The Loss of Privacy 250
Free Speech Issues 251
Government Censorship of Free Speech 252
The Impact of Scientific Breakthroughs 253
Genetically Engineered Foods 253
Sequencing of the Human Genome 255
Biotechnology and Stem Cell Research 256
Medical Breakthroughs 256
Summary 258
Key Terms 258
Internet Resources 258
Discussion Case: To Lock or Unlock Your Phone: Personal Privacy or National Security 259

CHAPTER 12

Regulating and Managing Technology 261

Government Regulation of Technology 262

The Role of Technology in Business 264
Access to Stakeholders' Personal Information 265
E-Business 266
The Use of Robots and Artificial Intelligence at Work 267
The Chief Information, Security, Technology Officer 269
Cybercrime: A Threat to Organizations and the Public 271
Exploring Why Hackers Hack 271
Costs of Cybercrime 272
Business Responses to Invasions of Information Security 274
Government Efforts to Combat Cybercrime 275
Summary 276
Key Terms 277
Internet Resources 277
Discussion Case: The Arrival of Autonomous Cars—Bright Future or Looming Threat? 278

PART SIX
BUSINESS AND ITS STAKEHOLDERS 281

CHAPTER 13
Shareholder Rights and Corporate Governance 282

Shareholders Around the World 283
Who Are Shareholders? 284
Objectives of Stock Ownership 285
Shareholders' Legal Rights and Safeguards 286
Corporate Governance 287
The Board of Directors 287
Principles of Good Governance 289
Special Issue: Executive Compensation 291
Shareholder Activism 295
The Rise of Institutional Investors 296
Social Investment 297
Shareholder Lawsuits 298
Government Protection of Shareholder Interests 299
Securities and Exchange Commission 299
Information Transparency and Disclosure 299
Insider Trading 300
Shareholders and the Corporation 301
Summary 302
Key Terms 302
Internet Resources 303
Discussion Case: Corporate Governance and Executive Misconduct at Wynn Resorts 303

CHAPTER 14
Consumer Protection 305

The Rights of Consumers 307
Self-Advocacy for Consumer Interests 308
How Government Protects Consumers 309
Goals of Consumer Laws 309
Major Consumer Protection Agencies 311
Consumer Privacy in the Digital Age 314
Using the Courts and Product Liability Laws 316
Strict Liability 317
Product Liability Reform and Alternative Dispute Resolution 317
Positive Business Responses to Consumerism 320
Managing for Quality 320
Voluntary Industry Codes of Conduct 321
Consumer Affairs Departments 322
Product Recalls 322
Consumerism's Achievements 323
Summary 323
Key Terms 324
Internet Resources 324
Discussion Case: Volkswagen's "Clean Diesel" Campaign 324

CHAPTER 15
Employees and the Corporation 327

The Employment Relationship 329
Workplace Rights 330
The Right to Organize and Bargain Collectively 330
The Right to a Safe and Healthy Workplace 333
Job Security and the Right to Due Process 334
Fair Wages and Income Inequality 337
The Right to Privacy in the Workplace 339
Electronic Monitoring 340
Romance in the Workplace 341
Employee Drug Use and Testing 342
Alcohol Abuse at Work 343
Employee Theft and Honesty Testing 344
The Right to Blow the Whistle and Free Speech in the Workplace 345
Summary 347
Key Terms 347
Internet Resources 347
Discussion Case: The Ugly Side of Beautiful Nails 348

CHAPTER 16
Managing a Diverse Workforce 350

The Changing Face of the Workforce 351
Gender and Race in the Workplace 353
Women and Minorities at Work 353
The Gender and Racial Pay Gap 354
Where Women and Persons of Color Manage 356
Breaking the Glass Ceiling 356
Women and Minority Business Ownership 359
Government's Role in Securing Equal Employment Opportunity 360
Equal Employment Opportunity 360
Affirmative Action 361
Sexual and Racial Harassment 362
What Business Can Do: Diversity and Inclusion Policies and Practices 364
Balancing Work and Life 367
Child Care and Elder Care 367
Work Flexibility 368
Summary 370
Key Terms 371
Internet Resources 371
Discussion Case: Apple and the Dreamers 371

CHAPTER 17
Business and Its Suppliers 374

Suppliers 376
Social, Ethical, and Environmental Issues in Global Supply Chains 378
Social Issues 379
Ethical Issues 380
Environmental Issues 382
Supply Chain Risk 383
Private Regulation of the Business–Supplier Relationship 384
Supply Chain Auditing 387
Supplier Development and Capability Building 389
Summary 392
Key Terms 393
Internet Resources 393
Discussion Case: IKEA's Sustainable Cotton Supply Chain 393

CHAPTER 18
The Community and the Corporation 396

The Business–Community Relationship 398
The Business Case for Community Involvement 399
Community Relations 401
Economic Development 401
Housing 402
Aid to Minority, Women, and Disabled Veteran-Owned Enterprises 402
Disaster, Terrorism, and War Relief 403
Corporate Giving 403
Forms of Corporate Giving 407
Priorities in Corporate Giving 409
Corporate Giving in a Strategic Context 410
Measuring the Return on Social Investment 412
Building Collaborative Partnerships 414
Summary 415
Key Terms 415
Internet Resources 416
Discussion Case: Salesforce's 1+1+1 Integrated Philanthropy Model 416

CHAPTER 19
Managing the Public and the Corporate Reputation 419

The General Public 420
What Is Reputation? 421
Why Does Reputation Matter? 422
The Public Relations Department 424
Public Relations in the Internet and Social Media Age 424
Brand Management 426
Crisis Management 427
Engaging Key Stakeholders with Specific Tactics 430
Executive Visibility 431
User-Generated Content 433
Paid Content 434
Event Sponsorship 434
Public Service Announcements 436
Image Advertisements 436
Summary 438
Key Terms 438
Internet Resources 438
Discussion Case: United Airlines—Navigating a Social Media Storm 439

CASES IN BUSINESS AND SOCIETY 441

1. **Profiting from Pain: Business and the U.S. Opioid Epidemic 442**
2. **Wells Fargo's Unauthorized Customer Accounts 453**

3. **The Carlson Company and Protecting Children in the Global Tourism Industry 462**

4. **BP Blowout: The Aftermath of the Gulf Oil Disaster 471**

5. **Google and the Right to Be Forgotten 480**

6. **General Motors and the Ignition Switch Recalls 490**

7. **The Upper Big Branch Mine Disaster 500**

8. **After Rana Plaza 510**

9. **The Boycott of Stoli Vodka 521**

Glossary 529

Bibliography 542

Indexes
Name 547
Subject 550

PART ONE

Business in Society

CHAPTER ONE

The Corporation and Its Stakeholders

Business corporations have complex relationships with many individuals and organizations in society. The term *stakeholder* refers to all those that affect, or are affected by, the actions of the firm. An important part of management's role is to identify a firm's relevant stakeholders and understand the nature of their interests, power, and alliances with one another. Building positive and mutually beneficial relationships across organizational boundaries can help enhance a company's reputation and address critical social and ethical challenges. In a world of fast-paced globalization, shifting public expectations and government policies, growing ecological concerns, and new technologies, managers face the difficult challenge of achieving economic results while simultaneously creating value for all of their diverse stakeholders.

This Chapter Focuses on These Key Learning Objectives:

LO 1-1 Understanding the relationship between business and society and the ways in which business and society are part of an interactive system.

LO 1-2 Considering the purpose of the modern corporation.

LO 1-3 Knowing what a stakeholder is and who a corporation's market and nonmarket and internal and external stakeholders are.

LO 1-4 Conducting a stakeholder analysis and understanding the basis of stakeholder interests and power.

LO 1-5 Recognizing the diverse ways in which modern corporations organize internally to interact with various stakeholders.

LO 1-6 Analyzing the forces of change that continually reshape the business and society relationship.

Amazon—which some have called the "Earth's biggest store"—is an important part of many of our lives. We browse on Amazon, watch on Amazon, and buy on Amazon. We freely disclose to Amazon our wishes, interests, and willingness to pay. You may well have purchased or rented this textbook from Amazon.

In 2018, Amazon was the largest Internet retailer in the world, measured both by annual revenue ($178 billion) and market capitalization (more than $800 billion). It was the second largest private employer in the United States (after Walmart), with more than 540,000 employees (not counting the additional 120,000 or so temporary workers the company brought on each year during the busy holiday season).[1] From its start in 1994 as a scrappy Seattle start-up selling books online, Amazon had grown at an astonishing pace; in 2017, Amazon was responsible for fully 70 percent of all growth in U.S. online commerce.[2] By 2018, the company's founder and CEO, Jeff Bezos, had become the world's richest person, with a net worth greater than $100 billion.[3] Shareholders in the company had been richly rewarded; in early 2018, the price of Amazon's stock was more than 12 times higher than it had been a decade earlier. The company was enormously popular with consumers, who turned to Amazon for one-click convenience, free and speedy delivery, and the ability to compare a seemingly endless assortment of products on the basis of price and reviews. Small businesses affiliated with Amazon Marketplace were able to tap into the company's global e-commerce platform and unrivaled logistics to reach customers they never could have reached before. No doubt, many had benefited from Amazon's success.

Yet the company had also become the target of criticism from many quarters, charged with destroying brick-and-mortar businesses, relentlessly driving their own employees, unfairly besting competitors, and pressuring communities for concessions. Consider that:

- Much of Amazon's success had come at the expense of brick-and-mortar stores. Iconic retailers—such as Macy's, JCPenney, and Target—had shed thousands of jobs as Amazon attracted ever-larger slices of consumer spending. A leading economist calculated that the rise of online commerce had caused the cumulative loss of 1.2 million retailing jobs—positions such as cashiers, salespeople, and stock clerks—in the United States.[4] Many of these jobs were held by women and minorities (who made up 60 percent and 40 percent, respectively, of department store employees).[5] Traditional retailing, concluded Scott Galloway, the author of *The Four: The Hidden DNA of Amazon, Apple, Facebook, and Google,* had been "ravaged and depopulated by a single player"—Amazon.[6]
- Amazon's own employees, by some accounts, were subject to an unusually punishing work culture. An investigative report by *The New York Times,* based on interviews with more than 100 current and former white-collar employees, found a pattern of setting "unreasonably high" performance standards, continually monitoring performance, and weeding out employees in a "rank and yank" system that one called "purposeful Darwinism." Turnover rates were among the highest in the Fortune 500. Said one former marketer, "Amazon is where overachievers go to feel bad about themselves."[7]

[1] "Amazon Is Now the Size of a Small Country," *Business Insider,* January 16, 2018.

[2] "U.S. E-Commerce Sales Grow 16.0% in 2017," *Internet Retailer,* at *www.digitalcommerce360.com*, February 16, 2018.

[3] "Jeff Bezos Is Now the Richest Person in History," *http://money.cnn.com*, January 9, 2018.

[4] Michael Feroli, chief U.S. economist at J.P. Morgan, cited in "Amazon to Add 100,000 Jobs as Brick-and-Mortar Retail Crumbles," *The New York Times,* January 12, 2017.

[5] "The Silent Crisis of Retail Employment," *The Atlantic,* April 18, 2017, and "Decline in Retail Jobs Felt Entirely by Women," *Institute for Women's Policy Research,* December 2017.

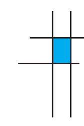
[6] Scott Galloway, *The Four:* Scott Galloway, *The Four: The Hidden DNA of Amazon, Apple, Facebook, and Google* (New York: Penguin, 2017), Chapter 2.

[7] "Inside Amazon: Wrestling Big Ideas in a Bruising Workplace," *The New York Times,* August 15, 2015.

- Amazon's control of both online and voice-activated search gave it powerful advantages—leading to what some saw as unfair competition. One study found that under some conditions, products displayed under "customers who bought this item also bought" were dominated by Amazon's own private-label brands.[8] Alexa, Amazon's voice-activated virtual assistant on Echo and other digital devices, also gave the company an edge. The consulting firm Bain & Company found that Alexa's recommendations were biased toward "Amazon's Choice" and the company's own private-label products (after products the customer had previously ordered). "The 'endless aisle' just got a lot smaller," Bain concluded.[9]
- In 2017, Amazon announced it would invest $5 billion to open a second North American headquarters outside Seattle, promising to create 50,000 new jobs paying $100,000 or more. This was a tantalizing prospect, and 238 cities and regions submitted proposals, with at least six offering financial incentives of $1 billion or more. Some public officials thought this was well worth it, but others thought taxpayer money should not be used to subsidize such a successful company. "Blindly giving away the farm isn't our style," said the mayor of San Antonio, Texas, which dropped out of the race.[10]

Amazon's experience illustrates, on a particularly large scale, the challenges of managing successfully in a complex network of stakeholders. The company's actions affected not only itself, but also many other people, groups, and organizations in society. Customers, employees, business partners and suppliers, competitors, shareholders, creditors, governments, and local communities all had a stake in Amazon's decisions.

Every modern company, whether small or large, is part of a vast global business system. Whether a firm has 50 employees or, like Amazon, more than half a million—its links to customers, suppliers, employees, and communities are certain to be numerous, diverse, and vital to its success. This is why the relationship between business and society is important for you to understand as both a citizen and a manager.



Business and Society

Business today is arguably the most dominant institution in the world. The term *business* refers here to any organization that is engaged in making a product or providing a service for a profit. Consider that in the United States today there are 6 million businesses, according to government estimates, and in the world as a whole, there are uncounted millions more. Of course, these businesses vary greatly in size and impact. They range from a woman who helps support her family by selling handmade tortillas by the side of the road in Mexico City for a few pesos, to ExxonMobil, a huge corporation that employs almost 75,000 workers and earns annual revenues approaching $237 billion in almost every nation in the world.

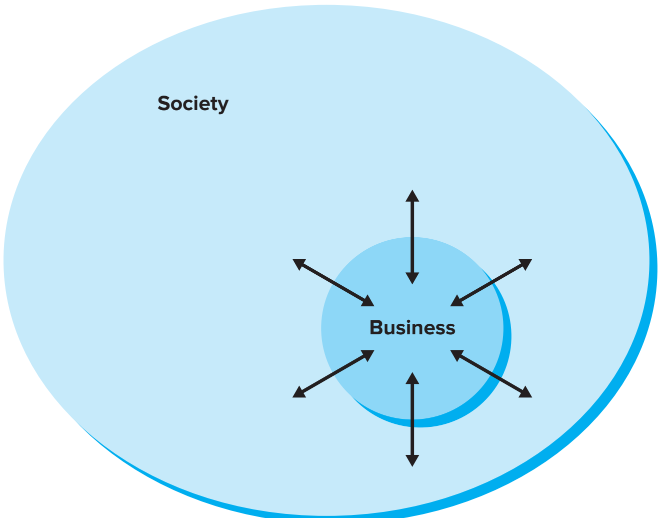
Society, in its broadest sense, refers to human beings and to the social structures they collectively create. In a more specific sense, the term is used to refer to segments of humankind, such as members of a particular community, nation, or interest group. As a set of organizations created by humans, business is clearly a part of society. At the same time, it is also a distinct entity, separated from the rest of society by clear boundaries. Business

[8] "The Antitrust Case Against Facebook, Google, and Amazon," *The Wall Street Journal,* January 16, 2018, and "How Amazon Steers Shoppers to Its Own Products," *The Wall Street Journal,* June 23, 2018; see also Galloway, op. cit.

[9] "Dreaming of an Amazon Christmas?" Bain & Company, November 9, 2017.

[10] "Amazon Just Revealed the Top Cities for HQ2—Here Are the Ones Throwing Hundreds of Millions to Land It," *Business Insider,* January 18, 2018, and "As Cities Woo Amazon to Build Second Headquarters, Incentives Are Key," *The Wall Street Journal,* October 19, 2017.

FIGURE 1.1
Business and Society: An Interactive System



is engaged in ongoing exchanges with its external environment across these dividing lines. For example, businesses recruit workers, buy supplies, and borrow money; they also sell products, donate time, and pay taxes. This book is broadly concerned with the relationship between business and society. A simple diagram of the relationship between the two appears in Figure 1.1.

As the Amazon example that opened this chapter illustrates, business and society are highly interdependent. Business activities impact other activities in society, and actions by various social actors and governments continuously affect business. To manage these interdependencies, managers need an understanding of their company's key relationships and how the social and economic system of which they are a part affects, and is affected by, their decisions.

A Systems Perspective

General systems theory, first introduced in the 1940s, argues that all organisms are open to, and interact with, their external environments. Although most organisms have clear boundaries, they cannot be understood in isolation, but only in relationship to their surroundings. This simple but powerful idea can be applied to many disciplines. For example, in botany, the growth of a plant cannot be explained without reference to soil, light, oxygen, moisture, and other characteristics of its environment. As applied to management theory, the systems concept implies that business firms (social organisms) are embedded in a broader social structure (external environment) with which they constantly interact. Corporations have ongoing boundary exchanges with customers, governments, competitors, suppliers, communities, and many other individuals and groups. Just as good soil, water, and light help a plant grow, positive interactions with society benefit a business firm.

Like biological organisms, moreover, businesses must adapt to changes in the environment. Plants growing in low-moisture environments must develop survival strategies, like the cactus that evolves to store water in its leaves. Similarly, a telecommunications company in a newly deregulated market must learn to compete by changing the products and services it offers. The key to business survival is often this ability to adapt effectively to changing conditions. In business, systems theory provides a powerful tool to help managers conceptualize the relationship between their companies and their external environments.

Systems theory helps us understand how business and society, taken together, form an **interactive social system**. Each needs the other, and each influences the other. They are entwined so completely that any action taken by one will surely affect the other. They are both separate and connected. Business is part of society, and society penetrates far and often into business decisions. In a world where global communication is rapidly expanding, the connections are closer than ever before. Throughout this book we discuss examples of organizations and people that are grappling with the challenges of, and helping to shape, business–society relationships.

The Stakeholder Theory of the Firm

What is the purpose of the modern corporation? To whom, or what, should the firm be responsible?[11] No question is more central to the relationship between business and society.

In the **shareholder theory of the firm** (sometimes also called the ownership theory), the firm is seen as the property of its owners. The purpose of the firm is to maximize its long-term market value, that is, to make the most money it can for shareholders who own stock in the company. Managers and boards of directors are agents of shareholders and have no obligations to others, other than those directly specified by law. In this view, owners' interests are paramount and take precedence over the interests of others.

A contrasting view, called the **stakeholder theory of the firm**, argues that corporations serve a broad public purpose: to create value for society. All companies must make a profit for their owners; indeed, if they did not, they would not long survive. However, corporations create many other kinds of value as well, such as professional development for their employees and innovative new products for their customers. In this view, corporations have multiple obligations, and all stakeholders' interests must be taken into account. This perspective was well expressed by Laurence Fink, the CEO of BlackRock, a global firm that manages more than $5 trillion worth of assets for its clients. In his 2018 letter to CEOs, Fink stated that ". . . every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."[12]

Supporters of the stakeholder theory of the firm make three core arguments for their position: *descriptive, instrumental,* and *normative.*[13]

The *descriptive argument* says that the stakeholder view is simply a more realistic description of how companies really work. Managers have to pay keen attention, of course, to their quarterly and annual financial performance. Keeping Wall Street satisfied by managing for growth—thereby attracting more investors and increasing the stock price—is a core part of any top manager's job. But the job of management is much more complex than this. In order to produce consistent results, managers have to be concerned with producing high-quality and innovative products and services for their customers, attracting

[11] For summaries of contrasting theories of the purpose of the firm, see Margaret M. Blair, "Whose Interests Should Corporations Serve," in Margaret M. Blair and Bruce K. MacLaury, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington, DC: Brookings Institution, 1995), Ch. 6, pp. 202–34; and James E. Post, Lee E. Preston, and Sybille Sachs, *Redefining the Corporation: Stakeholder Management and Organizational Wealth* (Palo Alto, CA: Stanford University Press, 2002).

[12] "Larry Fink's Annual [2018] Letter to CEOs: A Sense of Purpose," at *www.blackrock.com*.

[13] The descriptive, instrumental, and normative arguments are summarized in Thomas Donaldson and Lee E. Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications," *Academy of Management Review* 20, no. 1 (1995), pp. 65–71. See also, Post, Preston, and Sachs, *Redefining the Corporation,* Ch. 1.

and retaining talented employees, and complying with a plethora of complex government regulations. As a practical matter, managers direct their energies toward all stakeholders, not just owners.

> In what became known as the "dollar store wars," two companies made competing bids to buy Family Dollar, a U.S. discount retail chain based in Charlotte, North Carolina—each with very different consequences for stakeholders. One suitor, Dollar Tree, offered $76.50 per share for the company, while the other, Dollar General, offered $80—seemingly a better deal for shareholders. But the Dollar General deal faced likely government antitrust scrutiny and would probably have required the closure of thousands of stores, throwing employees out of work and depriving low-income communities of access to a discount store. In the end, after considering the impact on all stakeholders, Family Dollar's management recommended the lower-priced offer, and three-quarters of its shareholders agreed.[14]

The *instrumental argument* says that stakeholder management is more effective as a corporate strategy. A wide range of studies have shown that companies that behave responsibly toward multiple stakeholder groups perform better financially, over the long run, than those that do not. (This empirical evidence is further explored in Chapter 3.) These findings make sense, because good relationships with stakeholders are themselves a source of value for the firm. Attention to stakeholders' rights and concerns can help produce motivated employees, satisfied customers, committed suppliers, and supportive communities, all good for the company's bottom line.

The *normative argument* says that stakeholder management is simply the right thing to do. Corporations have great power and control vast resources; these privileges carry with them a duty toward all those affected by a corporation's actions. Moreover, all stakeholders, not just owners, contribute something of value to the corporation. A skilled engineer at Microsoft who applies his or her creativity to solving a difficult programming problem has made a kind of investment in the company, even if it is not a monetary investment. Any individual or group who makes a contribution, or takes a risk, has a moral right to some claim on the corporation's rewards.[15]

A basis for both the shareholder and stakeholder theories of the firm exists in law. The legal term *fiduciary* means a person who exercises power on behalf of another, that is, who acts as the other's agent. In U.S. law, managers are considered fiduciaries of the owners of the firm (its shareholders) and have an obligation to run the business in their interest. These legal concepts are clearly consistent with the shareholder theory of the firm. However, other laws and court cases have given managers broad latitude in the exercise of their fiduciary duties. In the United States (where corporations are chartered not by the federal government but by the states), most states have passed laws that permit managers to take into consideration a wide range of other stakeholders' interests, including those of employees, customers, creditors, suppliers, and communities. (Benefit corporations, firms with a special legal status that obligates them to do so, are further discussed in Chapter 3.)

[14] "Family Dollar Shareholders Approve Sale to Dollar Tree," *Charlotte Observer,* January 22, 2015.

[15] Abe Zakhem and Daniel E. Palmer, "Normative Stakeholder Theory," in David M. Wasieleski and James Weber (eds.), *Stakeholder Management, Business and Society 360: Volume 1,* pages 49–74 (Bingley, United Kingdom: Emerald Publishing Ltd., 2017). Another formulation of this point has been offered by Robert Phillips, who argues for a principle of stakeholder fairness. This states that "when people are engaged in a cooperative effort and the benefits of this cooperative effort are accepted, obligations are created on the part of the group accepting the benefit" [i.e., the business firm]. Robert Phillips, *Stakeholder Theory and Organizational Ethics* (San Francisco: Berrett-Koehler, 2003), p. 9 and Ch. 5.

In addition, many federal laws extend specific protections to various groups of stakeholders, such as those that prohibit discrimination against employees or grant consumers the right to sue if harmed by a product.

In other nations, the legal rights of nonowner stakeholders are often more fully developed than in the United States. For example, a number of European countries—including Germany, Norway, Austria, Denmark, Finland, and Sweden—require public companies to include employee members on their boards of directors, so that their interests will be explicitly represented. Under the European Union's so-called harmonization statutes, managers are specifically permitted to take into account the interests of customers, employees, creditors, and others.

In short, while the law requires managers to act on behalf of shareholders, it also gives them wide discretion—and in some instances requires them—to manage on behalf of the full range of stakeholder groups. The next section provides a more formal definition and an expanded discussion of the stakeholder concept.

The Stakeholder Concept

The term **stakeholder** refers to persons and groups that affect, or are affected by, an organization's decisions, policies, and operations.[16] The word *stake* originally meant a pointed stick or post. The word later became used as a verb, as when a person was said to mark territory with a stake to assert ownership—that is, to stake a claim.[17] In the context of management theory, *stake* is used more abstractly to mean an interest in—or claim on—a business enterprise. Those with a stake in the firm's actions include such diverse groups as customers, employees, shareholders (also called stockholders), governments, suppliers, professional and trade associations, social and environmental activists, and nongovernmental organizations. The term *stakeholder* is not the same as *stockholder,* although the words sound similar. Stockholders—individuals or organizations that own shares of a company's stock—are one of several kinds of stakeholders.

Business organizations are embedded in networks involving many participants. Each of these participants has a relationship with the firm, based on ongoing interactions. Each of them shares, to some degree, in both the risks and rewards of the firm's activities. And each has some kind of claim on the firm's resources and attention, based on law, moral right, or both. The number of these stakeholders and the variety of their interests can be large, making a company's decisions very complex, as the Amazon example illustrates.

Managers make good decisions when they pay attention to the effects of their decisions on stakeholders, as well as stakeholders' effects on the company. On the positive side, strong relationships between a corporation and its stakeholders are an asset that adds value. On the negative side, some companies disregard stakeholders' interests, either out of the belief that the stakeholder is wrong or out of the misguided notion that an unhappy customer, employee, or regulator does not matter. Such attitudes often prove costly to the company involved. Today, for example, companies know that they cannot locate a factory or store in a community that strongly objects. They also know that making a product that is perceived as unsafe invites lawsuits and jeopardizes market share.

[16] The term *stakeholder* was first introduced in 1963 but was not widely used in the management literature until the publication of R. Edward Freeman's *Strategic Management: A Stakeholder Approach* (Marshfield, MA: Pitman, 1984). For a comprehensive review of the stakeholder management literature, see Samantha Miles, "Stakeholder Theory Classification, Definitions and Essential Contestability," in David M. Wasieleski and James Weber (eds.) *Stakeholder Management, Business and Society 360: Volume 1,* pages 21–48 (Bingley, United Kingdom: Emerald Publishing Limited, 2017).

[17] "Origin and Meaning of Stake," Online Etymology Dictionary, at *www.etymonline.com*.

Exhibit 1.A Are Managers Stakeholders?

Are managers, especially top executives, stakeholders? This has been a contentious issue in stakeholder theory.

On one hand, the answer clearly is "yes" Like other stakeholders, managers are impacted by the firm's decisions. As employees of the firm, managers receive compensation—often very generous compensation, as shown in Chapter 13. Their managerial roles confer opportunities for professional advancement, social status, and power over others. Managers benefit from the company's success and are hurt by its failure. For these reasons, they might properly be classified as employees.

On the other hand, top executives are agents of the firm and are responsible for acting on its behalf. In the stakeholder theory of the firm, their role is to integrate stakeholder interests, rather than to promote their own more narrow, selfish goals. For these reasons, they might properly be classified as representatives of the firm itself, rather than as one of its stakeholders.

Management theory has long recognized that these two roles of managers potentially conflict. The main job of executives is to act for the company, but all too often they act primarily for themselves. Consider, for example, the many top executives of Lehman Brothers, MF Global, and Merrrill Lynch, who enriched themselves personally at the expense of shareholders, employees, customers, and other stakeholders. The challenge of persuading top managers to act in the firm's best interest is further discussed in Chapter 13.

Different Kinds of Stakeholders

Business interacts with society in many diverse ways, and a company's relationships with various stakeholders differ.

Market stakeholders are those that engage in economic transactions with the company as it carries out its purpose of providing society with goods and services. Each relationship between a business and one of its market stakeholders is based on a unique transaction, or two-way exchange. Shareholders invest in the firm and in return receive the potential for dividends and capital gains. Creditors loan money and collect payments of interest and principal. Employees contribute their skills and knowledge in exchange for wages, benefits, and the opportunity for personal satisfaction and professional development. In return for payment, suppliers provide raw materials, energy, services, finished products, and other inputs; and wholesalers, distributors, and retailers engage in market transactions with the firm as they help move the product from plant to sales outlets to customers. All businesses need customers who are willing to buy their products or services.

The puzzling question of whether or not managers should be classified as stakeholders along with other employees is discussed in Exhibit 1.A.

Nonmarket stakeholders, by contrast, are people and groups who—although they do not engage in direct economic exchange with the firm—are nonetheless affected by or can affect its actions. Nonmarket stakeholders include the community, various levels of government, nongovernmental organizations, business support groups, competitors, and the general public. Nonmarket stakeholders are not necessarily less important than others, simply because they do not engage in direct economic exchange with a business. On the contrary, interactions with such groups can be critical to a firm's success or failure, as shown in the following example.

In late 2017, a company called Energy Management Inc. (EMI) said it would finally call off its sixteen-year effort to build a wind farm off the shore of Cape Cod, Massachusetts, to supply clean, renewable power to New England customers. The project, called Cape Wind, had generated intense opposition from residents of Cape

Cod and nearby islands, who were concerned that its 130 wind turbines would spoil the view and get in the way of boats. A nonprofit group called Save Our Sound filed dozens of lawsuits, charging possible harm to wildlife, increased electricity rates, and danger to aircraft. Local utilities had withdrawn their commitments to buy power from the wind farm, and state regulators had denied permission for a power line connection to the mainland. "We were kept in a repeated sudden death period," said the company's discouraged owner, using a football analogy. "And the goal posts kept moving."[18]

In this instance, various stakeholders were able to block the company's plans completely—even though many did not have a market relationship with it.

Theorists also distinguish between **internal stakeholders** and **external stakeholders**. Internal stakeholders are those, such as employees and managers, who are employed by the firm. They are "inside" the firm, in the sense that they contribute their effort and skill, usually at a company worksite. External stakeholders, by contrast, are those who—although they may have important transactions with the firm—are not directly employed by it.

The classification of government as a nonmarket stakeholder has been controversial in stakeholder theory. Most theorists say that government is a nonmarket stakeholder (as does this book) because it does not normally conduct any direct market exchanges (buying and selling) with business. However, money often flows from business to government in the form of taxes and fees, and sometimes from government to business in the form of subsidies or incentives. Moreover, some businesses—defense contractors for example—*do* sell directly to the government and receive payment for goods and services rendered. For this reason, a few theorists have called government a market stakeholder of business. And, in a few cases, the government may take a direct ownership stake in a company—as the U.S. government did after the financial crisis of 2008–09 when it invested in several banks and auto companies, becoming a shareholder of these firms. Government also has special influence over business because of its ability to charter and tax corporations, as well as make laws that regulate their activities. The unique relationship between government and business is discussed throughout this book.

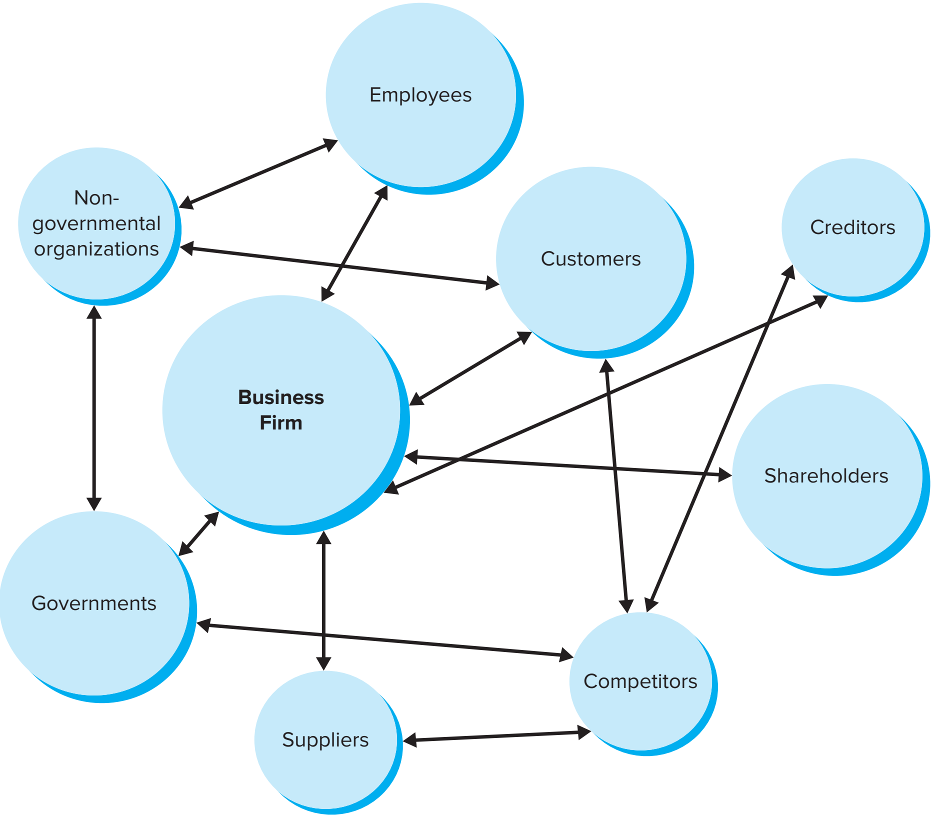
Other stakeholders also have some market and some nonmarket characteristics. For example, business support groups, such as the Chamber of Commerce, are normally considered a nonmarket stakeholder. However, companies may support the Chamber of Commerce with their membership dues—a market exchange. Communities are a nonmarket stakeholder, but receive taxes, philanthropic contributions, and other monetary benefits from businesses. These subtleties are further explored in later chapters.

Modern stakeholder theory recognizes that most business firms are embedded in a complex web of stakeholders, many of which have independent relationships with each other.[19] In this view, a business firm and its stakeholders are best visualized as an interconnected network. Imagine, for example, an electronics company, based in the United States, that produces smartphones, tablets, and music players. The firm employs people to design, engineer, and market its devices to customers in many countries. Shares in the company

[18] "Now It's Official: Cape Wind Project Dead," *Boston Globe,* December 1, 2017, and "After 16 Years, Hopes for Cape Cod Wind Farm Float Away," *The New York Times,* December 19, 2017. The story of the opposition to Cape Wind is told in Robert Whitcomb and Wendy Williams, *Cape Wind: Money, Celebrity, Energy, Class, Politics, and the Battle for Our Energy Future* (New York: PublicAffairs, 2008).

[19] Timothy J. Rowley, "The Power of and in Stakeholder Networks," in David M. Wasieleski and James Weber (eds.) *Stakeholder Management, Business and Society 360: Volume 1,* pp. 101–122 (Bingley, United Kingdom: Emerald Publishing Limited, 2017).

FIGURE 1.2
A Firm and its Stakeholders



are owned by investors around the world, including many of its own employees and managers. Production is carried out by suppliers in Asia. Banks provide credit to the company, as well as to other companies. Competing firms sell their products to some of the same customers, and also contract production to some of the same Asian suppliers. Nongovernmental organizations may seek to lobby the government concerning the firm's practices, and may count some employees among their members. A visual representation of this company and its stakeholders is shown in Figure 1.2.

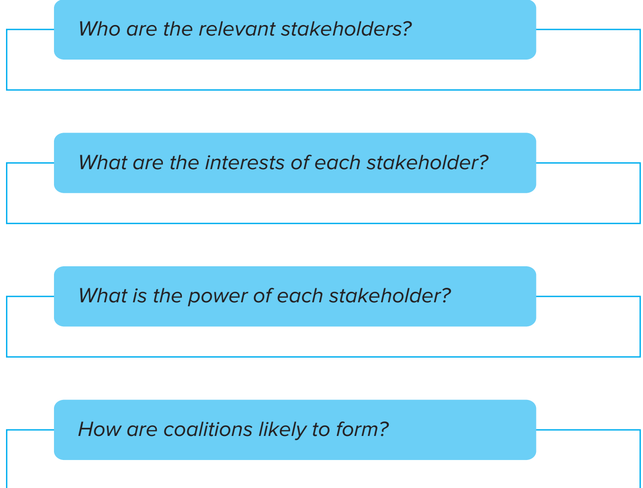
As Figure 1.2 suggests, some individuals or groups may play multiple stakeholder roles. Some theorists use the term *role sets* to refer to this phenomenon. For example, a person may work at a company, but also live in the surrounding community, own shares of company stock in his or her 401(k) retirement account, and even purchase the company's products from time to time. This person has several stakes in a company's actions.

Later sections of this book (especially Chapters 13 through 19) will discuss in more detail the relationship between business and its various stakeholders.

Stakeholder Analysis

An important part of the modern manager's job is to identify relevant stakeholders and to understand both their interests and the power they may have to assert these interests. This process is called **stakeholder analysis**. The organization from whose perspective the analysis is conducted is called the **focal organization**.

FIGURE 1.3
The Four Key Questions of Stakeholder Analysis



The first step of a stakeholder analysis is for managers of the focal organization to identify the issue at hand. For example, in the Cape Wind situation discussed earlier in this chapter, Energy Management Inc. had to analyze how to win regulatory approval for the construction of its wind farm. Once the issue is determined, managers must ask four key questions, as discussed below and summarized in Figure 1.3.

Who are the relevant stakeholders?

The first question requires management to identify and map the relevant stakeholders. Exhibit 1.B, which appears later in this chapter, provides a guide. However, not all stakeholders listed will be relevant in every management situation. For example, a privately held firm will not have shareholders. Some businesses sell directly to customers online, and therefore will not have retailers. In other situations, a firm may have a stakeholder—say, a creditor that has loaned money—but this group is not relevant to a particular issue that management faces.

But stakeholder analysis involves more than simply *identifying* stakeholders; it also involves understanding the nature of their interests, power, legitimacy, and links with one another.

Stakeholder Interests

What are the interests of each stakeholder?

Each stakeholder has a unique relationship to the organization, and managers must respond accordingly. **Stakeholder interests** are, essentially, the nature of each group's stake. What are their concerns, and what do they want from their relationship with the firm?[20]

Shareholders, for their part, have an ownership interest in the firm. In exchange for their investment, shareholders expect to receive dividends and, over time, capital appreciation. The economic health of the corporation affects these people financially; their personal wealth—and often, their retirement security—is at stake. They may also seek to achieve social objectives through their choice of investments. Customers, for their part, are most

[20] A full discussion of the interests of stakeholders may be found in R. Edward Freeman, *Ethical Theory and Business* (Englewood Cliffs, NJ: Prentice Hall, 1994).

interested in gaining fair value and quality in exchange for the purchase price of goods and services. Suppliers wish to obtain profitable orders, use their capacity efficiently, and build stable relationships with their business customers. Employees, in exchange for their time and effort, want to receive fair compensation and an opportunity to develop their job skills. Governments, public interest groups, and local communities have another sort of relationship with the company. In general, their stake is broader than the financial stake of owners, customers, and suppliers. They may wish to protect the environment, assure human rights, or advance other broad social interests. Managers need to understand these complex and often intersecting stakeholder interests.

Stakeholder Power

What is the power of each stakeholder?

Stakeholder power means the ability to use resources to make an event happen or to secure a desired outcome. Stakeholders have five different kinds of power: *voting power, economic power, political power, legal power,* and *informational power.*

Voting power means that the stakeholder has a legitimate right to cast a vote. Shareholders typically have voting power proportionate to the percentage of the company's stock they own. They typically have an opportunity to vote on such major decisions as mergers and acquisitions, the composition of the board of directors, and other issues that may come before the annual meeting. (Shareholder voting power should be distinguished from the voting power exercised by citizens, which is discussed below.)

For example, Starboard Value LP, a New York-based hedge fund, used its voting power as a shareholder to force change in a company it had invested in. Starboard bought more than 10 percent of the shares of Mellanox Technologies, an Israeli semiconductor company, and called for radical change, slamming management for "weak execution," "excessive spending," and "missed growth opportunities." When Mellanox did not respond aggressively enough, in 2018 Starboard and its allies fielded their own slate of nominees in the election for the board of directors and organized support from other voting shareholders. The company eventually compromised with Starboard, agreeing to add two of the activists' nominees to the board and a third if performance goals were not met. In recent years, activist investors like Starboard Value have won one board seat for every two board election campaigns they have waged.[21]

Suppliers, customers, employees, and other stakeholders have *economic power* with the company. Suppliers, for example, can withhold supplies or refuse to fill orders if a company fails to meet its contractual responsibilities. Customers may refuse to buy a company's products or services if the company acts improperly. They can boycott products if they believe the goods are too expensive, poorly made, or unsafe. Employees, for their part, can refuse to work under certain conditions, a form of economic power known as a strike or slowdown. Economic power often depends on how well organized a stakeholder group is. For example, workers who are organized into unions usually have more economic power than do workers who try to negotiate individually with their employers.

Governments exercise *political power* through legislation, regulations, or lawsuits. While government agencies act directly, other stakeholders use their political power

[21] "Mellanox, Starboard Settle on New Board Members," *Reuters,* June 19, 2018; "Starboard Value to Launch Proxy Fight for Entire Board at Mellanox," *The Wall Street Journal,* January 17, 2018; and "Review and Analysis of 2017 U.S. Shareholder Activism," Sullivan & Cromwell LLP, March 26, 2018.

indirectly by urging government to use its powers by passing new laws or enacting regulations. Citizens may also vote for candidates that support their views with respect to government laws and regulations affecting business, a different kind of voting power than the one discussed above. Stakeholders may also exercise political power directly, as when social, environmental, or community activists organize to protest a particular corporate action.

Stakeholders have *legal power* when they bring suit against a company for damages, based on harm caused by the firm; for instance, lawsuits brought by customers for damages caused by defective products, brought by employees for damages caused by workplace injury, or brought by environmentalists for damages caused by pollution or harm to species or habitat. After the mortgage lender Countrywide collapsed, many institutional shareholders, such as state pension funds, sued Bank of America (which had acquired Countrywide) to recoup some of their losses.

Finally, stakeholders have *informational power* when they have access to valuable data, facts, or details and are able to bring their own information and perspectives to the attention of the public or key decision makers. With the explosive growth of technologies that facilitate the sharing of information, this kind of stakeholder power has become increasingly important.

> Consumers' ability to use social networks to express their views about businesses they like—and do not like—has given them power they did not previously have. For example, Yelp Inc. operates a website where people can search for local businesses, post reviews, and read others' comments. In 2016, a dozen years after its launch, Yelp attracted 145 million unique visitors every month. Its reviewers collectively have gained considerable influence. Restaurants, cultural venues, hair salons, and other establishments can attract customers with five-star ratings and "People Love Us on Yelp" stickers in their windows—but, by the same token, can be badly hurt when reviews turn nasty. A Harvard Business School study reported that a one-star increase in an independent restaurant's Yelp rating led to a 5 to 9 percent increase in revenue. Some businesses have complained that Yelp reviewers have too much power. "My business just died," said the sole proprietor of a housecleaning business. "Once they locked me into the 3.5 stars, I wasn't getting any calls."[22]

Activists often try to use all of these kinds of power when they want to change a company's policy. For example, human rights activists wanted to bring pressure on Unocal Corporation to change its practices in Burma (Myanmar), where it had entered into a joint venture with the government to build a gas pipeline. Critics charged that many human rights violations occurred during this project, including forced labor and relocations. In an effort to pressure Unocal to change its behavior, activists organized protests at shareholder meetings (*voting power*), called for boycotts of Unocal products (*economic power*), promoted local ordinances prohibiting cities from buying from Unocal (*political power*), brought a lawsuit for damages on behalf of Burmese villagers (*legal power),* and gathered information about government abuses by interviewing Burmese refugees and publicizing the results online (*informational power).* These activists increased their chances of success by mobilizing many kinds of power. This combination of tactics eventually forced Unocal to pay compensation to people whose rights had been violated and to fund education and health care projects in the pipeline region.[23]

[22] Michael Luca, "Reviews, Reputation, and Revenue: The Case of Yelp.Com," Harvard Business School NOM Unit Working Paper No. 12-016, March 16, 2016; and "Is Yelp Fair to Businesses?" *PC World,* November 15, 2011.

[23] Further information about the campaign against Unocal is available at *www.earthrights.org/unocal*.

Exhibit 1.B provides a schematic summary of some of the main interests and powers of both market and nonmarket stakeholders.

Stakeholder Coalitions

An understanding of stakeholder interests and power enables managers to answer the final question of stakeholder analysis regarding coalitions.

How are coalitions likely to form?

Not surprisingly, stakeholder interests often coincide. For example, consumers of fresh fruit and farmworkers who harvest that fruit in the field may have a shared interest in reducing the use of pesticides, because of possible adverse health effects from exposure to chemicals. When their interests are similar, stakeholders may form coalitions, temporary alliances to pursue a common interest. Companies may be both opposed and supported by stakeholder coalitions, as shown in the example of the controversial Keystone XL pipeline.

TransCanada, a major North American energy company, sought approval to build a pipeline from Alberta, Canada, to Steele City, Nebraska, where it would connect to existing pipelines running to refineries and ports along the Gulf Coast. In opposing the Keystone XL pipeline, environmentalists argued it would enable the export of oil extracted from Canadian tar sands, an energy-intensive and dirty process. When burned, the tar sands oil would release carbon dioxide, contributing to further climate change, and spills from the pipeline could foul water supplies. They were joined in coalition by other groups, such as ranchers, farmers, and Native Americans whose land would be crossed by the pipeline. On the other side, construction unions, many local governments, and business groups supported the pipeline, saying that it would create jobs, reduce U.S. dependence on foreign oil, and provide a safer method of transport than trains or tanker trucks. In 2018, debate still raged, and construction on the project had not begun.[24]

Stakeholder coalitions are not static. Groups that are highly involved with a company today may be less involved tomorrow. Issues that are controversial at one time may be uncontroversial later; stakeholders that are dependent on an organization at one time may be less so at another. To make matters more complicated, the process of shifting coalitions does not occur uniformly in all parts of a large corporation. Stakeholders involved with one part of a large company often have little or nothing to do with other parts of the organization.

The discussion case at the end of this chapter describes the coalitions that developed in favor of and opposition to new regulations that would require the ride-hailing start-up Uber to insure drivers logged onto its system to look for customers.

Another variation of stakeholder analysis focuses on **stakeholder salience**. Some scholars have suggested that managers pay the most attention to stakeholders possessing greater salience. (Something is *salient* when it stands out from a background, is seen as important, or draws attention.) Stakeholders stand out to managers when they have power, legitimacy, and urgency. This section has already discussed various forms of stakeholder power. *Legitimacy* refers to the extent to which a stakeholder's actions are seen as proper or appropriate by the broader society, because they are clearly affected by the company's actions. *Urgency* refers to the time-sensitivity of a stakeholder's claim, that is, the extent to which it demands

[24] "Keystone XL Pipeline Has Enough Oil Suppliers, Will be Built, TransCanada Says," *Inside Climate News,* January 18, 2018; "Keystone Pipeline Pros, Cons and Steps to a Final Decision," *The New York Times,* November 18, 2014.

Exhibit 1.B

Stakeholders: Nature of Interest and Power

Stakeholder	Nature of Interest—Stakeholder Wishes To:	Nature of Power—Stakeholder Influences Company By:
Market Stakeholders		
Employees	■ Maintain stable employment in firm ■ Receive fair pay for work and mandated benefits ■ Work in safe, comfortable environment	■ Union bargaining power ■ Work actions or strikes ■ Publicity
Shareholders	■ Receive a satisfactory return on investments (dividends) ■ Realize appreciation in stock value over time	■ Exercising voting rights based on share ownership ■ Exercising rights to inspect company books and records
Customers	■ Receive fair exchange: value and quality for money spent ■ Receive safe, reliable products ■ Receive accurate information ■ Be able to voice concerns	■ Purchasing goods from competitors ■ Boycotting companies whose products are unsatisfactory or whose policies are unacceptable
Suppliers	■ Receive regular orders for goods ■ Be paid promptly for supplies delivered ■ Use capacity efficiently ■ Build stable relationships with business customers ■ Be treated ethically	■ Refusing to meet orders if conditions of contract are breached ■ Supplying to competitors
Retailers, Wholesalers	■ Receive quality goods in a timely fashion at reasonable cost ■ Offer reliable products that consumers trust and value	■ Buying from other suppliers if terms of contract are unsatisfactory ■ Boycotting companies whose goods or policies are unsatisfactory
Creditors	■ Receive repayment of loans ■ Collect debts and interest	■ Calling in loans if payments are not made ■ Utilizing legal authorities to repossess or take over property if loan payments are severely delinquent

immediate action. The more of these three attributes a stakeholder possesses, the greater the stakeholder's salience and the more likely that managers will notice and respond.[25]

Stakeholder Mapping

Once managers have conducted a stakeholder analysis, they can use it to develop a **stakeholder map**, a visual representation of the relationships among stakeholder interests, power, and coalitions with respect to a particular issue.[26] (A stakeholder map can

[25] Ronald K. Mitchell, Bradley R. Agle, and Donna J. Wood, "Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts," *Academy of Management Review* 22, no. 4 (1997), pp. 853–86.

[26] For two alternative approaches to stakeholder mapping, see David Saiia and Vananh Le, "A Map Leading to Less Waste," *Proceedings of the International Association for Business and Society* 20: 302–13 (2009); and Robert Boutilier, *Stakeholder Politics: Social Capital, Sustainable Development, and the Corporation* (Sheffield, UK: Greenleaf Publishing, 2009), Chs. 6 and 7.

Stakeholder	Nature of Interest—Stakeholder Wishes To:	Nature of Power—Stakeholder Influences Company By:
Nonmarket Stakeholders		
Communities	■ Employ local residents in the company ■ Ensure that the local environment is protected ■ Ensure that the local area is developed	■ Refusing to extend additional credit ■ Issuing or restricting operating licenses and permits ■ Lobbying government for regulation of the company's policies or methods of land use and waste disposal
Nongovernmental organizations	■ Monitor company actions and policies to ensure that they conform to legal and ethical standards ■ Promote social and economic development	■ Gaining broad public support through publicizing the issue ■ Lobbying government for regulation of the company
Business support groups (e.g., trade associations)	■ Provide research and information which will help the company or industry perform in a changing environment	■ Using its staff and resources to assist company in business endeavors and development efforts ■ Providing legal or "group" political support beyond that which an individual company can provide for itself
Governments	■ Promote economic development ■ Encourage social improvements ■ Raise revenues through taxes	■ Adopting regulations and laws ■ Issuing licenses and permits ■ Allowing or disallowing commercial activity
The general public	■ Protect social values ■ Minimize risks ■ Achieve prosperity for society ■ Receive fair and honest communication	■ Networking with other stakeholders ■ Pressing government to act ■ Condemning or praising individual companies
Competitors	■ Compete fairly ■ Cooperate on industry-wide or community issues ■ Seek new customers	■ Pressing government for fair competition policies ■ Suing companies that compete unfairly

also be used to represent stakeholder salience, to help a firm identify which stakeholders may require more of their attention.) Consider the following example:

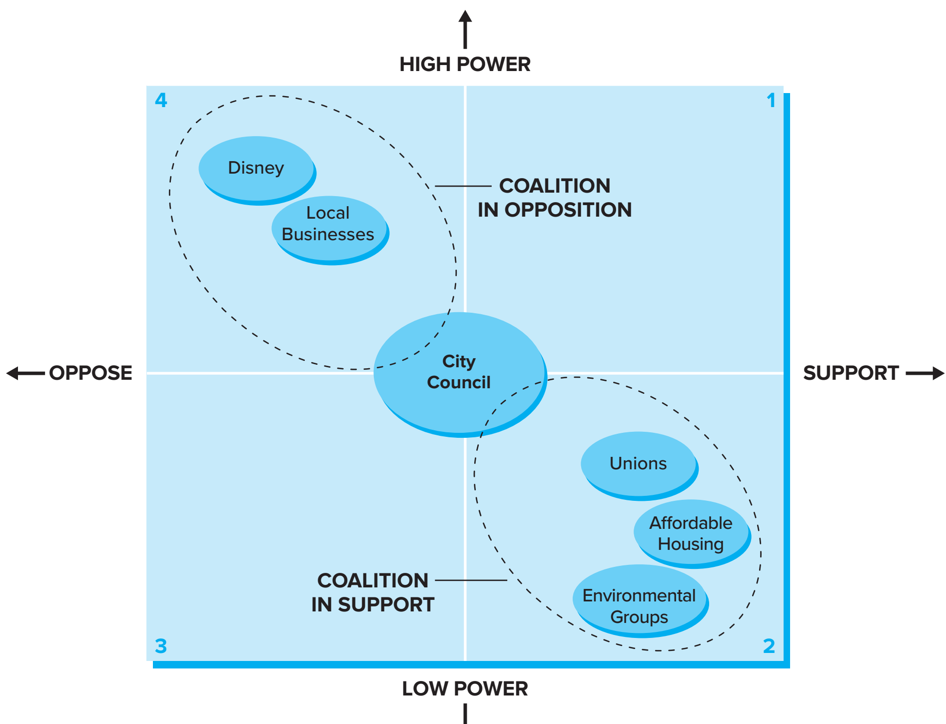
> In Anaheim, California, a real estate developer called SunCal purchased a large lot near to the Disneyland theme park. SunCal planned to build condominiums, with 15 percent of the units set aside for below-market-rate rental apartments. Because the site was in the resort district, the developer required special permission from the city council to proceed. Affordable housing advocates quickly backed SunCal's plans. Some unions representing Disney employees also supported the idea, as did environmentalists drawn by the prospect of reducing long commutes, a contributor to the region's air pollution. Disney, however, strenuously opposed SunCal's plan, arguing that the land should be used only for tourism-related development such as hotels and restaurants; the company was supported by the chamber of commerce and various businesses in the resort district. The city council itself was split.

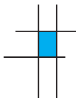
If SunCal conducted a stakeholder analysis of this situation, it would conclude that the *interests* of relevant stakeholders were divided. Some, including Disney and various local businesses and some politicians, opposed its plan. But others, including some unions, affordable housing advocates, environmentalists, and other politicians, supported it. An analysis of *coalitions* would show how these stakeholders were likely to ally with one another. An analysis of *power* would show that Disney had enormous clout in Anaheim, because it was the city's major employer and taxpayer, with power far exceeding that of other relevant stakeholders. SunCal would no doubt conclude from this analysis that it was unlikely to succeed in building on this site. A stakeholder map of this situation is shown in Figure 1.4. On the vertical axis, it shows various stakeholders' level of power; on the horizontal axis, it shows their position on the issue of SunCal's proposed development.

A stakeholder map is a useful tool, because it enables managers to see quickly how stakeholders feel about an issue. It helps them see how stakeholder coalitions are likely to form, how powerful these coalitions will be, and what outcomes are likely. The stakeholder map depicted in Figure 1.4 shows, for example, than the coalition in quadrant 4—Disney, local businesses, and some members of the City Council—is more powerful that the coalition in quadrant 2—unions, affordable housing activists, environmental groups, and other City Council members. An additional benefit of stakeholder analysis is that it can illuminate options that managers may not have initially noticed. In this example, SunCal might have realized that Disney (high opposition, high power) very much wanted to block the proposed development, but also had significant resources. Therefore, Disney might be willing to purchase the lot itself, providing funds for SunCal to use to purchase and develop another site, with support from unions, housing activists, and others. In short, stakeholder analysis and mapping can help managers "think outside the box."

FIGURE 1.4
Stakeholder Map of SunCal's Proposed Development

Source: Graphic design by Colorbox Industries. © 2018. All rights reserved. Used by permission.





The Corporation's Boundary-Spanning Departments

How do corporations organize internally to respond to and interact with stakeholders?

Boundary-spanning departments are departments, or offices, within an organization that reach across the dividing line that separates the company from groups and people in society. Building positive and mutually beneficial relationships across organizational boundaries is a growing part of management's role.

Figure 1.5 presents a list of the corporation's market and nonmarket stakeholders, alongside the corporate departments that typically have responsibility for engaging with them. As the figure suggests, the organization of the corporation's boundary-spanning functions

FIGURE 1.5 **The Corporation's Boundary-Spanning Departments**

Corporation

Shareholders
Shareholder Relations, Investor Relations
- External and internal audit
- SEC filings, compliance
- Communications
- Proxy election management

Customers
Customer Relations
- Customer service
- Total quality management
- Liability lawsuit defense
- Recall management

Community
Community Relations, Corporate Citizenship
- Corporate philanthropy
- Partners with community-based organizations
- Volunteerism, employee time contributions

NGOs, suppliers
Corporate Relations, Corporate Citizenship, Corporate Responsibility, External Affairs
- Environmental scanning
- Stakeholder engagement
- Social reporting and auditing

General public
Public Relations, Media Relations, Corporate Communications
- Public relations
- Brand management
- Image advertising
- Crisis management

Environment
Environment, Health & Safety, Sustainability
- EPA and state environmental compliance
- Internal environmental auditing
- Recycling, take-back

Employees
Human Resources, Labor Relations
- Communications
- Union negotiations
- OSHA, EEOC, and labor law compliance
- Diversity and family–work programs
- Healthcare

Government
Public Affairs, Governmental Affairs, Government Relations
- Public policy
- Lobbying
- Political action
- Trade associations
- Advocacy ads
- Grassroots mobilization

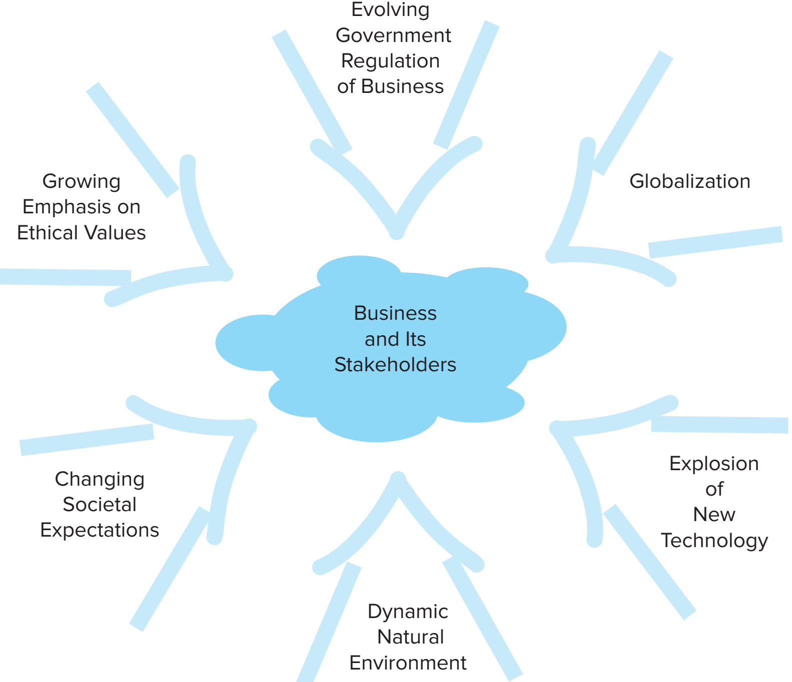
is complex. For example, in many companies, departments of public affairs or government relations interact with elected officials and regulators. Departments of investor relations interact with shareholders; human resources with employees; customer relations with customers; and community relations with the community. Specialized departments of environment, health, and safety may deal with environmental compliance and worker health and safety, and public relations or corporate communications. Many of these specific departments will be discussed in more detail in later chapters.

The Dynamic Environment of Business

A core argument of this book is that *the external environment of business is dynamic and ever changing.* Businesses and their stakeholders do not interact in a vacuum. On the contrary, most companies operate in a swirl of social, ethical, global, political, ecological, and technological change that produces both opportunities and threats. Figure 1.6 diagrams the six dynamic forces that powerfully shape the business and society relationship. Each of these forces is introduced briefly below and will be discussed in more detail later in this book.

Changing societal expectations. Everywhere around the world, society's expectations of business are rising. People increasingly expect business to be more responsible, believing companies should pay close attention to social issues and act as good citizens in society. New public issues constantly arise that require action. Increasingly, business is faced with the daunting task of balancing its social, legal, and economic obligations, seeking to meet its commitments to multiple stakeholders. Modern businesses are increasingly exploring opportunities to act in ways that balance numerous stakeholders' needs with their multiple obligations. These changes in society's expectations of business, and how managers have responded, are described in Chapters 2 and 3.

FIGURE 1.6
Forces That Shape the Business and Society Relationship



Globalization. We live in an increasingly integrated world economy, characterized by the unceasing movement of goods, services, and capital across national borders. Large transnational corporations do business in scores of countries. Products and services people buy every day in the United States or Germany may have come from Indonesia, Haiti, or Mexico. Today, economic forces truly play out on a global stage. A financial crisis on Wall Street can quickly impact economies around the world. Societal issues—such as the race to find a cure for Ebola, the movement for gender equality, or the demands of citizens everywhere for full access to the Internet—also cut across national boundaries. Chapter 4 addresses the challenges of globalization.

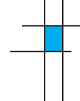
Growing emphasis on ethical reasoning and actions. The public also expects business to be ethical and wants corporate managers to apply ethical principles or values—in other words, guidelines about what is right and wrong, fair and unfair, and morally correct—when they make business decisions. Fair employment practices, concern for consumer safety, contribution to the welfare of the community, and human rights protection around the world have become more prominent and important. Business has created ethics programs to help ensure that employees are aware of these issues and act in accordance with ethical standards. The ethical challenges faced by business, both domestically and abroad—and business's response—are discussed in Chapters 5 and 6.

Evolving government regulations and business response. The role of government has changed dramatically in many nations in recent decades. Governments around the world have enacted a myriad of new policies that have profoundly constrained how business is allowed to operate. Government regulation of business periodically advances and then retreats, much as a pendulum swings back and forth. Because of the dynamic nature of this force, business has developed various strategies to influence elected officials and government regulators at federal, state, and local levels. Companies may seek to be active participants in the political process, and in recent years the courts have given them more opportunities to do so. The changing role of government, its impact, and business's response are explored in Chapters 7 and 8.

Dynamic natural environment. All interactions between business and society occur within a finite natural ecosystem. Humans share a single planet, and many of our resources—oil, coal, and gas, for example—are nonrenewable. Once used, they are gone forever. Other resources, like clean water, timber, and fish, are renewable, but only if humans use them sustainably, not taking more than can be naturally replenished. Climate change now threatens all nations. The relentless demands of human society, in many arenas, have already exceeded the carrying capacity of the Earth's ecosystem. The state of the Earth's resources and changing attitudes about the natural environment powerfully impact the business–society relationship. These issues are explored in Chapters 9 and 10.

Explosion of new technology and innovation. Technology is one of the most dramatic and powerful forces affecting business and society. It has led to the world appearing to be smaller and more connected. New technological innovations harness the human imagination to create new machines, processes, and software that address the needs, problems, and concerns of modern society. In recent years, the pace of technological change has increased enormously. From scientific breakthroughs in medicine to autonomous vehicles and artificial intelligence, change keeps coming. The extent and pace of technological innovation pose massive challenges for business, and sometimes government, as they seek to manage various privacy, security, and intellectual property issues embedded in this dynamic force.

As discussed in Chapters 11 and 12, new technologies often force managers and organizations to examine seriously the ethical implications of their use.



Creating Value in a Dynamic Environment

These powerful and dynamic forces—fast-paced changes in societal and ethical expectations, the global economy, government policies, the natural environment, and new technology—establish the context in which businesses interact with their many market and nonmarket stakeholders, as discussed in Chapters 13 to 19. This means that the relationship between business and society is continuously changing in new and often unpredictable ways. Environments, people, and organizations change; inevitably, new issues will arise and challenge managers to develop new solutions. To be effective, corporations must meet the reasonable expectations of stakeholders and society in general. A successful business must meet *all* of its economic, social, and environmental objectives. A core argument of this book is that *the purpose of the firm is not simply to make a profit, but to create value for all its stakeholders.* Ultimately, business success is judged not simply by a company's financial performance but by how well it serves broad social interests.

Summary

- Business firms are organizations that are engaged in making a product or providing a service for a profit. Society, in its broadest sense, refers to human beings and to the social structures they collectively create. Business is part of society and engages in ongoing exchanges with its external environment. Together, business and society form an interactive social system in which the actions of each profoundly influence the other.
- According to the stakeholder theory of the firm, the purpose of the modern corporation is to create value for all of its stakeholders. To survive, all companies must make a profit for their owners. However, they also create many other kinds of value as well for their employees, customers, suppliers, communities, and others. For both practical and ethical reasons, corporations must take all stakeholders' interests into account.
- Every business firm has economic and social relationships with others in society. Some are intended, some unintended; some are positive, others negative. Stakeholders are all those who affect, or are affected by, the actions of the firm. Some have a market relationship with the company, and others have a nonmarket relationship with it; some stakeholders are internal, and others are external.
- Stakeholders often have multiple interests and can exercise their economic, political, and other powers in ways that benefit or challenge the organization. Stakeholders may also act independently or create coalitions to influence the company. Stakeholder mapping is a technique for visually representing stakeholders' relationship to an issue facing a firm.
- Modern corporations have developed a range of boundary-crossing departments and offices to manage interactions with market and nonmarket stakeholders. The organization of the corporation's boundary-spanning functions is complex. Most companies have many departments specifically charged with interacting with stakeholders.
- A number of broad forces shape the relationship between business and society. These include changing societal and ethical expectations; a dynamic global economy; redefinition of the role of government; ecological and natural resource concerns; and the transformational role of technology and innovation. To deal effectively with these changes, corporate strategy must address the expectations of all of the company's stakeholders.

Key Terms

boundary-spanning departments, *19*
business, *4*
external stakeholder, *10*
focal organization, *11*
general systems theory, *5*
interactive social system, *6*
internal stakeholder, *10*
shareholder theory of the firm, *6*
society, *4*
stakeholder, *8*
stakeholder analysis, *11*
stakeholder coalitions, *15*
stakeholder interests, *12*
stakeholder (market), *9*
stakeholder (nonmarket), *9*
stakeholder map, *16*
stakeholder power, *13*
stakeholder salience, *15*
stakeholder theory of the firm, *6*

Internet Resources

www.economist.com	The Economist
www.fortune.com	Fortune
www.nytimes.com	The New York Times
www.wsj.com	The Wall Street Journal
www.bloomberg.com	Bloomberg
www.ft.com	Financial Times (London)
www.cnnmoney.com	CNN Money

Discussion Case: *Insuring Uber's App-On Gap*

At around 8 p.m. on a New Year's Eve, a mother and her two young children were walking home in San Francisco. At a busy intersection, the family waited for the "walk" signal and then started across the street. Just then, an SUV made a right turn, striking all three members of the family in the crosswalk. The mother and her 5-year-old son were seriously injured. Her 6-year-old daughter was killed. The man behind the wheel of the SUV identified himself as a driver for the ride-hailing service Uber.

Uber immediately distanced itself from the tragedy, saying that the driver was "not providing services on the Uber system at the time of the accident." The family's attorney contested this, saying that the driver was logged onto the Uber application, appeared on the system as available to accept a rider, and was interacting with his device when he struck the mother and children.

In other words, the tragic incident had apparently occurred during the *app-on gap*—the driver was on the road with his Uber application activated, but had not yet connected with or picked up a rider. So, who was responsible, the driver or the ride-hailing service?

Uber was, in the words of a *New York Times* columnist, "the hottest, most valuable technology startup on the planet." The company was founded in 2009 as "everyone's private driver," providing a premium town car service that could be summoned online. In 2012, it rolled out UberX, a service that enabled nonprofessional drivers to use their own vehicles to transport riders. Customers could use the Uber app to hail a car, connect with a willing driver, watch the vehicle approach on a map, pay their fare, and receive a receipt, all on their smartphone. Uber provided the technology and took a commission on each transaction.

Uber's disruptive business model caught on rapidly. By 2014, Uber's ride-sharing service had spread to more than 120 cities in 36 countries. In the United States, the service could reach 137 million people with an average pickup time of less than 10 minutes. Demand was growing so fast that Uber was scrambling to recruit 20,000 new drivers, whom Uber called "transportation entrepreneurs," every month. Private investors were enthusiastic about the company's prospects: Uber had attracted $1.2 billion in funding and was valued at $18.2 billion.

Drivers who partnered with Uber had the flexibility to drive when and as much as they wished. They could also make a decent living; the median annual income for its full-time drivers in San Francisco, for example, was about $74,000. But they also assumed risk. In the event of an accident, Uber instructed its drivers to submit a claim to their personal insurance carrier first. If it was denied, Uber's backup commercial liability insurance would go into effect, but only after the driver had been summoned by a customer or had one in the vehicle.

Traditional taxicab companies did not welcome competition from Uber. Cabdrivers in many cities across the world protested the entry of Uber into their markets, conducting strikes and "rolling rallies" charging Uber with unfair practices. Uber drivers did not have to comply with many of the rules that applied to taxicabs, such as those requiring commercial driver's licenses, regular mechanical inspections, and commercial liability insurance. Governments at city, state, and national levels had become involved, with some imposing restrictions and others even banning Uber outright.

In the wake of the 6-year-old's death in San Francisco, California legislator Susan Bonilla introduced a bill that would require Uber and other ride-hailing companies to provide commercial liability insurance from when the driver turned on the app to when the customer got out of the car, thus filling the app-on gap.

The American Insurance Association, representing insurance companies, supported the legislation, saying that personal auto policies should not be expected to cover ride-hailing drivers once they signaled availability. "This is not someone commuting to work or going to the grocery store or stopping to pick their children up from school," a spokesperson said. The family of the girl killed on New Year's Eve also supported Bonilla's bill, as did consumer attorneys and the California App-Based Drivers Association.

But others lined up in opposition. Uber and other ride-hailing companies strenuously objected to the bill, as did trade associations representing high-technology and Internet-based firms, apparently concerned about increases in their costs of doing business. The bill, said an Uber spokesperson, was "an example of what happens when special interest groups distract lawmakers from the best interests of consumers and small businesses."

Sources: "Deadly Pedestrian Accident Driver Claimed He Drove for Uber," January 1, 2014, *www.abclocal.go.com*; "Uber and a Child's Death," *The New York Times,* January 27, 2014; "An Uber Impact: 20,000 Jobs Created on the Uber Platform Every Month," Uber press release, May 27, 2014; "With Uber, Less Reason to Own a Car," *The New York Times,* June 11, 2014; "Uber and Airbnb's Incredible Growth in 4 Charts," VB News, June 19, 2014, online at *www.venturebeat.com*; "In Uber vs. Taxi Companies, Local Governments Play Referee," *Christian Science Monitor,* July 7, 2014; "The Company Cities Love to Hate," *Bloomberg Businessweek,* July 7, 2014; "Uber, Lyft, Sidecar Fight to Block New California Regulations," *San Jose Mercury News,* August 13, 2014; "The Question of Coverage for Ride Service Drivers," *The New York Times,* September 5, 2014; and private correspondence with the office of Assemblywoman Susan Bonilla.

Discussion Questions

1. Who are Uber's relevant market and nonmarket stakeholders in this situation?
2. What are the various stakeholders' interests? Please indicate if each stakeholder would likely support, or oppose, a requirement that Uber extend its insurance to cover the app-on gap.
3. What sources of power do the relevant stakeholders have?
4. Based on the information you have, draw a stakeholder map of this case showing each stakeholder's position on the issue, its degree of power, and likely coalitions. What conclusions can you draw from the stakeholder map?
5. Which of the stakeholders mentioned do you think has the most salience, and why?
6. Based on your stakeholder analysis and map, what do you think Uber should do in response to the bill introduced by Susan Bonilla, and why?

CHAPTER TWO

Managing Public Issues and Stakeholder Relationships

Businesses today operate in an ever-changing external environment, where effective management requires anticipating emerging public issues and engaging positively with a wide range of stakeholders. Whether the issue is growing concerns about climate change, health care, safety at work or in our schools, social equality, or consumer safety, managers must respond to the opportunities and risks it presents. To do so effectively often requires building relationships across organizational boundaries, learning from external stakeholders, and altering practices in response. Effective management of public issues and stakeholder relationships builds value for the firm.

This Chapter Focuses on These Key Learning Objectives:

LO 2-1 Identifying public issues and analyzing gaps between corporate performance and stakeholder expectations.

LO 2-2 Applying available tools or techniques to scan an organization's multiple environments and assessing stakeholder materiality.

LO 2-3 Describing the steps in the issue management process and determining how to make the process most effective.

LO 2-4 Identifying the managerial skills required to respond to emerging issues effectively.

LO 2-5 Understanding the various stages through which businesses can engage with stakeholders, what drives this engagement, and the role social media can play.

LO 2-6 Recognizing the value of creating stakeholder dialogue and networks.

A 2016 study from the Public Affairs Council found that many major corporations are feeling increased pressure to speak out on social issues, ranging from discrimination and human rights to environmental sustainability and quality education. Among companies with more than $15 billion in annual revenue, more than three in four said expectations for engagement had risen. Most of the pressure to engage in social issues, said the companies, has come from their own employees.[1]

Legislative battles in North Carolina, Tennessee, Mississippi, and Georgia prompted business leaders to take a stand favoring rights for transgender individuals. Dow Chemical, Alcoa, and Northrup Grumman lobbied elected officials and publicly condemned measures seen as discriminatory. Monsanto lead the fight in Missouri against a bill that would allow businesses to deny certain services to same-sex couples as a matter of religious freedom. In response to North Carolina's state legislature passing a law that blocked antidiscriminatory protections at the local level, Deutsche Bank, the German financial institution with significant business in the United States, said it would freeze its plans to add jobs in North Carolina. PayPal announced it would halt its plans to open a new global operations center there.

While some thought these issues had little to do with business, executives pointed out these discriminatory state laws could harm local economies and hamper business's ability to recruit and retain bright young workers. In the past few years, businesses have employed a number of measures to voice their views. These have ranged from joining coalitions, to issuing press releases, to engaging in lobbying at the state or local governmental levels. Experts believe that these efforts had some impact, such as in North Carolina where company protests contributed to the state legislature's repeal of a law that discriminated against gays and lesbians. Public reaction has been generally positive to these business actions. A Global Strategy Group poll found that 78 percent of Americans supported corporate engagement in social issues such as discrimination, human rights, and equality.[2]

In this case, emerging social issues focused on individual rights prompting various businesses and their executives to become engaged and take action. This will likely improve the communities where these firms hire employees, operate, and sell their products. Yet, as this chapter will show, companies sometimes also ignore or mismanage public issues.

Public Issues

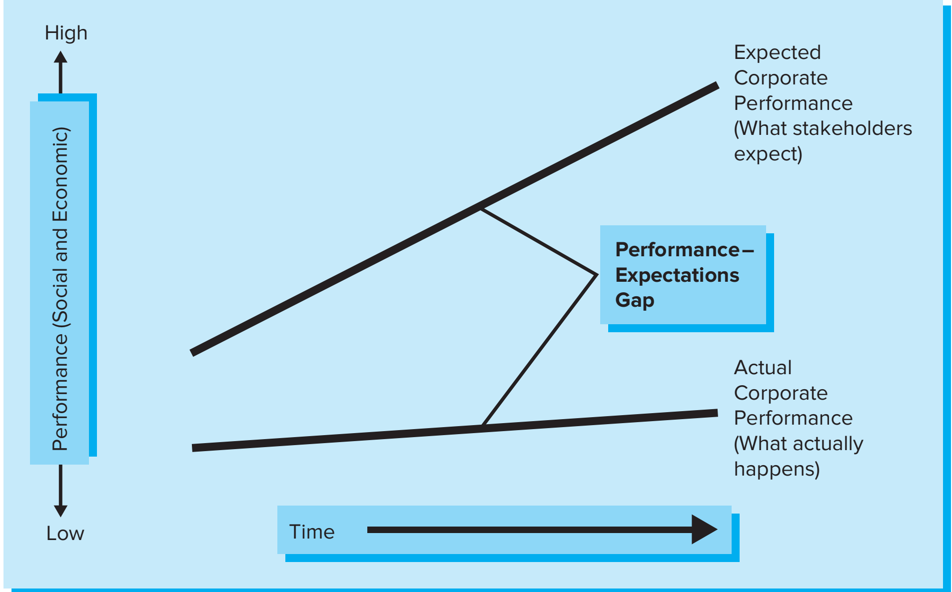
A **public issue** is any issue that is of mutual concern to an organization and one or more of its stakeholders. (Public issues are sometimes also called *social issues* or *sociopolitical issues.*) They are typically broad issues, often impacting many companies and groups, and of concern to a significant number of people. Public issues are often contentious—different groups may have different opinions about what should be done about them. They often, but not always, have public policy or legislative implications.

The emergence of a new public issue often indicates there is a *gap* between what the firm wants to do or is doing and what stakeholders expect. Scholars have called this the **performance–expectations gap**. Stakeholder expectations are a mixture of people's opinions, attitudes, and beliefs about what constitutes reasonable business behavior. Managers and organizations have good reason to identify emergent expectations as early as possible. Failure to understand stakeholder concerns and to respond appropriately will permit the

[1] "Taking a Stand: How Corporations Speak Out on Social Issues," *Public Affairs Council,* 2016.

[2] "Why Companies Are Getting More Engaged on Social Issues," *Public Affairs Council,* August 30, 2016, *pac.org*; "Big Business Speaks Up on Social Issues," *The Wall Street Journal,* April 17, 2016, *www.wsj.com*; and "Seeking End to Boycott, North Carolina Rescinds Transgender Bathroom Law," *Reuters,* March 30, 2017, *www.reuters.com*.

FIGURE 2.1
The Performance–Expectations Gap



performance–expectations gap to grow: the larger the gap, the greater the risk of stakeholder backlash or of missing a major business opportunity. The performance–expectations gap is pictured in Figure 2.1.

Emerging public issues are both an opportunity and a risk. On one hand, correctly anticipating the emergence of a public issue can confer a competitive advantage. However, they also are a risk because issues that firms do not anticipate and plan for effectively can seriously hurt a company, as the following example shows.

> The Italian–U.S. automobile maker, Fiat Chrysler, became aware of a serious problem involving more than 11 million vehicles, including older Jeeps with rear gasoline tanks that were linked to numerous fatal fires. Yet, Fiat Chrysler was slow to respond to the increasing expectations of its customers and regulators, the National Highway Traffic Safety Administration (NHTSA). The NHTSA accused the firm of misleading and obstructing regulators tasked with overseeing the resolution of many consumer complaints, inadequate and lagging repairs authorized through their dealerships, and failing to notify car owners of the recalls in a timely manner. The firm agreed to a consent agreement that included a fine of $105 million and an unprecedented buyback option covering hundreds of thousands of vehicles, whose owners can receive a trade-in or a financial incentive to get their vehicles repaired. Fiat Chrysler also agreed to submit to an independent monitor's audit of its recall performance over the following three-year period.[3]

Understanding and responding to changing stakeholder expectations is a business necessity. As Mark Moody-Stuart, former managing director of Royal Dutch/Shell, put it in an interview, "Communication with society. . . is a commercial matter, because society is your customers. It is not a soft and wooly thing, because society is what we depend on for our living. So we had better be in line with its wishes, its desires, its aspirations, its dreams.[4]

[3] "U.S. Auto Safety Regulators Fine Fiat Chrysler Record $105 million," *Reuters,* July 26, 2015, *www.reuters.com*.

[4] Interview conducted by Anne T. Lawrence, "Shell Oil in Nigeria," interactive online case published by *www.icase.co*.

Every company faces many public issues. Some emerge over a long period of time; others emerge suddenly. Some are predictable; others are completely unexpected. Some companies respond effectively; others do not. Consider the following recent examples of public issues and companies' responses:

- *Sexual harassment:* An often well-kept secret vaulted into the public spotlight in 2017: accusations of sexual harassment in the corporate boardroom, executive suite, and workplace. Numerous high-profile business leaders were accused, including Fox News host Bill O'Reilly, film producer Harvey Weinstein, television show host Matt Lauer, Fox News CEO Roger Ailes, Ford Motor Company president for North America Raj Nair, CEO of the Humane Society of the United States Wayne Pacelle, and billionaire and casino executive Steve Wynn, along with many others. These executives resigned or were fired amidst sexual harassment accusations.
- *Consumer safety:* The Centers for Disease Control and Prevention declared separate E. coli outbreaks that sickened hundreds of customers at two different Chipotle Mexican Grill restaurants in the Pacific Northwest in 2015. These incidents followed other occurrences where customers became ill from a salmonella outbreak involving tomatoes in Minnesota, as well as an outbreak of norovirus in California and Massachusetts. Chipotle tried to counter the negative publicity by pledging $10 million to help local growers meet new food safety standards and invited its 50,000 employees nationwide to tune in to a broadcasted meeting with executives at their Denver headquarters.
- *Protection of personal information:* Instances of the illegal acquisition, or hacking, of individuals' personal identification and financial information have become common occurrences. Yahoo, Equifax, Delta Airlines, FedEx, England's National Health Services, Merck Pharmaceuticals, Forever 21, Target, and many more organizations experienced data breaches that compromised and exposed personal data of its customers or employees. These breaches may have reflected managers' failure to keep abreast of the latest techniques used by sophisticated cybercriminals.

Whether the focus is sexual harassment in the workplace, consumer safety, or the protection of personal information, society has increased its demands that businesses take on important public issues and become more involved in addressing them. Another critical public issue that caught the attention of many business organizations after a school shooting in Florida—gun violence and school safety in America—is discussed in the case at the end of this chapter.

A survey of Millennials (people born between 1977 and 1994) was conducted in 2014 and found that four out of five Millennials "need (not just want) business to get involved in addressing social issues and believe business can make a greater impact." One Millennial from China explained: "Compared to governments, businesses have the potential and the possibility to make real change in society happen faster and more efficiently. Businesses have the resources—from financial means, collective intelligence to technology—to contribute and make a difference."[5]

Environmental Analysis

As new public issues arise, businesses must respond. Organizations need a systematic way of identifying, monitoring, and selecting public issues that warrant organizational action because of the risks or opportunities they present. Organizations rarely have full control of

[5] *The Future of Business Citizenship,* People's Insights Magazine, *www.scribd.com*.

a public issue because of the many factors involved. But it is possible for the organization to create a management system that identifies and monitors issues as they emerge.

To identify those public issues that require attention and action, a firm needs a framework for seeking out and evaluating environmental information. (In this context, *environmental* means *outside the organization;* in Chapters 9 and 10, the term refers to the natural environment.) **Environmental analysis** is a method managers use to gather information about external issues and trends, so they can develop an organizational strategy that minimizes threats and takes advantage of new opportunities.

Environmental intelligence is the acquisition of information gained from analyzing the multiple environments affecting organizations. Acquiring this information may be done informally or as a formal management process. If done well, this environmental intelligence can help an organization avoid crises and spot opportunities.

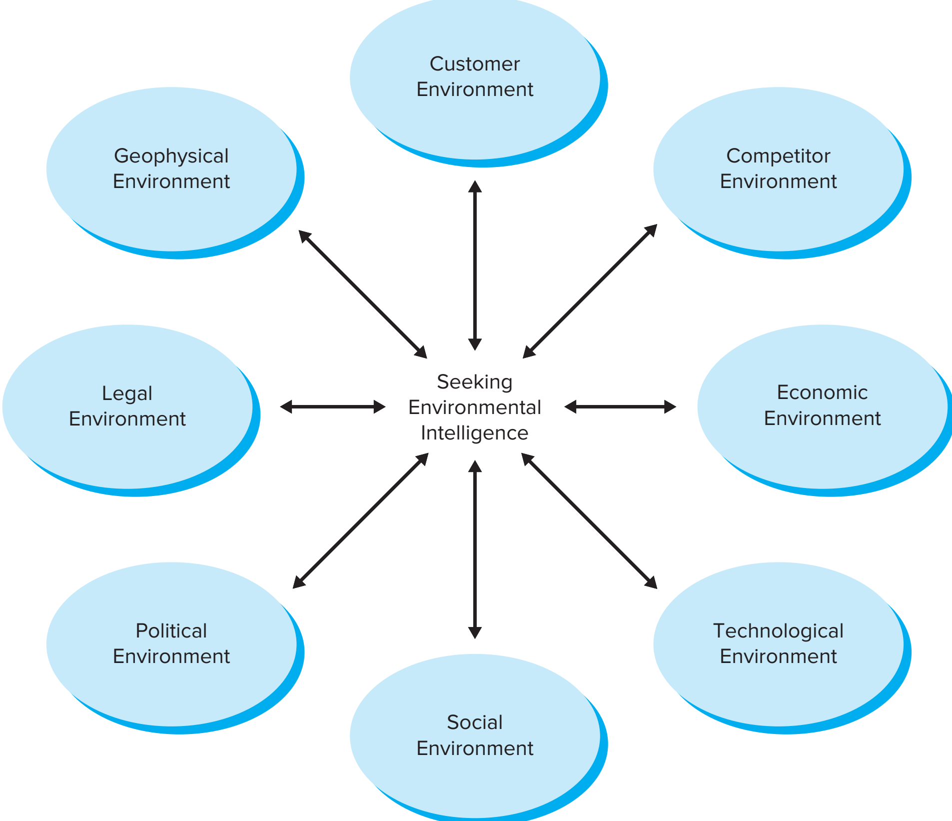
According to management scholar Karl Albrecht, scanning to acquire environmental intelligence should focus on eight *strategic radar screens.*[6] Radar is an instrument that uses microwave radiation to detect and locate distant objects, which are often displayed on a screen; law enforcement authorities use radar, for example, to track the speed of passing cars. Albrecht uses the analogy of radar to suggest that companies must have a way of tracking important developments that are outside of their immediate view. He identifies eight different environments that managers must systematically follow. These are shown in Figure 2.2 and described next.

- *Customer environment* includes the demographic factors, such as gender, age, marital status, and other factors, of the organization's customers as well as their social values or preferences, buying preferences, and technology usage. For example, the explosion of social media has created opportunities for creating new marketing approaches that provide potential consumers with coupons or sales information on their smartphones as they leave their car and walk toward the retail store.
- *Competitor environment* includes information on the number and strength of the organization's competitors, whether they are potential or actual allies, patterns of aggressive growth versus static maintenance of market share, and the potential for customers to become competitors if they "insource" products or services previously purchased from the organization. (This environment is discussed further in the next section of this chapter.)
- *Economic environment* includes information about costs, prices, international trade, and any other features of the economic environment. The severe recession that hit the world's economy in the late 2000s greatly shifted the behavior of customers, suppliers, creditors, and other stakeholders, dramatically impacting decision making in many firms.
- *Technological environment* includes the development of new technologies and their applications affecting the organization, its customers, and other stakeholder groups. Faster access to information through cell phones, tablets, and other handheld electronic devices changed how people around the world were alerted to the devastation of natural disasters or terrorist actions and how they could be contacted regarding new job openings or the launching of innovative consumer products.
- *Social environment* includes cultural patterns, values, beliefs, trends, and conflicts among the people in the societies where the organization conducts business or might

[6] Adapted from Karl Albrecht, *Corporate Radar: Tracking the Forces That Are Shaping Your Business* (New York: American Management Association, 2000).

FIGURE 2.2 Eight Strategic Radar Screens

Source: Adapted from Karl A. Albrecht, *Corporate Radar: Tracking the Forces That Are Shaping Your Business* (New York: American Management Association, 2000).



conduct business. Issues of civil or human rights, family values, and the roles of special interest groups are important elements in acquiring intelligence from the social environment.

- *Political environment* includes the structure, processes, and actions of all levels of government—local, state, national, and international. Awareness of the stability or instability of governments and their inclination or disinclination to pass laws and regulations is essential environmental intelligence for the organization. The emergence of strict environmental laws in Europe—including requirements to limit waste and provide for recycling at the end of a product's life—have caused firms all over the world that sell to Europeans to rethink how they design and package their products.
- *Legal environment* includes patents, copyrights, trademarks, and considerations of intellectual property, as well as antitrust considerations and trade protectionism and organizational liability issues. China's commitment to triple its patent filings from nearly one million in 2013 to three million by 2020 sent shock waves through the global business community.
- *Geophysical environment* relates to awareness of the physical surroundings of the organization's facilities and operations, whether it is the organization's headquarters or its field offices and distribution centers, and the organization's dependency and impact on natural resources such as minerals, water, land, or air. Growing concerns about global warming and climate change, for example, have caused many firms to seek to improve their energy efficiency.

The eight strategic radar screens represent a system of interrelated segments, each one connected to and influencing the others.

Companies do not become experts in acquiring environmental intelligence overnight. New attitudes have to be developed, new routines learned, and new policies and action programs designed. Many obstacles must be overcome in developing and implementing the effective scanning of the business environments. Some are structural, such as the reporting relationships between groups of managers; others are cultural, such as changing traditional ways of doing things. In addition, the dynamic nature of the business environments requires organizations to continually evaluate their environmental scanning procedures.

Competitive Intelligence

One of the eight environments discussed by Albrecht is the competitor environment. The term **competitive intelligence** refers to the systematic and continuous process of gathering, analyzing, and managing external information about the organization's competitors that can affect the organization's plans, decisions, and operations. (As discussed in Chapter 1, competitors may be considered a nonmarket stakeholder of business.) The acquisition of this information benefits an organization by helping it better understand what other companies in its industry are doing. Competitive intelligence enables managers in companies of all sizes to make informed decisions ranging from marketing, research and development, and investing tactics to long-term business strategies. "During difficult times, excellent competitive intelligence can be the differentiating factor in the marketplace," explained Paul Meade, vice president of the research and consulting firm Best Practices. "Companies that can successfully gather and analyze competitive information, then implement strategic decisions based on that analysis, position themselves to be ahead of the pack."[7]

However, the quest for competitors' information can also raise numerous ethical issues. Businesses may overstep ethical and legal boundaries when attempting to learn as much as they can about their competitors, as the following example shows.

> Today, Deloitte is one of the world's largest accounting firms, employing 245,000 people in 150 countries and providing various accounting and consulting services. But, in the mid-2000s, the firm wanted to dramatically grow its federal security consulting services from a $300 million to more than a billion dollars in annual revenues. Deloitte formed a competitive intelligence unit (CIU). "Our job was to spy on Ernst & Young, PriceWaterhouseCoopers, KPMG, and some of the consulting competitors," said a CIU employee. "We were trying to steal their pricing models, how they determined discounts, and especially new product lines or service lines."
>
> One example of how the CIU conducted its business occurred in 2007 when they learned that BearingPoint, a consulting firm, was struggling financially and had called an emergency meeting to determine its fate. Deloitte's CIU agents traveled to the meeting location and spent several days stationing themselves at a bar, picking up scraps of conversation from distraught BearingPoint partners. Others spent time in bathrooms. "You can't believe what people will say while they're in there," said a CIU agent. The best source for information was a Bearing Point meeting room the agents discovered. They entered the meeting room, found notes and other documents left behind, and brought this information back to Deloitte's CIU. According to one Deloitte CIU employee, "There were accounts that would have taken years

[7] See Best Practices report at *www.benchmarkingreports.com/competitiveintelligence*.

for Deloitte to develop relationships at the Department of Defense, the Department of Homeland Security, and other institutions. It was a huge opportunity."
A few years later, Deloitte was able to take advantage of an opportunity to buy BearingPoint's North American public services unit for $350 million as BearingPoint worked through a bankruptcy.

As the example above indicates, the perceived value of intellectual property or other information may be so great that businesses or their employees may be tempted to use unethical or illegal means to obtain such information. Although questionable, Deloitte employees did nothing illegal. Competitive intelligence acquired ethically remains one of the most valued assets sought by businesses. A business must balance the importance of acquiring information about its competitors' practices with the need to comply with all applicable laws, domestic and international, and to follow the professional standards of fairness and honesty. Disclosure of all relevant information prior to conducting an interview and avoidance of conflicts of interest are just a few of the ethical guidelines promoted by the Strategic and Competitive Intelligence Professional's code of ethics.[8]

Stakeholder Materiality

After the many environments are scanned, a company needs to evaluate and prioritize the impact that its stakeholders and their issues may have on the company. The importance attributed to a stakeholder is often referred to as materiality. **Stakeholder materiality** is an adaptation of an accounting term that focuses on the importance or significance of something. In this case, it describes a method used to prioritize the relevance of the stakeholders and their issues to the company.

Sonoco, a global provider of packaging products and services, completed its first stakeholder materiality assessment of economic, environmental, and social issues in 2014. The company began by identifying potential stakeholders and created a list of nine stakeholders: customers, suppliers, peers, shareholders, non-governmental organizations, community leaders, government regulators, employees, and leadership. The company then searched various sources for information on each stakeholder, such as websites, corporate social responsibility reports, mission statements, and 10-K filings to create a list of issues. They used a four-point scale to rate each stakeholder from low to high based on the significance of the issue to the stakeholder. This scoring system enabled Sonoco to identify highly influential stakeholder groups as having the greatest potential impact on the company's strategic objectives or those stakeholders most influenced by the company's operations.[9]

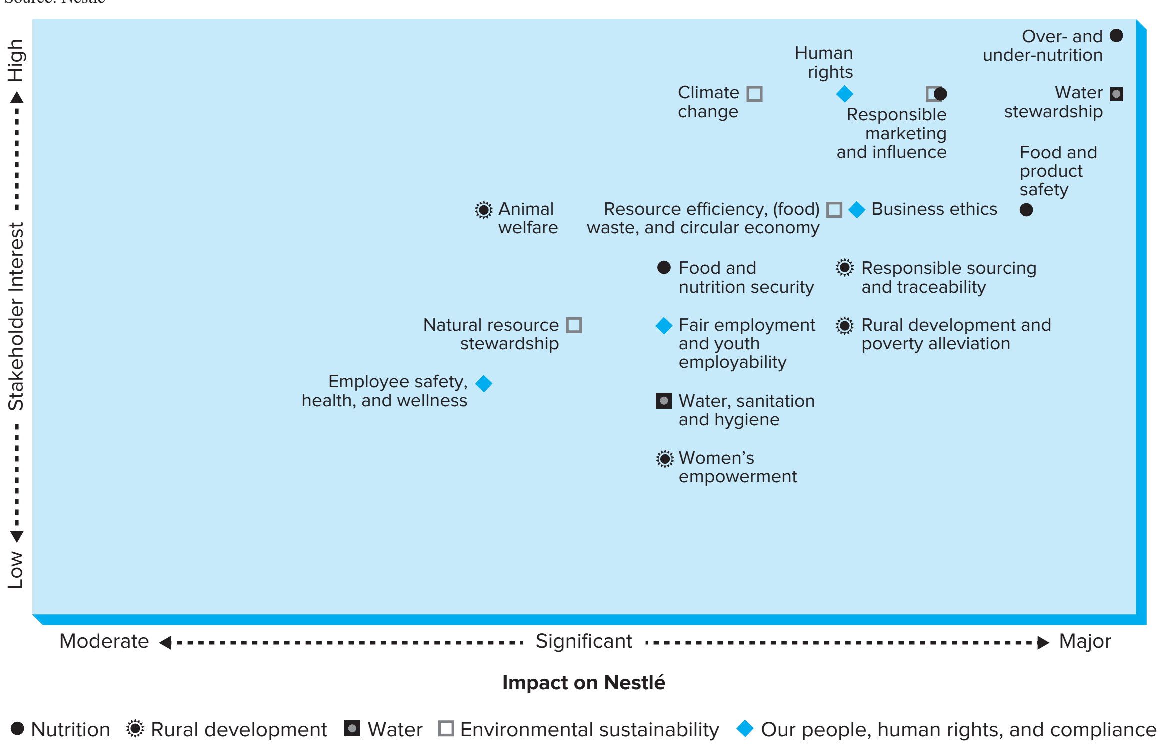
After the information is collected, it needs to be analyzed and placed on a matrix that shows the importance of the issue for the stakeholder and the importance of the issue assigned by the company. This evaluation allows the company to prioritize their attention on issues in the quadrant showing issues of importance to stakeholders AND the company. An example of such a matrix representing stakeholder materiality at Nestlé is shown in Figure 2.3. Nestlé assessed the degree of stakeholder importance for an issue, as well as the potential impact of the issue on Nestlé. This combination enabled the company to place a higher, or lower, priority on many public issues.

[8] For information about the professional association focusing on competitive intelligence, particularly with attention to ethical considerations, see the Strategic and Competitive Intelligence Professionals' website at *www.scip.org*.

[9] Information from Nestlé's website, *www.nestleusa.com/csv/what-is-csv/materiality-and-stakeholder-engagement*.

FIGURE 2.3 **The Stakeholder Materiality Matrix**

Source: Nestlé



The Issue Management Process

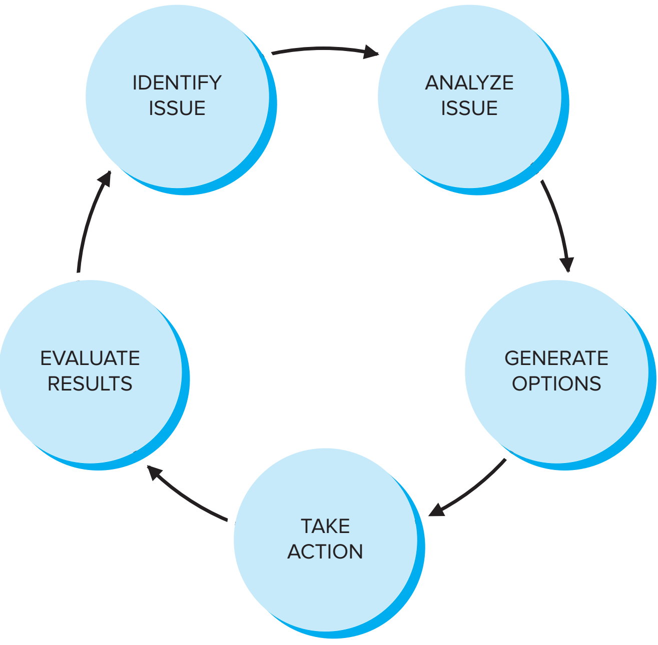
Once a company has identified a public issue and detects a gap between society's expectations and its own practices, what are its next steps? Proactive companies do not wait for something to happen; they actively manage issues as they arise. The process of doing so is called **issue management**. The **issue management process**, illustrated in Figure 2.4, has five steps or stages. Each of these steps is explained below, using the example of the poultry industry's response to concerns over antibiotics in chickens.

Identify Issue

Issue identification involves anticipating emerging concerns, sometimes called "horizon issues" because they seem to be just coming up over the horizon like the first morning sun. Sometimes managers become aware of issues by carefully tracking the media, experts' views, activist opinion, and legislative developments to identify issues of concern to the public. Normally, this requires attention to all eight of the environments described in Figure 2.2. Organizations often use techniques of data searching, media analysis, and public surveys to track ideas, themes, and issues that may be relevant to their interests all over the world. They also rely on ongoing conversations with key stakeholders. Sometimes firms are completely unaware of the issue before it emerges and must attempt to respond to mounting public pressure by activists or government regulators.

Consumer-health groups and the U.S. Food and Drug Administration (FDA) called on animal-breeding farms in the United States to reduce the use of antibiotics in

FIGURE 2.4
The Issue Management Process



their feed for cattle, hogs and chickens. Many poultry producers, for example, used antibiotics in their chickens' feed since it increased their weight and prevented outbreaks of illnesses. But the consumer groups and the FDA charged that overuse of antibiotics also increased the development of potentially deadly bacteria that antibiotics could not kill. These antibiotic-resistance bacteria could be transferred to people who ate the meat (or consumed the milk or eggs) of treated animals. Although the health risks were small, public outcry increased dramatically, and consumers called for action by the animal producers.[10]

The concern over increased health risk from antibiotics caught poultry producers by surprise, and many firms began an immediate investigation into the issue.

Analyze Issue

Once an issue has been identified, its implications must be analyzed. Organizations must understand how the issue is likely to evolve, and how it is likely to affect them. For each company, the ramifications of the issue will be different.

Understanding how the use of antibiotics could affect the health of humans consuming chickens was complex. On one hand, the company was concerned about the public's safety, and did not want customers to become ill if they consumed chickens raised with antibiotics. On the other hand, antibiotics were a mainstay for most poultry producers in the United States. Bigger, healthier chickens translated into greater profits. Poultry producers were unsure of the consequences of removing antibiotics for their companies, both in terms of their chickens' health but also the firms' profitability. One outbreak of illness could quickly spread throughout their entire flock of chickens, resulting in devastating costs for the

[10] "Tyson Seeks Lead in No-Antibiotics Poultry," *The Wall Street Journal*, February 21, 2017, *www.wsj.com*.

firm. Yet, they could not ignore the rising outrage over the use of antibiotics in the raising of chickens.[11]

Generate Options

An issue's public profile indicates to managers how significant an issue is for the organization, but it does not tell them what to do. The next step in the issue management process involves generating, evaluating, and selecting among possible options. This requires complex judgments that incorporate ethical considerations, the organization's reputation and good name, and other nonquantifiable factors.

Many of the poultry producers started to investigate if there were alternatives available to them to replace the use of antibiotics. Firms explored the use of organic and antibiotics-free production practices that could keep the flocks healthy and robust, while also keeping pace with the changing consumer demands. The use of probiotics—beneficial, plant-based bacteria that can strengthen immune systems—appeared to be a viable alternative.

Selecting an appropriate response often involves a creative process of considering various alternatives and rigorously evaluating them to see how they work in practice.

Take Action

Once an option has been chosen, the organization must design and implement a plan of action. Sometimes there may be unintended consequences from the actions undertaken by the company.

Purdue Farms, the third-largest U.S. poultry producer, addressed emerging consumer concerns about antibiotics by announcing its "no antibiotics ever" policy. The firm stated it would eliminate, by June 2016, antibiotics in all chicken products sold in supermarkets across the United States. Other poultry producers quickly followed. Tyson Foods, the country's largest poultry producer, announced in February 2017 that it would eliminate antibiotics used in its chicken products, including breasts, wings, and nuggets. "We believe our responsibility is to grow and grow responsibly," said Tyson's CEO Tom Hayes.[12]

Evaluate Results

Once an organization has implemented the issue management program, it must continue to assess the results and make adjustments if necessary. Many managers see issue management as a continuous process, rather than one that comes to a clear conclusion.

Although specific results from the switch to chickens raised without antibiotics had not yet been fully studied, experts made some predictions. Some argued that the likelihood of serious illness, even death, caused by ingesting antibiotic-resistant bacteria would be reduced. Others argued that more medical research jobs would be created to study probiotics and other alternative treatments to keep poultry and livestock healthy and growing.

[11] *Ibid., The Wall Street Journal,* February 21, 2017, and "Perdue to Eliminate Antibiotics in Some Chicken Products," *The Wall Street Journal,* February 26, 2016, *www.wsj.com*.

[12] *Ibid., The Wall Street Journal,* February 21, 2017, and "Adjuncts and Alternatives in the Time of Antibiotic Resistance and in Feed Antibiotic Bans," *Microbial Biotechnology,* June 22, 2017, *onlinelibrary.wiley.com*.

This example illustrates the complexity of the issue management process. Figure 2.4 is deliberately drawn in the form of a loop. When working well, the issue management process continuously cycles back to the beginning and repeats, pulling in more information, generating more options, and improving programmatic response. Such was the case with the concern over the use of antibiotics in animals. Poultry producers stated they were committed to addressing the issue and knew that they needed to monitor the progress being made with the development of technologies and new medicines to fully address an emerging public issue.

Contemporary issue management is truly an interactive process, as forward-thinking companies must continually engage in a dialogue with their stakeholders about issues that matter, as Purdue Farms, Tyson Foods, and other firms have learned. New challenges may emerge from anywhere in the world and at any time. Managers must not only implement programs, but continue to reassess their actions to be consistent with both ethical practices and long-term survival.

Organizing for Effective Issue Management

Who manages public issues? What departments and people are involved? There is no simple answer to this question. Figure 1.5, presented in Chapter 1, showed that the modern corporation has many boundary-spanning departments. Which part of the organization is mobilized to address a particular emerging issue often depends on the nature of the issue itself. For example, if the issue has implications for public policy or government regulations, the public affairs or government relations department may take a leadership role. (The public affairs department is further discussed in Chapter 8.) If the issue is an environmental one, the department of sustainability or environment, health, and safety may take on this role. Some companies combine multiple issue management functions in an office of external relations or corporate affairs. The following example illustrates how one company has organized to manage emerging public issues.

> At Publix, the largest employee-owned grocery chain in the United States with revenues of over $34.6 billion in 2017, the coordination of public issues is handled by six different, yet related, teams: corporate communications, customer care, government relations, media and community relations, social media, and special projects. The corporate communications team handles a wide array of internal communications, including an eight-page monthly newsletter, *Publix News.* When customers contact the company with a potential public issue, the customer care team responds to resolve customer concerns and answer customer questions. If the public issue has a governmental element, then the government relations team is organized to communicate with federal, state, and local officials regarding matters affecting the company's ability to effectively compete in the marketplace. Each division within the company has a media and community relations team who interacts with the news media and the communities served by the company to address any public issue. A social media team at Publix uses Facebook, Twitter, and other channels to monitor and handle any emerging public issues. And, finally, the special projects team preserves and promotes the company's history as an important part of the Publix culture. The company relies on its tradition to guide responses to public issues as they arise.[13]

[13] See the Publix Company website at *corporate.publix.com*.

Exhibit 2.A Coca-Cola Sets Recycling Goals

For many years, Coca-Cola was the target of environmental activists because the firm produced billions of plastic bottles that often ended up in landfills and oceans. In January 2018, the company announced an ambitious sustainability goal: it would collect and recycle the equivalent of all the packaging it put out into the world by 2030. The program was called "A World Without Waste" and included investing in more efficient packaging, local recycling programs, and consumer education.

The program was announced shortly after Greenpeace, an environmental advocacy group, identified Coca-Cola, PepsiCo, and Nestlé as some of the world's worst polluters. Greenpeace was also critical of Coca-Cola's new sustainability initiative. "The plan failed to include any reduction of the company's rapidly increasing use of single-use plastic bottles globally, which now stands at well over 110 billion annually," according to a Greenpeace press release.

Coca-Cola CEO James Quincey disagreed. "If we recollect all the bottles, there is no such thing a single use bottle. Every bottle comes back and every bottle has another life." Rather than tackle the difficult task of collecting every bottle it produced, Coca-Cola aimed to collect an equivalent number of bottles. But, Quincey admitted that the biggest challenge for his company's plan would be in developing countries that did not have modern systems of waste collection. "That's clearly going to be a lot of groundwork with a lot of other organizations and the governments to start building that infrastructure."

Source: "Coca-Cola, Criticized for Plastic Bottles, Sets Recycling Goals," *The Wall Street Journal,* January 19, 2018, *www.wsj.com*.

Public affairs professionals help companies and nonprofits manage their operations by anticipating governmental concerns and actions, understanding how stakeholders influence a firm's license to operate, and helping their organization deal with emerging threats and opportunities. The Foundation for Public Affairs (FPA) reported in 2017 that "when political risk and economic uncertainty are high, . . . the public affairs function becomes even more indispensable."[14] FPA survey data showed that 56 percent of companies had increased their public affairs budgets in the previous three years and only 26 percent had experienced a decrease. And CEOs are increasingly getting involved in public affairs, with 57 percent engaged moderately or extensively and only 9 percent not engaged at all. One example of an exemplary corporate response to an important public issue is described in Exhibit 2.A.

What kinds of managers are best able to anticipate and respond effectively to emerging public issues? What skill sets are required? The European Academy of Business in Society (EABIS) undertook a major study of leaders in companies participating in the United Nations Global Compact. (This initiative is a set of basic principles covering labor, human rights, and environmental standards, to which companies can voluntarily commit.) The researchers were interested in the knowledge and skills required of what they called the "global leader of tomorrow."

They found that effective global leadership on these public issues required three basic capabilities. The first was an understanding of the changing business *context:* emerging environmental and social trends affecting the firm. The second was an ability to lead in the face of *complexity*. Many emerging issues, the researchers found, were surrounded by ambiguity; to deal with them, leaders needed to be flexible, creative, and willing to learn from their mistakes. The final capability was *connectedness:* the ability to engage with external stakeholders in dialogue and partnership. More than three-fourths of executives polled said that these skills were important.[15]

[14] Quotation from "The State of Corporate Public Affairs," *Foundation for Public Affairs,* 2017.

[15] European Academy of Business in Society, *Developing the Global Leader of Tomorrow* (United Kingdom: Ashridge, December 2008). Based on a global survey of 194 CEOs and senior executives in September–October 2008.

Stakeholder Engagement

One of the key themes of this book is that companies that actively engage with stakeholders do a better job of managing a wide range of issues than companies that do not. The term **stakeholder engagement** is used to refer to this process of ongoing relationship building between a business and its stakeholders. In the animal-breeding farms example presented earlier in this chapter, the companies' challenge was to engage with its various stakeholder groups, consumers, the media, government agencies, suppliers and others, in addressing an emerging issue of food product safety. This section will further explore the various forms the business–stakeholder relationship takes, when stakeholder engagement is likely to occur, what drives this engagement, and the expanding role assumed by social media in stakeholder engagement.

Stages in the Business–Stakeholder Relationship

Over time, the nature of business's relationship with its stakeholders often evolves through a series of stages. Scholars have characterized these stages as *inactive, reactive, proactive,* and *interactive,* with each stage representing a deepening of the relationship. Sometimes, companies progress through this sequence from one stage to the next; other companies remain at one stage or another, or move backward in the sequence.[16]

- *Inactive* companies simply ignore stakeholder concerns. These firms may believe—often incorrectly—that they can make decisions unilaterally, without taking into consideration their impact on others. Executives at Home Depot failed to listen to their employees' concerns about potential breaches of the company's data security systems and later experienced the theft of detailed consumer information from 56 million credit and debit cards. Their inactive response was costly: according to some estimates, the information from the stolen cards could be used to make $3 billion in illegal purchases.
- Companies that adopt a *reactive* posture generally act only when forced to do so, and then in a defensive manner. For example, in the film *A Civil Action,* based on a true story, W. R. Grace (a company that was later bought by Beatrice Foods) allegedly dumped toxic chemicals that leaked into underground wells used for drinking water, causing illness and death in the community of Woburn, Massachusetts. The company paid no attention to the problem until forced to defend itself in a lawsuit brought by a crusading lawyer on behalf of members of the community.
- *Proactive* companies try to anticipate stakeholder concerns. These firms use environmental scanning practices to identify emerging public issues. They often have specialized departments, such as those at Publix, described earlier in the chapter. These firms are much less likely to be blindsided by crises and negative surprises. Stakeholders and their concerns are still, however, considered a problem to be managed, rather than a source of competitive advantage.
- Finally, an *interactive* stance means that companies actively engage with stakeholders in an ongoing relationship of mutual respect, openness, and trust. For example, in an effort to address continuing high unemployment rates, Starbucks teamed with Opportunity Finance Network, a group of community development financial institutions, to launch "Create Jobs for USA." Donations from Starbucks customers, employees, and others were pooled into a nationwide fund to promote community business lending. The

[16] This typology was first introduced in Lee Preston and James E. Post, *Private Management and Public Policy* (Englewood Cliffs, NJ: Prentice Hall, 1975). For a more recent discussion, see Sandra Waddock and Andreas Rasche, *Building the Responsible Enterprise: Where Vision and Values Meet Value* (Palo Alto: Stanford University Press, 2012).

focus of this program later expanded to include veterans with a goal of employing 10,000 veterans and active duty spouses by 2018.[17]

Firms with this approach recognize that positive stakeholder relationships are a source of value and competitive advantage for the company. They know that these relationships must be nurtured over time.

Drivers of Stakeholder Engagement

When are companies most likely to engage with stakeholders, that is, to be at the interactive stage? What drives companies to go beyond an inactive or reactive stage to a proactive or interactive stage of stakeholder engagement?

Stakeholder engagement is, at its core, a *relationship*. The participation of a business organization and at least one stakeholder organization is necessary, by definition, to constitute engagement. In one scholar's view, engagement is most likely when the company and its stakeholders both have an urgent and important *goal,* the *motivation* to participate, and the *organizational capacity* to engage with one another. These three elements are presented in Figure 2.5.

Goals

For stakeholder engagement to occur, both the business and the stakeholder must have a problem that they want solved. The problem must be both important and urgent (the concept of stakeholder materiality was discussed earlier in this chapter). Business is often spurred to act when it recognizes a gap between its actions and public expectations, as discussed earlier. The company may perceive this gap as a reputational crisis or a threat to its license to operate in society. For their part, stakeholders are typically concerned about an issue important to them—whether child labor, animal cruelty, environmental harm, or something else—that they want to see addressed.

Motivation

Both sides must also be motivated to work with one another to solve the problem. For example, the company may realize that the stakeholder group has technical expertise to help it address an issue. Or, it needs the stakeholder's approval, because the stakeholder is in a position to influence policymakers, damage a company's reputation, or bring a lawsuit. Stakeholders may realize that the best way actually to bring about change is to help a

FIGURE 2.5
Drivers of Stakeholder Engagement

Source: Adapted from Anne T. Lawrence, "The Drivers of Stakeholder Engagement: Reflections on the Case of Royal Dutch/Shell," *Journal of Corporate Citizenship,* Summer 2002, pp. 71–85.

	Company	**Stakeholders(s)**
Goal	To improve corporate reputation; to earn a license to operate; to win approval of society	To change corporate behavior on an issue of concern
Motivation	Needs stakeholder involvement because of their expertise or control of critical resources	Governmental campaigns, protest perceived as inadequate to change corporate behavior
Organizational capacity	Top leaders committed to engagement; well-funded department of external (stakeholder) affairs	Experienced staff; core group of activists committed to dialogue with business

[17] These programs are profiled in Starbucks' Global Responsibility Report at *globalassets.starbucks.com/assets/*.

company alter its behavior. In other words, both sides depend on each other to accomplish their goals; they cannot accomplish their objectives on their own. (Theorists sometimes refer to this as *interdependence.*)

Organizational Capacity

Each side must have the organizational capacity to engage the other in a productive dialogue. For the business, this may include support from top leadership and an adequately funded external affairs or comparable department with a reporting relationship to top executives. It may also include an issue management process that provides an opportunity for leaders to identify and respond quickly to shifts in the external environment. For the stakeholder, this means a leadership or a significant faction that supports dialogue and individuals or organizational units with expertise in working with the business community.

In short, engagement is most likely to occur where both companies and stakeholders perceive an important and urgent problem, see each other as essential to a solution, and have the organizational capacity to interact with one another.

The Role of Social Media in Stakeholder Engagement

Social media plays an increasingly important role in businesses' effort to address public issues and engage stakeholders. Beyond the common use of social media as an advertising tool, many companies now use social networks to identify and solve problems faster, share information better among their employees and partners, and bring customers' ideas for new product designs to market earlier.

> Experts argue that corporate social networking has its advantages and its disasdvantages. Some studies show that many employees enjoy creating a corporate social networking page that is separate from their public social networking profile. While adding work colleagues and supervisors to a public social networking group is possible, many people prefer to keep their social lives separate from their work lives. In addition, creating internal blog posts, commenting on projects, and keeping up with work-related news is advantageous to some workers, supporting the building of social network pages at work.

Yet, experts also point out that a corporate social network can cost thousands of dollars to build. In order to erect an internal networking platform to house the employees' social network pages, numerous specialists must be hired. Once a platform is constructed, employees must spend the time to create profiles, maintain updates, and network within a corporate social networking group, generally all occurring on company time. Many employees do not want to spend the time or effort building a corporate networking page. Since employees cannot access an internal social networking group after leaving a job, many employees feel as though spending time working on a networking page is futile. In addition, any information posted to a corporate social networking page remains the property of a company. Thus, most employees looking to gain recognition with new customers and new employers will not spend time building an internal social networking page.[18]

Despite some of the reservations voiced by employees, businesses and their public affairs managers have increasingly turned to social media platforms to engage with multiple stakeholders, resulting in communication that has become faster and more effective.

[18] Adapted from "What Is Social Networking?" *Wisegeek,* n.d., *www.wisegeek.com*.

Exhibit 2.B Merck and Access Accelerated

Around the world, approximately 400 million people lack access to effective and affordable health care. According to the World Health Organization, low- and middle-income countries bear about 90 percent of the world's disease burden. Merck, a German-based multinational chemical, pharmaceutical, and life sciences company, began a global partnership program, Access Accelerated, to tackle this complex challenge by researching innovative solutions, developing new approaches, and improving existing programs to help people at the point of care.

At the 2017 World Economic Forum, Merck convened with 21 other leading pharmaceutical companies and dozens of multilateral organizations, government agencies, and NGOs, as well as academic institutions, health industry associations, and experts from the private sector. They began a dialogue to explore accessing information on the world's most pressing health issues and to design how to best launch global initiatives to focus on improving both treatment and prevention of noncommunicable diseases in low- and middle-income countries.

By 2018, Merck and its business partners had joined the Kenya Ministry of Health, the World Bank Group, and AMPATH, a Kenyan hospital, to launch the first noncommunicable disease (NCD) county pilots. The pilots integrated NCD services into primary health care in two Kenyan counties: Busia and Trans Nzoia. In another effort, Celgene Corporation, a business partner in Access Accelerated, announced the launch of Celgene Cancer Care Links, a new grant program designed to support and enhance patient cancer care in resource-constrained countries.

Source: See Merck's *Corporate Responsibility Report* at *reports.emdgroup.com/2016/cr-report/products/access-to-health.html* and the Access Accelerated website, accessaccelerated.org

Stakeholder Dialogue

The process of engaging with stakeholders can take many forms, but it often eventually involves dialogue with stakeholders. One management theorist has defined dialogue as "the art of thinking together."[19] In **stakeholder dialogue**, a business and its stakeholders come together for face-to-face conversations about issues of common concern. There, they attempt to describe their core interests and concerns, define a common definition of the problem, invent innovative solutions for mutual gain, and establish procedures for implementing solutions. To be successful, the process requires that participants express their own views fully, listen carefully and respectfully to others, and open themselves to creative thinking and new ways of looking at and solving a problem. The promise of dialogue is that, together, they can draw on the understandings and concerns of all parties to develop solutions that none of them, acting alone, could have envisioned or implemented. A powerful, global example of stakeholder dialogue leading to action is described in Exhibit 2.B.[20]

Stakeholder Networks

Dialogue between a single firm and its stakeholders is sometimes insufficient to address an issue effectively. Corporations sometimes encounter public issues that they can address effectively only by working collaboratively with other businesses and concerned persons and organizations in **stakeholder networks**. One such issue that confronted Nike, Inc., was

[19] William Isaacs, *Dialogue and the Art of Thinking Together* (New York: Doubleday, 1999).

[20] This section draws on the discussion in Anne T. Lawrence and Ann Svendsen, *The Clayoquot Controversy: A Stakeholder Dialogue Simulation* (Vancouver: Centre for Innovation in Management, 2002). The argument for the benefits of stakeholder engagement is fully developed in Ann Svendsen, *The Stakeholder Strategy: Profiting from Collaborative Business Relationships* (San Francisco: Berrett-Koehler, 1998).

a growing demand by environmentally aware consumers for apparel and shoes made from organic cotton.

> Cotton, traditionally cultivated with large quantities of synthetic fertilizers, pesticides, and herbicides, is one of the world's most environmentally destructive crops. In the late 1990s, in response both to consumer pressure and to its own internal commitments, Nike began for the first time to incorporate organic cotton into its sports apparel products. Its intention was to ramp up slowly, achieving 5 percent organic content by 2010. However, the company soon encountered barriers to achieving even these limited objectives. Farmers were reluctant to transition to organic methods without a sure market, processors found it inefficient to shut down production lines to clean them for organic runs, and banks were unwilling to loan money for unproven technologies. The solution, it turned out, involved extensive collaboration with groups throughout the supply chain—farmers, cooperatives, merchants, processors, and financial institutions—as well as other companies that were buyers of cotton, to facilitate the emergence of a global market for organic cotton. By 2015, 88 to 90 percent of Nike's cotton-containing apparel used at least 5 percent organic cotton. Nike reported in its 2014–2015 sustainable business report that they are committed to their goal of "100% of our cotton more sustainably (certified organic, licensed to the Better Cotton Standard System for recycled cotton) across NIKE, Inc. by the end of calendar year 2020."[21]

In this instance, Nike realized that in order to reach its objective, it would be necessary to become involved in building a multi-party, international network of organizations with a shared interest in the issue of organic cotton.

The Benefits of Engagement

Engaging interactively with stakeholders—whether through dialogue, network building, or some other process—carries a number of potential benefits. Managers increasingly recognize the critical nature of this corporate strategy as the number of stakeholders and the complexity of the issues involving stakeholders are increasing significantly, as one business consulting organization reports.[22]

> In an era of hyper-transparency and intensifying political and social disruptions, companies are re-evaluating their purpose in society and the benefits of engaging with multiple stakeholders. There are growing calls from government and civil society for corporations to become partners in supporting a more inclusive economy and sustainable environment and these expectations will only increase. More than ever before, companies face competitive pressure to integrate new ideas and voices into their work. These changes are adding significant value to the business and the communities in which they operate.[23]

Companies deeply engaging in stakeholder partnerships bring a number of distinct strengths. Stakeholder groups are often aware of shifts in popular sentiment before

[21] Nike's description of its sustainability targets and measures are provided in Nike's Sustainable Business Report, 2014–2015 found at *about.nike.com*.

[22] For an overview of stakeholder engagement, see Michael Yaziji and Jonathan Doh, *NGOs and Corporations: Conflict and Collaboration:* (Cambridge, UK: Cambridge University Press, 2009), ch. 7, "Corporate-NGO Engagements: From Conflict to Collaboration," pp. 123–45.

[23] "The Future of Stakeholder Engagement," *BSR,* October 2016, p. 3.

companies are, and are thus able to alert companies to emerging issues. For example, as described earlier in this chapter, Purdue Farms' and Tyson Foods' engagements with consumer-activist groups and government agencies helped raise its awareness of concerns about their antibiotic use in animals. Stakeholders often operate in networks of organizations very different from the company's; interacting with them gives a firm access to information in these networks. As introduced at the beginning of this chapter, businesses took action against various social issues, joining social activist and community groups in protest of the government's actions. Community groups raised important issues about gun violence and gun control after a school shooting in Florida, causing businesses to re-think their positions on these social issues, as discussed at the end of this chapter.

Firms are learning that their engagement with stakeholders is of critical importance to the organization and need to address multiple levels of engagement. This engagement should include both internal, as well as external, stakeholders and emphasize issues that directly affect corporate strategy. As the BSR report on stakeholder engagement points out, there are five drivers fueling a change in stakeholder engagement: communication, individual empowerment, automation of work, climate change and other sustainability issues, and supply chain impact.[24]

Companies are learning that it is important to take a strategic approach to the management of public issues, both domestically and globally. This requires thinking ahead, understanding what is important to stakeholders, scanning the environment, and formulating action plans to anticipate changes in the external environment. Effective issue management requires involvement both by professional staff and leaders at top levels of the organization. It entails communicating across organizational boundaries, engaging with the public, and working creatively with stakeholders to solve complex problems.

Summary

- A public issue is an issue that is of mutual concern to an organization and one or more of the organization's stakeholders. Stakeholders expect a level of performance by businesses, and if it is not met a gap between performance and expectation emerges. The larger the gap, the greater risk of stakeholder backlash or missed business opportunity.
- The eight strategic radar screens (the customer, competitor, economic, technological, social, political, legal, and geophysical environments) enable public affairs managers to assess and acquire information regarding their business environments. Managers must also assess the importance or materiality of public issues to the firm and its stakeholders.
- The issue management process includes identification and analysis of issues, the generation of options, action, and evaluation of the results.
- In the modern corporation, the issue management process takes place in many boundary-spanning departments. Some firms have a department of external affairs or corporate relations to coordinate these activities and top management support is essential for effective issue management.
- Stakeholder engagement involves building relationships between a business firm and its stakeholders around issues of common concern and is enhanced by understanding the goals, motivations, and organizational capacities relevant to the engagement. Social media is playing a more expansive role in stakeholder engagement.
- Stakeholder dialogue is central to good stakeholder engagement, supported by network building or partnerships.

[24] Each of these drivers of stakeholder engagement are discussed in detail in "The Future of Stakeholder Engagement, *Ibid.*

Key Terms

competitive intelligence, *31*
environmental analysis, *29*
environmental intelligence, *29*
issue management, *33*
issue management process, *33*
performance–expectations gap, *26*
public issue, *26*
stakeholder engagement, *38*
stakeholder dialogue, *41*
stakeholder materiality, *32*
stakeholder network, *41*

Internet Resources

www.wn.com/publicissues	World News, Public Issues
www.nifi.org	National Issues Forum
www.un.org/en/globalissues	United Nations, Global Issues
www.issuemanagement.org	Issue Management Council
www.scip.org	Strategic and Competitive Intelligence Professionals
www.wfs.org	World Future Society
www.globalissues.org	Global Issues
millennium-project.org	The Millennium Project
www.cfr.org	Council on Foreign Relations
pac.org/fpa	Foundation for Public Affairs, Public Affairs Council

Discussion Case: *Businesses Respond to the Movement for School Safety*

The quiet community of Parkland, Florida, was rocked in 2018 when a 19-year-old former student entered Marjory Stoneman Douglas High School with a duffel bag containing an AR-15-style rifle, a vest with additional magazines for the weapon, and a semi-automatic version of the M16 rifle used by the U.S. military. Within minutes, he had shot and killed 17 people, and the nation mourned another tragic school shooting.

In response, Parkland students launched the #NeverAgain movement and protested continuing gun violence, especially in schools; the lack of gun control measures; and a mental health system that had allowed someone with a troubled history to purchase an assault rifle. A month later hundreds of thousands of people—children, parents, politicians, and celebrities—gathered for "The March For Our Lives" in Washington, DC, jamming onto Pennsylvania Avenue from the White House to the U.S. Capitol in what may have been the biggest rally for tighter gun control in American history. Other similar marches and protests were held that day in nearly every major U.S. city. Many called on Congress to take action and pass strict gun control legislation, as had also occurred after prior mass shooting incidents in Las Vegas, Newtown, Orlando, and other cities and towns.

Some protesters simply called for a ban on assault rifles and more thorough background checks for gun purchasers. Others specifically targeted the National Rifle Association (NRA), an advocacy organization that had vigorously opposed any restrictions on gun ownership. In response to the Parkland students, NRA's CEO Wayne LaPierre told an audience at the Conservative Political Action Conference that "as usual the opportunists wasted not one second to exploit tragedy for gain," adding that gun control

advocates and the media "hate the NRA, they hate the Second Amendment [to the U.S. Constitution, which states the right of the people to keep and bear arms], [and] they hate individual freedom."

In the wake of the Parkland shootings and subsequent protests, several companies broke their relationship with the NRA and its members. MetLife, a large insurance company, announced it would stop providing discounts for auto and home insurance for NRA members. "We value all our customers but have decided to end our discount program with the NRA," the company announced in a press statement. The cybersecurity firm Symantec stopped its discount program for NRA members who purchased its LifeLock identity theft protection service and Norton antivirus software. SimpliSafe, a home security services company, ended its NRA promotions. Numerous rental car companies, including Hertz, Enterprise (which also operates Alamo and National), and Avis Budget, ended their NRA-membership discount programs.

The First National Bank of Omaha was among the first banks to end a Visa credit card with NRA branding that offered cardholders 5 percent cashback on gas and sporting goods purchases. Bank of America said they would no longer lend money to manufacturers of military-inspired firearms that civilians could use, such as AR-15-style rifles. Delta and United Airlines, two of America's largest passenger airline carriers, cut ties with the NRA after a call to boycott the NRA became a top trend on Twitter. Both airline companies ended discount programs for NRA members through their group travel programs, including United's program to offer discounts to NRA members traveling to the NRA's annual meeting. "Bank and other companies are sensitive to being on the wrong side of a social media campaign, which can spread pretty quickly these days," said University of Michigan marketing professor Erik Gordon. "They don't want to risk having people march or boycott."

The NRA was quick to fire back. In an official statement, the organization said, "Some corporations have decided to punish NRA membership in a shameful display of political and civic cowardice. In time, these brands will be replaced."

Some businesses experienced a backlash to their actions. Senator Michael Crapo, the head of the Senate banking committee, sent blistering letters to top executives at some major banks accusing them of using their market power to manage social policy. He warned them against developing ways to monitor gun transactions through their payments systems. The Georgia state legislature removed a provision in a tax bill which would have given Delta Airlines a $40 million airline fuel tax exemption. Analysts calculated that only 13 NRA members actually had used Delta's group travel discount, resulting in a cost to Delta of more than $3 million per NRA passenger served. Delta's CEO responded, "The decision [to cancel the NRA discount] was not made for economic gain and our values are not for sale." Others argued that the so-called liberal reaction by businesses to join the gun protesters galvanized conservative groups, deepening their support of the NRA and their resolve to protect their right to bear arms.

Sources: "NRA-Affiliated Businesses Shed Ties after Parkland, Florida, School Shooting," *USA Today,* February 23, 2018, *www.usatoday.com*; "Firms Reassess Involvement in Gun Industry in Wake of Florida Shooting," *The Wall Street Journal,* February 25, 2018, *www.wsj.com*; "Banks Tried to Curb Gun Sales; Now Republicans Are Trying to Stop Them," *The New York Times,* May 25, 2018, *www.nytimes.com*; and, "Only 13 NRA Members Used Delta's Discount, It Cost the Airline a $40 Million Tax Break," *Washington Post,* March 3, 2018, *www.washingtonpost.com*.

Discussion Questions

1. What was the public issue facing the companies in this case?
2. Describe the "performance–expectations gap" found in the case. What were the stakeholders' (community and school students) expectations, and how did they differ from businesses' performance?
3. If you applied the strategic radar screens model to this case, which of the eight environments would be most significant, and why?
4. Apply the issue management life cycle process model to this case. Which stages of the process can you identify?
5. In your opinion, did businesses respond appropriately to this issue? Why or why not?
6. If you had been a manager of one of the airlines or banks discussed in the case, what would you have decided to do (or not do) in the face of emerging public concern about gun violence in schools?

CHAPTER THREE

Corporate Social Responsibility and Citizenship

The idea that businesses bear broad responsibilities to society as they pursue economic goals is an age-old belief. Both market and nonmarket stakeholders expect businesses to act responsibly, and many companies have responded by making social goals a part of their overall business operations and adopting the goal of being a good corporate citizen. Businesses embracing these responsibilities often build positive relationships with stakeholders, discover business opportunities in serving society, and transform a concern for financial performance into a vision of integrated financial, social, and environmental performance. Business ventures of all sizes—entrepreneurial, small to medium business enterprises, and corporate endeavors—hold innate responsibilities to those they impact market and nonmarket stakeholders. Establishing effective structures and processes to meet a company's social and corporate citizenship responsibilities, assessing the results of these efforts, and reporting on the firm's performance to the public are important challenges facing today's managers and business owners.

This Chapter Focuses on These Key Learning Objectives:

LO 3-1 Understanding the role of big business and the responsible use of corporate power in a democratic society.

LO 3-2 Knowing when the idea of corporate social responsibility originated and investigating how a company's purpose or mission can integrate social objectives with economic and legal objectives.

LO 3-3 Examining the key arguments in support of and concerns about corporate social responsibility.

LO 3-4 Defining global corporate citizenship and recognizing the rapidly evolving management practices to support global citizenship.

LO 3-5 Examining businesses with an explicitly social mission, such as social ventures and B corporations.

LO 3-6 Distinguishing among the sequential stages of global corporate citizenship.

LO 3-7 Understanding how businesses assess and report their social performance.

Do managers have a responsibility to their shareholders? Certainly they do, because the owners of the business have invested their capital in the firm, exhibiting the ownership theory of the firm presented in Chapter 1. Do managers also have a responsibility, a *social* responsibility, to their company's other market and nonmarket stakeholders—the people who live where the firm operates, who purchase the firm's product or service, or who work for the firm? Does the stakeholder theory of the firm, described in detail in Chapter 1, expand a firm's obligations to include multiple stakeholders present in an interactive social system? Generally, yes, but while managers may have a clear responsibility to respond to all stakeholders, just how far should this responsibility go? Consider the following examples:

Starbucks Coffee Company launched a $70 million initiative to help coffee farming communities around the world mitigate their climate change impacts and promote long-term crop stability. Starbucks transformed a 240-hectare farm located on the slopes of the Poas Volcano in Costa Rica into a global agronomy center, enabling the company to expand its Coffee and Farming Equity practices program (C.A.F.E.). Starbucks' chairman Howard Schultz said, "This investment, and the cumulative impact it will have when combined with programs we have put into place over the last forty years, will support the resiliency of coffee farmers and their families as well as one million people that represent our collective coffee supply chain."[1]

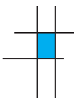
Joshua Shapiro visited three small villages in Uganda and was shocked by the unsafe cooking conditions he saw there. Kitchens were small, dark, and unventilated. People could barely breathe. According to the World Health Organization, around 3 billion people cook and heat their homes using open fires and simple stoves burning wood, animal dung, and crop waste for fuel. Shapiro, an engineer in Carnegie Mellon University's CREATE lab, began working on an idea and returned five years later as part of the Toyota's *Ideas for Good* project to install a half-dozen hand-built, solar-powered ventilation systems to clear the air in the kitchens. Schapiro and his venture partner, Mike Taylor, assembled and installed an additional 25 systems during their second trip to Uganda and planned to construct hundreds more. These social entrepreneurs were funded by gifts and grants from various nonprofit organizations, corporations, and individuals.[2]

Are the efforts described above examples of social responsibility and citizenship practiced by a corporation and social entrepreneurs? Do they represent a successful merger of social and economic objectives, or should these programs be questioned as inappropriate uses of business assets—finances, personnel, and products? How far should an organization or entrepreneur go to help those in society in need of their support? How much is too much?

This chapter describes the role business plays in society, introduces the concepts of corporate social responsibility and global citizenship, and describes how businesses implement them in practice. How organizations should balance their multiple responsibilities—economic, legal, and social—and become a valued corporate citizen is an ongoing challenge. What are the advantages and drawbacks of being socially responsible? Should the purpose or mission of the business explicitly seek to integrate social objectives with economic objectives? How does a business become a better corporate citizen; what steps are necessary? What standards do businesses use to assess their social performance, and how do they report their performance to stakeholders?

[1] "Starbucks Expands $70 Million Ethical Sourcing Program with New Global Agronomy Center," *Fort Mills Times,* March 19, 2013, *www.fortmilltimes.com.*

[2] "CMU Researchers Hope to Install Ventilation Systems to Remove Harmful Cooking Fumes," *Pittsburgh Post-Gazette,* July 8, 2017, *www.post-gazette.com.*



CORPORATE POWER AND RESPONSIBILITY

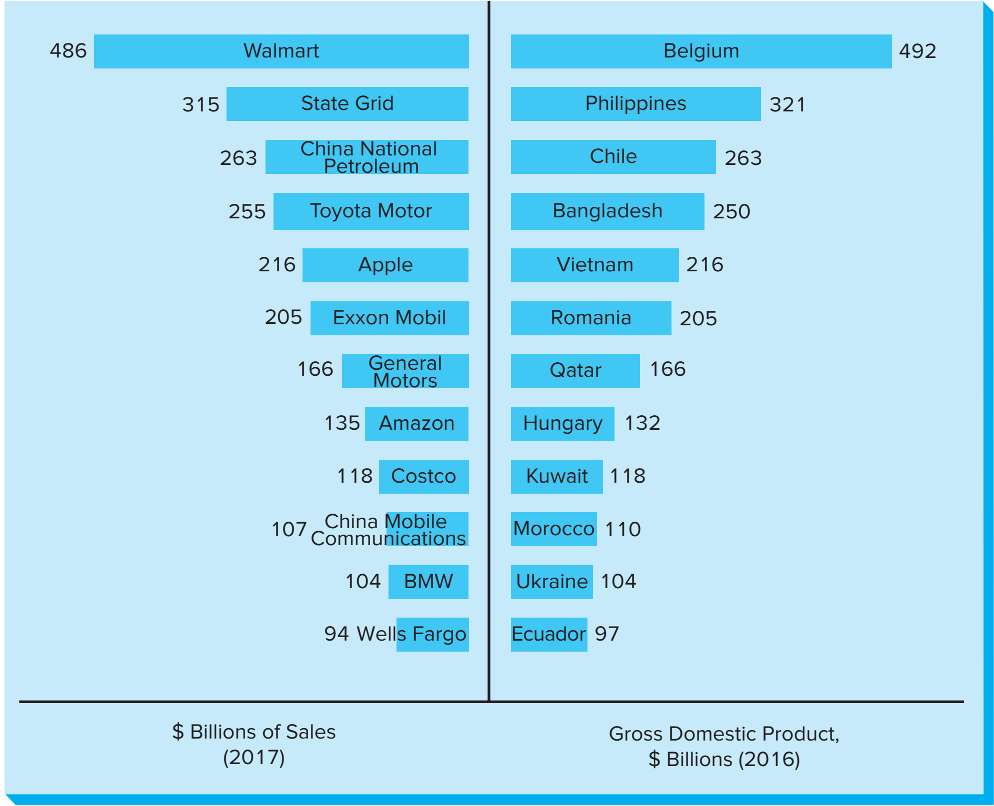
Undeniably, businesses, especially large corporations—whether by intention or accident, and whether for good or evil—play a major role in all that occurs in society. The power exerted by the world's largest business organizations is obvious and enormous. This influence, termed **corporate power**, refers to the capability of corporations to influence government, the economy, and society, based on their organizational resources.

One way to get a sense of the economic power of the world's largest companies is to compare them with nations. Figure 3.1 shows some leading companies alongside countries whose total gross domestic product is about the same as these companies' revenue. The revenues of the wealthiest company in the world, Walmart, are about the same as the gross domestic product (GDP) of Belgium. China Natural Petroleum's revenues are the same as Chile's GDP; Apple's revenues are the same as Vietnam's GDP; Amazon's revenues are the same as Hungary's GDP; and BMW's revenues are the same as Ukraine's GDP.

The size and global reach of major international enterprises such as Walmart and the others listed in Figure 3.1 give them tremendous power. Through their ever-present marketing, they influence what people want and how they act around the world. We count on corporations for job creation; much of our community well-being; the standard of living

FIGURE 3.1 Comparison of Annual Sales Revenue and the Gross Domestic Product for Selected Multinational Enterprises and Nations in $ Billions*

Sources: "*Fortune* Global 500," *fortune.com;* and World Bank data, *databank.worldbank.org*.



*2017 $ billions of sales compared to 2016 gross domestic product in $ billions.

we enjoy; the tax base for essential municipal, state, and national services; and our needs for banking and financial services, insurance, transportation, communication, utilities, entertainment, and a growing proportion of health care. These corporations have the resources to make substantial contributions to political campaigns, as discussed in Chapter 8, thus influencing the policies of governments. They dominate not only the traditional domains of product manufacture and service delivery, but also increasingly reach into such traditionally public sector activities as education, law enforcement, and the provision of social services.[3]

The following well-known quotation, frequently appearing in journals for business executives, challenges its readers to assume a responsible role for business in society:

> Business has become . . . the most powerful institution on the planet. The dominant institution in any society needs to take responsibility for the whole. . . . Every decision that is made, every action that is taken, must be viewed in light of that kind of responsibility.[4]

The tremendous power of the world's leading corporations has both positive and negative effects. A big company may have definite advantages over a small one. It can command more resources, produce at a lower cost, plan further into the future, and weather business fluctuations somewhat better. Globalization of markets can bring new products, technologies, and economic opportunities to developing societies, and help those in need. For example, as discussed in Chapter 11, UPS teamed up with regional African health care providers to use drones for shipping needed medical supplies within minutes, rather than hours, to save lives.

Yet, the concentration of corporate power can also harm society. Huge businesses can disproportionately influence politics, shape tastes, and dominate public discourse. They can move production from one site to another, weakening unions and communities. These companies can also use their economic influence to collude to fix prices, divide markets, and quash competition in ways that can negatively affect consumer choices, employment opportunities, or the creation of new businesses. The Carbon Majors Report released in 2017 claimed that, since 1988, just 100 companies had been the source of more than 70 percent of the world's greenhouse gas emissions. Multinational energy companies, including ExxonMobil, Shell, BP, and Chevron, were identified as among the highest emitting investor-owned companies.[5]

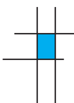
The focused power found in the modern business corporation means that every action it takes can affect the quality of human life—for individuals, for communities, and for the entire globe. The obligation this gives rise to is the notion of the *iron law of responsibility*. The **iron law of responsibility** says that in the long run those who do not use power in ways that society considers responsible will tend to lose it.

Given the virtually immeasurable power in the hands of the leaders of large, global corporations, stakeholders throughout the social system expect business to take great care in wielding its power responsibly for the betterment of society. As a result, social responsibility has become a worldwide expectation.

[3] For two classic analyses of corporate power, see Alfred C. Neal, *Business Power and Public Policy* (New York: Praeger, 1981); and Edwin M. Epstein and Dow Votaw, eds., *Rationality, Legitimacy, Responsibility: Search for New Directions in Business and Society* (Santa Monica, CA: Goodyear, 1978). More recent treatments may be found in Luis Suarez-Villa, *Corporate Power, Oligopolies, and the Crisis of the State* (Albany, NY: State University of New York Press, 2015) and Steve Coll, *Private Empire" ExxonMobil and American Power* (New York: Penguin Books, 2012).

[4] David C. Korten, "Limits to the Social Responsibility of Business," *The People-Centered Development Forum,* article 19, June 1, 1996.

[5] "Just 100 Companies Responsible for 71% of Global Emissions, Study Says," *The Guardian,* July 10, 2017, *www.theguardian.com.*



CORPORATE SOCIAL RESPONSIBILITY AND CITIZENSHIP

Corporate social responsibility (CSR) means that a corporation should act in a way that enhances society and its inhabitants and be held accountable for any of its actions that affect people, their communities, and their environment. This concept is based in the root of the term *responsibility,* meaning "to pledge back," creating a commitment to give back to society and the organization's stakeholders.[6] It implies that harm to people and society should be acknowledged and corrected if possible. It may require a company to forgo some profits if its social impacts seriously hurt some of its stakeholders or if its funds can be used to have a positive social impact.

Being socially responsible does not mean that a company must abandon its other missions. As discussed later in this chapter, a business has many responsibilities: economic, legal, and social; the challenge for management is to integrate them all into a coherent and comprehensive mission. As Axel Weber, chairman of UBS, a Swiss global financial services company, explained,

> "I see it as my duty to understand the scope and scale of societal challenges. [At UBS] we consider the immediate and long-term effects of these challenges. We look at how they may impact the firm, our clients, and other stakeholders, and what action we may need to take in response. Acting responsibly, achieving a positive societal change—through our own activities as well as through the products, services and advice we offer to our clients—that's one of our key roles."[7]

More recently, many companies have adopted the term **corporate citizenship** to refer the actions they take to put their commitments to corporate social responsibility into practice. The term *global corporate citizenship,* similarly, refers to putting these commitments into practice worldwide, not only locally or regionally. Companies demonstrate their corporate citizenship by proactively building stakeholder partnerships, discovering business opportunities in serving society, and transforming a concern for financial performance into a vision of integrated financial *and* social performance.

The Origins of Corporate Social Responsibility

In the United States, the idea of corporate social responsibility appeared around the start of the 20th century. Corporations at that time came under attack for being too big, too powerful, and guilty of antisocial and anticompetitive practices. Critics tried to curb corporate power through antitrust laws, banking regulations, and consumer protection laws.

Faced with this social protest, a few farsighted business executives advised corporations to use their power and influence voluntarily for broad social purposes rather than for profits alone. Some of the wealthiest business leaders—steelmaker Andrew Carnegie is a good example—became great philanthropists who gave much of their wealth to educational and charitable institutions. Other business leaders, like automaker Henry Ford, developed paternalistic programs to support the recreational and health needs of their employees. These business leaders believed that business had a responsibility to society that went beyond their efforts to make profits.

Today a new cohort of philanthropists is emerging. Mark Zuckerberg, CEO of Facebook, and his wife, physician Priscilla Chan, announced that they would give away about

[6] For a more complete discussion of the roots of corporate social responsibility and how it is practiced, see Jerry D. Goldstein and Andrew C. Wicks, "Corporate and Stakeholder Responsibility: Making Business Ethics a Two-Way Conversation," *Business Ethics Quarterly* 17 (2007), pp. 375–98.

[7] "Interview with Axel Weber on Corporate Culture and Responsibility at UBS," UBS website, *www.ubs.com.*

99 percent of their Facebook shares through the Chan Zuckerberg Initiative. The initiative focused on "personalized learning, curing disease, connecting people and building strong communities." Some have predicted that this new cohort of business executives could amass even greater wealth than their predecessors, through inheritance, entrepreneurial success, and other means. They will be in a position to transform charitable giving unlike any previous generation.[8] Corporate philanthropy is discussed in more detail in Chapter 18.

William C. Frederick, a leading scholar and a coauthor of several earlier editions of this textbook, described how business's understanding of corporate social responsibility has evolved over the past half century.[9] During each of four historical periods, corporate social responsibility has had a distinct focus, set of drivers, and policy instruments, as shown in Figure 3.2. Corporate social responsibility is defined in its most basic form as "learning to live with, and respect, others." In his view, corporate social responsibility evolved from a stewardship, to

FIGURE 3.2 Evolving Phases of Corporate Social Responsibility

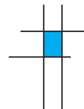
Source: William C. Frederick, "Corporate Social Responsibility: Deep Roots, Flourishing Growth, Promising Future," in Andrew Crane, Abagail Williams, Dirk Matten, Jeremy Moon, and Donald S. Siegel, (Editors), *The Oxford Handbook of Corporate Social Responsibility* (Oxford: Oxford University Press, 2008), pp. 522–532.

	Phases of Corporate Social Responsibility	CSR Drivers	CSR Policy Instruments
CSR_1 Early in the 20th century but formally in the 1950s–60s	**Corporate Social Stewardship** Corporate philanthropy—acts of charity Managers as public Trustee-stewards Balancing social pressures	Executive conscience Company image/reputation	Philanthropic funding Public relations
CSR_2 1960s–70s	**Corporate Social Responsiveness** Social impact analysis Strategic priority for social response Organizational redesign and training for responsiveness Stakeholder mapping and implementation	Social unrest/protest Repeated corporate misbehavior Public policy/government regulation Stakeholder pressures think tank policy papers	Stakeholder strategy Regulatory compliance Social audits Public affairs function Governance reform Political lobbying
CSR_3 1980s–90s	**Corporate/Business Ethics** Foster an ethical corporate culture Establish an ethical organizational climate Recognize common ethical principles	Religious/ethnic beliefs Technology-driven value changes Human rights pressures Code of ethics Ethics committee/officer/audits Ethics training Stakeholder negotiations	Mission/vision/values Statements CEO leadership ethics
CSR_4 1990s–present	**Corporate/Global Citizenship** Stakeholder partnerships Integrate financial, social, and environmental performance Identify globalization impacts Sustainability of company and environment	Global economic trade/investment High-tech communication networks Geopolitical shifts/competition Ecological awareness/concern NGO pressures	Intergovernmental compacts Global audit standards NGO dialogue Sustainability audits/ reports

[8] "Facebook's Mark Zuckerberg and Wife Giving Away 99% of Shares," *The Wall Street Journal,* December 1, 2015, *www.wsj.com;* and, *Portraits of Young Philanthropists: How Generation X and Generation Y Are Transforming Charitable Giving,* (New York, The Economist, 2014).

[9] For a comprehensive review of the history of corporate social responsibility see William C. Frederick, "Corporate Social Responsibility: From Founders to Millennials," in James Weber and David M. Wasieleski (eds.) *Business and Society 360: Corporate Social Responsibility,* pp. 3–38, (Bingley, UK: Emerald Publishers, 2018).

strategic responsiveness, to an ethics-based understanding based in culture, to what Frederick calls the most recent phase of corporate social responsibility: *corporate citizenship.*



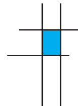
BALANCING SOCIAL, ECONOMIC, AND LEGAL RESPONSIBILITIES

Being socially responsible by meeting the public's continually changing expectations requires wise leadership at the top of the corporation. Companies with the ability to recognize profound social changes and anticipate how they will affect operations have proven to be survivors. They get along better with government regulators, are more open to the needs of the company's stakeholders, and often cooperate with legislators as new laws are developed to cope with social problems.

> Nestlé, the world's leading nutrition, health, and wellness company with its headquarters in Switzerland, launched a large-scale research project on children's nutrition leading to product modification or new product development. The global initiative focused on 10 countries and collaborated with over 240,000 public health opinion leaders, third-party organizations, and pediatricians around the world. The Kids Nutrition and Health Study targeted children's nutrient intake, dietary patterns, and family lifestyle factors. The aim was to help parents ensure the healthy growth and development of their children, while also giving the company insights into how to modify existing product ingredients and develop new products.[10]

The actions taken by Nestlé are an example of a business organization's leaders being guided by **enlightened self-interest**. This concept reflects the notion that providing value to stakeholders is in a business's *long run* self-interest. Nestlé's research initiative certainly cost the company money in the short run, but new product development and assistance to the families and children who used their products and the communities where they lived would also bring long-term benefits through enhanced reputation and customer loyalty.

Social responsibility is not a business organization's sole responsibility. In addition, as members of civil society, organizations have legal obligations, as well as economic responsibilities, to their owners and other stakeholders affected by the financial well-being of the firm. Any organization or manager must seek to juggle these multiple responsibilities—economic, legal, and social. The belief that the business of business is solely to attend to shareholders' return on investment and make a profit is no longer widely held and has no legal foundation, as discussed next in the chapter. Rather, many business executives believe the key challenge facing their organizations today is to meet their multiple economic and social responsibilities simultaneously.



THE CORPORATE SOCIAL RESPONSIBILITY QUESTION

As we have seen, there are various views about the expression of business's social responsibilities and these views evolve over time. The arguments supporting corporate social responsibility and concerns about it are detailed next and summarized in Figure 3.3.

Support for Corporate Social Responsibility

Many business executives believe that companies should make a profit but should balance this with their social responsibilities. Clearly, many stakeholder groups see the value in

[10] "Nestlé in Society: Creating Shared Value and Meeting Our Commitments, 2016," *Nestlé's Annual Social Report,* 2016, *www.nestle.com/csv.*

FIGURE 3.3
The Support for and Concerns about Corporate Social Responsibility

In Support for Corporate Social Responsibility	Concerns about Corporate Social Responsibility
Balances corporate power with responsibility. Discourages government regulation. Promotes long-term profits for business. Improves stakeholder relationships. Enhances business reputation.	Lowers economic efficiency and profit. Imposes unequal costs among competitors. Imposes hidden costs passed on to stakeholders. Requires skills business may lack. Places responsibility on business rather than individuals.

corporate socially responsible action, since it preserves the environment, protects consumers, safeguards the safety and health of employees, and prevents job discrimination, but shareholders also expect business to maintain a strong return on their financial investments. Government officials also support CSR in that it ensures corporate compliance with laws and regulations that protect the general public from abusive business practices. In other words, both businesspeople and stakeholders, and both supporters and critics of business, have reasons for wanting businesses to act in socially responsible ways.

Balances Corporate Power with Responsibility

Today's business enterprise possesses much power and influence. Most people believe that responsibility must accompany power, whoever holds it. This obligation, presented earlier in this chapter, is the *iron law of responsibility*. Corporations' reputations, especially in the banking industry, have taken a hit since the economic downturn of 2008–09. Half of American adults surveyed said their trust in banks had declined after the downturn, joining a growing distrust of Wall Street and mortgage lenders. This shows one example of how managers' misuse of corporate power and their lack of responsibility as trustees of the public's wealth can result in their loss of power.

Discourages Government Regulation

One of the most appealing arguments in support of CSR is that voluntary socially responsible acts may head off increased government regulation of business. Some regulation may reduce freedom for both business and society, and freedom is a desirable public good. In the case of business, regulations tend to add economic costs and restrict flexibility in decision making. From business's point of view, participating in programs typically the focus for government efforts, can produce a unique business opportunity as the following example illustrates.

> In the United States, food producers could use up to ten different label phrases on their packages, ranging from "expires on" to "better if used by." Many consumers complained to the Department of Agriculture that they were increasingly confused by the different messages. In 2017, the Food Marketing Institute and the Grocery Manufacturers Association, the two largest trade groups for the U.S. grocery industry, announced they had adopted standardized, voluntary regulations to clear up what product date labels mean. Manufacturers would begin to put on their food packages "use by" or "best if used by." This change was meant to explain to the consumer when the product would be at its peak flavor and safe to consume—and potentially stave off further government rules on labeling.[11]

[11] "Changes Planned to Sell-by Dates on Food," *telegram.com,* February 16, 2017, *www.telegram.com.*

Businesses may act in a socially responsible way to benefit its stakeholders, but also to fend off additional burdensome government regulations, as the example above illustrates. Therefore, if business by its own socially responsible behavior can discourage greater government involvement in the business–consumer stakeholder relationship, it is accomplishing a public good as well as its own private good.

Promotes Long-Term Profits for Business

At times, social initiatives by business produce long-run business profits. In 1951, a New Jersey judge ruled in a precedent-setting case, *Barlow et al. v. A.P. Smith Manufacturing,* that a corporate donation to Princeton University was an *investment* by the firm, and thus an allowable business expense. The rationale was that a corporate gift to a school, though costly in the present, might later provide a flow of talented graduates to work for the company. The court ruled that top executives must take "a long-range view of the matter" and exercise "enlightened leadership and direction" when it comes to using company funds for socially responsible programs.[12]

> A classic example of the long-term benefits of social responsibility was the Johnson & Johnson Tylenol incident in the 1980s, when several people died after ingesting Extra-Strength Tylenol capsules laced with the poison cyanide. To ensure the safety of its customers, Johnson & Johnson immediately recalled the product, an action that cost the firm millions of dollars in the short term. The company's production processes were never found defective. Customers rewarded Johnson & Johnson's responsible actions by continuing to buy its products, and in the long run the company once again became profitable.

Empirical evidence has supported this view. Studies generally have found that most of the time, more responsible companies also had better financial results; the statistical association has been highly to modestly positive across the range of all prior studies. According to one recent study, when firms practice socially responsible activities the firm's financial performance is enhanced, especially in a highly competitive industry environment.[13]

Improves Stakeholder Relationships

Managers often believe that developing a strong social agenda and series of social programs will improve the firm's stakeholder relationships. Whether it improved the quality of people it attracted as employees, or appealed to consumers to purchase the firm's product or services, or built strong ties with the community residents in which it operated, or persuaded investors to purchase company stock, managers felt that social action by the firm was viewed positively by stakeholders. In a national survey of 1,000 executives, 70 percent said that company-sponsored social programs aided them in recruiting employees and 68 percent reported that employees were more engaged in their work if they were involved in social-oriented projects on and off the job.[14] As Doris Gonzalez, director of corporate citizenship at IBM, explained:

> "Corporate Social Responsibility has long stopped being just a 'nice to have' set of programs that help companies tell their story of how they invest resources in a local community. These programs are at the core of employee engagement, retention

[12] *Barlow et al. v. A.P. Smith Manufacturing* (1951, New Jersey Supreme Court), discussed in Clarence C. Walton, *Corporate Social Responsibility* (Belmont, CA: Wadsworth, 1967), pp. 48–52.

[13] Kim Kwang-Ho, Kim MinChung, and Qian Cuili, "Effects of Corporate Social Responsibility on Corporate Financial Performance: A Competitive-Action Perspective," *Journal of Management,* 44 (2018), pp. 1097–1118.

[14] "Covestro Grant to Expand 'Social Purpose' Programs," *Pittsburgh Post-Gazette,* April 6, 2018, *www.post-gazette.com.*

and recruiting, as well as making an impact in the community. Most importantly, in order to be sustainable, corporate responsibility programs must be aligned with business strategies. At IBM, the corporate giving programs make a difference in the communities where employees live and work as well as improve the skills and success of the staff, and ultimately, our business."[15]

This belief was borne out in recent research where corporate social responsibility was analyzed in comparison to the relationships between the firm and various stakeholders. As one study concluded, "The quality of the relationship between the company and its stakeholders represents a key factor that affects the success of the company." Managers must be acutely aware of these relationships and understand how best to manage them.[16]

Enhances Business Reputation

The social reputation of the firm is often viewed as an important element in establishing trust between the firm and its stakeholders. **Reputation** refers to desirable or undesirable qualities associated with an organization or its actors that may influence the organization's relationships with its stakeholders.[17] Reputation Institute created the RepTrak® model that examines 15 stakeholders in more than 25 industries, involving more than 7,000 companies in 40 countries. Since 2005, *Forbes Magazine* has published its annual "World's Most Reputable Companies" list to recognize firms with exemplary reputations.[18]

As further explored in Chapter 19, a firm's reputation is a valuable intangible asset, as it prompts repeat purchases by loyal consumers and helps to attract and retain better employees to spur productivity and enhance profitability. Employees who have the most to offer may be attracted to work for a firm that contributes to the social good of the community, or is more sensitive to the needs and safety of its consumers, or takes better care of its employees. Research has confirmed that a firm's "good deeds" or reputation increases its attractiveness to employees.[19] An example of a company that has embraced having a solid reputation when managing their stakeholders is described next.

Sodexo, a provider of integrated food and facilities management services throughout North America including many hospitals, senior living centers, colleges, universities, and school districts, was committed to developing a positive reputation. "Being a responsible corporate citizen is at the core of Sodexo's business," declared the company's website. "We set the benchmark in areas such as sustainability, diversity and inclusion, wellness, and the fight against hunger." Sodexo's "The Better Tomorrow Plan" impacted 80 countries at 30,600 locations and engaged the company's 380,000 employees. The program addressed 14 different issues, such as reducing the firm's carbon and water usage in all company operations and at all client's locations, providing and promoting varied and balanced food options to

[15] Doris B. Gonzalez, "The Role CSR Plays in Employee Engagement," *CRO Magazine,* March/April 2016, *www.thecro.com.*

[16] The quote is from Andrija Baric, "Corporate Social Responsibility and Stakeholders: Review of the Last Decade (2006–2015)," *Business Systems Research* 8 (2017), pp. 133–46.

[17] The definition of reputation is adapted from John F. Mahon, "Corporate Reputation: A Research Agenda Using Strategy and Stakeholder Literature," *Business & Society* 41, no. 4 (December 2002), pp. 415–45. For the "reputation index," see Charles Fombrun, *Reputation: Realizing Value from the Corporate Image* (Cambridge, MA: Harvard University Press, 1996) and Rating Research LLC, *www.ratingresearch.com.*

[18] See *www.reputationinstitute.com* and *fortune.com/worlds-most-admired-companies.*

[19] Turhan Erkmen and Emel Esen, "The Mediating Role of Trust to Managers on the Relationship Between Corporate Reputation Practices and Employees' Course of Actions to Customers, *Social Responsibility Journal* 10 (2014), pp. 296–82.

its clients, increasing the purchase of products sourced from fairly and responsibly certified sources, and ensuring compliance with a Global Sustainable Supply Chain Code of Conduct.[20]

Concerns about Corporate Social Responsibility

The economist Milton Friedman famously stated in 1970, "There is only one responsibility of business, namely to use its resources and engage in activities designed to increase its profits." Some people in the business world—such as the 16 percent of CEOs in a McKinsey survey who believe that the appropriate role of business is to provide the highest possible returns to shareholders while obeying all laws and regulations—clearly agree with this view. According to some of the more radical critics of the private business system, social responsibility is nothing but a clever public relations smokescreen to hide business's true intentions to make as much money as possible, often at the expense of workers, communities, and customers.[21] See Figure 3.3 again for some of the concerns about corporate social responsibility, discussed next.

Lowers Economic Efficiency and Profits

According to one argument, when a business uses some of its resources for social purposes, it risks lowering its efficiency or even going out of business.

Life was very good for Aaron Feuerstein in the mid-1990s. His company, Malden Mills, was flourishing, despite a sharp decline in the textile industry in the United States. Malden Mills' popular flagship product, Polartec, was widely used in high-performance athletic and aerobic apparel, outerwear products, and had even been adopted for military use. On December 11, 1995, as Feuerstein was returning from his 70th birthday party, he saw his factory burn to the ground. Critics thought Feuerstein should just accept the $300 million in insurance money and relocate or dissolve the business. Feuerstein was committed to his employees, so he vowed to keep them all on the payroll, at a cost of $1.5 million per week, and continue their benefits for at least 90 more days. The eventual cost of $25 million in employee wages, lawsuits filed by injured employees, and the $100 million cost to rebuild the factory turned out to be too much for Feuerstein's company. By 2001, Malden Mills had filed for bankruptcy, and Feuerstein eventually lost control of the company.[22]

In this example, Feuerstein's motives were admirable; his commitments to his employees eventually became too costly and threatened the survival of the firm.

Business managers and economists argue that the business of business is business. Businesses are told to concentrate on producing goods and services and selling them at the lowest competitive price. When these economic tasks are done, the most efficient firms survive. Even though corporate social responsibility is well-intended, such social activities lower business's efficiency, thereby depriving society of higher levels of economic production needed to maintain everyone's standard of living.[23]

[20] The quotation and information about Sodexo is from the company's website, *www.sodexousa.com.*

[21] For an investigation and critical analysis of the impact of corporate social responsibility see Daina Mazutis, "Much Ado about Nothing: The Glacial Pace of CSR Implementation in Practice," in James Weber and David M. Wasieleski (eds.) *Business and Society 360: Corporate Social Responsibility,* pp. 177–244, (Bingley, UK: Emerald Publishers, 2018).

[22] "The Mensch of Malden Mills: CEO Aaron Feuerstein Puts Employees First," *CBS News 60 Minutes,* July 3, 2003, *cbsnews.com;* and, David W. Gill, "Was Aaron Feuerstein Wrong?" *Ethix,* June 25, 2011, *ethix.org.*

[23] This argument is most often attributed to Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits," *The New York Times Magazine,* September 13, 1970, pp. 33, 122–26.

Imposes Unequal Costs among Competitors

Another concern about social responsibility is that it imposes greater costs on more responsible companies, putting them at a competitive disadvantage. Consider the following scenario:

> A manufacturer operating in multiple countries wishes to be more socially responsible worldwide and decides to protect its employees by installing more safety equipment at its plants than local law requires. Other manufacturers in competition with this company do not take similar steps, choosing to install only as much safety equipment as required by law. As a result, their costs are lower, and their profits higher. In this case, the socially responsible firm penalizes itself and even runs the risk of going out of business, especially in a highly competitive market.

This kind of problem becomes acute when viewed from a global perspective, where laws and regulations differ from one country to the next. If one nation requires higher and more costly pollution control standards, or stricter job safety rules, or more stringent premarket testing of prescription drugs than other nations, it imposes higher costs on business. This cost disadvantage means that competition cannot be equal. Foreign competitors who are the least socially responsible will actually be rewarded because they will be able to capture a bigger share of the market.

Imposes Hidden Costs Passed On to Stakeholders

Many social proposals undertaken by business do not pay their own way in an economic sense; therefore, someone must pay for them. Ultimately, society pays all costs. For example, if a company chooses to install expensive pollution abatement equipment, the air may be cleaner, but ultimately someone will have to pay. Shareholders may receive lower dividends, employees may be paid less, or consumers may be charged higher prices. If the public knew that it would eventually have to pay these costs, and if it knew how high the true costs were, it might not be so insistent that companies act in socially responsible ways. The same might be true of government regulations intended to produce socially desirable business behavior. By driving up business costs, these regulations often increase prices and lower productivity.

Requires Skills Business May Lack

Businesspeople are not primarily trained to solve social problems. They may know about supply chain management, marketing, accounting, finance, information technology, and personnel work, but what do they know about inner-city issues or world poverty or violence in schools? Putting businesspeople in charge of solving such problems may lead to unnecessarily expensive and poorly conceived approaches. Business analysts might be tempted to believe that methods that succeed in normal business operations will also be applicable to complex social problems, even though different approaches may work better in the social arena.

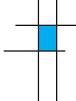
A related idea is that public officials who are duly elected by citizens in a democratic society should address societal issues. Business leaders are not elected by the public and therefore do not have a mandate to solve social problems. In short, businesspeople do not have the expertise or the popular support required to address what are essentially issues of public policy.

Places Responsibility on Business Rather Than Individuals

The entire idea of *corporate* responsibility is misguided, according to some critics. Only *individual persons* can be responsible for their actions. People make decisions; organizations do not. An entire company cannot be held liable for its actions, only those individuals

who are involved in promoting or carrying out a policy. Therefore, it is wrong to talk about the social responsibility of *business* when it is the social responsibility of *individual businesspersons* that is involved. If individual business managers want to contribute their own personal money to a social cause, let them do so; but it is wrong for them to contribute their company's funds in the name of corporate social responsibility.[24] Together, the above arguments claim that the attempt to exercise corporate social responsibility places added burdens on both business and society without producing the intended effect of social improvement or produces it at excessive cost.

This view was challenged several years ago when a survey by the consulting firm McKinsey reported that a solid majority—84 percent—of business executives said that they believe that companies should balance their responsibility to their investors with their responsibilities of other business stakeholders. In another survey of executives, 80 percent said that companies must demonstrate a mission that balances profit and purpose to grow and be successful.[25] Recently, senior executives from all over the world were asked about the role of corporate social responsibility as part of their business strategy. Their responses are shown in Figure 3.4.



SOCIAL ENTREPRENEURS AND B CORPORATIONS

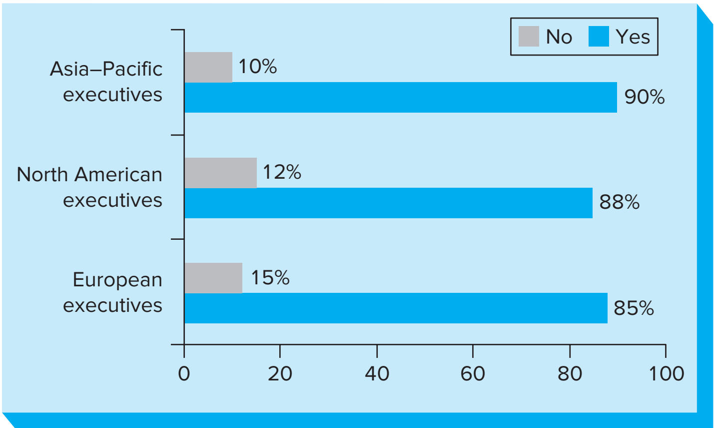
Some businesses have a social mission at their very core. Two such businesses are ventures launched by social entrepreneurs and benefit corporations.

Social entrepreneurs are like traditional entrepreneurs who act boldly to pursue opportunities, attract support, and build new organizations. Yet, unlike traditional entrepreneurs, social entrepreneurs are typically driven by a core mission to create and sustain social rather than economic value. When a person or group of people identify a social need and use their entrepreneurial skills to address this need, this process is called **social entrepreneurship**, and the organizations they found are called **social ventures**. Although

FIGURE 3.4
The Role of CSR in Business Strategy

Source: "Top Trends 2016," *Ethical Corporation, ethicalcorp.com.*

Senior executives were asked: Is CSR becoming an increasingly important part of your business strategy? Their responses were:



[24] This argument, like the "lowers economic efficiency and profits" argument, often is attributed to Friedman, "Social Responsibility of Business" Ibid.

[25] "Covestro Grant Expand 'Social Purpose' Programs," *Pittsburgh Post-Gazette,* April 6, 2018, *www.post-gazette.com.*

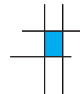
their primary purpose is to achieve a social or environmental objective, this focus does not preclude these entrepreneurs from creating an economically viable organization that can continue to address social needs.

B Corporations are businesses that focus on social responsibility and corporate citizenship by blending their social and environmental objectives with financial goals to use the power of business to solve social and sustainability challenges. To qualify for B Corporation status, an organization must meet rigorous, independent social and environmental performance standards, assessed by the nonprofit organization, B Lab. The idea is that a business cannot just claim it is socially responsible, but it must prove it by meeting the B Lab standards. By 2018, there were 2,504 organizations, in more than 50 countries and 35 U.S. states among 130 industries that had received the B Corp certification. (Certified B Corporations are different from businesses that are chartered in a state as a "benefit corporation." Benefit corporations use the protection afforded by state-driven statutes to enable the company to address social objectives, as well as financial objectives, without facing legal challenges by stockholders for shirking the firm's financial responsibilities.)

Certified B Corporations are more likely to receive various government recognitions, such as the U.S. Drug Administration's organic seal, or to qualify for a LEED certification for their buildings (designating environmental excellence), or to be certified as engaging in fair trade. B Corporations are subjected to random audits, and these reports are made public, adding a layer of transparency to the process and certification. In addition, B Corporations must modify their company's bylaws in order to formalize their social mission.[26]

The metrics used by B Lab to assess a company's submission for review can be completed online in 1 to 3 hours, and include meeting rigorous standards that demonstrate a company's leadership commitment to specific environmental and social commitments to improve their stakeholders' well-being, including their workers and the community. In addition, these companies are held to specific standards of accountability for their actions and must demonstrate transparency of their decisions and practices regarding their stakeholder impacts.

Warby Parker is a B Corporation. Four college friends started the company to design, manufacture, and distribute high-quality eyeglasses selling for around $95 rather than the more common $500 price tag. Its founders also wanted to have a social impact, so they adopted the policy that for every pair of eyeglasses sold, one pair would be donated to someone in need. Warby Parker also pledged to become one of the few carbon-neutral eyewear brands in the world. "It was important to the four of us that if we are going to dedicate our life savings and our time to building an organization, we wanted to have a positive impact," said Neil Blumenthal, one of the founders. This combination of economic and social objectives qualified Warby Parker for B Corporation certification.[27]



MANAGEMENT SYSTEMS FOR CORPORATE SOCIAL RESPONSIBILITY AND CITIZENSHIP

Corporate social responsibility and citizenship require more than espoused values; they require action. Companies must establish management processes and structures to carry out their citizenship commitments. This section describes some of the ways forward-thinking companies are changing to improve their ability to act as socially responsible citizens.

[26] For an overview of the B Corporation movement see Caddie Putnam Rankin, "Safeguarding Corporate Social Responsibility: The Benefit Movement," in James Weber and David M. Wasieleski (eds.) *Business and Society 360: Corporate Social Responsibility*, pp. 245–64, (Bingley, UK: Emerald Publishers, 2018).

[27] See the B Corporation website at *www.bcorporation.net* and the Warby Parker website at *www.warbyparker.com*.

BSR, a management consultancy formerly called Businesses for Social Responsibility, surveyed its more than 300 members and found that the goal of a global citizenship management system was to integrate corporate responsibility and citizenship concerns into a company's values, culture, operations, and business decisions at all levels of the organization. They also found that the CEO exerted the greatest influence over the company's CSR agenda, more so than consumers, investors, employees or the government.[28] Managers engaged in corporate citizenship are increasingly being tasked by executive leadership to work across departments and business units on a global basis to ensure the company has developed a strong approach to meeting a range of stakeholder expectations. This responsibility has evolved from overseeing programs targeted primarily toward the community and only utilizing philanthropy and volunteers, to a more integrated approach that leverages company skills and resources that impact society and drive stakeholder expectations.[29]

Corporate citizenship is a rapidly evolving area of managerial practice in many organizations. While businesses administer this corporate activity in different ways, Elin Wallberg at Samsung Electronics provides one example of a manager with an extensive social program background who is directing her firm's corporate citizenship strategy.

> Elin Wallberg has served as the corporate citizenship officer of Samsung Electronics Nordic since 2014. Wallberg is responsible for corporate citizenship in the Nordic region, which includes heading Samsung's programs in technology, innovation, education, and learning, where young innovators create start-up firms aimed to benefit the next generation. Wallberg had over 10 years of experience in driving innovation in technology and partnerships in various organizations. Prior to joining Samsung, she was head of programs at Global Child Forum, where she ran the initiative Children in a Digital World. Before that, she had been instrumental at Save the Children in setting up the Centre for Child Rights and Corporate Social Responsibility in Beijing.[30]

CEOs increasingly have accepted the multiple responsibilities of business notion—economic, social and legal—that make up the citizenship profile, as described by senior Walmart executives:

> "Long-term capitalism takes a deeper view of business's role in society, recognizing that, in the long run, the interests of stakeholders converge with the interests of the broader community. The actions of any one company may reverberate throughout the various systems in which it operates, generating second- and third-order benefits. . . . Under long-term capitalism, companies recognize that fact and, through concerted actions with otters of sufficient scale, work to ensure constant improvements to those systems."[31]

Visionary CEOs clearly see citizenship as an opportunity to create value for their organization, gain a competitive advantage, and help address some of the world's biggest challenges. As businesses have become more committed to citizenship, specialized consultancies and professional associations for managers with responsibility in this area have emerged. Many of these organizations, including BSR, whose study is cited earlier, are profiled in Exhibit 3.A.

[28] "The State of Sustainable Business 2017," *BSR,* July 2017, *www.bsr.org.*

[29] "Best Practices in Corporate Citizenship Structures," *tcc group blog,* December 18, 2017, *www.tccgrp.com.*

[30] From *www.crunchbase.com/person/elin-wallberg.*

[31] "Business and Society in the Coming Decades," *McKinsey & Company,* April 2015, *www.mckinsey.com.*

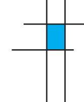
Exhibit 3.A

Professional Associations and Consultancies in Corporate Social Responsibility and Citizenship around the Globe

As the practice of corporate citizenship has spread, so have professional associations and consultancies serving managers in this arena. Among the leading organizations are these:

- In the United States, *BSR* (formerly Business for Social Responsibility) provides consulting services to its network of more than 250 member companies and other partners to build a just and sustainable world.
- *Canadian Business for Social Responsibility* seeks to accelerate and scale corporate social and environmental sustainability in Canada by strategically bringing together stakeholders to tackle key issues.
- *The European Network for Corporate Social Responsibility Europe* (CSR Europe) is the leading European business network with 48 multinational corporate members and 42 national partner organizations, representing over 10,000 companies. It provides the opportunity for companies to share best practices on CSR and innovate with peers.
- *Forum Empresa* is an American alliance of CSR-based business organizations to promote CSR throughout the Americas, with over 133 independent organizations from more than 67 different countries. *Forum Empresa*'s programs reach over 6,000 companies around the world.
- Established in 2001 in South Africa, the *African Institute of Corporate Citizenship* is committed to being the center of excellence in corporate citizenship in Africa and it focuses on the role of business in building sustainable communities.
- From its origins as a sustainability pioneer in the region, *CSR Asia* has evolved to help hundreds of organizations across Asia embrace sustainability at every level.
- Launched in 2002, the *Asian Forum on Corporate Social Responsibility* (AFCSR) is Asia's leading annual conference and awards program on corporate social responsibility.

Source: More information about these organizations is available online at *www.bsr.org, www.cbsr.ca, www.csreurope.org, www.csr360gpn.org, aiccafrica.org, csr-asia.com,* and *www.asianforumcsr.com.*



STAGES OF CORPORATE CITIZENSHIP

Companies do not become socially responsible or good corporate citizens overnight. The process takes time. New attitudes have to be developed, new routines learned, new policies and action programs designed, and new relationships formed. Many obstacles must be overcome. What process do companies go through as they proceed down this path? What factors push and pull them along?

Philip H. Mirvis and Bradley K. Googins of the Center for Corporate Citizenship at Boston College developed a five-stage model of global corporate citizenship, based on their work with hundreds of practitioners in a wide range of companies.[32] In their view, firms typically pass through a sequence of five stages as they develop as corporate citizens. Each stage is characterized by a distinctive pattern of concepts, strategic intent, leadership, structure, issues management, stakeholder relationships, and transparency, as illustrated in Figure 3.5.

Elementary Stage. At this stage, citizenship is undeveloped. Managers are uninterested and uninvolved in social issues. Although companies at this stage obey the law, they do not move beyond compliance. Companies tend to be defensive; they react only when threatened. Communication with stakeholders is one-way: from the company to the stakeholder.

[32] Philip H. Mirvis and Bradley K. Googins, *Stages of Corporate Citizenship: A Developmental Framework* (Chestnut Hill, MA: Center for Corporate Citizenship at Boston College, 2006). For a contrasting stage model, based on the experience of Nike, see Simon Zadek, "The Path to Corporate Responsibility," *Harvard Business Review,* December 2004, pp. 125–32.

FIGURE 3.5 The Stages of Global Corporate Citizenship

Source: Adapted from the Boston College Center for Corporate Citizenship's "Stages of Corporate Citizenship: A Developmental Framework," by Philip Mirvis, Ph.D. and Bradley K. Googins, Ph.D., 2006.

	Citizenship Content	Strategic Intent	Leadership	Structure	Issues Management	Stakeholder Relationships	Transparency
Stage 5: Transforming	Change the game	Market creation or social change	Visionary, ahead of the pack	Mainstream: business driven	Defining	Multi-organization	Full disclosure
Stage 4: Integrated	Sustainability or triple bottom line	Value proposition	Champion, in front of it	Organizational alignment	Proactive, systems	Partnership alliance	Assurance
Stage 3: Innovative	Stakeholder management	Business case	Steward, on top of it	Cross-functional coordination	Responsive, programs	Mutual influence	Public reporting
Stage 2: Engaged	Philanthropy, environmental protection	License to operate	Supporter, in the loop	Functional ownership	Reactive, policies	Interactive	Public relations
Stage 1: Elementary	Jobs, profits, and taxes	Legal compliance	Lip service, out of touch	Marginal, staff-driven	Defensive	Unilateral	Flank protection

Engaged Stage. At this second stage, companies typically become aware of changing public expectations and see the need to maintain their license to operate. Engaged companies may adopt formal policies, such as governing labor standards or human rights. They begin to interact with and listen to stakeholders, although engagement occurs mainly through established departments. Top managers become involved. Often, a company at this stage will step up its philanthropic giving or commit to specific environmental objectives. Brew Dog, a Scottish-based brewery and pub chain, announced that it would distribute 10 percent of its profits to its staff and another 10 percent to charities chosen by the company's workers and investors. The company demonstrated philanthropy, supportive leadership, and interactive stakeholder relationships, all part of corporate citizenship at the engaged stage.[33]

Innovative Stage. At this third stage, organizations may become aware that they lack the capacity to carry out new commitments, prompting a wave of structural innovation. Departments begin to coordinate, new programs are launched, and many companies begin reporting their efforts to stakeholders. (Social reporting is discussed later in this chapter.) External groups become more influential. Companies begin to understand more fully the business reasons for engaging in citizenship. The actions taken by Nestlé and Sodexo, described earlier in this chapter, illustrate a company at this stage.

Integrated Stage. As they move into the fourth stage, companies see the need to build initiatives that are more coherent. Mirvis and Googins cite the example of Asea Brown Boveri (ABB), a Swedish–Swiss multinational pioneering technology leader, which carefully coordinates its many sustainability programs from the CEO level down to line officers in more than 100 countries where the company has a presence.

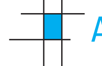
[33] "Brew Dog Gives Away 20 Percent of Profits," *Ethical Performance,* September 29, 2017, *ethicalperformance.com.*

Integrated companies may adopt sustainability/triple bottom line measures, turn to external audits, and enter into ongoing partnerships with stakeholders.

Transforming Stage. This is the fifth and highest stage in the model. Companies at this stage have visionary leaders and are motivated by a higher sense of corporate purpose. They partner extensively with other organizations and individuals across business, industry, and national borders to address broad social problems and reach underserved markets.

Northwestern Mutual, a U.S. life insurance and financial services organization, illustrates the transforming stage of corporate citizenship. The company's signature outreach program focused on fundraising to cure childhood cancer. A review of social issues that mattered to employees and representatives found that this program aligned with the company's mission—helping others build a secure future. After selecting the childhood cancer focus, the company commissioned a survey to understand the current field of research. The survey discovered inadequate financial support addressing this disease. Northwestern Mutual created a strategic philanthropy and community relations department to engage its employees with local neighborhoods, schools, and cultural programs and events—all to bring more attention to childhood cancer. "By involving multiple stakeholders in our corporate citizenship efforts, we foster transparent and synergistic relationships," said John Kordsmeier, president of the Northwestern Mutual Foundation.[34]

The model's authors emphasize that individual companies can be at more than one stage at once, if their development progresses faster in some areas than in others. For example, a company might audit its activities and disclose the findings to the public in social reports (transparency, stage 5), but still be interacting with stakeholders in a pattern of mutual influence (stakeholder relationships, stage 3). This is normal, the authors point out, because each organization evolves in a way that reflects the special challenges it faces. Nevertheless, because the dimensions of global corporate citizenship are linked, they tend to become more closely aligned over time.



ASSESSING AND REPORTING SOCIAL PERFORMANCE

As companies around the world expand their commitment to corporate responsibility and citizenship, they have also improved their capacity to measure performance and assess results. A **social audit** is a systematic evaluation of an organization's social, ethical, and environmental performance.[35]

In a social audit, a company's performance is evaluated relative to a set of externally imposed standards. The results of the audit are used to improve the firm's performance and to communicate with stakeholders and the public. The scholar Simon Zadek has identified six benefits of social audits. They help businesses know what is happening within their firm, understand what stakeholders think about and want from the business, tell stakeholders what the business has achieved, strengthen the loyalty and commitment of stakeholders, enhance the organization's decision making, and improve the business's overall performance.

[34] "The Corporate Citizen," *Boston College Center for Corporate Citizenship,* Winter 2016, p. 28.

[35] The concept of a social audit was first introduced in Howard R. Bowen, *Social Responsibilities of the Businessman* (New York: Harper, 1953).

Today, many businesses use social audits to measure the societal impact of their actions. In a world where the use of company resources must be justified, the greater the social equity documented, the stronger the argument a business can make that it is meeting its social obligations. Businesses also used their social audit results to minimize risks or capitalize on opportunities. They see the process as fostering innovation within the company. Some believe that to communicate with the organization's stakeholders in a transparent manner is simply the ethical thing to do.

Social Audit Standards

In response to the emerging efforts by governments to promote global citizenship, a number of different corporate citizenship standards have been developed that establish measures or benchmarks against which a firm's citizenship activities (or those of its suppliers or partners) can be compared in a social audit. Social audits look not only at what an organization does, but also at the results of these actions. For example, if a company supports a tutorial program at a local school, the audit might not only look at the number of hours of employee volunteerism, but also assess changes in student test scores as an indicator of the program's social impact.

Audit standards can be created in three different ways. Companies can develop standards designed to set expectations of performance for themselves or their suppliers or partners. For example, Apple developed its own supplier code of conduct. Or, companies within an industry can agree on a common industrywide standard, as several high technology companies did when they agreed to the Responsible Business Alliance (RBS) Code of Conduct, formerly the Electronic Industry Citizenship Coalition.

> The RBA Code of Conduct is a set of standards on social, environmental and ethical issues in the electronics industry supply chain. The standards set out in the Code of Conduct reference international norms including the Universal Declaration of Human Rights, ILO International Labor Standards, OECD Guidelines for Multinational Enterprises, International Organisation for Standards, the Social Accountability 8000, and many more (some of these standards are discussed next). The RBA Code of Conduct is reviewed every three years to ensure its relevance to international norms and issues members may face in their supply chains.[36]

Both companywide and industrywide supply chain codes of conduct, as well as auditing processes, are further described in Chapter 17.

Finally, audit standards can be developed by global nongovernmental organizations or standard-setting organizations. A number of such organizations have developed standards to judge corporate performance. These include the International Organisation for Standards (ISO 14001 and 26000), Social Accountability 8000, AccountAbility (or AA 1000), and the United Nations Global Compact and the Global Reporting Initiative, which is profiled in Exhibit 3.B.

Social Reporting

When a company decides to publicize information collected in a social audit, this is called **corporate social reporting**. While there is a risk of incurring reputational damage from exposing any problems publicly, many companies see value in practicing **transparency**. The term transparency refers to a quality of complete clarity; a clear glass window, for example, is said to be transparent. When companies clearly and openly report their performance—financial,

[36] See the *Responsible Business Alliance* website at *responsiblebusiness.org.*

Exhibit 3.B The Global Reporting Initiative (GRI)

The GRI is based on the belief that a sustainable global economy should combine long-term profitability with ethical behavior, social justice, and environmental care. This means that when companies and organizations consider sustainability—and integrate it into how they operate—they must consider four key areas of their performance and impacts: economic, environmental, social, and governance.

GRI's Sustainability Reporting Framework is a reporting system that enables all companies and organizations to measure, understand, and communicate this information using common metrics, so performance can be compared across firms and industries. The GRI Guidelines offer an international reference for all those interested in the disclosure of the governance approach and the environmental, social, and economic performance and impacts of organizations. The Guidelines are developed through a global multi-stakeholder process involving representatives from business, labor, civil society, and financial markets, as well as auditors and experts in various fields; and in close dialogue with regulators and governmental agencies in several countries.

Sources: See the Global Reporting Initiatives website at *www.globalreporting.org.*

social, and environmental—to their various stakeholders, they are acting with transparency. One region where the trend toward corporate reporting and transparency has been particular apparent is Australia and New Zealand.

> By 2014, 99 percent of all Australian and New Zealand companies indicated that they would conduct an assessment of their business operations and publicly report the results that year, according to a study by the Australian Centre for Corporate Social Responsibility. They attributed their nearly unanimous preference for reporting to the International Integrated Reporting Commission's Integrated Reporting Framework and the new Global Reporting Initiative fourth generation (G4) guidelines (see Exhibit 3.B). The companies surveyed said they believed in transparent reporting because they understood it could build a reputation for responsibility, contribute to the company's brand, engage senior leadership in strategic conversations, improve stakeholder engagement, and identify opportunities for improvement. According to Victoria Whitaker, head of GRI Focal Point Australia, "businesses around the world are recognizing that reporting can help them understand the context in which they operate and the stakeholders whom they serve. Done well it informs corporate strategy and decision making."[37]

A survey of business firms by KPMG, an accounting and consulting firm, reported on the state corporate social reporting in 2017, as shown in Exhibit 3.C. This survey found that 93 percent of the world's largest companies produced some type of a corporate social report for external stakeholders that covered social and environmental responsibility practices.

As noted in Exhibit 3.C, an emerging trend in corporate reporting is the integration of legally required financial information with social and environmental information into a single **integrated report**. By 2017, a majority of the largest companies included information of corporate responsibility in their annual financial reports. This reflected a dramatic rise in integrated reporting, from 8 percent in 2008 and 51 percent in 2013 to 78 percent by 2017.[38]

[37] Information from "The 10th Year-Progress and Prospects for CSR in Australia and New Zealand," *Australian Centre for Corporate Social Responsibility,* 2014. Also see Colin Higgins, Markus J. Milne, and Bernadine van Gramberg, "The Uptake of Sustainability Reporting in Australia," *Journal of Business Ethics,* 2015, pp. 445–68.

[38] KPMG report 2017, *Ibid.*

Exhibit 3.C The State of Corporate Social Reporting, 2017

In the *KPMG Survey of Corporate Responsible Reporting 2017,* the following trends were noted:

- Corporate responsibility (CR) reporting has filtered down from large companies to mid-sized companies, as 75 percent of the 4,900 large and mid-cap firms surveyed issued CR reports.
- Across all industry sectors, CR reporting was more than 60 percent, the first time in the survey's history.
- Companies in Latin America reported a large surge in CR reporting, driven by regulation, foreign investor demands, and the need to build and protect public trust.
- Integrated Reporting has taken off in Japan, Brazil, Mexico, and Spain. Most of the largest companies, 78 percent, integrate financial and nonfinancial data in their reports, suggesting they believe that CR information is relevant for investors.
- Around two-thirds of all reports utilize the Global Reporting Initiative (GRI) G4 Guidelines or Standards.

Why do companies publish social responsibility reports? According to one study, most firms (80 percent) are motivated by ethical concerns. Ethical drivers replaced economic considerations (80 percent versus 50 percent) as the primary motivator for publishing these reports, a complete reverse from a few years ago when economic considerations were viewed as the most important. Nearly two-thirds of the 250 firms worldwide reported that they engaged with their stakeholders in a structured way, up from 33 percent a decade earlier. These relevant stakeholder groups have expanded from social and environmental groups to include financial analysts and investors. Other firms pointed to increasing governmental regulatory pressure to report financial as well as nonfinancial data.[39]

In today's business climate, multiple stakeholders demand that businesses adopt measurable standards for corporate responsibility and citizenship, audit their organizations according to these standards, and report the results to the public.

Summary

- The world's largest corporations are capable of wielding tremendous influence, at times even more than national governments, due to their economic power. Because of this potential influence, the organizations' stakeholders expect businesses to enhance society when exercising their power.
- The idea of corporate social responsibility was adopted by business leaders in the United States in the early 20th century. It has evolved from a notion of stewardship and strategic responsiveness to an ethics-based understanding found in culture and the practice of corporate citizenship. Socially responsible businesses attempt to balance economic, legal, and social obligations. Following an enlightened self-interest approach, a firm may be economically rewarded while society benefits from the firm's actions.
- Corporate social responsibility is a controversial notion. Some argue that its benefits include discouraging government regulation, promoting long-term profitability for the firm, and enhancing the company's stakeholder relationships and business reputation. Others believe that it lowers efficiency, imposes undue costs, and shifts unnecessary obligations to business. Most executives believe that they should use their corporate

[39] "Socially Responsible Investment Analysts Find More Large U.S. Companies Reporting on Social and Environmental Issues," Social Investment Research Analysts Network report, *www.kld.com;* and KPMG report 2017, *Ibid.*

power and influence to balance their response to multiple stakeholders rather than maximize stockholders' return alone.

- Global corporate citizenship refers to putting a commitment to serving various stakeholders into practice by building stakeholder partnerships, discovering business opportunities in serving society, and transforming a concern for financial performance into a vision of integrated financial *and* social performance worldwide. Global corporate citizenship programs can be considered a strategic investment by the firm.
- Social entrepreneurs incorporate social and environmental benefit into their core business mission. B Corporations, similarly, are businesses that seek and achieve certification, through rigorous assessments by the nonprofit B Lab organization, gained via specific social and environmental standards.
- Companies progress through five distinct stages as they develop as global corporate citizens; these are termed the elementary, engaged, innovative, integrated, and transforming stages. A specific company may be at more than one stage at once, as it may be progressing more quickly on some dimensions than on others.
- Many companies have created systemic audits of their social, ethical, and environmental performance, measured against industrywide performance expectations as well as auditing standards developed by global standard-setting organizations. An emerging trend is the practice of communicating social, environmental, and financial results to stakeholders through an integrated corporate report.

Key Terms

B Corporation, *60*
corporate citizenship, *51*
corporate power, *49*
corporate social reporting, *65*
corporate social responsibility, *51*
enlightened self-interest, *53*
integrated report, *66*
iron law of responsibility, *50*
reputation, *56*
social audit, *64*
social entrepreneurs, *59*
social entrepreneurship, *59*
social venture, *59*
transparency, *65*

Internet Resources

www.bsr.org BSR: The business of a better world
www.businessinsociety.eu The Business in Society Gateway
www.bcorporation.net *Certified B Corporation*
www.csrwire.com The Corporate Social Responsibility Newswire
consciouscompanymedia.com *Conscious Company Media*
www.3blassociation *3BL Association*
www.unicef.org/csr *UNICEF and Corporate Social Responsibility*
www.globalreporting.org Global Reporting Initiative
www.unglobalcompact.org United Nations Global Compact

Discussion Case: *Corporate Social Responsibility at Gravity Payments*

Dan Price, the founder of Gravity Payments, a small, privately owned company that provided high-service and low-cost credit card processing, surprised his 120-person staff when he announced in 2015 that over the next three years he would raise the salary of all employees, even the lowest paid clerk, customer service representative, and salesperson, to a minimum of $70,000. The average annual salary at that time at Gravity was around $48,000, so the increase would nearly double some employees' salaries. Price explained that he would pay for the wage increases by cutting his own salary from nearly $1 million to $70,000 and using 75 to 80 percent of the company's anticipated $2.2 million in profit.

Price's announcement was met with mixed reactions. Some employees were thrilled, clapping and whooping when they heard the announcement. "I'm freaking out," said one employee. Others—many from the financial services community—said that this was just a costly publicity stunt. The conservative radio show host Rush Limbaugh said he "smelled a socialist agenda." However, others were supportive. Other talk show hosts lined up interviews with Price. Job seekers by the thousands sent in résumés. Harvard business professors flew out to Gravity Payment's headquarters to conduct a case study. Third graders wrote Price thank-you notes, and single women wanted to date him.

Price was no stranger to the spotlight. He had earned the honor of Entrepreneur of the Year in 2014 from *Enterprise Magazine. GeekWire* named Price its Young Entrepreneur of the Year in 2013, and in 2010 he received the Small Business Administration's National Young Entrepreneur of the Year award. Price also annually donated 10 percent of Gravity's profits to charity. The equitable employee salary announcement seemed like another step toward achieving Price's goals as a business owner.

Price launched Gravity (a name, Price explained, that was selected since "you could understand [it] on the phone") while attending college, but the firm actually grew out of a technology consulting business he created while in high school. His goal was to manage credit card transactions for small businesses, like coffeehouses, in a more affordable and transparent way. "I never intended to make a lot of money, or really any," said Price. "I was really upset at this industry for the way they were treating my [consulting] clients, and I just wanted to blow the thing up. So I was like, 'I'm going to charge a third of what everyone [else does].'"

Financial analysts recognized Gravity Payments' success; his company processed nearly $10 billion in credit card transactions and generated revenues of about $150 million annually. When asked why he did not "cash out," Price responded, "I'll ask my friends who have sold their businesses, 'Did that business get to the goal that you originally had in mind?' And they're all happy they sold because of the phenomenal financial outcome. But when I ask them, 'Did you actually accomplish the nonfinancial goal that you set out in starting a business?' . . . they almost all say no."

Price encountered hard times in 2008 when Gravity lost 20 percent of its revenue nearly overnight because customers were running less volume through the system during the economic recession. Price recalled that half of his staff was in his office asking for raises and the other half was definitely afraid they were going to lose their jobs. So, he called his employees together and explained that the company had eight months of cash in the bank. "If we hold our expenses steady and just sell the same amount every month for five months, we'll get back to break-even and not have to do any benefit cuts, any layoffs, anything like that," he told his staff. Given Price's response during the economically challenging times,

it did not surprise his employees when he took the bold move of promising every employee a salary of $70,000 annually.

Price's commitment to a new company minimum wage captured national attention given the soaring disparity between executives' pay and that of their employees. In the United States, where the pay gap was the greatest for any country, chief executives earned more than 300 times what the average worker made (as discussed in more detail in Chapter 13). Some people, like Gilded Age's executive J. Pierpont Morgan and management scholar Peter Drucker, advocated a 20-to-1 executive to average employee ratio. Price's 1-to-1 ratio was unprecedented in the business community. "The market rate for me as a CEO compared to a regular person is ridiculous, it's absurd," explained Price, who admitted that his only main extravagances were snowboarding and picking up the bar bill for his friends. He drove a 12-year-old Audi, which he received in a barter for service from the local dealer. "As much as I'm a capitalist, there is nothing in the market that is making me do it," said Price, referring to paying wages that would make it possible for his employees "to go after their own American dream, buy a house and pay for their children's education."

Price admitted that hearing his employees' problems with making ends meet on wages that were well above the $7.50 per hour minimum wage or even at $40,000 a year "just eats at me inside." He wanted to address the social issue of wage inequality and felt that as a business leader he was in a position to do something, but he wanted to do something that would not result in raising prices for his customers or cutting back on services. Hayley Vogt, a 24-year-old communications coordinator at Gravity who earned $45,000 annually, said, "I'm completely blown away right now [after hearing Price's announcement]." She said she had worried about covering rent increases and a recent emergency room bill. "Everyone is talking about this $15 minimum wage in Seattle and it's nice to work someplace where someone is actually doing something about it and not just talking about it."

Fifteen months after Price's unprecedented announcement, his employees decided that he should not be driving around in his outdated Audi, so they bought him a Tesla. Price posted to his Facebook page, "Gravity employees saved up and pitched in over the past six months and bought me my dream car. A brand new, gorgeous blue #Tesla. Still in shock. How do I even begin to say thank you?" As for the pay raises, commentators remained divided. Paul Davidson, of *USA Today,* commented, "Big pay hikes may yield surprisingly beneficial results, especially in the current tight labor market." Yet, other experts said that the outsized, across-the-board increase Price shelled out should not set a benchmark for most companies.

Sources: "One Company's New Minimum Wage: $70,000 a Year," *The New York Times,* April 13, 2015, *www.nytimes.com;* "A Company Copes with Backlash Against the Raise that Roared," *The New York Times,* July 31, 2015, *www.nytimes.com;* "Employees Just Bought a Tesla for their CEO Because He Raised Minimum Salaries to $70,000," *Business Insider,* July 14, 2016, *www.businessinsider.com;* and, "Does a $70,000 Minimum Wage Work?" *USA Today,* May 26, 2016, *www.usatoday.com.*

Discussion Questions

1. Is Price demonstrating elements of corporate social responsibility by his actions in this case, or not?
2. How is Price exhibiting the fourth Phase of Corporate Citizenship (Figure 3.2, 1990s to present: Corporate/Global Citizenship) in his actions at Gravity Payments?
3. What arguments in support of, or concerns about, corporate social responsibility (referring to Figure 3.3) are relevant to this case?
4. Is Price acting like an executive of a firm that could be certified as a B corporation?
5. What stage of global corporate citizenship (using Figure 3.5) is Gravity Payments operating at, and why do you think so?

CHAPTER FOUR

Business in a Globalized World

The world economy has become increasingly integrated, and many businesses have extended their reach beyond national borders. Yet the process of globalization is controversial, and the involvement of corporations in other nations is not always welcome. Doing business in diverse political and economic systems and in societies with stark differences in wealth and income poses difficult challenges. When a multinational corporation buys resources, manufactures products, or sells goods and services in multiple countries, it is inevitably drawn into a web of global social and ethical issues. Understanding what these issues are and how to manage them through collaborative action with governments and civil society organizations is a vital skill for today's managers.

This Chapter Focuses on These Key Learning Objectives:

LO 4-1 Defining globalization and classifying the major ways in which companies enter the global marketplace.

LO 4-2 Identifying the international financial and trade institutions that have shaped the globalization process in recent decades.

LO 4-3 Analyzing the benefits and costs of the globalization of business.

LO 4-4 Identifying the major types of political and economic systems in which companies operate across the world.

LO 4-5 Understanding global inequalities of wealth and income and analyzing the special challenges of serving those at the "bottom of the pyramid."

LO 4-6 Assessing how businesses can work collaboratively with governments and the civil sector to address global social issues.

In 2016, Uber finally gave up on its quest to dominate the huge Chinese market for ride-hailing services. After two years of bruising competition, during which it lost $2 billion, Uber threw in the towel and agreed to sell its business there to its Chinese competitor, Didi Chuxing. In exchange, Uber received $1 billion and a 20 percent minority stake in Didi, and both companies agreed to give the other's CEO a seat on its board. Uber had made an enormous effort, but in the end, could not overcome the many obstacles to besting its local rival. The U.S.–based company had struggled to set up in-country servers to get around China's Internet firewall, deal with Chinese customers' aversion to paying by credit card, and comply with government regulations that pressured the company to collaborate with municipal taxi companies. Didi, by contrast, was able to leverage its local connections and financing to become a formidable opponent, even against the ride-hailing industry's world leader. Commented the author of *Global Vision: How Companies Can Overcome the Pitfalls of Globalization,* "China is an incredibly complex market that differs culturally, politically, and economically from the United States."[1]

In 2018, the process of globalization was in some ways at a crossroads. In many respects, the world's economy remained as deeply integrated and interdependent as ever. Multinational enterprises continued to deliver much-needed technical know-how, capital, managerial experience, products, and services across national borders. At the same time, populist political movements in the United States, Europe, and elsewhere had pushed back against international trade agreements and common markets, citing the costs of globalization to their own industries and citizens. Some firms, like Uber, were pulling back from expensive foreign commitments, and the profits of multinationals compared with domestic firms were dropping.[2] How companies can best deal with the challenges of doing business in a world of great complexity and flux is the subject of this chapter. It will also examine the respective roles of business, civil society organizations, and governments in addressing common global problems.

The Process of Globalization

Globalization refers to the increasing movement of goods, services, capital, and labor across national borders. Globalization is a *process,* that is, an ongoing series of interrelated events. International trade and financial flows integrate the world economy, leading to the spread of technology, culture, and politics. Thomas Friedman, a columnist for *The New York Times* and a well-known commentator, has described globalization as a *system* with its own internal logic:

> Globalization is not simply a trend or a fad but is, rather, an international system. It is the system that has now replaced the old Cold War system, and, like that Cold War system, globalization has its own rules and logic that today directly or indirectly influence the politics, environment, geopolitics, and economics of virtually every country in the world.[3]

[1] "Why Uber Couldn't Crack China," *Fortune,* August 7, 2017; "The Real Reason Uber is Giving Up in China," *Harvard Business Review,* August 2, 2016; and "Uber Slayer: How China's Didi Beat the Ride-Hailing Superpower," October 6, 2016, at *www.bloomberg.com.* See also Robert Salomon, *Global Vision: How Companies Can Overcome the Pitfalls of Globalization* (Basingstoke, UK: Palgrave Macmillan, 2016).

[2] "Multinationals: The Retreat of the Global Economy," *The Economist,* January 28, 2017.

[3] Thomas L. Friedman, *The Lexus and the Olive Tree* (New York: Anchor Books, 2000), p. ix.

The process of globalization is so pervasive that it affects all businesses—whether they are small or large, local or multinational, or an employer of one or many.

Firms can enter and compete in the global marketplace in several ways. Many companies first build a successful business in their home country, and then export their products or services to buyers in other countries. In other words, they develop *global market channels* for their products. Nestlé, for example, began in Switzerland, but now sells its food and beverage products all over the world. An emerging trend is what *The Economist* magazine has called a rising cohort of small companies that, while remaining local, have successfully used e-commerce platforms to sell to customers around the world. PayPal, the digital payments firm, has reported that it facilitates $80 billion a year in cross-border transactions, many of which are of this type.[4]

Other firms begin in their home country but realize that they can cut costs by locating some or all of their *global operations* in another country. This decision leads to establishing manufacturing plants or service operations abroad. For example, BMW, which is headquartered in Germany, has manufacturing facilities in 15 countries, including Brazil, Thailand, Egypt, Indonesia, and the United States. Finally, a third strategy involves subcontracting manufacturing to suppliers located abroad. In other words, these companies develop *global supply chains.* For example, in the apparel and shoe industries, companies such as Nike, Gap, and Abercrombie & Fitch have extensive networks of suppliers outside the United States—mostly in Asia—that make products of their design. Suppliers and their relationship to lead firms are further discussed in Chapter 17.

These three strategies of globalization can be summarized in three words: *sell, make,* and *source.* Today, many companies have all three elements of global business—market channels, manufacturing operations, and supply chains.

Major Multinational Enterprises

A **multinational enterprise (MNE)** is a firm with significant foreign assets or revenues, or that has subsidiaries outside its home country. Although only one in a thousand of the world's businesses are multinational, because they are among the largest, they have an outsized impact. By some estimates, MNEs account for more than half of world trade, comprise 40 percent of the world's stock value, and own much of its intellectual property.[5] Their *affiliates*—meaning suppliers, subcontractors, retailers, and other entities with which they have some business relationship—collectively produce 10 percent of global gross domestic product (GDP).[6]

Although many firms conduct business across national boundaries, most global commerce is carried out by a small number of powerful firms. (Corporate power is further discussed in Chapter 3.) Who are these leading multinational enterprises? Figure 4.1 lists the top 10 nonfinancial MNEs, ranked in order of the value of the foreign assets they control. Leading the list is Royal Dutch Shell, the international petroleum company. Rounding out the group are several of the world's leading automakers, other petroleum companies, a food and beverage maker, and a telecommunications firm.[7] Although Figure 4.1 does not include any information technology firms (such as Google, Apple, and Microsoft), the number of such firms in the top 100 has more than doubled in the past five years. For their

[4] "Multinationals: The Retreat of the Global Economy," *The Economist,* January 28, 2017.

[5] Ibid.

[6] "Globalization in the Age of Trump," *Harvard Business Review,* July–August 2017.

[7] United Nations Conference on Trade and Development, *World Investment Report 2017, www.unctad.org.* Data are for 2016.

FIGURE 4.1
The World's Top 10 Nonfinancial Multinational Enterprises, Ranked by Foreign Assets

Source: United Nations, "The World's Top 100 Non-Financial MNEs, Ranked by Foreign Assets, 2016," *www.unctad.org.* All data are for the year 2016.

Corporation	Home Economy	Industry	Foreign Assets (in $ millions)
Royal Dutch Shell	United Kingdom	Petroleum	$349,720
Toyota Motor	Japan	Motor vehicles	303,678
BP	United Kingdom	Petroleum	235,124
Total	France	Petroleum	233,217
Anheuser-Busch InBev	Belgium	Food & Beverages	208,012
Volkswagen Group	Germany	Motor vehicles	197,254
Chevron	United States	Petroleum	189,116
General Electric	United States	Industrial and Commercial Machinery	178,525
Exxon Mobil Corporation	United States	Petroleum	165,969
Softbank Corp	Japan	Telecommunications	145,611

part, the world's major financial institutions also extend across the globe; four of the five largest banks in the world, ranked by assets, are in China.[8] JP Morgan Chase, the largest U.S.–based bank, operates in more than 60 countries.

Although much of global commerce is carried out by a small number of large firms, globalization affects almost all businesses, whatever their size and reach. Even small, local firms use products and services that originate abroad, and they often compete with other businesses from around the world.

Another important aspect of globalization is the worldwide flow of capital. **Foreign direct investment (FDI)** occurs when a company, individual, or fund invests money in another country, for example, by buying shares of stock in or loaning money to a foreign firm. The world economy is bound together by such cross-border flows of capital. In 2016, FDI was $1.75 trillion, still below its average right before the financial crisis of 2008.[9] An emerging trend in foreign direct investment is the rise of *sovereign wealth funds.* These are funds operated by governments to invest their foreign currency reserves. They are most commonly operated by nations that export large amounts of oil and manufactured goods; the largest are run by Norway, the United Arab Emirates (Abu Dhabi), China, Kuwait, and Saudi Arabia. In recent years, sovereign wealth funds have made significant cross-border investments.

In past years, some U.S. companies sought to avoid corporate taxes by merging with companies located in other countries with lower tax rates and shifting their headquarters there, in a phenomenon known as *inversion.* For example, in 2014 Burger King (based in the United States) acquired Tim Horton's, a Canadian coffee-and-donut chain, for $11.5 billion. After the acquisition, Burger King reincorporated in Canada and renamed itself Restaurant Brands International, saving the company an estimated $275 million in U.S. taxes over the next three years. Many commentators expected this trend would slow after the implementation in 2018 of new tax legislation in the United States, which reduced corporate tax rates from 35 percent to 21 percent.

[8] "Bank Rankings: Top Banks in the World," *www.accuity.com.* Data are as of February 2017.

[9] UNCTAD, "World Investment Report 2017," *www.unctad.org.*

Finally, globalization involves the movement of people across national borders. Although recent political movements in some countries have sought to block or reduce the inflow, human migration has continued. In 2017, 258 million persons—about 3.4 percent of the world's population—were living in countries other than those in which they were born. The proportion was higher—12 percent—in developed countries. More than half of the world's migrants were living in just ten countries, topped by Saudi Arabia (37 percent of its population), Canada (22 percent), and the United States and Germany (15 percent each).[10] Some of these people had migrated legally, some illegally; some were seeking economic opportunity, while others were fleeing war or persecution. In the mid to late 2010s, as many as 800,000 people a year poured out of Syria to escape brutal armed conflict, many settling in Europe.

How did European businesses respond to this influx of refugees from Syria and nearby countries? In 2015, dozens of German companies joined together as *Wir Zusammen,* or "We Together," under the leadership of the CEO of the country's largest Internet provider, to pool their resources to help integrate migrants. This was potentially a boon to an economy in which more than a million jobs were unfilled. The idea was for the companies to collaborate in providing language training, housing, and training—and even sports leagues. For example, ThyssenKrupp, a major conglomerate and member of the group, created hundreds of internships and apprenticeships for refugees. *Wir Zusammen* also ran an ad campaign designed to encourage Germans to see migrants as partners, not threats.[11]

A study of 300 companies in Germany found that integrating these workers was challenging, because of language barriers and lack of documentation. But the companies reported that many refugee employees had succeeded when given appropriate support.[12]

The role of businesses in employing immigrant workers is further explored in Chapter 16.

International Financial and Trade Institutions

Global commerce is carried out in the context of a set of important **international financial and trade institutions (IFTIs)**. The most important of these are the World Bank, the International Monetary Fund, and the World Trade Organization. By setting the rules by which international commerce is transacted, these institutions increasingly determine who wins and who loses in the global economy.

The **World Bank (WB)** was set up in 1944, near the end of World War II, to provide economic development loans to its member nations. Its main motivation at that time was to help rebuild the war-torn economies of Europe. Today, the World Bank is one of the world's largest sources of economic development assistance; it provided $61 billion in loans, grants, equity investments and guarantees in 2016 for roads, dams, power plants, and other infrastructure projects, as well as for education, health, and social services. The bank gets its funds from dues paid by its member countries and from money it borrows in the international capital markets. Representation on the bank's governing board is based on economic power; that is, countries have voting power based on the size of their economies.

[10] "Migrants Are on the Rise Around the World, and Myths About Them Are Shaping Attitudes," *The New York Times,* June 20, 2018.

[11] "German Billionaire Rallies Business to Migrant Cause," *Financial Times,* January 7, 2017.

[12] "International Migration Report 2017," United Nations Department of Economic and Social Affairs, December 2017; "How 300 Companies Integrated 2,500 Refugees into Germany's Labor Market," Boston Consulting Group, May 30, 2017, *www.bcg.com*; and "Germany Bets on Second Time Lucky with Migrant Workers," *Reuters,* August 18, 2017.

As the United States—the bank's largest shareholder—became increasingly reluctant to support the bank's mission during the Trump administration, the bank's leadership began to turn to partnerships with private investors to fund various development projects.[13]

The World Bank's sister organization is the **International Monetary Fund (IMF)**. Founded at the same time as the bank (and today residing across the street from it in Washington, DC), the IMF has a somewhat narrower purpose: to stabilize the system of currency exchange rates and international payments to enable member countries to participate in global trade. It does this by lending foreign exchange to member countries. Like the World Bank, the IMF sometimes imposes strict conditions on governments that receive its loans. These conditions may include demands that governments cut spending, devalue their currencies, increase exports, liberalize financial markets, and reduce wages. These conditions often lead to hardship.

> One country that was particularly hard hit by loan conditions was Greece, one of the poorest nations in the European Union. Beginning in 2010, the IMF, the European Central Bank, and several European countries made a series of multibillion-dollar loans to Greece to enable it to pay its bills and service its debts. In exchange, the lenders imposed severe conditions, including sharp cuts in government spending and the sale of public assets. The Greek economy shrank by a quarter, the unemployment rate rose to 27 percent, and half its young people were thrown out of work. Public pensions and salaries were slashed. The Greek people voted in a new government whose candidates had called the austerity measures "waterboarding" and advocated for a restructuring of the country's debt. By 2018, Greece's economy had finally improved somewhat, and the nation hoped to be able to renegotiate its loans on more favorable terms.[14]

Significant progress has been made to reduce indebtedness by poor countries. By the mid-2000s, many developing countries had accumulated huge debts to the World Bank, the IMF, and other lenders. The total amount of money owed was almost $3 trillion. One of the unintended consequences of past loans was persistent poverty, because a large share of many nations' earnings went to pay off debt rather than to develop the economy or improve the lives of citizens. In response, many industrialized nations extended aid to heavily indebted countries to enable them to pay down loans to the World Bank, IMG, and other lenders. By 2017, more than $77 billion in **debt relief** had been extended to 36 heavily indebted countries, significantly reducing these nations' payments and enabling them to direct more resources to alleviating poverty.[15]

However, problems remained. Poor countries still owed billions more, and the world financial crisis weakened their ability to pay—and the ability of developed countries to offer aid. And, so-called *vulture funds* sought to take advantage of the indebted countries, a situation that is profiled in Exhibit 4.A.

The final member of the triumvirate of IFTIs is the **World Trade Organization (WTO)**. The WTO, founded in 1995 as a successor to the General Agreement on Tariffs and Trade (GATT), is an international body that establishes the ground rules for trade among nations. Most of the world's nations are members of the WTO, which is based in Switzerland.

[13] "The World Bank is Remaking Itself as a Creature of Wall Street," *The New York Times,* January 25, 2018.

[14] "Plausible that Greece Will Exit Bailout Programme This Year," *Financial Times,* January 4, 2018; and "Explaining Greece's Debt Crisis," *The New York Times,* June 17, 2016.

[15] "Heavily Indebted Poor Countries Initiative and Multilateral Debt Relief Initiative, Statistical Update," (Washington, D.C.: International Monetary Fund, September 1, 2017).

Exhibit 4.A Vulture Funds and Heavily Indebted Nations

A "vulture fund" is a private equity fund (also called a hedge fund) that buys the debt of weak companies or heavily indebted countries with the intention of making a profit. (The term analogizes these investors to vultures, birds of prey that feed on dead or dying animals.) For example, when Argentina defaulted on about $81 billion of loans in 2001, a hedge fund called Elliott Management bought some of these defaulted loans at a deep discount. It then sued, demanding that Argentina pay back the loans at full face value with interest, much more than it had paid. In 2012, a U.S. judge ruled in favor of the hedge fund—and said that until Argentina paid what it owed to Elliott Management, it was barred from paying *any* of its creditors (who had already agreed to accept less). In 2016, Argentina finally capitulated, agreeing to pay $2.4 billion to settle debt that Elliott Management had purchased 15 years earlier for just $117 million, generating an enormous windfall. Both the IMF and the World Bank said that the behavior of vulture funds like Elliott Management threatened the financial recovery of fragile economies. "When vulture funds sue for such exorbitant amounts, it's clearly taking away money that should be invested in health, education, infrastructure, and other social problems, and goes to line the pockets of already wealthy investors," said a representative of the nongovernmental organization (NGO) Africa Action.

Sources: "How One Hedge Fund Made $2 Billion from Argentina's Economic Collapse," *The Washington Post,* March 29, 2016; and "A Good Week for Vulture Funds," *The New Yorker,* March 5, 2016.

Its major objective is to promote free trade; that is, to eliminate barriers to trade among nations, such as tariffs. A **tariff** is a tax on an imported (or sometimes exported) product, often imposed by governments to protect their own industries from foreign competition. Unlike the WB and the IMF, the WTO does not lend money or foreign exchange; it simply sets the rules for international trade. The WTO conducts multiyear negotiations, called *rounds,* on various trade-related topics, rotating its meetings among different cities.

Under the WTO's most favored nation rule, member countries may not discriminate against foreign products. Most import restrictions (such as protective tariffs) are illegal. Under rare circumstances, they are permitted to protect a nation from an imported product scientifically proven to be unsafe—or to safeguard a nation's industry from a sudden, unforeseen, and damaging surge in imports. The Trump administration cited the latter exception when it imposed tariffs on imported solar panels in 2018, saying the restrictions were needed to protect American industry from unfair foreign competition. Exhibit 4.B explores whether jobs were gained or lost because of this protectionist policy. (Trade policy is further discussed in Chapter 7, and corporate efforts to obtain protective tariffs are described in the discussion case at the end of Chapter 8.)

If countries disagree about the interpretation of this or any other WTO rule, they can bring a complaint before the WTO's Dispute Settlement Body (DSB), a panel of appointed experts, which meets behind closed doors. Usually, member countries comply voluntarily with the DSB's rulings. If they do not, the DSB can allow the aggrieved nation to take retaliatory measures, such as imposing their own tariffs. Rulings are binding; the only way a decision can be overruled is if every member country opposes it.

These three international financial and trade institutions are important because no business can operate across national boundaries without complying with the rules set by the WTO, and many businesses in the developing world are dependent on World Bank and IMF loans for their very lifeblood. The policies these institutions adopt, therefore, have much to do with whether globalization is perceived as a positive or negative force, a subject to which we turn next.

Exhibit 4.B

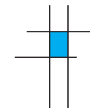
Tariffs on Solar Panels: Job Creator or Job Destroyer?

In 2018, President Trump imposed a 30 percent tariff on imported solar panels and cells, set to phase out after four years. "Our companies have been decimated," the president said, "and those companies are going to be coming back strong." The immediate effect of the tariff was to raise the prices of imported solar panels and cells, most of which came from China, South Korea, and Malaysia.

Two U.S.–based solar equipment manufacturers responded enthusiastically. Suniva praised the move for "holding China and its proxies accountable," and SolarWorld said it was "hopeful [the tariffs] will be enough." How many U.S. jobs were protected or created? According to the Solar Foundation, although 38,000 American workers were employed in all aspects of solar manufacturing, only 2,000 made solar panels and cells. One foreign solar-panel maker reportedly contacted the city of Jacksonville, Florida, after the tariff announcement to discuss opening a manufacturing plant there, promising as many as 800 new jobs.

Other companies opposed the tariffs, saying they would eliminate the jobs of many Americans who installed and maintained solar systems for businesses, homes, and utilities. Almost 90 percent of solar panels were imported, and as their prices rose, demand for these systems was expected to fall. The Solar Energy Industries Association, a trade group, estimated that the tariffs would lead to the loss of 23,000 U.S. jobs in 2018 alone as solar investments were cancelled or delayed. The chief executive of SunPower, a U.S. firm that sourced its panels from Asia, commented that tariffs would "burden domestic manufacturers and suppliers of other key components, raise prices for customers, and eliminate tens of thousands of jobs." And some feared that the Administration's move would prompt retaliation from Asian countries, hurting U.S. exporters. "This is now really starting to escalate," said one prominent economist.

Sources: "Manufacturers Fight Over New Tariffs' Effect on U.S. Jobs," *The Wall Street Journal,* January 23, 2018; "Job Creator, or Job Killer? Trump Angers Solar Installers with Panel Tariff" and "Q&A: Winners, Losers of Trump's Solar Panel Tariff," *The New York Times,* January 23, 2018; "Trump Says Solar Tariff Will Create 'Lots of Jobs.' But It Could Wipe Out Many More," *The Washington Post,* January 29, 2018; and "President Trump's Solar Tariffs Are a Big Blow to Renewables," *Fortune,* January 22, 2018.



The Benefits and Costs of Globalization

Globalization has both benefits and costs, and not all countries and stakeholders are affected equally. In this section, we present some of the arguments advanced by both sides in the debate over this important issue.

Benefits of Globalization

Proponents of globalization point to its many benefits. One of the most important of these is that globalization tends to increase economic productivity. That means, simply, that more is produced with the same effort.

Why should that be? As the economist David Ricardo first pointed out, productivity rises more quickly when countries produce goods and services for which they have a natural talent. He called this the *theory of comparative advantage.* Suppose, for example, that one country had a climate and terrain ideally suited for raising sheep, giving it an advantage in the production of wool and woolen goods. A second country had a favorable combination of iron, coal, and water power that allowed it to produce high-grade steel. The first country would benefit from trading its woolen goods for the second country's steel, and vice versa; and the world's economy overall would be more productive than if both countries had tried to make everything they needed for themselves. In other words, in the context of free trade, specialization (everyone does what they are best at) makes the world economy as a whole more efficient, so living standards rise.

Many countries today have developed a specialization in one or another skill or industry. India, with its excellent system of technical education, has become a world

> powerhouse in the production of software engineers. China has become expert in electronics manufacturing. France and Italy, with their strong networks of skilled craftspeople and designers, are acknowledged leaders in the world's high fashion and footwear design industries. The United States, with its concentration of actors, directors, special effects experts, and screenwriters, is the global headquarters for the movie industry.

Comparative advantage can come from several possible sources, including natural resources; the skills, education, or experience of a critical mass of people; or an existing production infrastructure.

Globalization also tends to reduce prices for consumers. If a shopper in the United States goes into Walmart to buy a shirt, he or she is likely to find one at a very reasonable price. Walmart sources its apparel from all over the world, enabling it to push down production costs. Globalization also benefits consumers by giving them access to a wide range of diverse goods and the latest "big thing." Teenagers in Malaysia can enjoy the latest Johnny Depp or Jennifer Lawrence movie, while American children can play with new Sony PlayStation games from Japan.

For the developing world, globalization also brings benefits. It helps entrepreneurs the world over by giving all countries access to foreign investment funds to support economic development. Globalization also transfers technology. In a competitive world marketplace, the best ideas and newest innovations spread quickly. Multinational corporations train their employees and partners how to make the fastest computer chips, the most productive food crops, and the most efficient light bulbs. In many nations of the developing world, globalization has meant more manufacturing jobs in export sectors and training for workers eager to enhance their skills.

The futurist Allen Hammond identifies two additional benefits of globalization. First, he says that world trade has the potential of supporting the spread of democracy and freedom.

> The very nature of economic activity in free markets. . . requires broad access to information, the spread of competence, and the exercise of individual decision making throughout the workforce—conditions that are more compatible with free societies and democratic forms of government than with authoritarian regimes.[16]

Second, according to Hammond, global commerce can reduce military conflict by acting as a force that binds disparate peoples together on the common ground of business interaction. "Nations that once competed for territorial dominance," he writes, "will now compete for market share, with money that once supported military forces invested in new ports, telecommunications, and other infrastructure." In this view, global business can become both a stabilizing force and a conduit for Western ideas about democracy and freedom.

Costs of Globalization

If globalization has all these benefits, why are so many individuals and organizations so critical of it? The answer is complex. Just as some gain from globalization, others are hurt by it. From the perspective of its victims, globalization does not look nearly so attractive.

One of the costs of globalization is job insecurity. As businesses move manufacturing across national borders in search of cheaper labor, workers at home are laid off. Jobs in the domestic economy are lost as imports replace homemade goods and services. In the American South, for example, tens of thousands of jobs in the textile industry have been lost, as jobs have shifted to low-labor cost areas of the world, leaving whole communities

[16] Allen Hammond, *Which World? Scenarios for the 21st Century* (Washington DC: Island Press, 1998), p. 30.

devastated. In the past, mainly manufacturing was affected by the shift of jobs abroad; more recently, clerical, white-collar, and professional jobs have also been "offshored." Many customer service calls originating in the United States are now answered by operators in the Philippines and India. The back-office operations of many banks—sorting and recording check transactions, for example—are done in India and China. Aircraft manufacturers are using aeronautical specialists in Russia to design parts for new planes. Even when jobs are not actually relocated, wages may be driven down because companies facing foreign competition try to keep their costs in check. Much of the opposition to globalization in affluent nations comes from people who feel their own jobs, pay, and livelihoods threatened by workers abroad who can do their work more cheaply.

Some evidence suggests a countertrend, as some companies have moved production back to the United States, in part to gain greater control over the supply chain. Wages have increased in China and many other developing nations, while wages in the United States have stagnated. Productivity is considerably higher in the United States than in China. And, some small businesses have found that solving everyday production problems with a contractor halfway around the globe can be daunting. "If we have an issue in manufacturing, in America we can walk down to the plant floor," explained the founder of a business called LightSaver Technologies that made emergency lights for homeowners. "We can't do that in China." The company had recently relocated production from China to a facility near its headquarters in California.[17]

Not only workers in rich countries are affected by globalization. When workers in Indonesia began organizing for higher wages, Nike Corporation moved much of its production to Vietnam and China. Many Indonesian workers lost their jobs. Some call this feature of global capitalism the **race to the bottom**.

Another cost of globalization is that environmental and labor standards may be weakened as companies seek manufacturing sites where regulations are most lax. Just as companies may desire locations offering the cheapest labor, they may also search for locations with few environmental protections; weak regulation of occupational health and safety, hours of work, and discrimination; and few rights for unions. A related concern is that the World Trade Organization's most favored nation rules make it difficult for individual nations to adopt policies promoting environmental or social objectives, if these have the effect of discriminating against products from another country.

For example, the United States banned the importation of Indonesian clove cigarettes, saying that the sweet-flavored cigarettes attracted younger smokers, drawing them into nicotine addiction and violating U.S. tobacco control laws. Indonesia brought a complaint before the WTO's dispute settlement body. The WTO ruled in Indonesia's favor, saying that because the United States permitted the sale of another flavored cigarette—menthols—it had acted in a discriminatory way by excluding Indonesian clove cigarettes. The dispute was finally settled after Indonesia agreed to the ban in exchange for other concessions from the United States.[18]

Critics of globalization say that incidents such as this one show that free trade rules are being used to restrict the right of sovereign nations to make their own laws setting health or environmental standards for imported products.

[17] "Small U.S. Manufacturers Give Up on 'Made in China,'" *Bloomberg Businessweek,* June 21, 2012.

[18] "U.S., Indonesia Settle Fight over Clove Cigarettes," *The Hill,* October 3, 2014. Details on this and other cases before the WTO's dispute settlement body are available at *www.wto.org.*

FIGURE 4.2
Benefits and Costs of Globalization

Benefits of Globalization	Costs of Globalization
Increases economic productivity.	Causes job insecurity.
Reduces prices for consumers.	Weakens environmental and labor standards.
Gives developing countries access to foreign investment funds to support economic development.	Prevents individual nations from adopting policies promoting environmental or social objectives, if these discriminate against products from another country.
Transfers technology.	Erodes regional and national cultures and undermines cultural, linguistic, and religious diversity.
Spreads democracy and freedom, and reduces military conflict.	Is compatible with despotism.

Another cost of globalization is that it erodes regional and national cultures and undermines cultural, linguistic, and religious diversity. In other words, global commerce makes us all very much the same. Is a world in which everyone is drinking Coke, watching Hollywood movies, texting on an iPhone, and wearing Gap jeans a world we want, or not? Some have argued that the deep **anti-Americanism** present in many parts of the world reflects resentment at the penetration of the values of dominant U.S.–based multinational corporations into every corner of the world.

With respect to the point that globalization promotes democracy, critics charge that market capitalism is just as compatible with despotism as it is with freedom. Indeed, multinational corporations are often drawn to nations that are governed by antidemocratic or military regimes, because they are so effective at controlling labor and blocking efforts to protect the environment. For example, Unocal's joint-venture collaboration to build a gas pipeline with the military government of Myanmar (Burma), a notorious abuser of human rights, may have brought significant financial benefits to the petroleum company.

Figure 4.2 summarizes the major points in the discussion about the costs and benefits of globalization.

This discussion raises the very real possibility that globalization may benefit the world economy as a whole, while simultaneously hurting many individuals and localities. An ongoing challenge to business, government, and society is to find ways to extend the benefits of globalization to all, while mitigating its adverse effects.[19]

Doing Business in a Diverse World

Doing business in other nations is much more than a step across a geographical boundary; it is a step into different social, political, cultural, and economic realities. As shown in Chapters 1, 2, and 3, even businesses operating in one community or one nation cannot function successfully without considering a wide variety of stakeholder needs and interests. When companies operate globally, the number of stakeholders to be considered in decision making, and the diversity of their interests, increases dramatically.

[19] For arguments for and against globalization, and on strategies to make the world's governing institutions more effective, see Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy* (New York: W.W. Norton, 2011); Jagdish Bhagwati, *In Defense of Globalization* (New York: Oxford University Press, 2007); and Joseph E. Stiglitz, *Making Globalization Work* (New York: W.W. Norton, 2007).

Comparative Political and Economic Systems

The many nations of the world differ greatly in their political, social, and economic systems. One important dimension of this diversity is how power is exercised, that is, the degree to which a nation's people may freely exercise their democratic rights. **Democracy** refers broadly to the presence of political freedom. Arthur Lewis, a Nobel laureate in economics, described it this way: "The primary meaning of democracy is that all who are affected by a decision should have the right to participate in making that decision, either directly or through chosen representatives." According to the United Nations, democracy has four defining features:[20]

- Fair elections, in which citizens may freely choose their leaders from among candidates representing more than one political party.
- An independent media, in which journalists and citizens may express their political views without fear of censorship or punishment.
- Separation of powers among the executive, legislative, and judicial branches of government.
- An open society where citizens have the right to form their own independent organizations to pursue social, religious, and cultural goals.

During much of the twentieth century, democratic rights spread for the first time to many nations around the world. Consider, for example, that at the beginning of the 20th century *no* country in the world had universal suffrage (all citizens can vote); today, a majority of countries do. The collapse of communist party rule in the former Soviet Union and its satellites in eastern and central Europe in the early 1990s was followed by the first open elections ever in these countries. These changes led some observers to call the end of the 20th century the "third wave of democracy."

Somewhere after the turn of the century, however, the trend toward democratization seemed to stall. According to a study by Freedom House, a nongovernmental research organization, 2017 marked the eleventh consecutive year in which more of the world's nations experienced *declines* in political rights and civil liberties than experienced improvements. In some countries that already lacked freedom, authoritarian leaders further consolidated their power. For example, in China, the regime placed further restrictions on dissent within the ruling Communist Party; and in Russia, the regime intimidated opponents and repressed free elections. Perhaps more surprisingly, formerly free countries suffered setbacks. In Venezuela, which had been democratic for more than 40 years, the elected president stripped the legislature of power, killed demonstrators, and imprisoned political opponents, effectively ushering in authoritarian rule. Declines in democratic rights also occurred in Turkey, Ethiopia, Hungary, and other nations. In all, Freedom House concluded that in 2017 one quarter of the world's nations were "not free," when rated on their political rights and civil liberties; an additional 30 percent were only "partly free."[21]

The degree to which human rights are protected also varies widely across nations. *Human rights,* further discussed in Chapters 5 and 17, refer broadly to the rights and privileges accorded to all people, simply by virtue of being human, for example, the rights to a decent standard of living, free speech, religious freedom, and due process of law, among others. Fundamental human rights have been codified in various international agreements,

[20] United Nations Development Programme, *Human Development Report 2000* (New York: Oxford University Press, 2000), Ch. 3, "Inclusive Democracy Secures Rights," pp. 56–71. The quotation from Arthur Lewis appears on p. 56.

[21] Freedom House, "Freedom in the World 2017: Populists and Autocrats, the Dual Threat to Global Democracy," at *http://freedomhouse.org*. See also: "How Stable Are Democracies? 'Warning Signs Are Flashing Red,'" *The New York Times,* November 29, 2016.

the most important of which is the Universal Declaration of Human Rights of 1948.[22] The second half of the 20th century was a period of great advances in human rights in many regions, and over half of the world's nations have now ratified *all* of the United Nations' human right covenants. Nonetheless, many human rights problems remain. Consider the following examples:

- More than 5 million children die each year before their fifth birthday. Most of these deaths are due to diseases such as pneumonia, diarrhea, and malaria, which are preventable with proper vaccinations, nutrition, and basic medical care. Although this number has fallen by more than half since 1990, it is still tragically high.[23]
- Gross violations of human rights have not been eliminated. *Genocide,* mass murder of innocent civilians, has occurred all too recently in Syria, Rwanda and Burundi, Iraq, Bosnia and Herzegovina, Democratic Republic of the Congo, Somalia, East Timor, and Sudan.
- The International Labor Organization estimated in 2017 that 25 million people worldwide were victims of forced labor, trafficking, and human slavery. Their labor generated annual profits of $150 billion. (The topic of forced labor is further explored in Chapter 17.) More than half of them were women and girls, who had been forced into prostitution or domestic work.[24] The efforts of a major hotel chain, The Carlson Companies, to prevent the use of their facilities for prostitution or child trafficking is described in a case at the end of this book.
- Minority groups and indigenous peoples in many nations still lack basic political and social rights. In Nepal, the life expectancy of "untouchables," the lowest caste, is fully 15 years less than that of Brahmins, the highest caste.

The absence of key human rights in many nations remains a significant issue for companies transacting business there.

Another dimension of difference among nations today is how economic assets are controlled, that is, the degree of economic freedom. On one end of the continuum are societies in which assets are privately owned and exchanged in a free and open market. Such **free enterprise systems** are based on the principle of voluntary association and exchange. In such a system, people with goods and services to sell take them voluntarily to the marketplace, seeking to exchange them for money or other goods or services. Political and economic freedoms are related: as people gain more control over government decisions they often press for greater economic opportunity; open markets may give people the resources to participate effectively in politics. But this is not always the case. The special situation of China with respect to political and economic freedom is explored in Exhibit 4.C.

At the other end of the continuum are systems of **central state control**, in which economic power is concentrated in the hands of government officials and political authorities. The central government owns the property that is used to produce goods and services. Private ownership may be forbidden, or greatly restricted, and most private markets are illegal. Very few societies today operate based on strict central state control of the economy. More common is a system of mixed free enterprise and central state control in which some industries are state controlled, and others are privately owned. For example, in Nigeria, the

[22] For more information on the Universal Declaration of Human Rights and other United Nations agreements on human rights, see the website of the U.N. High Commissioner for Human Rights at *www.unhchr.org*.

[23] United Nations Children's Fund (UNICEF) data on child mortality are available online at *https://data.unicef.org.*

[24] ILO and Walk Free Foundation, *Global Estimates of Modern Slavery: Forced Labour and Forced Marriage* (2017); and ILO, *Profits and Poverty: The Economics of Forced Labour* (2014).

Exhibit 4.C China: A Case of Authoritarian Capitalism?

Democracy, a *political* system in which citizens choose their own leaders and may openly express their ideas, and capitalism, an *economic* system in which the means of creating wealth are privately owned and controlled, have historically often developed in tandem. The two are not always coupled, however. During the early years of the 20th century, for example, capitalism coexisted with nondemocratic, fascist governments in Germany, Spain, and Japan. More recently, scholars have coined the term "authoritarian capitalism" to refer to modern states that combine elements of a market economy with political control by nonelected elites. A prime example is China. In its drive for economic development, the Chinese government has granted considerable freedom to private individuals to own property, invest, and innovate. The result has been very rapid growth in much of the country over the past two decades. At the same time, the Chinese communist authorities have vigorously held onto political power and suppressed dissent. As further explored in Chapter 12, the Chinese government operates one of the most sophisticated systems of Internet censorship in the world, restricting its citizens' ability to search using Google, connect with friends on Facebook, and access the websites of organizations out of favor with the authorities. It has also held onto ownership of some big companies, such as the China National Petroleum Corporation and China Mobile. In what direction will China and other authoritarian capitalist nations evolve in the future? "Some believe these countries could ultimately become liberal democracies through a combination of internal development, increasing affluence, and outside influence," commented the political scientist Azar Gat. "Alternatively, they may have enough weight to create a new nondemocratic but economically advanced Second World."

Sources: "The Rise of State Capitalism," *The Economist,* January 21, 2012; Azar Gat, "The Return of the Authoritarian Capitalists," *International Herald Tribune,* June 14, 2007; and "The Return of Authoritarian Great Powers," *Foreign Affairs,* July/August 2007.

oil industry is controlled by a government-owned enterprise that operates in partnership with foreign companies such as Shell and Chevron, but many other industries are privately controlled. In the social democracies of Scandinavia, such as Norway, the government operates some industries but not others. In the United States, the government temporarily took partial ownership in some banks, including Citigroup, as they faltered during the financial crisis.

The Heritage Foundation, a conservative think tank, has scored the nations of the world according to an *index of economic freedom* defined as "the fundamental rights of every human being to control his or her own labor and property." In economically free societies, governments "refrain from coercion or restraint of liberty beyond the extent necessary to protect and maintain liberty itself." Among the freest nations in 2018, by this measure, were Hong Kong, Singapore, and Canada; among the most repressed were Iran, Venezuela, and—the least free in the world—North Korea. The United States ranked 48th out of 183 countries.[25]

Global Inequality and the Bottom of the Pyramid

Nations also differ greatly in their overall levels of economic and social development. Ours is a world of great inequalities. Nations themselves differ in economic development, and individual wealth and income varies widely within and among nations.

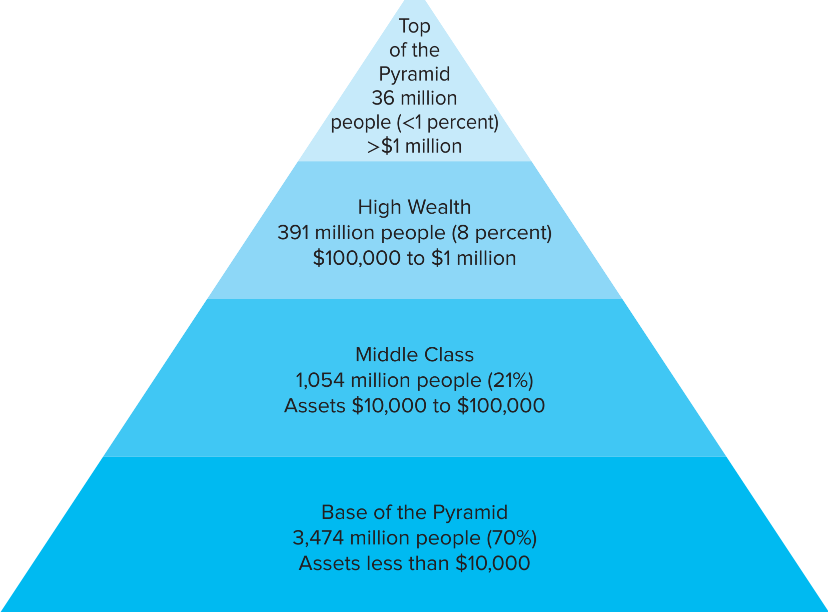
Inequality may be measured in two ways: by wealth and income.

Wealth refers to assets that a person accumulates and he or she owns at a point in time. Levels of wealth can be expressed as a pyramid, as shown in Figure 4.3. Most of the world's

[25] Available at *www.heritage.org*.

FIGURE 4.3
The Global Wealth Pyramid

Source: Adapted from Credit Suisse, Global Wealth Report 2017, Figure 1, p. 21.



population—about 70 percent—are at the base, or bottom, of the pyramid, owning less than $10,000 worth of assets. They might own some work tools, household furnishings, and a bicycle or used car. More than 90 percent of adults in India and Africa (and only 20 percent of adults in developed countries) are at the bottom of the pyramid. About a fifth of the world's people are considered middle class, with assets between $10,000 and $100,000. This group is present in all countries, but is growing especially fast in China (whose share of the world's middle class has more than doubled since 2000). These individuals might have equity in a home and some retirement savings. High wealth individuals, with assets above $100,000, are concentrated in the United States, Europe, Japan, and Australia. At the top of the pyramid—just over one-half of 1 percent of the world's population—are millionaires. Forty-three percent of these millionaires reside in the United States. Not reported separately in Figure 4.3 are so-called ultra-high net worth individuals, with wealth above $50 million. In 2017, about 148,000 people worldwide were in this category.[26]

Another way to conceptualize inequality is in terms of *income*—how much a person earns in a day or a year. Some theorists have defined the **bottom of the pyramid** as individuals who earn below $3,000 a year (or about $8 a day) in local purchasing power. By this measure, about 4 billion people globally are part of this segment.[27]

Whether measured by assets or income, historically, major multinational corporations have focused most of their attention on the top of the pyramid and, to some extent, the middle. But today, they are increasingly facing the challenge of bringing products, services, and employment to the many at the bottom of the pyramid. As the scholar C. K. Prahalad argued in his book *The Fortune at the Bottom of the Pyramid,* this group, while often overlooked, represents an incredible business opportunity. Although the poor earn

[26] Data in this paragraph are drawn from Credit Suisse, *Global Wealth Report 2017,* "The Global Wealth Pyramid," November 2017.

[27] This definition was first proposed in World Resources Institute and International Finance Corporation, "The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid," March 2007, *www.wri.org.*

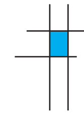
little individually, collectively they represent a vast market—and they often pay a "poverty premium," creating an opening for companies able to deliver quality products at lower prices. The size of this market has been estimated at as high as $5 trillion.[28] Many businesses are learning that focusing on the bottom of the pyramid can foster social development and provide employment in underserved communities—and reap profits.

For example, S.C. Johnson, a global manufacturer of household cleaning supplies and other consumer chemicals, launched a business called WOW in rural Ghana. In partnership with the Gates Foundation and the Center for Sustainable Global Enterprise, the company developed a packet of products specifically designed to help poor families prevent malaria, an illness spread by mosquitos. Insect repellants and cleaning products were provided in refillable containers and sold by subscription in small amounts to groups of homemakers, village by village. "Since our initial launch of WOW, we've learned so much about what consumers in Ghana want and how to construct a sustainable business model in the process," said the company's vice president of international markets marketing.[29]

One product that people in poor countries often desperately need is loans with which to operate or expand their farms or small businesses. Commercial banks have historically been reluctant to make small loans to people with little or no collateral. In response to this need, a new system has emerged called **microfinance**. This occurs when financial organizations provide loans to low-income clients or solidarity lending groups (a community of borrowers) who traditionally lack access to banking or related services.

In Indonesia, a midsized bank called BTPN grew rapidly after it decided in 2008 to expand into microloans to what its executives called the "productive poor." BTPN set up numerous small branches in rural areas and equipped staff with portable devices that could scan fingerprints, to facilitate doing business with illiterate customers. Typical loans were for $4,000 or less, with a term of a year or two, made to traders and small shopkeepers. As the economy rebounded from the global financial crisis, many entrepreneurs were eager to grow their businesses. BTPN's model benefited both these customers and the bank, which by 2011 had become one of the most profitable in Indonesia.[30]

One of the most recognized microfinance institutions is the Grameen Bank in Bangladesh. Grameen Bank has had amazing results; by 2018, it had made 1.7 million microloans, helping nearly 10 million people. Grameen Foundation and its affiliates and partners have spread this approach to millions more across Asia, Africa, and Latin America.[31]



Collaborative Partnerships for Global Problem Solving

As the preceding section suggested, doing business in a diverse world is exceptionally challenging for businesses. One solution to the challenging questions facing transnational

[28] C.K. Prahalad, *The Fortune at the Bottom of the Pyramid* (Philadelphia: Wharton School Publishing, 2004). See also C.K. Prahalad and Stuart L. Hart, "The Fortune at the Bottom of the Pyramid," *Strategy + Business,* No. 26, 2002.

[29] "SC Johnson Expands WOW Business Concept in Ghana," press release, October 8, 2014, and "Reality Check at the Bottom of the Pyramid," *Harvard Business Review,* June 2012.

[30] Gardner Bell, Ryan Nelson, and Carl Zeithaml, "BTPN (A): Banking for the Bottom of the Pyramid in Indonesia," William Davidson Institute of the University of Michigan, January 26, 2015; and *The Economist,* "Rich Pickings: Microlending Has Helped Make BTPN One of Asia's Most Profitable Banks," April 20, 2011.

[31] Data available at *www.grameen.com* and *www.grameenfoundation.org*.

corporations is to approach them collectively, through a collaborative process. An emerging trend is the development of collaborative, multisector partnerships focused on specific social issues or problems in the global economy. These partnerships have been termed **global action networks (GANs)**.[32] This final section of Chapter 4 describes this approach.

A Three-Sector World

The term *sector* refers to broad divisions of a whole. In this context, it refers to major parts or spheres of society, such as business (the private sector), government (the public sector), and civil society. **Civil society** comprises nonprofit, educational, religious, community, family, and interest-group organizations; that is, social organizations that do not have a commercial or governmental purpose.

The process of globalization has spurred development of civil society. In recent decades, the world has witnessed the creation and growth of large numbers of **nongovernmental organizations (NGOs)** concerned with such issues as environmental risk, labor practices, worker rights, community development, and human rights. (NGOs are also called *civil society organizations* or *civil sector organizations.*) The number of NGOs accredited by the United Nations has soared in recent years, rising from 1,000 in 1996 to more than 4,500 in 2016. This figure counts just major organizations.[33] Worldwide, the total number of international NGOs is estimated to be around 55,000.[34] (Many millions more NGOs operate regionally or locally.)

Experts attribute the growth of NGOs to several factors, including the new architecture of global economic and political relationships. As the Cold War has ended, with democratic governments replacing dictatorships, greater openness has emerged in many societies. More people, with more views, are free to express their pleasure or displeasure with government, business, or one another. NGOs form around specific issues or broad concerns (environment, human rights) and become voices that must be considered in the public policy debates that ensue.

Each of the three major sectors that participate in global action networks—business, government, and civil society—has distinctive resources and competencies, as well as weaknesses. For example, businesses have access to capital, specialized technical knowledge, networks of commercial relationships, and the management skills to get projects completed on time and on budget. On the other hand, the short-term orientation of many businesses may lead them to disregard the long-term impacts of their actions on others. For their part, government agencies have knowledge of public policy, an ability to enforce rules, and revenue from taxation, but are often inflexible, slow to mobilize, and poorly coordinated. Finally, NGOs often enjoy strong community knowledge, volunteer assets, and inspirational leaders, but may lack financial resources and technical skill and may suffer from a narrow, parochial focus.[35] One model highlighting various attributes of the business, government, and civil society sectors is presented in Figure 4.4.

Many businesses have realized that these differences across sectors can be a resource to be exploited. In this view, global action networks—alliances among organizations from the

[32] Steve Waddell, *Global Action Networks: Creating Our Future Together* (New York: Palgrave Macmillan, 2011).

[33] Data available at *http://csonet.org/*.

[34] *Global Civil Society 2012* (London: Palgrave Macmillan, 2012).

[35] This paragraph draws on Steven Waddell, "Core Competences: A Key Force in Business-Government-Civil Society Collaborations," *Journal of Corporate Citizenship,* Autumn 2002, pp. 43–56.

FIGURE 4.4 Distinctive Attributes of the Three Major Sectors

Source: Adapted from Steven Waddell, "Core Competences: A Key Force in Business-Government-Civil Society Collaborations," *Journal of Corporate Citizenship*, Autumn 2002, pp. 43–56, Tables 1 and 2.

	Business	Government	Civil Society
Organizational form	For-profit	Governmental	Nonprofit
Goods produced	Private	Public	Group
Primary control agent	Owners	Voters/rulers	Communities
Primary power form	Money	Laws, police, fines	Traditions, values
Primary goals	Wealth creation	Societal order	Expression of values
Assessment frame	Profitability	Legality	Justice
Resources	Capital assets, technical knowledge, production skills	Tax revenue, policy knowledge, regulatory and enforcement power	Community knowledge, inspirational leadership
Weaknesses	Short-term focus, lack of concern for external impacts	Bureaucratic, slow-moving, poorly coordinated internally	Amateurish, lack of financial resources, parochial perspective

three sectors—can draw on the unique capabilities of each and overcome specific weaknesses that each has.

One example of a global action network was the Kimberley Process, an initiative to end the trade in *conflict diamonds*—gemstones that had been mined or stolen by rebels fighting internationally recognized governments. The problem was that combatants in civil wars in Africa had seized control of diamond mines in Sierra Leone, Angola, and the Congo, and were selling uncut diamonds to fund their operations. Concerned that the image of diamonds as a symbol of romance would be tarnished, the World Diamond Congress and the international diamond company DeBeers joined forces with the governments of nations with legitimate diamond industries and NGOs campaigning to end civil violence. Together, these parties developed the Kimberley Process, a system for tracking diamonds all the way from the mine to the jewelry shop, so that consumers could be assured that their gem was "conflict-free."

In this case, although the interests of the parties were somewhat different, they were each able to bring their distinctive capabilities to bear to accomplish a common objective. A similar multiparty effort to ban conflict minerals—ones mined in war-torn areas of the Congo—is profiled in the discussion case at the end of this chapter. Other applications of the principle of cross-sector networks and collaborations are explored in Chapters 10 and 17.

The process of globalization presents today's business leaders with both great promise and great challenge. Despite periodic global economic downturns and the ever-present threat of war and terrorism, the world's economy continues to become more integrated and interdependent. Multinational corporations, with their financial assets and technical and managerial skills, have a great contribution to make to human betterment. Yet, they must operate in a world of great diversity, and in which their presence is often distrusted or feared. Often, they must confront situations in which political and economic freedoms are lacking and human rights are routinely violated. The challenge facing forward-looking companies today is how to work collaboratively with stakeholders to promote social and economic justice, while still achieving strong bottom-line results.

Summary

- Globalization refers to the increasing movement of goods, services, capital, and labor across national borders. Firms can enter and compete in the global marketplace by exporting products and services; locating operations in another country; or buying raw materials, components, or supplies from sellers abroad.
- The process of globalization is driven by technological innovation, improvements in transportation, the rise of major multinational enterprises, and social and political reforms.
- Globalization brings both benefits and costs. On one hand, it has the potential to pull nations out of poverty, spread innovation, and reduce prices for consumers. On the other hand, it may also produce job loss, reduce environmental and labor standards, and erode national cultures. An ongoing challenge is to extend the benefits of globalization to all, while mitigating its adverse effects.
- Multinational enterprises operate in nations that vary greatly in their political, social, and economic systems. They face the challenge of deciding how to do business in other nations, while remaining true to their values.
- In a world of great inequalities of wealth and income, businesses are making progress in understanding how to serve the poor to aid social development while earning a profit.
- Businesses can work with governments and civil society organizations around the world in collaborative partnerships that draw on the unique capabilities of each to address common problems.

Key Terms

anti-Americanism, *81*
bottom of the pyramid, *85*
central state control, *83*
civil society, *87*
debt relief, *76*
democracy, *82*
foreign direct investment (FDI), *74*
free enterprise system, *83*
global action network (GAN), *87*
globalization, *72*
international financial and trade institution (IFTI), *75*
International Monetary Fund (IMF), *76*
microfinance, *86*
multinational enterprise (MNE), *73*
nongovernmental organizations (NGOs), *87*
race to the bottom, *80*
tariff, *77*
World Bank (WB), *75*
World Trade Organization (WTO), *76*

Internet Resources

www.wto.org	World Trade Organization
www.imf.org	International Monetary Fund
www.worldbank.org	World Bank
www.ifg.org	International Forum on Globalization
www.globalpolicy.org	Global Policy Forum
www.weforum.org	The World Economic Forum
www.un.org/en/sections/resources-different-audiences/civil-societyx	United Nations and Civil Society

Discussion Case: *Intel and Conflict Minerals*

In 2017, Intel joined more than two dozen other companies, nongovernmental organizations, and government entities in launching the second phase of the Public-Private Alliance for Responsible Minerals Trade (PPA). The company had been an early leader in the effort to bring social responsibility to its minerals supply chain: in 2014, Intel had become the first electronics firm to announce that its products would be certified as *conflict-free*. This meant they would contain no *conflict minerals*—tantalum, tungsten, tin, or gold sourced from mines that financed horrific civil conflict in the Democratic Republic of the Congo (DRC) and nearby countries. "The solution isn't easy," Intel's CEO had noted at the time. "But nothing worthwhile ever is."

Of the four conflict minerals, the one most important to Intel and other electronics companies is tantalum. Columbite-tantalite, commonly known as "coltan," is a black metallic ore. When refined, it produces tantalum, which is used to regulate electricity in portable consumer electronics, such as smartphones, laptops, play stations, and digital cameras. The largest share of coltan comes from Africa; other sources include Australia, Brazil, and Canada.

In the late 2000s, a common goal to ban conflict minerals emerged among members of an oddly matched group—the electronics industry, the United Nations, governments, and human rights organizations. Their efforts led, ultimately, to a set of international guidelines, national laws, and voluntary initiatives whose goal was to keep the electronics industry and its customers from inadvertently supporting killing, sexual assault, and labor abuses.

The Democratic Republic of the Congo is a nation of 79 million people in central Africa, covering a vast region the size of Western Europe. Since the late 1990s, the DRC has been the site of a brutal regional conflict, in which armed militias, including some from neighboring states, have fought for control. Despite the presence of United Nations troops, as many as 5 million people have died—the most in any conflict since World War II. Warring groups have used sexual assault as a weapon to control the population; an estimated 200,000 Congolese women and girls have been raped, often in front of their husbands and families.

The United Nations and several NGOs reported that militias had systematically looted coltan and other minerals from eastern Congo, using the profits to fund their operations. According to the human rights group Global Witness:

> In the course of plundering these minerals, rebel groups and the Congolese army have used forced labor (often in extremely harsh and dangerous conditions), carried out systematic extortion, and imposed illegal "taxes" on the civilian population. They have also used violence and intimidation against civilians who attempt to resist working for them or handing over the minerals they produce.

Said a representative of The Enough Project, another human rights group, "In eastern Congo, you see child miners [with] no health or safety standards. Minerals are dug by hand, traded in sacks, smuggled across borders."

Once mined—whether in the Congo or elsewhere—raw coltan made its way through a complex, multistep global supply chain. Local traders sold to regional traders, who shipped the ore to processing companies such as H.C. Starck (Germany), Cabot Corporation (United States), and Ningxia (China). Their smelters produced refined tantalum powder, which was then sold to parts makers such as Kemet (United States), Epcos (Germany), and Flextronics (Singapore). They sold, in turn, to original equipment manufacturers such as Dell (United States), Sony (Japan), and Nokia (Finland).

By the time coltan reached the end of this convoluted supply chain, determining its source was nearly impossible. Steve Jobs, then the CEO of Apple, commented in an e-mail in 2010, "We require all of our suppliers to certify in writing that they use conflict-free

materials. But honestly there is no way for them to be sure. Until someone invents a way to chemically trace minerals from the source mine, it's a very difficult problem."

As public awareness of atrocities in the Congo grew, governments began to act. The Organization for Economic Cooperation and Development, an alliance of mostly European nations, issued guidance for companies that wished to responsibly source minerals. In 2010, the U.S. Congress passed the Wall Street Reform and Consumer Protection Act (also known as the Dodd-Frank Act, and further discussed in Chapters 7 and 13). This law included a provision, Section 1502, which required companies to disclose whether tantalum, tin, tungsten, and gold used in their products had come from the DRC or adjoining countries. Although the Securities and Exchange Commission (SEC) announced in 2017 that it no longer intended to enforce this provision, the matter remained in legal limbo, and many firms continued to collect and disclose this information.

Along with governments, companies also acted. For its part, Intel sent teams to visit 107 different smelters and refiners in 23 countries, educating their partners about conflict minerals and collecting information about the origin of raw materials they processed. The company collaborated with other companies in the Electronics Industry Citizenship Coalition (EICC) to develop a Conflict-Free Smelter Assessment Program, a voluntary system in which an independent third-party auditor evaluated smelters and refiners and designated them as conflict-free. Minerals would be "bagged and tagged" and then tracked through each step of the supply chain. By 2017, this program had certified 247 smelters and refiners.

Intel and other companies in the coalition were particularly concerned that they remove from their products only conflict minerals, not minerals coming from legitimate mines in conflict areas. To this end, they worked with government agencies and civil society organizations, including the U.S. State Department and RESOLVE, an NGO working to map the conflict mineral supply chain, to form the Public-Private Alliance for Responsible Minerals Trade. This multisector initiative worked to support responsible mines and to develop effective chain-of-custody programs in the Congo. Evidence suggested that these collaborative efforts had enjoyed some success: by 2016, over three-quarters of the tantalum, tungsten, and tin mines in eastern Congo surveyed by the International Peace Information Service were found free of control by armed groups.

Sources: "Intel's Efforts to Achieve a Conflict-Free Supply Chain," White Paper, May 2017, *www.intel.com;* "Conflict Minerals Rule—Will It Stay or Will It Go?" May 11, 2017, *www.conflictmineralslaw.com;* The Enough Project, *Demand the Supply: Ranking Consumer Electronics and Jewelry Retail Companies on Their Efforts to Develop Conflict-Free Minerals Supply Chains from Congo,* November 2017, *www.enoughproject.org;* Peter Eichstaedt, *Consuming the Congo* (Chicago: Lawrence Hill, 2011); and Michael Nest, *Coltan* (Cambridge, UK: Polity Press, 2011). More information on the Public-Private Alliance for Responsible Minerals Trade is available at *www.resolv.org*.

Discussion Questions

1. How do conflict minerals, and in particular, conflict coltan get their name? What groups benefited from the trade in conflict minerals? What groups were hurt by it?
2. Consider the three sectors discussed in this chapter (business, government, and civil society). What were the interests of each, with respect to conflict coltan, and in what ways did their interests converge?
3. Why was Intel unable to eliminate conflict minerals from its supply chain unilaterally, that is, without the help of others?
4. In what ways did Intel collaborate with other sectors (governments and civil society) in its efforts to eliminate conflict minerals from its products? What strengths and weaknesses did each sector bring to the task?
5. What further steps could be taken by governments, NGOs, and companies to strengthen the process to exclude conflict minerals from the global supply chain?

PART TWO

Business and Ethics

CHAPTER FIVE

Ethics and Ethical Reasoning

People who work in business frequently encounter and must deal with on-the-job ethical issues. Being ethical is important to the individual, the organization, and the global marketplace in today's business climate. Managers and employees alike must learn how to recognize ethical dilemmas and know why they occur. In addition, they need to be aware of the role their own ethical character plays in their decision-making process, as well as the influence of the ethical character of others. Finally, managers and employees must be able to analyze the ethical problems they encounter at work to determine an ethical resolution to these dilemmas.

This Chapter Focuses on These Key Learning Objectives:

LO 5-1 Defining ethics and business ethics.

LO 5-2 Evaluating why businesses should be ethical.

LO 5-3 Knowing why ethical problems occur in business.

LO 5-4 Identifying managerial values and people's spirituality as influences on ethical decision making.

LO 5-5 Understanding stages of moral reasoning.

LO 5-6 Analyzing ethical problems using generally accepted ethics theories.

LO 5-7 Understanding how moral intensity affects ethical decision-making.

Qualcomm, the U.S.–based multinational communication giant, was fined $853 million by a South Korean regulator for alleged antitrust violations, the highest penalty ever imposed on any company operating in South Korea. The three-year investigation by the Korea Fair Trade Commission claimed that Qualcomm used its dominant market position as leverage in negotiations with mobile-phone makers to force them to accept unfair contractual terms. The commission stated that Qualcomm's contracts were unfair because it required mobile-phone makers to purchase comprehensive wireless-technology licenses, including ones they would never use. The agreements also required these makers to provide their patents to Qualcomm free of charge.[1]

The former owner of the Peanut Corporation of America, Stewart Parnell, was sentenced to 28 years in prison when found guilty of multiple felony counts for conspiring to hide that his company's products had salmonella contamination. Over a two-year period, nine people died and 700 customers became seriously ill from consuming the company's food. Under Parnell's direction, Peanut Corporation executives falsified lab test results on their products, explicitly stating that the food was safe to eat. In a shortsighted effort to save the company, Parnell caused injury or death to hundreds of people, violated customers' right to safety, and breached their trust in the company. The severity and breadth of the effects of Parnell's decisions contributed to his long prison sentence.[2]

Certainly, the actions taken by executives at Qualcomm and the Peanut Corporation were highly unethical. What does it mean for an action to be ethical or unethical? This chapter explains the meaning of ethics, explains why businesses and managers should be ethical, and identifies the different types of ethical problems that occur in business. It also presents several ethical decision-making frameworks and shows how decisions are influenced both by the core elements of an individual's ethical character and the moral intensity of the dilemma. Then, Chapter 6 builds on this foundation with a discussion of how ethical performance in business can be improved by strengthening the organization's culture and climate and by providing organizational safeguards, such as policies, training, and reporting procedures.

The Meaning of Ethics

Ethics is a conception of right and wrong conduct. It tells us whether our behavior is moral or immoral and deals with fundamental human relationships—how we think and behave toward others and how we want them to think and behave toward us. **Ethical principles** are guides to moral behavior. For example, in most societies lying, stealing, deceiving, and harming others are considered to be unethical and immoral. Honesty, keeping promises, helping others, and respecting the rights of others are considered to be ethically and morally desirable behavior. Such basic rules of behavior are essential for the preservation and continuation of organized life everywhere.

These notions of right and wrong come from many sources. Religious beliefs are a major source of ethical guidance for many. The family institution—whether two parents, a single parent, or a large family with brothers and sisters, grandparents, aunts, cousins, and

[1] "Qualcomm Faces $853 Million Fine from South Korea over Alleged Antitrust Violations," *The Wall Street Journal,* December 28, 2016, *www.wsj.com*.

[2] "Ex-Peanut Executive Sentenced to 28 years in Prison for Salmonella Coverup," *Wall Street Journal,* September 21, 2015, www.wsj.com.

other kin—imparts a sense of right and wrong to children as they grow up. Schools and schoolteachers, neighbors and neighborhoods, friends, admired role models, ethnic groups, and the ever-present electronic media and the Internet influence what we believe to be right and wrong in life. The totality of these learning experiences creates in each person a concept of ethics, morality, and socially acceptable behavior. This core of ethical beliefs then acts as a moral compass that helps guide a person when ethical puzzles arise.

Ethical ideas are present in all societies, organizations, and individual persons, although they may vary greatly from one to another. Your ethics may not be the same as your neighbor's; one particular religion's notion of morality may not be identical to another's; or what is considered ethical in one society may be forbidden in another society. These differences raise the important and controversial issue of **ethical relativism**, which holds that ethical principles should be defined by various periods of time in history, a society's traditions, the special circumstances of the moment, or personal opinion. In this view, the meaning given to ethics would be relative to time, place, circumstance, and the person involved. In that case, the logical conclusion would be that there would be no universal ethical standards on which people around the globe could agree. However, for companies conducting business in several societies at one time, whether or not ethics is aligned can be vitally important; we discuss these issues in more detail in Chapter 6.

For the moment, however, we can say that despite the diverse systems of ethics that exist within our own society and throughout the world, all people everywhere do depend on ethical systems to tell them whether their actions are right or wrong, moral or immoral, approved or disapproved. Ethics, in this basic sense, is a universally common human condition, found everywhere.

Are ethics the same as laws? In other words, can we determine what is right or moral by asking what is legal? Some people have argued that the best way to assure ethical business conduct is to insist that business firms obey society's laws. However, laws and ethics are not quite the same. **Laws** are society's formal written rules about what constitutes right and wrong conduct in various spheres of life. For example, hydraulic fracturing in oil drilling operations is legal in many communities but some argue it is unethical due to its potential for destroying the environment. While it may be illegal for environmentalists to attempt to stop work operations by blockading a drilling location, they believe they are acting ethically by protecting the environment.

Laws are similar to ethics because both define proper and improper behavior. Yet, ethical concepts—like the people who believe in them—are more complex than written rules of law. As we see in the Qualcomm and Peanut Corporation examples at the beginning of this chapter, both cases involved legal violations. However, they also involved ethical issues concerning the proper treatment of organizational stakeholders. Ethics deal with human dilemmas that frequently go beyond the formal language of law and the meanings given to legal rules.

What Is Business Ethics?

Business ethics is the application of general ethical ideas to business behavior. Business ethics is not a special set of ethical ideas different from ethics in general and applicable only to business. If dishonesty is considered to be unethical and immoral, then anyone in business who is dishonest with stakeholders—employees, customers, suppliers, shareholders or competitors—is acting unethically and immorally. If protecting others from harm is considered to be ethical, then a company that recalls a dangerously defective product is acting in an ethical way. To be considered ethical, business must draw its ideas about what is proper behavior from the same sources as everyone else in society. Business should not try

to make up its own definitions of what is right and wrong. Employees and managers may believe at times that they are permitted or even encouraged to apply special or weaker ethical rules to business situations, but society does not condone or permit such an exception.

How common are such exceptions? The Ethics and Compliance Initiative has tracked observations of unethical behavior in the workplace since 2000. Its reports show that consistently about half of all employees' surveyed report observing unethical practices at work, year after year. In 2017, employees stated that lying to employees and external stakeholders was the most common unethical practice they observed (26%), followed by abusive behavior (21%), Internet abuse (16%), and conflicts of interest and health violations (each at 15%). This report implies that pressure on managers to act unethically remains a serious problem for businesses. The Institute for Leadership and Management reported that 63 percent of managers said they were expected to behave unethically at some point in their careers.[3]

Why Should Business Be Ethical?

Why should business be ethical? What prevents a business firm from piling up as much profit as it can, in any way it can, regardless of ethical considerations? Figure 5.1 lists the major reasons why business firms should promote a high level of ethical behavior.

Enhance Business Performance

Some people argue that one reason for businesses to be ethical is that it enhances the firm's performance, or simply: *ethics pays.*

> Empirical studies have supported the economic benefits of being perceived as an ethical company. *Ethisphere* also found a strong link between ethics and financial performance. Companies that were on *Ethisphere*'s 2017 list of the *World's Most Ethical Companies* outperform the Standard and Poor's 500 by 3.3 percent with five-year annual returns exceeding 16 percent.[4] This positive relationship between ethics and profits can be seen in Figure 5.2.

Businesses increasingly are recognizing that ethics pays and are encouraging ethical behavior by their employees. Business executives recognize that ethical actions can directly affect their organization's bottom line.

Costs to business of unethical behavior go far beyond government fines. News reports of a company's ethical or unethical behavior has been shown to affect its share price in either direction, respectively. According to the Ethical Investment Research Service, such reports influence a firm's share price between 0.5 percent and 3 percent.[5]

FIGURE 5.1
Why Should Business Be Ethical?

- To enhance business performance.
- To comply with legal requirements.
- To prevent or minimize harm.
- To meet demands of business stakeholders.
- To promote personal morality.

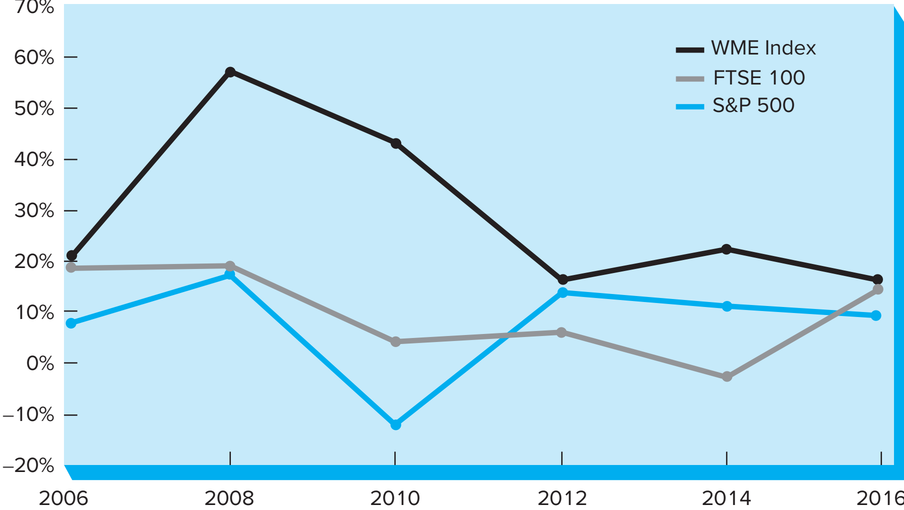
[3] See the Ethics Resource Center's studies, such as "The 2013 National Business Ethics Survey of the U.S. Workforce," *Ethics Resource Center,* Washington, D.C., 2014, and "Three Out of Five Managers Pressured to Behave Unethically at Work, According to New Research," *Institute of Leadership and Management,* June 10, 2013, press release.

[4] "A Clear Correlation: Ethical Companies Outperform," *Ethisphere,* June 9, 2017, *insights.ethisphere.com*.

[5] "How Do Ethics Affect the Financial Results of a Company?" *Chron,* n.d., *smallbusiness.chron.com*.

FIGURE 5.2
World's Most Ethical Index versus S&P 500 and FTSE 100, 2006–2017

Source: The pre-2012 financial data was from *www.ethisphere.com/2011-worlds-most-ethical-companies*. Additional data collected from publicly available financial data sources.



Companies with bad reputations face increased recruiting costs, especially when recruiting women and more experienced employees. According to a survey by Career Builder, 71 percent of United States workers claim they would not apply for a job at a company with a bad reputation.[6] By contrast, companies with good reputations find it easier to recruit desirable employees, enjoy lower costs to bring these candidates on board, and have greater retention among employees, according to a report by Alexander Mann Solutions, a leader of talent acquisition and management services.[7]

Comply with Legal Requirements

Doing business ethically is also often a legal requirement. Two legal requirements, in particular, provide direction for companies interested in being more ethical in their business operations. Although they apply only to U.S.–based firms, these legal requirements also provide a model for firms that operate outside the United States.

The first is the **U.S. Corporate Sentencing Guidelines**, which provide a strong incentive for businesses to promote ethics at work.[8] The sentencing guidelines come into play when a firm has been found guilty of criminal wrongdoing and is facing sentencing for the criminal act. To determine the sentencing, the judge computes a culpability (degree of blame) score using the guidelines, based on whether or not the company has:

1. Established standards and procedures to reduce criminal conduct.
2. Assigned high-level officer(s) responsibility for compliance.
3. Not assigned discretionary authority to "risky" individuals.
4. Effectively communicated standards and procedures through training.

[6] "71 Percent of U.S. Workers Would Not Apply to a Company Experiencing Negative Publicity," *Career Builder,* July 20, 2017, *press.careerbuilder.com*.

[7] "The Cost of Bad Reputation," *Corporate Responsibility Magazine,* October 2014.

[8] For a thorough discussion of the U.S. Corporate Sentencing Guidelines, see Dan R. Dalton, Michael B. Metzger, and John W. Hill, "The 'New' U.S. Sentencing Commission Guidelines: A Wake-Up Call for Corporate America," *Academy of Management Executive,* 1994, pp. 7–13; and Jillian Hewitt, "Fifty Shades of Gray: Sentencing Trends in Major White-Collar Cases," *The Yale Law Journal,* Feb 2016, pp. 1018–71.

5. Taken reasonable steps to ensure compliance—monitor and audit systems, maintain and publicize reporting system.
6. Enforced standards and procedures through disciplinary mechanisms.
7. Following detection of offense, responded appropriately and prevented reoccurrence.

The U.S. Sentencing Commission reviewed and made important revisions to the Sentencing Guidelines in 2004 and each year from 2010 through 2016, yet the "seven steps" described above remain the blueprint for many businesses in designing their ethics and compliance program.[9]

Another legal requirement imposed upon U.S. businesses is the **Sarbanes-Oxley Act** of 2002 (often referred to as SOX).[10] Born from the ethics scandals at Enron, WorldCom, Tyco, and others, this law seeks to ensure that firms maintain high ethical standards in how they conduct and monitor business operations. For example, the Sarbanes-Oxley Act requires executives to vouch for the accuracy of a firm's financial reports and requires them to pay back bonuses based on earnings that are later proved fraudulent, called *clawback*. The act also established strict rules for auditing firms.[11]

Fifteen years after its creation, some financial experts questioned if SOX was effective or not. Some pointed to the fact that the Act has not totally eliminated fraudulent financial reports since the Enron and Arthur Andersen debacles that gave rise to SOX in 2002. Other experts found, however, that many corporations had become more committed to enhancing their corporate culture, which better guaranteed that employees did the right thing, treated customers fairly, and did not take short cuts.[12]

Prevent or Minimize Harm

Another reason businesses and their employees should act ethically is to prevent harm to the general public and the corporation's many stakeholders. One of the strongest ethical principles is stated very simply: *Do no harm.* The notorious examples of outright greed and other unethical behavior by managers in the financial community contributed in part to the long-lasting Great Recession in the United States and around the world. These managers' unethical actions were responsible for significant harm to many stakeholders in society. Investors' portfolios dropped in value, retirees saw their nest eggs dwindle, hundreds of thousands of employees lost their jobs, and many small businesses failed. The "do no harm" principle encompasses more than economic consequences to stakeholders. The loss of salary, retirement funds, and investment value indeed generate significant economic harm to the employees and investors affected by organizational indiscretions. But, research has shown that psychological and emotional harm is likely to manifest as well.

> According to a 2013 Gallup poll, the longer an individual is unemployed, the more likely that person is to experience poor psychological well-being.[13] In a 2014 meta-analysis of studies examining the effects of unemployment on mental health,

[9] For a discussion of the most recent sentencing guidelines amendments, see www.ussc.gov.

[10] Banerjee Gaurango and Halil D. Kaya, "Short-Term and Long-Term Impact of Sarbanes-Oxley Act on Director Commitment and Composition of Corporate Board Committees," *Journal of Financial Management & Analysis,* January–June 2017, pp. 1–11, and Matthew Hoag, Mark Myring and Joe Schroeder, "Has Sarbanes-Oxley Standardized Audit Quality? *American Journal of Business,* 2017, pp. 2–23.

[11] See *www.sarbanes-oxley-association.com/Sarbanes_Oxley_News*.

[12] "Law's Big Weapon Sits Idle," *The Wall Street Journal,* July 29, 2012, *online.wsj.com* and "Sarbanes-Oxley: 14 Years On," *International Banker,* June 30, 2016, *internationalbanker.com*.

[13] "In U.S., Depression Rates Higher for Long-Term Unemployed," *Gallup,* 2013, *news.gallup.com*.

> it was found that an average of 34 percent of unemployed workers experienced psychological problems compared to 16 percent among employed workers.[14]

Another workplace behavior that exemplifies physical, economic, and psychological harm in organizations is sexual harassment. This issue has received increased attention in the press due to the allegations of sexual harassment and assault by executives and supervisors in many business corporations. Recently, the car-share company, Uber, for example, fired 20 employees for sexual harassment amidst a probe over 200 employees alleged to be involved in sexist behavior in the organization. The increased attention to the harms caused by sexual harassment focuses on not only the economic harm to the victims but also the physical and psychological damage to those harassed. This issue is discussed in greater detail in Chapter 16.[15]

Meet Demands of Business Stakeholders

Another reason businesses should be ethical is that stakeholders demand it. As discussed in Chapter 3, organizational stakeholders expect that companies will exhibit high levels of ethical performance and social responsibility. If employees view their company as ethical, they likely take greater pride in working there, have higher overall work satisfaction, and are willing to recommend the company as a good place to work. Scholars reviewing work in this field found that consumers who considered companies as being ethical or involved in socially responsible programs are more inclined to purchase these companies' products.[16]

Promote Personal Morality

A final reason for promoting ethics in business is a personal one. Most people want to act in ways that are consistent with their own sense of right and wrong. It shows how a lack of personal morality by the firm's leader can adversely affect employees. Being pressured to contradict their personal values creates emotional stress. Knowing that one works in a supportive ethical climate contributes to one's sense of psychological security.

> According to a 2015 report by the Institute for Business Ethics, British employees have a negative perception of corrupt business practices they saw at work–ranging from the misuse of company resources to cheating on travel expenses to nepotism. More than 50 percent of the employees surveyed considered these workplace practices unacceptable. The survey found that since 2005, British workers had developed attitudes increasingly critical of work actions that appeared to be unethical.[17]

The Ethics and Compliance Initiative, cited earlier in this chapter, stated in their 2017 report that "employees are reporting misconduct at the highest rates ever," noting that 69 percent of employees responding to their survey indicated they had reported the misconduct they had observed at work. Some of the most common types of misconduct reported included misuse of confidential information, giving or accepting bribes or kickbacks, stealing company property, and sexual harassment.[18]

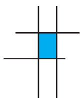
[14] Paul Karsten and Klaus Moser, "Unemployment Impairs Mental Health: Meta-Analyses," *Journal of Vocational Behavior,* 2014, pp. 264–82.

[15] Michelle Paludi and Richard Barickman, "Definitions and Incidence of Academic and Workplace Sexual Harassment," *Academic and Workplace Sexual Harassment: A Resource Manual* (Albany, New York: SUNY Press. 1991), pp. 2–5, and "Uber Fires 20 Employees in Sexual Harassment Probe," *CNN Tech,* June 6, 2017, money.cnn.com.

[16] Omer Farooq, Marielle Payaud, Dwight Merunka, and Pierre Valette-Florence, "The Impact of Corporate Social Responsibility on Organizational Commitment: Exploring Multiple Mediation Mechanisms," *Journal of Business Ethics,* 2014, pp. 563–80.

[17] "Surveys on Business Ethics, 2017," *Institute for Business Ethics,* February 8, 2018, *www.ibe.org.uk*.

[18] Ibid., "The State of Ethics and Compliance in the Workplace, 2018, p. 7.



Why Ethical Problems Occur in Business

If businesses have so many reasons to be ethical, why do ethical problems occur? Although not necessarily common or universal, ethical problems occur frequently in business. Finding out what causes them is one step toward minimizing their impact on business operations and on the people affected. Some of the main reasons are summarized in Figure 5.3 and are discussed next.

Personal Gain and Selfish Interest

Desire for personal gain, or even greed, causes some ethics problems. Businesses sometimes employ people whose personal values are less than desirable, who will put their own welfare ahead of all others, regardless of the harm done to other employees, the company, or society.

A manager or employee who puts his or her own self-interest above all other considerations is called an **ethical egoist**.[19] Self-promotion, a focus on self-interest to the point of selfishness, and greed are traits commonly observed in an ethical egoist. The ethical egoist tends to ignore ethical principles accepted by others, believing that ethical rules are made for others. Altruism—acting for the benefit of others when self-interest is sacrificed—is seen to be sentimental or even irrational. "Looking out for number one" is the ethical egoist's motto, as demonstrated by the Parnell example at the beginning of this chapter and the following story:

> Former Fiat Chrysler Automobiles executive, Alphons Iacobelli, was indicted in 2017 on charges that he used millions of dollars of company money designated for a union account to pay for his own lavish expenses. Iacobelli diverted funds earmarked for a union training center to purchase a $350,000 Ferrari and two gold Montblanc pens worth over $70,000 for himself. Additionally, during this period, he remodeled his kitchen and built a swimming pool for his home.[20]

FIGURE 5.3
Why Ethical Problems Occur in Business

Reason	Nature of Ethical Problem	Typical Approach	Attitude
Personal gain and selfish interest	Selfish interest versus others' interests	Egotistical mentality	"I Want it!"
Competitive pressures on profits	Firm's interest versus others' interests	Bottom-line mentality	"We have to beat the others at all costs!"
Conflicts of interest	Multiple obligations or loyalties	Favoritism mentality	"Help yourself and those closest to you!"
Cross-cultural contradictions	Company's interests versus diverse cultural traditions and values	Ethnocentric mentality	"Foreigners have a funny notion of what's right and wrong."

[19] For a compact discussion of ethical egoism, see Denis G. Arnold, Tom L. Beauchamp, and Norman E. Bowie, *Ethical Theory and Business,* 9th ed. (Upper Saddle River, NJ: Pearson, 2012), pp. 12–17; and Laura P. Hartman, Joe DesJardins, and Chris MacDonald, *Business Ethics: Decision-Making for Personal Integrity and Social Responsibility,* 4th ed. (New York: McGraw-Hill, 2017), p. 70.

[20] "Ex-Fiat Chrysler Executive Accused of Siphoning Millions with Union Leader." *The New York Times,* July 26, 2017, *www.nytimes.com*.

Competitive Pressures on Profits

When companies are squeezed by tough competition, they sometimes engage in unethical activities to protect their profits. This may be especially true in companies whose financial performance is already substandard. Research has shown that managers of poor financial performers and companies with financial uncertainty are more prone to commit illegal acts. In addition, intense competitive pressure in the global marketplace has resulted in unethical activity, such as price fixing, falsifying documents, or the use of kickbacks or bribes.

In a misguided and unethical effort to boost sales, Tenet Healthcare Corporation gave kickbacks to hospitals and medical clinics for obstetric referrals in its hospital network. In 2016, the hospital chain pleaded guilty to criminal fraud and bribery charges also involving two of their subsidiaries, Atlanta Medical Center and North Fulton Medical Center, and agreed to pay $524 million to the states of Georgia and South Carolina and to the federal government. Georgia Attorney General Olens claimed that the company took advantage of vulnerable pregnant women by pushing for these referrals to be brought into their hospital network.[21]

Conflicts of Interest

Ethical challenges in business often arise in the form of conflicts of interest. A **conflict of interest** occurs when an individual's self-interest conflicts with acting in the best interest of another, when the individual has an obligation to do so.[22] For example, if a purchasing agent directed her company's orders to a firm from which she had received a valuable gift, regardless if this firm offered the best quality or value, she would have acted unethically because of a conflict of interest. In this situation, she would have acted to benefit herself, rather than in the best interests of her employer. A failure to disclose a conflict of interest may represent deception in and of itself and may hurt the person or organization on whose behalf judgment has been exercised. Many ethicists believe that even the *appearance* of a conflict of interest should be avoided, because it undermines trust.

Many cases of unethical activity illustrate conflicts of interest, in which opportunities for organizational self-enrichment conflict with the long-term viability of the firm and the best interests of employees, customers, suppliers, and stockholders. The situation at Peanut Corporation, introduced at the beginning of this chapter, describes an organizational conflict of interest where executives falsified lab test results on their products that exposed its consumers to salmonella contamination in order to maintain short-term company profitability. Many firms seek to guard against the dangers inherent in conflicts of interest by including prohibitions of any such practices in their codes of ethics, as discussed in Chapter 6.

Cross-Cultural Contradictions

Some of the knottiest ethical problems occur as corporations do business in other societies where ethical standards differ from those at home. Today, policymakers and strategic planners in all multinational corporations, regardless of the nation where they are headquartered, often face this kind of ethical dilemma. Consider the following situation:

For decades the Great Britain-based pesticide manufacturer, Syngenta, has produced a lethal weed killer, Paraquat. Only one sip of Paraquat can cause death.

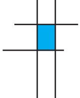
[21] "Tenet Healthcare to Pay $515 Million to Settle Kickback Allegations." *The Wall Street Journal,* October 3, 2016, *www.wsj.com*.

[22] Based on John R. Boatright and Jeffrey D. Smith, *Ethics and the Conduct of Business,* 8th ed. (Upper Saddle River, NJ: Pearson, 2016).

The product is banned in the European Union, China, and many other countries—but not the United States. In 2016, the U.S. Environmental Protection Agency reported that the pesticide was linked to Parkinson's disease, resulting in a further review of its use. But according to the U.S. Department of Agriculture, the use of this chemical remains widespread in the United States because paraquat is highly successful at killing and preventing the spread of weeds in agricultural applications. Syngenta's decision to continue its production and sale in the United States is certainly linked to economic benefits for the company.[23]

This episode raises the issue of *ethical relativism,* which was defined earlier in this chapter. Although the sale of the pesticide paraquat in the United States was still *legal,* was it *ethical?* Is the selling of unsafe products by any measure *ethical* if it is not forbidden by the receiving nation, especially if the company knows that the products are exported to another country where others are exposed to serious health risks?

As business becomes increasingly global, with more and more corporations penetrating overseas markets where cultures and ethical traditions vary, these cross-cultural questions will occur more frequently.



The Core Elements of Ethical Character

The ethical analysis and resolution of ethical dilemmas in the workplace significantly depend on the ethical character and moral development of managers and other employees. Good ethical practices not only are possible, but also become normal with the right combination of these components.

Managers' Values

Managers are key to whether a company and its employees will act ethically or unethically. The values held by managers, especially the top-level managers, serve as models for others who work at the company. Unfortunately, according to a 2017 survey Americans hold a dim view of business executives' and managers' values. Forty-five percent of those polled believe that corporate CEOs should be fired for unethical transgressions in their companies. In this same survey, the public shared that a violation of trust between a company and its customers is the most serious ethical offense, with 61 percent indicating that the CEO should be terminated for such behavior.[24]

In an annual Gallup poll that rated 22 occupations for honesty and ethics, nurses—for the sixteenth straight year—came out on top. In 2017, only 16 percent of those surveyed saw business executives as having "very high" or "high" ethical standards or honesty. This placed executives below clergy, lawyers, and bankers on this list. Advertising practitioners ranked lower than business executives, with car salespeople, members of Congress, and lobbyists at the bottom of the list.[25]

How do executives view their own values? Studies generally show that most U.S. managers focus on themselves and place importance on values such as having a comfortable and exciting life. Researchers also found that new CEOs tend to be more self-interested and

[23] "This Pesticide Is Prohibited in Britain. Why Is It Still Being Exported?" *The New York Times,* December 20, 2016, *www.nytimes.com*.

[24] "Punishing CEOs for Bad Behavior: 2017 Public Perception Survey," *Rock Center for Corporate Governance,* Stanford University, February 2017, *www.gsb.stanford.edu*.

[25] "Honesty/Ethics in the Professions," *Gallup Poll,* December 4–11, 2017, *www.gallup.com*.

short-term focused, possibly in an effort to immediately drive up company profits, rather than valuing long-term investments in research and development or capital expenditures. However, a recent study found that today's managers place slightly more importance on moral values, such as honesty and forgiveness, than managers did in the 1980s, who focused more on competency values, like capability and independence. Interestingly, the study also compared the personal values orientations of managers from the 1980s and today to those of Millennials (individuals born between 1980 and 2000). While generally, Millennials' personal values orientations were discovered to be consistent with those of managers from the 1980s and 2010s, they did indicate a greater self-focused preference than managers from previous research.[26]

Spirituality in the Workplace

A person's **spirituality**—that is, a personal belief in a supreme being, religious organization, or the power of nature or some other external, life-guiding force—has always been a part of the human makeup. In 1953, *Fortune* published an article titled "Businessmen on Their Knees" and claimed that American businessmen (women generally were excluded from the executive suite in those days) were taking more notice of God. More recently, cover stories in *Fortune, Bloomberg Businessweek,* and other business publications have documented a resurgence of spirituality or religion at work.

As far back as 1976, scholars have found a positive relationship between an organization's economic performance and attention to spiritual values. They have shown that spirituality positively affects employee and organizational performance by enhancing intuitive abilities and individual capacity for innovation, as well as increasing personal growth, employee commitment, and responsibility. Spirituality also helps employees who are dealing with workplace stress. In a study on workplace spirituality in the United States and Mexico, meaningful work was found to be directly related to reduced workplace stress.[27]

Organizations have responded to the increased attention to spirituality and religion at work by acting to accommodate their employees' spiritual needs.

> The chief diversity officer at PricewaterhouseCoopers found office space in their Asia-Pacific region facility to provide a prayer room for their Muslim employees. In the United States, employers are required by law to make substantial accommodations for their employees' religious practices, as long as it does not create major hardships for the organization. Ford's Interfaith Network, a group of employees focusing on religious issues, successfully lobbied the company to install sinks designed for the religious washings that Muslim employees perform.[28]

However, others disagree with the trend toward a stronger presence of religion in the workplace. They hold the traditional belief that business is a secular—that is,

[26] James Weber, "Discovering the Millennials' Personal Values Orientation: A Comparison to Two Managerial Populations," *Journal of Business Ethics,* 2017, 4, 143, pp. 517–29.

[27] For a study establishing a link between spirituality and economic performance, see Christopher P. Neck and John F. Milliman, "Thought Self-Leadership: Finding Spiritual Fulfillment in Organizational Life," *Journal of Managerial Psychology,* 1994, pp. 9–16; and for studies showing how promoting spirituality as a way to reduce workplace stress, see Amal Altaf and Mohammad Atif Awan, "Moderating Effect of Workplace Spirituality on the Relationship of Job Overload and Job Satisfaction," *Journal of Business Ethics,* 2011, pp. 93–99; and "Workplace Spirituality and Stress: Evidence from Mexico and US," *Management Research Review,* 2015, pp. 29–43.

[28] "When Religious Needs Test Company Policy," *The New York Times,* February 25, 2007, *www.nytimes.com*; and "More Businesses Turning to Workplace Chaplains," *PilotOnline.com*, October 30, 2011, *pilotonline.com*.

nonspiritual—institution. They believe that business is business, and spirituality is best left to churches, synagogues, mosques, and meditation rooms, not corporate boardrooms or shop floors. This, of course, reflects the separation of church and state in the United States and many other countries.

Beyond the philosophical opposition to bringing spirituality into the business environment, procedural or practical challenges arise. Whose spirituality should be promoted? The CEO's? With greater workplace diversity comes greater spiritual diversity, so which organized religion's prayers should be cited or ceremonies enacted? How should businesses handle employees who are agnostics or atheists (who do not follow any religion)?

Just as personal values and character strongly influence employee decision making and behavior in the workplace, so does personal spirituality, from all points on the religious spectrum, impact how businesses operate.

Managers' Moral Development

People's values and spirituality exert a powerful influence on the way ethical work issues are treated. Since people have different personal histories and have developed their values and spirituality in different ways, they are going to think differently about ethical problems. This is as true of corporate managers as it is of other people. In other words, the managers in a company are likely to be at various **stages of moral development**. Some will reason at a high level, others at a lower level.

A summary of the way people grow and develop morally is diagrammed in Figure 5.4. From childhood to mature adulthood, most people move steadily upward in their moral reasoning capabilities from stage 1. Over time, they become more developed and are capable of more advanced moral reasoning, although some people never use the most advanced stages of reasoning in their decision processes.

At first, individuals are limited to an ego-centered focus (stage 1), fixed on avoiding punishment and obediently following the directions of those in authority. (The word *ego* means "self.") Slowly and sometimes painfully, the child learns that what is considered to be right and wrong is pretty much a matter of reciprocity: "I'll let you play with my toy if I can play with yours" (stage 2). At both stages 1 and 2, however, the individual is mainly

FIGURE 5.4
Stages of Moral Development and Ethical Reasoning

Source: Adapted from Lawrence Kohlberg, *The Philosophy of Moral Development* (New York: Harper & Row, 1981).

Age Group	Development Stage and Major Ethics Referent	Basis of Ethics Reasoning
Mature adulthood	**Stage 6** Universal principles: justice, fairness, universal human rights	Principle-centered reasoning
Mature adulthood	**Stage 5** Moral beliefs above and beyond specific social custom: human rights, social contract, broad constitutional principles	Principle-centered reasoning
Adulthood	**Stage 4** Society at large: customs, traditions, laws	Society- and law-centered reasoning
Early adulthood, adolescence	**Stage 3** Social groups: friends, school, coworkers, family	Group-centered reasoning
Adolescence, youth	**Stage 2** Reward seeking: self-interest, own needs, reciprocity	Ego-centered reasoning
Childhood	**Stage 1** Punishment avoidance: avoid harm, obedience to power	Ego-centered reasoning

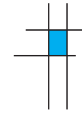
concerned with his or her own pleasure. The self-dealings of Alphons Iacobelli, described earlier in this chapter, exemplify ego-centered reasoning. By taking money from his company for personal use, he personally benefited, without apparent concern for others.

In adolescence the individual enters a wider world, learning the give-and-take of group life among small circles of friends, schoolmates, and similar close-knit groups (stage 3). Studies have reported that interaction within groups can provide an environment that improves the level of moral reasoning. This process continues into early adulthood. At this point, pleasing others and being admired by them are important cues to proper behavior. Most people are now capable of focusing on other-directed rather than self-directed perspectives. When a manager "goes along" with what others are doing or what the boss expects, this would represent stage 3 behavior. On reaching full adulthood—the late teens to early 20s in most modern, industrialized nations—most people are able to focus their reasoning according to society's customs, traditions, and laws as the proper way to define what is right and wrong (stage 4). At this stage, a manager would seek to follow the law; for example, he or she might choose to curtail a chemical pollutant because of government regulations mandating this.

Stages 5 and 6 lead to a special kind of moral reasoning. At stage 5, individuals apply their moral beliefs above and beyond specific social custom and consider changing law based on rational reflection of social utility. Stage 6 emphasizes ethical reasoning using broad principles and relationships, such as human rights and constitutional guarantees of human dignity, equal treatment, and freedom of expression. For example, at this stage, an executive might decide to pay wages above the minimum required by law, because this is the morally just thing to do.[29]

Researchers have consistently found that most managers typically rely on criteria associated with reasoning at stages 3 and 4, although some scholars argue that these results may be slightly inflated.[30] Although they may be capable of more advanced moral reasoning that adheres to or goes beyond society's customs or law, managers' ethical horizons most often are influenced by their immediate work group, family relationships, or compliance with the law.

The development of a manager's moral character can be crucial to a company. Some ethics issues require managers to move beyond selfish interest (stages 1 and 2), beyond company interest (stage 3 reasoning), and even beyond sole reliance on society's customs and laws (stage 4 reasoning). Needed is a manager whose personal character is built on a caring attitude toward all affected, recognizing others' rights and their essential humanity (a combination of stage 5 and 6 reasoning). The moral reasoning of upper-level managers, whose decisions affect companywide policies, can have a powerful and far-reaching impact both inside and outside the company.



Analyzing Ethical Problems in Business

Underlying an ethical decision framework is a set of universal ethical values or principles, notions that most people anywhere in the world would hold as important. While a list of ethical principles may be exhaustive, these values seem to be generally accepted: do no

[29] For details and research findings, see Lawrence Kohlberg, *The Philosophy of Moral Development* (San Francisco: Harper & Row, 1981); and Anne Colby and Lawrence Kohlberg, *The Measurement of Moral Judgment, Volume I: Theoretical Foundations and Research Validations* (Cambridge: Cambridge University Press, 1987).

[30] James Weber and Janet Gillespie, "Differences in Ethical Beliefs, Intentions, and Behaviors," *Business & Society,* 1998, pp. 447–67; and James Weber and David Wasieleski, "Investigating Influences on Managers' Moral Reasoning," *Business & Society,* 2001, pp. 79–111.

FIGURE 5.5
Four Methods of Ethical Reasoning

Method	Critical Determining Factor	An Action Is Ethical When . . .	Limitations
Virtues	Values and character	It aligns with good character	Subjective or incomplete set of good virtues
Utilitarian	Comparing benefits and costs	Net benefits exceed net costs	Difficult to measure some human and social costs; majority may disregard rights of the minority
Rights	Respecting entitlements	Basic human rights are respected	Difficult to balance conflicting rights
Justice	Distributing fair shares	Benefits and costs are fairly distributed	Difficult to measure benefits and costs; lack of agreement on fair shares

harm; be compassionate, fair, and just, and honest; respect others' rights; and do your duty/act responsibly.[31] Business managers and employees need a set of decision guidelines that will shape their thinking when on-the-job ethics issues occur. The guidelines should help them (1) identify and analyze the nature of an ethical problem and (2) decide which course of action is likely to produce an ethical result. The following four methods of ethical reasoning can be used for these analytical purposes, as summarized in Figure 5.5.

Virtue Ethics: Pursuing a "Good" Life

Some philosophers believe that the ancient Greeks, specifically Plato and Aristotle, developed the first ethical theory, which was based on values and personal character. Commonly referred to as **virtue ethics**, it focuses on character traits that a good person should possess, theorizing that moral values will direct the person toward good behavior. Aristotle argued, "Moral virtue is a mean between two vices, one of excess and the other of deficiency, and it aims at hitting the mean in feelings, desires, and action."[32] A variety of people have suggested lists of moral values over the years as shown in Figure 5.6.

As indicated by the different views expressed in Figure 5.6, to some extent what counts as a moral virtue depends on one's personal beliefs and is often influenced by an organization or society.

> When placing virtue ethics in a business context, ethicist Robert Solomon explains, "The bottom line of the Aristotelian approach to business ethics is that we have to get away from 'bottom line' thinking and conceive of business as an essential part of the good life, living well, getting along with others, having a sense of self-respect, and being a part of something one can be proud of."[33]

However, others argue that virtue ethics is not a thoroughly developed ethical system of rules and guidelines, but rather a system of values that form good character. Scholars posit that virtue ethics emphasizes how a person lives. This notion is centered on the characteristics of the person committing the action. If an agent is virtuous, then the actions that

[31] See Rushworth Kidder, *Moral Courage* (New York: HarperCollins, 2005).

[32] For discussions of virtue ethics, see Laura P. Hartman, Joe DesJardins, and Chris MacDonald, *Business Ethics: Decision-Making for Personal Integrity and Social Responsibility,* 4th ed. (New York: McGraw-Hill, 2017), pp. 85–89.

[33] Robert C. Solomon, *Ethics and Excellence: Cooperation and Integrity in Business* (New York: Oxford University Press, 1992), p. 104.

FIGURE 5.6
Lists of Moral Values across Time

Plato and Aristotle, 4th century BC	St. Thomas Aquinas, 1225–1274	Benjamin Franklin, 1706–1790	Robert Solomon, 1942–2007
• Courage	• Faith	• Cleanliness	• Honesty
• Self-control	• Hope	• Silence	• Trust
• Generosity	• Charity	• Industry	• Toughness
• Magnificence	• Prudence	• Punctuality	
• High-mindedness	• Justice	• Frugality	
• Gentleness	• Temperance		
• Friendliness	• Fortitude		
• Truthfulness	• Humility		
• Wittiness			
• Modesty			

Sources: Plato and Aristotle's values are from Steven Mintz, "Aristotelian Virtue and Business Ethics Education," *Journal of Business Ethics,* 1996; St. Thomas Aquinas's values are from Manuel G. Velasquez, *Business Ethics: Concepts and Cases,* 9th ed. (Upper Saddle River, NJ: Pearson, 2012); Benjamin Franklin's values, from the American Industrial Revolution era, are from Peter McMylor, *Alisdair MacIntyre: Critic of Modernity* (London: Routledge, 1994); and Robert Solomon's moral values can be found in Robert C. Solomon, *Ethics and Excellence: Cooperation and Integrity in Business* (New York: Oxford University Press, 1992).

individual takes should be acceptable.[34] Yet, virtue ethics also suffers from this challenge: whose values? Does a set of values provide a sufficient framework to resolve the most complex ethical dilemmas found in global business? Does a manager sometimes have to be or seem to be "the bad person" or do or seem to do "a bad thing" for the sake of some ultimate ethical good? Would this be virtuous or vicious?[35]

Utility: Comparing Benefits and Costs

Another approach to ethics emphasizes *utility,* or the overall amount of good that can be produced by an action or a decision. This ethical approach is called **utilitarian reasoning**. It is often referred to as cost–benefit analysis because it compares the costs and benefits of a decision, a policy, or an action, as shown in Figure 5.5. These costs and benefits can be economic (expressed in dollar amounts), social (the effect on society at large), or human (usually a psychological or emotional impact). After business managers add up all the costs and benefits and compare them with one another, the net cost or the net benefit should be apparent. For a utilitarian, the alternative where the benefits most outweigh the costs is the ethically preferred action because it produces the greatest good for the greatest number of people in society.

The main drawback to utilitarian reasoning is the difficulty of accurately measuring both costs and benefits. Some things can be measured in monetary terms—goods produced, sales, payrolls, and profits—but others that are less tangible, such as employee morale, psychological satisfaction, or the worth of a human life, are trickier. Human and social costs are particularly difficult to measure with precision. But unless they can be measured, the cost–benefit calculations will be incomplete, and it will be difficult to know whether the overall result is good or bad, ethical or unethical. Another limitation of utilitarian reasoning is that the majority may override the rights of those in the minority. Since utilitarian reasoning is primarily concerned with the end results of an action, managers

[34] Miguel Alzola, "Virtuous Persons and Virtuous Actions in Business Ethics and Organizational Research," *Business Ethics Quarterly,* 2015, pp. 287–318.

[35] For a critique of virtue ethics, see John R. Boatright and Jeffrey D. Smith, Ethics and the Conduct of Business, 8th ed. (Upper Saddle River, NJ: Pearson, 2016).

Exhibit 5.A

Do Patients Have the "Right to Try"

By 2018, 38 states had enacted "Right to Try" laws and more were considering such legislation. These efforts catapulted this ethical question into national prominence and touches on some of the methods for ethical reasoning discussed in this chapter.

At the core of this debate is whether or not terminally ill patients have the ethical right to try therapy or experimental drugs that are still in the testing phase at pharmaceutical companies in the hope of stopping the spread of their disease or possibly saving their lives. Patients were often naturally focused on the potential benefits of using these drugs, even if they were still under development and might be risky or ineffective. An executive at The Goldwater Institute, a libertarian group supporting Right to Try laws, explained, "The goal is for terminally ill patients to have choice when it comes to end-stage disease. Right to Try is something that will help terminally ill people all over the country." These sentiments were echoed by Larry Kutt, a 65-year-old man with an advanced blood cancer hoping to gain access to a therapy currently being tested by several pharmaceutical companies, who said, "It's my life and I want the chance to save it."

Critics have called efforts to create a federal Right to Try statue "a cruel shame," causing more harm than good by creating false hope. Dr. David Gorski, a Michigan surgeon, argued that releasing unapproved therapies could cause untold pain in a person's final days, even hastening death. Focusing on a benefits-versus-harms perspective, Dr. Gorski explained, "They are far more likely to harm patients than to help them."

The formal legal position in the United States was based on a 2007 court ruling that stated patients did not have a constitutional right to medicines that were not federally approved. The Food and Drug Administration had a program under which terminally ill patients, who had exhausted their treatment options, could try to obtain therapies that had passed at least the first of three FDA investigation phases. But, the law did not require pharmaceutical companies to provide the treatment, nor did it mandate that insurance companies cover these therapies. Also, the law did allow insurance companies to deny coverage to patients while they use drugs under investigation. In 2015, Johnson & Johnson created a panel of bioethicists to study patients' requests for potentially lifesaving medicines and make recommendations to the pharmaceutical firm.

Sources: "Patients Seek 'Right to Try' New Drugs," *The New York Times,* January 10, 2015, *www.nytimes.com*; "Federal 'Right to Try' Bill: Wrong on the Law, and Wrong for Patients," *The Hill,* June 28, 2016, *thehill.com*; and, "U.S. Senator Introduces a 'Right to Try' Bill for Desperate Patients," *Stat,* May 10, 2016, *www.statnews.com*.

using this reasoning process often fail to consider the means taken to reach the end. Some of these challenges are evident in Exhibit 5.A.

Despite these drawbacks, cost–benefit analysis is widely used in business. Because this method works well when used to measure economic and financial outcomes, business managers sometimes are tempted to rely on it to decide important ethical questions without being fully aware of its limitations or the availability of still other methods that may improve the ethical quality of their decisions.

Rights: Determining and Protecting Entitlements

Human rights are another basis for making ethical judgments. A right means that a person or group is entitled to something or is entitled to be treated in a certain way, as shown in Figure 5.5. The most basic human rights are the rights to life, safety, free speech, freedom, being informed, due process, and property, among others. Denying those rights or failing to protect them for other persons and groups is normally considered to be unethical and is the core of the debate over the "Right to Try" controversy profiled in Exhibit 5.A. This approach to ethical reasoning holds that individuals are to be treated as valuable ends in themselves just because they are human beings. Using others for your own purposes is unethical if, at the same time, you deny them their goals and purposes.

The main limitation of using rights as a basis of ethical reasoning is the difficulty of balancing conflicting rights. For example, an employee's right to privacy may be at odds with an employer's right to protect the firm's assets by testing the employee's honesty. Rights also clash when U.S. multinational corporations move production to a foreign nation, causing job losses at home but creating new jobs abroad. In such cases, whose job rights should be respected?[36]

Despite this kind of problem, the protection and promotion of human rights is an important ethical benchmark for judging the behavior of individuals and organizations. Surely most people would agree that it is unethical to deny a person's fundamental rights to life, freedom, privacy, growth, and human dignity. By defining the human condition and pointing the way to a realization of human potentialities, such rights become a kind of common denominator of ethical reasoning, setting forth the essential conditions for ethical actions and decisions.

Justice: Is It Fair?

A fourth method of ethical reasoning concerns **justice**. As shown in Figure 5.5, a common question in human affairs is, Is it fair or just? Employees want to know if pay scales are fair. Consumers are interested in fair prices when they shop. When new tax laws are proposed, there is much debate about their fairness—where will the burden fall, and who will escape paying their fair share?[37] After the U.S. government bailed out several big banks and insurance companies in 2008–9, many people wondered if it was fair that some of their top executives continued to receive big bonuses while their employees, shareholders, and bondholders suffered—and taxpayers absorbed the cost.

Justice, or fairness, exists when benefits and burdens are distributed equitably and according to some accepted rule. For society as a whole, social justice means that a society's income and wealth are distributed among the people in fair proportions. A fair distribution does not necessarily mean an equal distribution. Most societies try to consider people's needs, abilities, efforts, and the contributions they make to society's welfare. Since these factors are seldom equal, fair shares will vary from person to person and group to group.

Justice reasoning is not the same as utilitarian reasoning. A person using utilitarian reasoning adds up costs and benefits to see if one is greater than the other; if benefits exceed costs, then the action would probably be considered ethical. A person using justice reasoning considers who pays the costs and who gets the benefits; if the shares seem fair (according to society's rules), then the action is probably just.

Applying Ethical Reasoning to Business Activities

Anyone in the business world can use these four methods of ethical reasoning to gain a better understanding of ethical issues that arise at work. Usually, all four can be applied at the same time. Using only one of the four methods is risky and may lead to an incomplete understanding of all the ethical complexities that may be present. It also may produce a lopsided ethical result that will be unacceptable to others.

Once the ethical analysis is complete, the decision maker should ask this question: Do all of the ethics approaches lead to the same decision? If so, then the decision, policy, or activity is probably ethical. If the application of all ethics theories result in a "no, this is not ethical," then it is probably unethical. The reason you cannot be *absolutely* certain is

[36] For a discussion of ethical rights, see John R. Boatright and Jeffrey D. Smith, *Ethics and the Conduct of Business,* 8th ed. (Upper Saddle River, NJ: Pearson, 2016); and Velasquez, *Business Ethics: Concepts and Cases,* pp. 90–98.

[37] For an interesting discussion of "what is fair?" see Patrick Primeaux and Frank P. LeVeness, "What is Fair: Three Perspectives," *Journal of Business Ethics* 84 (2009), pp. 89–102.

that different people and groups (1) may honestly and genuinely use different sources of information, (2) may rely on different values or definitions of what is a virtuous character, (3) may measure costs and benefits differently, (4) may not share the same meaning of justice, or (5) may rank various rights in different ways. Nevertheless, any time an analyst obtains a consistent result when using all of the approaches, it indicates that a strong case can be made for either an ethical or an unethical conclusion.

What happens when the application of the four ethical approaches does not lead to the same conclusion? A corporate manager or employee then has to assign priorities to each method of ethical reasoning. What is most important to the manager, to the employee, or to the organization—virtue, utility, rights, or justice? What ranking should they be given? A judgment must be made, and priorities must be determined. These judgments and priorities will be strongly influenced by a company's culture and ethical climate. Some will be sensitive to people's needs and rights; others will put themselves or their company ahead of all other considerations.

The Moral Intensity of an Ethical Issue

Studies have shown that individuals make decisions differently based on the characteristics or type of ethical dilemma they face. **Moral intensity** refers to a person's perception of how morally *severe* an ethical issue is.[38] This simple insight appears to profoundly affect individuals' decisions and actions. Generally, issues that have high moral intensity evoke greater ethical attention and consideration by the decision maker than issues with low moral intensity.

Several factors contribute to the moral intensity of an issue.

- The *magnitude of consequences.* For example, issues that involve a life-or-death component, where serious physical harm could result from a decision that is made (such as Parnell's decision involving salmonella described at the beginning of this chapter) would normally be thought of as having higher moral intensity than an issue involving minor economic harm (such as stealing paper clips from the company supply closet).
- Issues are also different based on how close the decision maker feels to the people affected by the decision—the issue's *proximity.* Proximity refers to the social, physical, and psychological distance decision makers perceive themselves to have from those affected by the decision. Alphons Iacobelli's decision to use millions of dollars of company money designated for a union account to pay for his own lavish expenses would be considered an issue with very high moral intensity.
- *Social consensus* refers to the degree of social agreement that a proposed act is either acceptable or unacceptable. For example, the social consensus that sexual harassment is unacceptable has increased because of the "#MeToo" social movement, discussed earlier in this chapter.
- Moral intensity is also influenced by the *probability* that a decision maker's action will lead to the consequences predicted. The likelihood that people will die if they ingest paraquat is very high. But, the chance that they will contract Parkinson's disease from long-term exposure is still not verified by scientific research. Thus, the moral intensity of the former situation is higher than the latter.
- Finally, ethical issues vary in terms of how quickly the effects of the consequences of the decision take effect. *Temporal immediacy* refers to the length of time that the predicted

[38] This notion was first introduced by Thomas Jones in "Ethical Decision Making by Individuals in Organizations: An Issue-Contingent Model," *Academy of Management Review,* 1991, 16, pp. 366–95.

consequences will occur from the present moment of the decision. As discussed in the "Right to Try" example, terminally ill patients feel a greater temporal immediacy given the short time they have left to live. Decisions that involve immediate consequences are more morally intense than decisions where the effects will occur in the distant future.

Research has shown that the moral intensity characteristics of an ethical issue influence the entire ethical decision-making process, from moral sensitivity and awareness to moral intention and judgment. Managers and business students alike show that their ethical reasoning is strongly influenced by the moral intensity of the ethical dilemmas they face.[39]

Summary

- Ethics is a conception of right and wrong behavior, defining for us when our actions are moral and when they are immoral. Business ethics is the application of general ethical ideas to business behavior.
- Ethical business behavior enhances business performance, complies with legal requirements, prevents or minimizes harm, is demanded by business stakeholders, and promotes personal morality.
- Ethics problems occur in business for many reasons, including the selfishness of a few, competitive pressures on profits, the clash of personal values and business goals, and cross-cultural contradictions in global business operations.
- Managers' on-the-job values tend to be company-oriented, assigning high priority to company goals. Managers often value being competent and place importance on having a comfortable or exciting life, among other values. In addition, individual spirituality can greatly influence how a manager understands ethical challenges; increasingly, it is recognized that organizations must acknowledge employees' spirituality in the workplace.
- Individuals reason at various stages of moral development, with most managers focusing on personal rewards, recognition from others, or compliance with company rules as guides for their reasoning.
- People in business can analyze ethics dilemmas by using four major types of ethical reasoning: virtue ethics, utilitarian reasoning, rights reasoning, and justice reasoning.
- The perceived moral intensity of an issue, as determined by the issue's characteristics, affects how individuals make ethical decisions.

[39] James Weber, "Influences Upon Managerial Moral Decision Making: Nature of Harm and Magnitude of Consequences," *Human Relations,* 1996, pp. 1–16; Tara J. Shawver and William F. Miller, "Moral Intensity Revisited: Measuring the Benefit of Accounting Ethics Interventions," *Journal of Business Ethics,* 2017, pp. 587–603; and Robert E. Crossler, James H. Long, Tina M. Loraas, and Brad S. Trinkle, "The Impact of Moral Intensity and Ethical Tone Consistency on Policy Compliance," *Journal of Information Systems;* pp. 49–64.

Key Terms

business ethics, *96*
conflict of interest, *102*
ethical egoist, *101*
ethical principles, *95*
ethical relativism, *96*
ethics, *95*
human rights, *109*
justice, *110*
laws, *96*
moral intensity, *111*
Sarbanes-Oxley Act, *99*
spirituality, *104*
stages of moral development, *105*
U.S. Corporate Sentencing Guidelines, *98*
utilitarian reasoning, *108*
virtue ethics, *107*

Internet Resources

www.ethics.org — Ethics and Compliance Initiative
www.ibe.org.uk — Institute for Business Ethics
www.business-ethics.org — International Business Ethics Institute
www.soxlaw.com — Sarbanes-Oxley Act
www.sarbanes-oxley-association.com — *Sarbanes Oxley Compliance Professionals Association*
www.oge.gov — United States Office of Government Ethics
www.ussc.gov — United States Sentencing Commission
www.cfsaw.org — Center for Spirituality at Work

Discussion Case: *LafargeHolcim and ISIS in Syria*

In 2017, French authorities investigated and indicted several former executives of the world's largest cement manufacturer, LafargeHolcim (Lafarge), for paying the Islamic State terrorist group to protect their factory in Syria and its workers. The indictment charged Bruno Lafont and Eric Olsen—two former CEOs—and the former senior executive of Syrian operations, Christian Herrault, with financing a terrorist organization and endangering the lives of others.

Lafarge was a major multinational cement company based in France, employing 81,000 workers at 2,300 sites in 80 countries around the world. The company had maintained operations in Syria since 2010, after investing more than $708 million to refurbish a factory in Jalabiyeh, a town near the Turkish border. This plant created hundreds of jobs for local residents, generated thousands of tons of cement every day, and supported other businesses nearby.

Just a year after Lafarge started operations in Jalabiyeh, civil war broke out between President Bashar al-Assad's government and various rebel factions. Between 2011 and 2013, the area near the factory was occupied by a succession of armed military groups before the Islamic State (also known as ISIS) seized control. During this period, militants intercepted and detained Lafarge employees as they came and went from work, making it dangerous for employees and difficult for managers to run the plant efficiently.

In 2011, Lafarge management started paying the militants through intermediaries, essentially to leave the company alone and allow it to operate. The company's subsidiary in Syria, Lafarge Cement Syria (LCS), paid about $15.2 million for this purpose between 2011 and 2014; a large part of this money went directly to ISIS. Herrault admitted that Lafarge was involved in a "racket," but said that he regularly informed top managers of the company and that everything was under control.

In an official statement justifying management's decision to pay off the militant groups, the company stated, "Very simply, chaos reigned, and it was the task of local management to ensure that the intermediaries did whatever was necessary to secure its supply chains and the free movement of its employees." Lafarge said that they did not think they had any other options to keep the plant operational and minimize risks to their employees.

The company also took other steps to protect its workers and keep the militants at bay. After militant forces kidnapped nine Lafarge employees and transferred them to local militia camps, local managers spent more than $200,000 to secure their release. Lafarge also attempted to ease tensions by purchasing raw materials from ISIS-held areas to support the region's economy. In 2013, a Lafarge memo emphasized the threat posed by terrorists. "It becomes more and more difficult to operate without being required to directly or indirectly

negotiate with these [ISIS] networks classified as terrorists' networks by international organizations and the USA," the memo concluded.

Despite the company's efforts, workers continued to be at risk. French courts reviewed charges submitted by 11 Lafarge workers through Sherpa, a French law association whose primary mission was the protection of workers, that Lafarge placed them in a high-risk environment and put their lives in danger. "Lafarge acted as if it was above the law," said Marie-Laure Guislain, the head of litigation at Sherpa. "But it played a role in an armed conflict, as well as in the violation of human rights, and must be held accountable."

Olsen resigned as CEO amidst an internal investigation of the firm's top management that found that the money funneled to the terrorist groups was used, in part, to permit factory workers to move to and from the facility. This inquiry also found that Olsen was not responsible for, or aware of, the activity. According to extensive testimony and eyewitness accounts of former and current employees as well as a review of internal company correspondence, the payments to the militant groups did not guarantee the safety of plant employees. More than twelve workers were kidnapped between 2012 and 2014. There were multiple accounts of employees being held at gunpoint on their way to and from work.

In 2014, ISIS forces declared a caliphate, asserting their control over a region, including parts of Syria. Within weeks, as the fighting for territory continued, air strikes were heard outside the Lafarge plant. When ISIS militants claimed responsibility for the truck bombing at a Turkish-owned cement plant nearby, Lafarge temporarily halted production and told its workers to stay home. Some workers, considered nonessential by management, were ferried by bus to operations in Manbji, a city in northern Syria. Yet, managers ordered about 30 workers to report to work to keep the Jalabiyeh plant operating.

Ultimately, in 2015, as a team of employees and managers gathered for work one morning outside the plant, the factory's doctor warned that ISIS had just captured a nearby village. "You've got to get out of here," he warned. "ISIS is coming!" When the workers discovered that evacuation buses promised by management were not there, they escaped in their own vehicles. ISIS captured the factory that evening. "What I want to know," Mostafa Haji Mohamad, a medical worker at the Syrian factory, said of Lafarge in an interview, "is why did they leave us there to face our deaths? The factory was the only thing they cared about."

Sources: "France Investigates Lafarge Executives for Terrorist Financing," *The New York Times,* December 8, 2017, *www.nytimes.com*; "Former LafargeHolcim CEO Charged with Syria Terrorism Funding," *Bloomberg,* December 8, 2017, *www.bloomberg.com*; "Top Lafarge Executives, Including Former CEO, Indicted on Terror Financing Charges," *France24,* December 9, 2017, *www.france24.com*; and, "Lafarge Paid 13 Million Euros to Armed Groups to Keep Operating in Syria," *Reuters,* December 12, 2017, *www.reuters.com*; and "'ISIS Is Coming!' How a French Company Pushed the Limits in War-Torn Syria," *The New York Times,* March 10, 2018, *www.nytimes.com*.

Discussion Questions

1. Do you agree with the French government's charges against Lafarge and its managers? Why or why not?
2. What arguments did Lafarge managers make to justify their decision to pay terrorist groups in Syria? Do you believe that these were their real reasons?
3. Do you believe that Lafarge's actions in Syria were ethical or unethical? Use the four methods of ethical reasoning (see Figure 5.5) to support your view.
4. Evaluate the moral intensity of the decision Lafarge managers made, based on the dimensions of moral intensity.
5. Is there anything Lafarge could have done to protect its employees adequately without paying terrorists?

CHAPTER SIX

Organizational Ethics

Faced with increasing pressure to create an ethical environment at work, businesses can take tangible steps to improve their ethical performance. The organization's culture and ethical work climate play a central role in promoting ethics at work. Ethical situations arise in all areas and functions of business, and often professional associations seek to guide managers in addressing these challenges. Corporations can also implement ethical safeguards to create a comprehensive ethics program. This can become a complex challenge when facing different customs and regulations around the world.

This Chapter Focuses on These Key Learning Objectives:

LO 6-1 Classifying an organization's culture and ethical climate.

LO 6-2 Recognizing ethics challenges across the multiple functions of business.

LO 6-3 Creating effective ethics policies and identifying responsible individuals to become the organization's ethics and compliance officer.

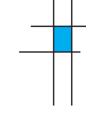
LO 6-4 Constructing successful ethics reporting mechanisms, ethics training programs, and similar safeguards.

LO 6-5 Understanding how to conduct business ethically in the global marketplace.

In 2016, British regulators fined the U.S. pharmaceutical giant Pfizer $107 million for overcharging 48,000 patients in their national health care system for the generic version of the epilepsy drug phenytoin sodium. Pfizer had worked with the drug distribution company, Flynn Pharma Limited, to de-brand the drug in 2012 in order to raise the price to insurers. Generic drugs are not normally subject to government—pharmaceutical company negotiations, so the prices could be freely determined by Pfizer. The drug company charged wholesalers and pharmacies a price 17 times higher than the amount it had charged before 2012.[1]

In 2016, Wells Fargo, a global banking and financial giant, was fined $185 million for issuing credit cards to consumers without their consent. Over a period of five years, Wells Fargo employees opened around 1.5 million unauthorized bank accounts and issued over half a million credit cards fraudulently. Over time, consumers started to accumulate banking fees for accounts they did not want or know about. Some of the victims were even contacted by debt collectors for not paying their fees. Wells Fargo refunded approximately $2.6 million to the affected consumers, but the damage to these individuals' credit ratings lingered on. Over 5,300 Wells Fargo employees and managers involved in the scandal were fired as the firm cited major weaknesses in the company's corporate culture.[2]

Pfizer and Wells Fargo are just two of many companies from around the world that over the years have been charged with excessive pricing, defrauding their customers, lying about their finances, mishandling investors' funds, jeopardizing the safety of consumers, and many other illegal and unethical activities. *Why are business executives, managers, and employees repeatedly being caught conducting illegal and unethical activities? What can firms do to minimize or prevent the unethical activities perpetrated by their executives and employees? Can companies set in place systems or programs to monitor workplace activities to detect illegal or unethical behavior?*



Corporate Ethical Climates

Personal values and moral character play key roles in improving a company's ethical performance, as discussed in Chapter 5. However, they do not stand alone, because personal values and character can be affected by a company's culture and ethical climate.

The terms c*ulture* and *climate* are often used interchangeably and, in fact, are highly interrelated. **Corporate culture** is a blend of ideas, customs, traditional practices, company values, and shared meanings that help define normal behavior for everyone who works in a company. Culture is "the way we do things around here." Erica Salmon Byrne, executive vice president, governance and compliance for The Ethisphere Institute, warns businesses and the public:

> "This is a lesson we have learned, re-learned, and will likely learn again. Regulators around the globe are increasingly calling on organizations to examine their culture. From Enron to Volkswagen, the *Challenger* to WorldCom, there are multiple examples of organizations with formal systems that say one thing and cultures that promote another. When those kinds of alignment gaps are allowed to persist, you eventually have a failure of one variety or another: ethics, quality, safety, or a combination of all three ."[3]

[1] "Pfizer Fined $107 Million for Overcharging U.K. for Epilepsy Drug," *The Wall Street Journal,* December 7, 2016, *www.wsj.com.*

[2] "Wells Fargo Fined $185 Million for Fraudulently Opening Accounts," *The New York Times,* September 8, 2016, Page B1, *www.nytimes.com.*

[3] Erica Salmon Byrne, "Culture Matters," *Ethikos,* September–October 2016, pp. 1–2.

The Ethics Resource Center (ERC) observed that a "strong ethical culture in a company has a profound impact on the kinds of workplace behavior that can put a business in jeopardy." Weak ethical cultures can foster ongoing bad behavior. In a national business ethics survey conducted by the Ethics and Compliance Initiative, 26 percent of employees reported that misconduct they had observed in their companies was part of an ongoing pattern. Forty-one percent claimed that the unethical behavior was repeated a second time, indicating a weak ethical work culture.[4]

Most companies have a kind of moral atmosphere. People can feel which way the ethical winds are blowing. They pick up subtle hints and clues that tell them what behavior is approved and what is forbidden. The **ethical climate** represents an unspoken understanding among employees of what is and is not acceptable behavior based on the expected standards or norms used for ethical decision making. It is the part of broader corporate culture that sets the ethical tone in a company. One way to view ethical climates is diagrammed in Figure 6.1. Three distinct ethical criteria are *egoism* (self-centeredness), *benevolence* (concern for others), and *principle* (respect for one's own integrity, for group norms, and for society's laws). (These parallel the levels of moral development developed by Lawrence Kohlberg that are discussed in Chapter 5.) These ethical criteria can be used to describe how individuals, a company, or society at large approach various moral dilemmas.

For example, if a company approaches ethics issues with benevolence in mind, it would emphasize friendly relations with its employees, stress the importance of team play and cooperation for the company's benefit, and recommend socially responsible courses of action. However, a company using egoism would be more likely to think first of promoting the company's profit and striving for growth at all costs, as illustrated by the following example:

> A Brazilian meat company, JBS, lost many of its customers and business partners amid a bribery scandal in 2017. The company admitted to bribing almost 2,000 politicians in exchange for subsidies that helped make JBS the largest meatpacker in the world. Restaurants and supermarkets in Brazil, including Domino's Pizza Brasil and Subway, stopped buying JBS meats because of the corrupt behavior. The backlash against JBS even reached the United States, as Walmart publicly stated that they would not tolerate unethical behavior by their suppliers and would monitor the situation at JBS closely. Its shortsighted, self-focused actions had very high reputational costs to the company.[5]

Researchers have found that multiple ethical climates, or subclimates, may exist within one organization. For example, one company might include managers who often interact with the public and government regulators, using a principle-based approach, compared to

FIGURE 6.1
The Components of Ethical Climates

Source: Adapted from Bart Victor and John B. Cullen, "The Organizational Bases of Ethical Work Climates," *Administrative Science Quarterly* 33 (1988), p. 104.

Ethical Criteria	Focus of Individual Person	Organization	Society
Egoism (self-centered approach)	Self-interest	Company interest	Economic efficiency
Benevolence (concern-for-others approach)	Friendship	Team interest	Social responsibility
Principle (integrity approach)	Personal morality	Company rules and procedures	Laws and professional codes

[4] "National Business Ethics Survey 2013," *Ethics and Compliance Initiative,* 2013, *www.ethics.org.*

[5] "Business Partners Back Away from JBS amid Bribery Scandal," *The Wall Street Journal,* June 8, 2017. *www.wsj.com.*

another group of managers, whose work is geared toward routine process tasks and whose focus is mainly egoistic—higher personal pay or company profits.[6]

Corporate ethical climates can also signal to employees that ethical transgressions are acceptable. By signaling what is considered to be right and wrong, corporate cultures and ethical climates can pressure people to channel their actions in certain directions desired by the company. This kind of pressure can work both for and against good ethical practices.

Business Ethics across Organizational Functions

Not all ethics issues in business are the same. Because business operations are highly specialized, ethics issues can appear in any of the major functional areas of a business firm. Accounting, finance, marketing, information technology, supply chain, and other areas of business all have their own particular brands of ethical dilemmas. In many cases, professional associations in these functional areas have attempted to define a common set of ethical standards, as discussed next.

Accounting Ethics

The accounting function is a critically important component of every business firm. By law, the financial records of publicly held companies are required to be audited by a certified professional accounting firm. Company managers, external investors, government regulators, tax collectors, and labor unions rely on such public audits to make key decisions. Honesty, integrity, transparency, and accuracy are absolute requirements of the accounting function, and the impact can be devastating for organizations when these values are absent.

> In 2016, the United Kingdom established a new regulatory body, the Financial Reporting Council (FRC), to monitor auditing firms and investigate questionable financial statements. This action was in response to a $5.5 billion lawsuit against PricewaterhouseCoopers LLC for the auditing firm's failure to uncover a mortgage lender fraud scheme. This action was part of a Europe-wide initiative to place auditors under greater scrutiny and to ensure they delivered fair and accurate accounting statements to organizational stakeholders.[7]

Accountants often are faced with conflicts of interest, introduced in Chapter 5, where loyalty or obligation to the company (the client) may be divided or in conflict with self-interest (of the accounting firm) and the interests of others (shareholders and the public). For example, while conducting an audit of a company, should the auditor look for opportunities to recommend to the client consulting services that the auditor's firm can provide? Sometimes, accounting firms may be tempted to soften their audit of a company's financial statements if the accounting firm wants to attract the company's nonaudit business. For this reason, the Sarbanes-Oxley Act severely limits the offering of nonaudit consulting services by the auditing firm.

Examples of the U.S. accounting profession's efforts promoting ethics are shown in Exhibit 6.A. Spurred by a threat of liability suits filed against accounting firms and a desire

[6] James Weber, "Influences upon Organizational Ethical Subclimates: A Multi-departmental Analysis of a Single Firm," *Organization Science* 6 (1995), pp. 509–23. For a summary of ethical climate research, see Aditya Simha and John B. Cullen, "Ethical Climates and Their Effects on Organizational Outcomes: Implications from the Past and Prophesies for the Future," *Academy of Management Perspectives,* 2012, pp. 20–34.

[7] "The Morning Risk Report: Auditors under Increased Scrutiny," *The Wall Street Journal,* August 16, 2016, *blogs.wsj.com.*

Exhibit 6.A

Excerpts of the Professional Codes of Conduct in Accounting and Finance

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA)

Code of Professional Conduct

These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage. The Principles include: professional responsibilities, serving the public interest, maintaining integrity, maintaining objectivity and independence, exhibiting due care, and adhering to the Principles when providing services.*

CHARTERED FINANCIAL ANALYST (CFA)®

CFA Institute Code of Ethics and Standards of Professional Conduct

Members of CFA Institute (including Chartered Financial Analyst® (CFA®) charterholders) and candidates for the CFA designation ("Members and Candidates") must act with integrity, competence, diligence, respect, and in an ethical manner, place the integrity of the investment profession and the interests of clients above their own personal interests, exercise independent professional judgment when making decisions, practice in a professional and ethical manner, promote the integrity for the ultimate benefit of society, and maintain their professional competence.†

*Source: AICPA Code of Professional Conduct. American Institute of CPAs. For a full text of the professional code, see www.aicpa.org.
†Source: CFA Institute. For full text see www.cfapubs.org/doi/pdf/10.2469/ccb.v2014.n6.1.

to reaffirm professional integrity, these standards go far toward ensuring a high level of honest and ethical accounting behavior.[8]

In addition, a new international Code of Ethics for professional accountants was unveiled in 2018. According to Kim Gibson, member of the International Ethics Standards Board for Accountants (IESBA), "the new standards are designed to be easier to use, navigate, and enforce; be more relevant for professional accountants in business, [and] distinguish more clearly between requirements and application material."[9]

Financial Ethics

Within companies, the finance department and its officers are typically responsible for managing the firm's assets and raising capital—for example, by issuing stocks and bonds. Financial institutions, such as commercial banks, securities firms, and so forth, assist in raising capital and managing assets for both individuals and institutions. Whether working directly for a business or in a firm that provides financial services, finance professionals face a particular set of ethical issues. Consider the following ethical lapses in corporate finance:

- Barclays PLC and four of their former top executives were charged with fraud by convincing Qatari to make payments to inflate the bank's financial condition during the financial crisis. The United Kingdom's Fraud Office filed the criminal suit against

[8] For several excellent examples of ethical dilemmas in accounting, see Leonard J. Brooks and Paul Dunn, *Business & Professional Ethics for Directors, Executives and Accountants,* 8th ed. (Stamford, CT: Cengage Learning, 2017); and Steven M. Mintz and Roselyn E. Morris, *Ethical Obligations and Decision-Making in Accounting: Text and Cases,* 4th ed. (New York: McGraw-Hill, 2016).

[9] "5 Things You Need to Know about the New International Ethics Code," *Journal of Accountancy,* May 8, 2018, *www.journalofaccountancy.com.*

Barclays for conspiracy to commit fraud. Two separate financial capital investments by Qatari financiers raised nearly $15 billion to save the bank from collapse in the 2008 recession. This latest suit came on top of another investigation of Barclays over failures of disclosure linked to Qatar capital investments.[10]

- In 2018, the Royal Bank of Scotland agreed to pay $4.9 billion to settle with the U.S. Justice Department over the sale of toxic mortgage-backed securities during the lead-up to the global financial crisis. This settlement cleared the path for the bank's privatization, ending the long-running probe into the bank's actions. This settlement was in addition to the bank's earlier payments involving these securities—$5.5 billion to the Federal Housing Finance Agency, $500 million settlement with the State of New York, and $125 million agreed to be paid to two large California pension funds.[11]

These and other lapses in ethical conduct occurred despite efforts by the finance professions to foster an ethical environment. As shown in Exhibit 6.A, the highly regarded Chartered Financial Analyst Institute, which oversees financial executives performing many different types of jobs in the financial discipline, emphasizes self-regulation as the best path for ethical compliance.[12]

Marketing Ethics

Marketing refers to advertising, distributing, and selling products or services. Within firms, the marketing department is the functional area that typically interacts most directly with customers. Outside the firm, advertising agencies and other firms provide marketing services to businesses. The complex set of activities involved in marketing generates its own distinctive ethical issues.

One issue in marketing ethics emphasizes honesty and transparency in advertising and data about advertising.

In 2017, a tech start-up, Outcome Health, which installed and ran video monitors in physicians' offices to show pharmaceutical advertising to patients, misled their corporate customers. Outcome Health inappropriately charged pharmaceutical companies for the placement of their ads on video screens that were never installed. The company even inflated data about how well the ads were performing and manipulated reports of third-party analyses of the success of the marketing strategy. The deceit also impacted the company's investors, as Outcome Health overestimated its revenue by including the false data. These allegations were still being investigated in 2018.[13]

In addition to the general ethical questions that surround the marketing or advertising of products to consumers, consumer health and safety are another key ethics issue in marketing. Chapter 14 discusses several other issues in marketing ethics, including deceptive advertising, firm liability for consumer injury, and a firm's responsibility for the unethical use of products by buyers.

To improve the ethics of the marketing profession, the American Marketing Association (AMA) has adopted a code of ethics for its members, as shown in Exhibit 6.B. The AMA

[10] "Barclays, Four Former Top Executives Charged with Fraud over Fundraising with Qatari Investors," *Wall Street Journal,* June 20, 2017, *www.wsj.com.*

[11] "RBS in $4.9 Billion U.S. Settlement Over Mortgage-Backed Securities," *The Wall Street Journal,* May 10, 2018, *www.wsj.com.*

[12] For a good example of other financial ethics issues, see John B. Boatright, *Ethics in Finance,* 3rd ed. (Malden, MA: Wiley-Blackwell, 2014).

[13] "Outcome, A Hot Tech Startup, Misled Advertisers with Manipulated Information, Sources Say," *The Wall Street Journal,* October 13, 2017, *www.wsj.com.*

Exhibit 6.B Excerpts of the Professional Codes of Conduct in Marketing and Information Technology

AMERICAN MARKETING ASSOCIATION (AMA)

Statement of Ethics

The American Marketing Association commits itself to promoting the highest standard of professional ethical norms and values for its members (practitioners, academics, and students). As Marketers, we must do no harm, avoiding harmful actions or omissions by embodying high ethical standards and adhering to all applicable laws and regulations; foster trust in the marketing system, striving for good faith and fair dealing as well as avoiding deception in product design, pricing, communication, and delivery of distribution; and, embrace ethical values, building relationships and enhancing consumer confidence by affirming these core values: honesty, responsibility, fairness, respect, transparency, and citizenship.

We expect AMA members to be courageous and proactive in leading and/or aiding their organizations in the fulfillment of the explicit and implicit promises made to those stakeholders.*

ASSOCIATION OF INFORMATION TECHNOLOGY PROFESSIONALS (AITP)

Code of Ethics and Standards of Conduct

This code begins with a commitment by each association's member to promote the understanding of information processing methods and procedures, an obligation to fellow members to uphold the ideals of AITP and cooperate with my fellow members and treat them with honesty and respect at all times, an obligation to society to the dissemination of knowledge pertaining to the general development and understanding of information processing, an obligation to employers to discharge this obligation to the best of my ability, to guard my employer's interests and to advise him wisely and honestly, an obligation to my country to uphold my nation and shall honor the chosen way of life of my fellow citizens, and to accept these obligations as a personal responsibility and as a member of this Association.**

*Source: American Marketing Association's Statement of Ethics, 2017, as it appears in www.marketing.com.

**Source: Association of Information Technology Professionals, 2011–16. A full text of the AITP code of ethics can be found at www.aitp.org.

code advocates professional conduct guided by ethics, adherence to applicable laws, and honesty and fairness in all marketing activities. The code seeks to help marketing professionals translate general ethical principles into specific working rules.[14]

Information Technology Ethics

One of the most complex and fast-changing areas of business ethics is in the field of information technology. Ethical challenges in this field involve invasions of privacy; the collection and storage of, and access to, personal and business information, especially through e-commerce transactions; confidentiality of electronic mail communication; copyright protection regarding software, music, and intellectual property; cyberbullying; and numerous others.

> VTech, an electronics toymaker, agreed to pay a $650,000 penalty in 2018 for collecting personal information from hundreds of thousands of U.S. children without obtaining consent from their parents in violation of child privacy law. The Federal Trade Commission also required the Hong Kong-based company and its U.S. subsidiary to strengthen its data security measures and conduct external security audits of its operations as a part of the settlement. VTech's actions were exposed after a

[14] "Statement of Ethics," *American Marketing Association,* n.d., *www.ama.org.*

Exhibit 6.C Professional Code of Conduct in Supply Chain Management

Similar to the other professional associations, whose codes of ethical conduct are presented in Exhibits 6.A and 6.B, the Institute for Supply Management (ISM) developed its Principles and Standards of Ethical Supply Chain Management Conduct with Guidelines that emphasize integrity, value, and loyalty across 10 main principles. The specific principles are avoid impropriety, conflict of interest, and negative influences; be responsible to your employer, suppliers and customers, and social responsibility and sustainability practices; protect confidentiality; avoid reciprocity; follow applicable laws, regulations, and trade agreements; and exhibit professional competence.

Source: Institute for Supply Management's *Principles and Standards of Ethical Supply Management Conduct with Guidelines* from www.instituteforsupplymanagement.org.

cyberattack incident in 2015, which revealed more than 6 million children's personal information, including name, gender, and birth date. Additionally, nearly 5 million parents' personal information was breached.[15]

As discussed in later chapters of this book, the explosion of information technology has raised serious questions of trust between individuals and businesses. In response to calls by businesspeople and academics for an increase in ethical responsibility in the information technology field, professional organizations have developed or revised professional codes of ethics, as shown in Exhibit 6.B.[16]

Supply Chain Ethics

Production and operations functions are part of an organizations' supply chain and have also been at the center of some ethics storms.

Kobe Steel Limited, a Japanese metals manufacturer, admitted to misleading 500 companies about the quality of the copper the firm shipped to its customers for over 10 years. Japan's Quality Assurance Organization is responsible for certifying that the quality of products meets Japanese and international standards. This agency investigated Kobe's alleged manipulation of quality reports in 2017. The company admitted to falsifying quality documents on tens of thousands of metal orders involving copper piping and later to covering up evidence. Breaches in the failure to report accurate information expanded to include other manufacturing facilities owned by Kobe, violating laws, regulatory standards, and customers' trust.[17]

Similar to other professional associations, supply chain managers also are guided by a professional code of ethics, shown in Exhibit 6.C.

Efforts by professional associations to guide their members toward effective resolution of ethical challenges make one point crystal clear: All areas of business, all people in business, and all levels of authority in business encounter ethics dilemmas from time to time. Ethics issues are a common thread running through the business world. Specific steps that businesses can take to make ethics work are discussed next.

[15] "Electronic Toymaker VTech Reaches $650K FTC Settlement Over Child Privacy Rule Violations," *USA Today,* January 8, 2018, *www.usatoday.com.*

[16] For further discussion of ethics in information technology, see Sara Baase, *A Gift of Fire: Social, Legal, and Ethical Issues for Computing and the Internet,* 5th ed. (Upper Saddle River, NJ: Pearson, 2017); and Richard A. Spinello, *Cyberethics: Morality and Law in Cyberspace,* 6th ed. (Burlington, MA: Jones & Bartlett Learning, 2016).

[17] "Kobe Steel Admits 500 Companies Misled in Scandal," *The Wall Street Journal,* October 13, 2017, *www.wsj.com*; "Kobe Steel Finds More Products Shipped with Quality Issues," *The Wall Street Journal,* October 20, 2017, *www.wsj.com.*

Making Ethics Work in Corporations

Any business firm can improve the quality of its ethical performance. Doing so requires a company to build ethical safeguards into its everyday routines. This is sometimes called *institutionalizing ethics.* The percentage of the world's largest firms (the *Fortune 500* or *1000* as reported in *Fortune* magazine each year) that have adopted these safeguards since the 1980s is shown in Figure 6.2.

A 2015 Ethics Research Center study found that employees in large organizations with an effective ethics and compliance program were less likely to feel pressure to compromise their ethical standards (3 percent), compared to those without effective programs (23 percent). They were also less likely to observe misconduct (33 percent versus 62 percent) and less likely to experience retaliation (4 percent versus 59 percent). Employees at organizations with an effective ethics program were nearly three times more likely to report observed misconduct at work (87 percent versus 32 percent).[18]

Building Ethical Safeguards into the Company

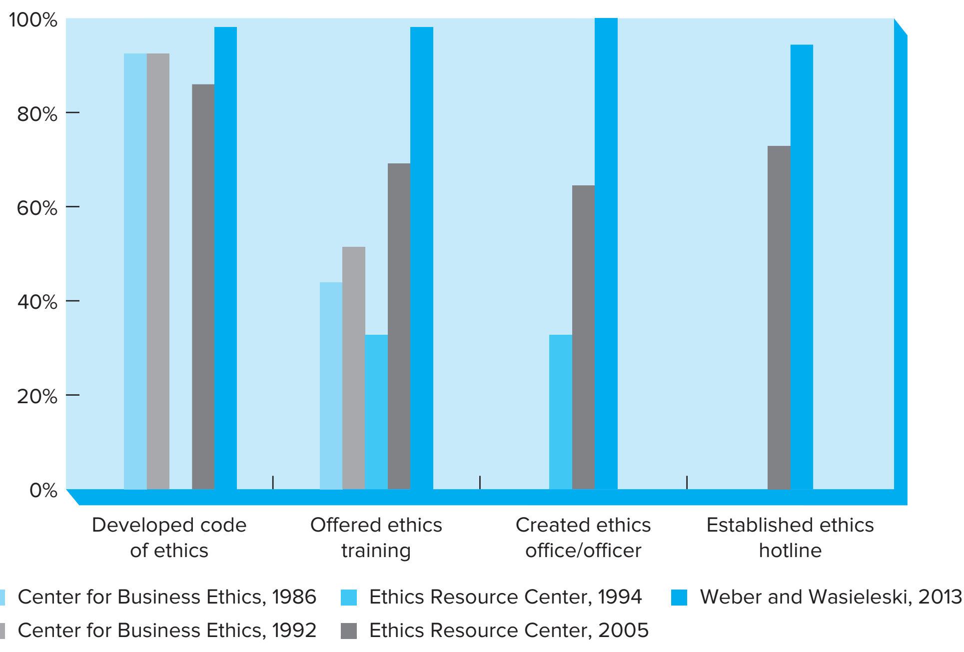
Managers and employees need guidance on how to handle day-to-day ethical situations; their own personal ethical compass may be working well, but they need to receive directional signals from the company. Several organizational steps can be taken to provide this kind of ethical awareness and direction.

Lynn Sharp Paine, a Harvard Business School professor, has described two distinct approaches to ethics programs: a compliance-based approach and an integrity-based approach. A compliance-based program seeks to avoid legal sanctions. This

FIGURE 6.2

Percentage of Firms Reporting They Have the Ethical Safeguard

Sources: Center for Business Ethics, "Are Corporations Institutionalizing Ethics?" *Journal of Business Ethics* 5 (1986), pp. 85–91; Center for Business Ethics, "Instilling Ethical Values in Large Corporations," *Journal of Business Ethics* 11 (1992), pp. 863–67; Ethics Resources Center, *Ethics in American Business: Policies, Programs and Perceptions* (Washington, DC, Ethics Resource Center, 1994); Ethics Resource Center, *National Business Ethics Survey: How Employees View Ethics in Their Organizations 1994–2005,* (Washington, DC, Ethics Resource Center, 2005); and James Weber and David Wasieleski, "Corporate Ethics and Compliance Programs: A Report, Analysis and Critique," *Journal of Business Ethics* 112 (2013), pp. 609–26.



[18] "The State of Ethics in Large Companies," *Ethics Research Center,* 2015, *www.ethics.org.*

approach emphasizes the threat of detection and punishment in order to channel employee behavior in a lawful direction. Paine also described an integrity-based approach to ethics programs. Integrity-based ethics programs combine a concern for the law with an emphasis on employee responsibility for ethical conduct. Employees are told to act with integrity and conduct their business dealings in an environment of honesty and fairness. From these values a company will nurture and maintain business relationships and will be profitable.[19]

Researchers found that both approaches lessened unethical conduct, although in somewhat different ways. Compliance-based ethics programs increased employees' willingness to seek ethical advice and sharpened their awareness of ethical issues at work. Integrity-based programs, for their part, increased employees' sense of integrity, commitment to the organization, willingness to deliver bad news to supervisors, and their perception that better decisions were made.[20]

Top Management Commitment and Involvement

Research has consistently shown that the "tone at the top"—the example set by top executives—is critical to fostering ethical behavior. As Dan Amos, CEO and Chairperson for Aflac states, "Ethics is a mindset, not an option."[21] When senior-level managers and directors signal employees, through their own behavior, that they believe ethics should receive high priority in all business decisions, they have taken a giant step toward improving ethical performance throughout the company.

Whether the issue is sexual harassment, honest dealing with suppliers, or the reporting of expenses, the commitments (or lack thereof) by senior management and the employees' immediate supervisor and their involvement in ethics as a daily influence on employee behavior are the most essential safeguards for creating an ethical workplace.

Ethics Policies or Codes

As shown in Figure 6.2, many U.S. businesses, especially large firms, have **ethics policies or codes**. An example of a corporate ethics code is shown in Exhibit 6.D. The purpose of such policies and codes is to provide guidance to managers and employees when they encounter an ethical dilemma. Research has shown significant differences among countries. In the United States and Latin America, ethics policies were found to be primarily *instrumental*—that is, they provided rules and procedures for employees to follow in order to adhere to company policies or societal laws. In Japan, most policies were a mixture of *legal compliance* and *statements of the company's values and mission. Values and mission* policies were also popular with European and Canadian companies.[22] Despite some differences in orientation, codes of ethics are clearly becoming more common.

Typically, ethics policies cover issues such as developing guidelines for accepting or refusing gifts from suppliers, avoiding conflicts of interest, maintaining the security of proprietary information, and avoiding discriminatory personnel practices. Yet, researchers have found that a written ethics policy, while an important contributor, is insufficient by itself to bring about ethical conduct. Companies must circulate ethics policies frequently and widely among employees and external stakeholder groups (for example, customers,

[19] Lynn Sharp Paine, "Managing for Organizational Integrity," *Harvard Business Review,* March–April 1994, pp. 106–17.

[20] Gary R. Weaver and Linda Klebe Trevino, "Compliance and Values Oriented Ethics Programs: Influences on Employees' Attitudes and Behavior," *Business Ethics Quarterly* 9 (1999), pp. 315–35.

[21] "Top CEOs Place High Value on Corporate Ethics and Social Responsibility to Drive Business," *Forbes,* September 11, 2017, *www.forbes.com.*

[22] Ronald C. Berenbeim, *Global Corporate Ethics Practices: A Developing Consensus* (New York: Conference Board, 1999).

Exhibit 6.D

3M's Code of Conduct

Named one of the world's most ethical companies in 2018 for the fifth straight year by Ethisphere Institute, 3M maintains its reputation for its personal integrity, shared values, and ethical business practices around the world. Their code of conduct emphasizes six main principles:

1. **Be Good.** Obey the law and 3M's Code of Conduct.
2. **Be Honest.** Act with uncompromising honesty and integrity.
3. **Be Fair.** Play by the rules, whether working with government, customers, or suppliers.
4. **Be Loyal.** Protect 3M's interests, assets, and information.
5. **Be Accurate.** Keep complete and accurate business records.
6. **Be Respectful.** Respect one another and our social and physical environment around the world.[23]

Source: www.3m.com

suppliers, or competitors). Many companies use posters, quick reference guides, and brochures to raise awareness and importance of their code.[24]

Ethics and Compliance Officers

Ethical lapses in large corporations throughout the 1980s prompted many firms to create a new position: the **ethics and compliance officer** (ECO), or sometimes called the chief compliance officer (CCO) or the chief integrity officer (CIO). A second surge of attention to ethics and the creation of ethics offices came in response to the 1991 U.S. Corporate Sentencing Guidelines, discussed in Chapter 5. The wave of corporate ethics scandals in the early 2000s and the passage of the Sarbanes-Oxley Act once again turned businesses' attention toward entrusting ethical compliance and the development and implementation of ethics programs to an ethics or compliance officer. From 2000 to 2004, the number of members in the Ethics Officer Association doubled from 632 to more than 1,200 members and continued to grow to approximately 1,300 members representing over 400 organizations in over 50 countries by 2015. In 2015, the Ethics and Compliance Officer Association (ECOA), having renamed itself to reflect the growing number of managers charged with both compliance and ethics issues, and the Ethics Resource Center, America's oldest non-profit organization advancing high ethical standards and practices in public and private institutions, merged into the Ethics and Compliance Alliance. One member of the ECOA is profiled in Exhibit 6.E.

A PricewaterhouseCoopers 2018 global compliance survey reported that 30 percent of the company's ethics and compliance officers annually review the company's code of conduct and 49 percent update their firm's compliance training and communication programs. Technology also plays a larger role for ethics officers. Half of the ethics and compliance officers surveyed reported they used technology to monitor employees' compliance with ethics and compliance-related policies and procedures. "To prevent blind spots and flag exceptions as they occur, we must look to automation and technology to conduct real-time data mining and analytics," explained Karen Griffin, executive vice present and chief compliance officer at Mastercard.[25]

[23] "3M Recognized by Ethisphere Institute as a World's Most Ethical Company for 5th Consecutive Year," *3M News Center,* Press Release, February 12, 2018, *news.3m.com*; and *3Msource.mmm.com/businessconduct.*

[24] "The 2014 Ethics and Compliance Program Effectiveness Report," *LRN,* 2014, pp. 30–31.

[25] "Getting Ahead of the Watchdogs: Real-Time Compliance Management, 2018 State of Compliance," *PricewaterhouseCoopers,* 2018, *www.pwc.com/us/stateofcompliance.*

Exhibit 6.E

Meet Brad Smith, Microsoft's Chief Compliance Officer

Brad Smith serves as Microsoft's chief compliance officer, as well as its president and chief legal officer. He is responsible for the company's corporate, external, and legal affairs, leading a team of more than 1,400 business, legal, and corporate affairs professionals working in 55 countries. These teams are responsible for the company's legal work, its intellectual property portfolio, patent licensing business, corporate philanthropy, government affairs, public policy, corporate governance, and social responsibility work. Smith plays a key role in representing the company externally and in leading the company's work on a number of critical issues including privacy, security, accessibility, environmental sustainability, and digital inclusion. Smith joined Microsoft in 1993 before becoming general counsel in 2002. Previously, he spent three years leading the legal and corporate affairs team in Europe and five years serving as the deputy general counsel responsible for legal and corporate affairs outside of the United States.

Sources: From the Leadership page in the Microsoft website, *news.microsoft.com*.

Ethics Reporting Mechanisms

In most companies, when employees are troubled about some ethical issue they seek out their immediate supervisor or someone else in senior management. But what if the employee is reluctant, for whatever reason, to raise the issue with their immediate supervisor? In that case, they can turn to their company's **ethics reporting mechanisms** and call a "helpline" or send an e-mail expressing their concerns, anonymously if they wish. Ethics reporting systems typically have three uses: (1) to provide interpretations of proper ethical behavior involving conflicts of interest and the appropriateness of gift giving, (2) to create an avenue to make known to the proper authorities allegations of unethical conduct, and (3) to give employees and other corporate stakeholders a way to discover general information about a wide range of work-related topics.

A 2014 study found that 87 percent of firms made at least substantial progress on providing employees with a secure and anonymous channel for reporting concerns. Another study found that more than one-third of the firms surveyed reported that the volume of calls to the organization's reporting mechanism increased somewhat or a great deal in the last two years and only 12 percent of firms reported a decline in calls.[26]

While more and more employees are willing to use their companies' ethical reporting mechanisms, a number of challenges remain. Executives tend to use the helpline more often than those farther down the organizational chart. The Ethics Resource Center study found that middle managers were "an area of vulnerability within companies" since they were less likely to use the helpline. The report also discovered that rates of helpline usage were lower in foreign-owned companies than in their U.S. counterparts. Yet, many businesses described greater success when employees use the company's helpline/hotline and were better able to avoid more serious ethical violations. Technology seemed to be the key.

A recent trend in corporate governance involves the use of ethics ambassadors, or liaisons, whose role is to promote and spread compliance and ethics messages throughout an organization. Most liaison programs focus on risk assessment and encouraging employees to communicate ethical infractions when they take place. New liaison programs go beyond this approach and try to design ways to better communicate the ethics message to employees despite various competing sub-cultures within a given organization.[27]

[26] "2014 LRN Study," *Ibid.,* p. 30; and "Helpline Calls and Incident Reports," *Society of Corporate Compliance,* 2014.

[27] "A Different Approach to Ethics Liaison Programs," *Ethikos,* May/June 2016, pp. 1–4.

But no matter how advanced the technology used in an ethics and compliance program, the ethics and compliance officer never really knows what to expect when monitoring calls to the helpline, as the following example showed:

> "Oh, boy, this is one of those days," thought the ethics officer at a midsized manufacturing firm when she received a call on the ethics helpline that a toilet in the company's administration building was overflowing. She called maintenance and they found that someone had clogged up the toilet drain. When the same call was received a week later, the ethics officer knew she had to investigate. Through interviews with personnel who worked on that floor, she discovered that the supervisor had refused to allow workers to take bathroom breaks when needed, and an employee had boasted that "he was going to get even with his supervisor and plug up the toilet" to attract attention to unsafe working conditions. The call about the overflowing toilet and subsequent investigation allowed the ethics officer to address the real issue, counsel the supervisor, and repair the deteriorating working conditions at her company.[28]

Ethics Training Programs

Another step companies can take to build in ethical safeguards is to offer **employee ethics training**. This is generally the most expensive and time-consuming element of an ethics program. Studies have shown that only 20 to 40 percent of small businesses formally offer ethics training to their employees, often using less formal ways to communicate ethical values and procedures. Larger businesses, by contrast, usually conduct regular ethics training. As shown in Figure 6.3, businesses have several motivations for developing employee ethics training programs. In general, larger and more mature organizations are more inclined to believe that a culture of ethics encourages employees to speak up; whereas, small- and medium-size organizations are more likely to define training as an alignment with regulatory guidelines.[29]

As shown in Figure 6.3, most ethics and compliance training programs focus on making sure employees know what the law requires and the company expects. Some firms have gone further, exploring how individuals can contribute to strengthening the firm's ethical culture.

> An ethics training seminar sponsored by the Italian Cultural Institute in Copenhagen focused on the importance of individual creativity in making company cultures more ethical. Speakers at this cross-country congress of corporate governance professionals championed the great capacity of human ingenuity to facilitate ethical behavior in organizations. For example, sessions at this conference included "The Responsibility of Individuals and Organizations for Community Development and Progress" and "Innovative Approaches to Sustainable Development: From the Education of New Generations to the Processes for the Integration of Social Responsibility into Business Models."[30]

One approach to ethics training in organizations that has become increasingly popular is known as "giving voice to values." This approach is described in Exhibit 6.F.

The effectiveness of the ethics and compliance program is important to executives. Companies used to conduct formal ethics audits to ensure the quality of these programs, but today most firms have turned to a company-wide risk assessment audit to determine

[28] Based on an interview with an ethics and compliance officer who requested that her firm and her identity remain anonymous.

[29] See "Is Your Ethics and Compliance Training Really Preparing Your Employees?" *Compliance and Ethics Professional,* March–April 2012, *www.corporatecompliance.org;* and "2017 Ethics & Compliance Training Benchmark Report," *NAVEXGlobal* (Lake Oswego, OR: NAVEXGlobal, 2017).

[30] "Culture and Creativity as Key to Development Danish and Italian Applications: Ideas that Change the World," conference sponsored by the Italian Cultural Institute in Copenhagen, *www.fiveonlus.eu.*

Exhibit 6.F

Giving Voice to Values

Giving Voice to Values (GVV) was created Mary Gentile as an innovative approach to values-driven leadership development in business education and the workplace. As Gentile explained, "Rather than a focus on ethical analysis, the Giving Voice to Values curriculum focuses on ethical implementation and asks the questions: "What if I were going to act on my values? What would I say or do? How could I be most effective?" By 2018, this program was piloted in over 1,000 schools, companies, and other organizations on every continent. The GVV curriculum offers practical exercises, cases, modules, scripts, and teaching plans for handling a wide range of ethical conflicts in the workplace.

The challenge for many moral managers is acting effectively on their beliefs in the day-to-day life of their organizations. Educator Mary Gentile tries to empower business leaders and managers by enabling them to give voice to—and to act on—their values at work. Gentile's Giving Voice to Values program believes that the key is knowing how to act on your values despite opposing pressure. "GVV starts from the premise that most of us already want to act on our values, but that we also want to feel that we have a reasonable chance of doing so effectively and successfully. This pedagogy and curriculum are about raising those odds," said Gentile.

Source: From *www.darden.virginia.edu/ibis/initiatives/giving-voice-to-values.*

FIGURE 6.3
Objectives and Motivations for Employee Ethics Training Programs

Source: "2017 Ethics & Compliance Training Benchmark Report," *NAVEXGlobal*, 2017, Lake Oswego, OR: NAVEXGlobal).

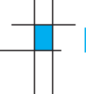
the effectiveness of the ethics program along with other risks. Experts believe that integrating various ethics safeguards into a comprehensive program is critically important and minimizes the firm's risk. When all five components discussed in this chapter—top management commitment, ethical policies or codes, compliance officers, reporting mechanisms, and training programs—are used together, they reinforce each other and become more effective.

As seen in Chapter 5, Ethisphere's "The World's Most Ethical Companies" financially outperformed the S&P 500 and FTSE 1000 every year since 2005. Figure 6.4 shows the 13 companies that have made the World's Most Ethical Companies list each year from 2007–2017.

FIGURE 6.4
The World's Most Ethical Companies and Their Industries, According to *Forbes* Magazine

Source: "The World's Most Ethical Companies, *Forbes,* March 14, 2017, *www.forbes.com.*

These firms were ranked among the highest ethical firms each year from 2007 through 2017.	
AFLAC	(insurance)
Deere and Company	(industrial manufacturing)
Ecolab	(chemicals)
Fluor Corporation	(engineering)
General Electric	(diversified)
International Paper	(paper products)
Kao Corporation	(consumer products)
Milliken & Company	(industrial manufacturing)
PepsiCo	(food & beverage)
Starbucks Coffee Company	(restaurants)
Texas Instruments	(computers)
UPS	(transportation)
Xerox	(computers)



Ethics in a Global Economy

Doing business in a global context raises a host of complex ethical challenges. One example of unethical activity is **bribery**, a questionable or unjust payment often to a government official to ensure or facilitate a business transaction. The act of bribery introduces an economic force that is not based on the product or service's quality or other sales characteristics, therefore the element of bribery corrupts the economic exchange.

Bribery is found in nearly every sector of the global marketplace, but is more common in some countries than others.

A Berlin-based watchdog agency, Transparency International, annually publishes a survey that ranks countries by their level of corruption, as perceived by executives and the public. In the 2017 survey, countries where having to pay a bribe was least likely included New Zealand, Denmark, Finland, Norway, and Switzerland. At the other end of the index, Syria, South Sudan, and Somalia were considered the world's most corrupt countries, along with Afghanistan, Yemen, Sudan, Libya, and North Korea. The United States was tied for 16th on the list of 180 countries, with Canada 8th, Singapore and Sweden tied for 6th, the United Kingdom tied for 8th with the Netherlands, India tied for 81st with Ghana, China tied for 77th with Serbia and Suriname, and Russia tied for 135th.[31]

In some settings, corruption is so common as to be almost unavoidable. Transparency International interviewed over 160,000 adults from 119 countries around the globe from March 2014 to January 2017, to discover regional differences in corruption. This study found that one in four people claim to have paid a bribe when accessing public services in the 12 months prior to the survey. On average, the European Union had the lowest reported bribery rate at 9 percent compared to an average rate of 30 percent in the Middle East, North Africa, and the Commonwealth of Independent States in Eurasia. Latin American

[31] For a complete list of all countries according to their perceived level of corruption, see *https://www.transparency.org/news/feature/corruption_perceptions_index_2017.*

and Asia Pacific regions were close behind with average bribery rates up to 29 percent. A survey in Nigeria found that Nigerians paid about $4.6 billion in bribes each year. According to a 2017 study by the Prosecutor General's Office in Russia, 25 percent of Russians admitted to having paid a bribe in the prior year.[32]

Bribery has significant economic, as well as ethical, consequences. Mythili Raman, a former senior executive at the Department of Justice explained,

> "Our fight against foreign corruption is critical for so many reasons. The corrosive effects of transnational corruption are felt not just overseas, but also here in the United States. Although we may not experience as acutely, or as personally, some of the consequences of foreign bribery, such as hospitals or roads that go unbuilt because infrastructure funds are siphoned off by a corrupt official, American companies are harmed. They are denied the ability to compete in a fair and transparent marketplace. Instead of being rewarded for their efficiency, innovation and honest business practices, U.S. companies suffer at the hands of corrupt governments and lose out to corrupt competitors."[33]

The following examples further demonstrate the harmful effects of bribery.

- Brazilian state-run oil company Petroleo Brasileiro SA announced that their corruption scandal contributed to their stock shares dropping 6.2 billion reais ($2.1 billion) in value and led to a revised accounting charge of 44.6 billion reais ($14.8 billion) for 2014 after determining that assets were overvalued on its balance sheet.
- Alstom, a French conglomerate, plead guilty and paid $772 million to the United States for bribing Indonesian government officials with more than $4 billion to win power contracts from 2000 to 2011. Since Alstom has U.S. affiliate companies that are headquartered in Connecticut, it is governed by United States laws, specifically the Foreign Corrupt Practices Act (the FCPA is introduced later in the chapter).
- Rolls-Royce, the luxury automobile, jet and marine engine manufacturer, settled a long-term corruption investigation by agreeing to pay U.S. and British government authorities more than $800 million in penalties. The company admitted in 2017 to engaging in corrupt business dealings overseas years earlier.[34]

Efforts to Curtail Unethical Practices

Despite the prevalence of bribery, both companies and countries have taken a strong stand against it.

Huguette Labelle, the chair of Transparency International, stated, "People believe they have the power to stop corruption, and the number of those willing to combat the abuse of power, secret dealings, and bribery is significant." Seventy-one percent of respondents to a

[32] "People and Corruption: Citizens' Voices from Around the World," *Transparency International,* 2017, *www.transparency.org*; "Corruption Currents: Study Says Nigerians Pay $4.6 Billion in Bribes Per Year," *The Wall Street Journal,* August 17, 2017, *www.wsj.com*; and "A Quarter of Russians Pay Bribes, Anonymous Survey Says," *Moscow Times,* December 11, 2017, *www.moscowtimes.com.*

[33] "Acting Assistant Attorney General Mythili Raman Speaks at the Global Anti-Corruption Compliance Congress," *Ethikos,* May/June 2014, pp. 1–2.

[34] "Brazil's Petrobras Reports Nearly $17 Billion in Asset and Corruption Charges," *The Wall Street Journal,* April 22, 2015, *www.wsj.com*; "Alstom to Pay U.S. Record $772 Million in Fine in Bribery Scheme," *The New York Times,* December 22, 2014, *www.nytimes.com*; and, "Rolls-Royce to Pay More than $800 Million to Settle Corruption Probe," *The Wall Street Journal,* January 14, 2017, *www.wsj.com.*

Dow Jones Anti-Corruption survey said their companies had delayed or stopped activities with business partners over concerns about breaking anti-corruption regulations.

> In 2017, Samsung Electronics' vice-chairman, Lee Jae-yong, was convicted of bribery and sentenced to a five-year jail sentence. Lee was found guilty of bribing South Korea's president and of involvement in a corruption scandal that had compromised the previous government regime in his country. Allegedly, Lee had attempted to bribe President Park Geun-hye to get her to support business deals important to Samsung. The company admitted that it was complicit in the agreement to pay a close friend of Park $38 million. Prosecutors claimed that some of the payments made by Samsung were to guarantee that certain business deals were made for Samsung's benefit. Park was later removed from political office and was tried and convicted of bribery and coercion. This bribery scandal spanned both corporate and political boundaries.[35]

Numerous efforts are under way to curb unethical business practices throughout the world. The most common method is government intervention and regulation.

Since 1977, the **U.S. Foreign Corrupt Practices Act** (FCPA) has prohibited executives of U.S.-based companies or businesses operating in the U.S. from paying bribes to government officials, political parties, or political candidates. To achieve this goal, the FCPA requires U.S. companies with foreign operations to adopt accounting practices that ensure full disclosure of the company's transactions. In 2014, companies paid $1.56 billion to resolve FCPA cases. In 2015, companies paid $133 million; in 2016, $2.48 billion; and, in 2017, $1.92 billion.[36]

The United Kingdom's Bribery Act was passed in 2010. Some believed it was even more stringent than the U.S.'s FCPA. The U.K. Bribery Act differs from the FCPA in that it

- prohibits the bribery of another person and receiving or accepting a bribe, whereas the FCPA only prohibits bribery of government officials. Bribery of a private business executive would be illegal under British, but not U.S., anticorruption law.
- does not require that the improper offer, promise, or payment be made "corruptly," as the FCPA does require evidence of the intent to corrupt.
- does not provide exemptions for "facilitating payments" or the defense that there are reasonable and bona fide contractual or promotional expenses, as the FCPA does.
- contains a strict liability offense for failure to prevent bribery by commercial organizations; the FCPA does not.[37]

Other governments have drafted and passed new legislation to combat corruption and bribery. In 2013, Brazil, one of the world's top 10 largest economies, approved an anti-bribery law that imposed civil and criminal penalties on firms for acts committed against local and foreign government officials. Fines can be as high as 20 percent of the company's annual gross revenues. India joined Brazil in 2014 by passing its own anticorruption legislation.

The Mexican government approved a major anticorruption reform bill in 2016 that revised 14 constitutional articles, creating two new laws and changing five others. Backed by civil society groups, this reform represented the largest and broadest attempt to address

[35] "Samsung Heir Lee Jae-yong Convicted of Bribery, Gets Five Years in Jail," *The Wall Street Journal,* August 25, 2017, *www.wsj.com.*

[36] "2017 FCPA Enforcement Index," *The FCPA Blog,* January 2, 2018, *www.fcpzblog.com.*

[37] *Bribery Act 2010,* 2010, *www.legislation.gov.uk/ukpga/2010/23/contents.*

rampant corruption in the country. Among the areas addressed by the new measures, declaration of assets by public contractors is now mandatory.[38]

While enforcement is often spotty, some countries have enforced their bribery laws aggressively. China imposed a $487 million fine on British pharmaceutical GlaxoSmith-Kline (GSK) for bribery, after Glaxo reportedly used payoffs to persuade hospitals and doctors to administer or sell Glaxo pharmaceuticals to their patients.[39]

While governmental efforts continue to emerge, a business scholar argued that "a legalistic approach, by itself, is unlikely to be effective in curbing bribery," since culture has such a strong influence. Most effective in combating bribery may be an integrative approach of economic development, social investment in education, and business-friendly policies, in addition to anticorruption laws and punishments to combat bribery.[40]

Businesses of all sizes and from many diverse industries around the world have attempted to respond to the increasing pressure to create an ethical environment at work. As discussed, the organization's culture and ethical work climate play a central role in promoting ethics at work and encouraging employees to act ethically. Businesses have implemented many ethical safeguards to create effective ethics programs. Challenges remain as organizations expand their operations globally and encounter a complex network of different customs and regulations.

Summary

- A company's culture and ethical climate tend to shape the attitudes and actions of all who work there, sometimes resulting in high levels of ethical behavior and at other times contributing to less desirable ethical performance.
- Not all ethical issues in business are the same, but ethical challenges occur in all major functional areas of business. Professional associations for each functional area often attempt to provide a standard of conduct to guide practice.
- Companies can improve their ethical performance by creating a values-based ethics program that relies on top management leadership and organizational safeguards, such as ethics policies or codes, ethics and compliance offices and officers, ethics reporting mechanisms, and ethics training programs.
- Companies that have a comprehensive, or multifaceted, ethics program often are better able to promote ethical behavior at work and avoid unethical action by employees.
- Ethical issues, such as bribery, are evident throughout the world, and many international agencies and national governments are actively attempting to minimize such unethical behavior through economic sanctions and international codes.

[38] "Mexico Wins: Anti-Corruption Reform Approved," *Forbes,* July 18, 2016, *www.forbes.com.*

[39] "Finally, Companies in Brazil Can Be Prosecuted for Corruption," *Transparency International,* July 8, 2013, *blog.transparency.org*; "Indian: New Anti-Corruption Law," *The Law Library of Congress,* January 8, 2014, *www.loc.gov*; and "China Fines GlaxoSmithKline Nearly $500 Million in Bribery Case," *The New York Times,* September 19, 2014, *www.nytimes.com.*

[40] Rajib Sanyal, "Determinants of Bribery in International Business: The Cultural and Economic Factors," *Journal of Business Ethics 59* (2005), pp. 139–45.

Key Terms

bribery, *129*
corporate culture, *116*
employee ethics training, *127*
ethical climate, *117*
ethics and compliance officer, *125*
ethics policies or codes, *124*
ethics reporting mechanisms, *126*
U.S. Foreign Corrupt Practices Act, *131*

Internet Resources

thecro.com	*CR: Corporate Responsibility Magazine*
www.dii.org	Defense Industry Initiative on Business Ethics and Conduct
ecoaconnects.theecoa.org	*Ethics and Compliance Initiative Connects (Ethics and Compliance Officer Association)*
www.ethicaledge.com	Ethics and Policy Integration Centre
ethisphere.com	Ethisphere Institute
www.ethics.org	Ethics and Compliance Initiative Connects (Ethics Resource Center)
www.globalethics.org	Institute for Global Ethics
www.saiglobal.com	SAI Global
www.business-ethics.org	International Business Ethics Institute
www.corporatecompliance.org	Society of Corporate Compliance and Ethics
www.transparency.org	Transparency International

Discussion Case: *Equifax's Data Breach*

The credit reporting company Equifax was at the center of a massive data breach affecting over 145 million customers. In 2017, hackers took advantage of a vulnerability in Equifax's website software and stole the personal information, including names, addresses, and Social Security numbers, of as many as 145 million Americans. A separate but related incident at Equifax involved 15 million British citizens who had their records violated from 2011 to 2016. The failure of Equifax's internal reporting and control measures led to a widespread violation of peoples' rights to the privacy of their personal information and became a huge public relations crisis for the company.

Equifax's top lawyer, John Kelley, was investigated by the board of directors for his possible involvement in a cover-up of the hack and his mishandling of the situation. Kelley was responsible for approving the sales of company stock by executives after the breach was discovered, but before it had been revealed to the public. Upon the disclosure of the breach, company stock price fell 14 percent. Investors sold approximately $4.5 billion (25 percent) of the company's market value after the hack was made public.

More than 10 million Americans had their driver's license data exposed during the hack. Many people who had provided their driver's license information to the company were simply verifying their information in order to receive credit reports and ratings from Equifax. Some had entered their information on the company's web page in an effort to settle credit report disputes. The credit report dispute web page had been particularly vulnerable to security breaches. Equifax CEO Richard Smith admitted during congressional

hearings that he and other executives had been aware of the security weaknesses, but that a single employee at the firm had not properly heeded security warnings and did not ensure the implementation of software fixes. Smith added that there was a failure in their software systems designed to scan for the absence of "patches" necessary to protect private information.

Other internal control mechanisms at Equifax appeared to have been either ignored or dysfunctional. Frederick Lemieux, director of Georgetown University's graduate program in Applied Intelligence, blamed the breach on what he called "passive complicity" in the firm's culture. (*Complicity* means being involved in wrongdoing; *passive complicity* implies that executives were guilty of wrongdoing by not actively preventing it.) That top executives seemed to worry more about their own stock portfolios than the security of their customers' personal information was troubling to many ethics experts. Observers also criticized the company for its delay in going public about the breach. Finally, it appeared that knowledge of the potential for hacking was isolated to only one employee. A more robust system where multiple individuals were responsible for preventing a problem might have avoided the hack.

Unlike banks, credit reporting agencies are relatively lightly regulated, and they typically rely on internal systems to maintain security. Lemieux stated, "there is no incentive to comply with the best industry practices and no incentives to spend [funds on these programs] because you're not accountable for it." He noted that credit reporting agencies did not face the same financial or legal consequences that banks or other businesses, like Target or Home Depot, encountered when hacked. Pamela Pressman, president of the Center for Responsible Enterprise and Trade, said that the breach should remind Equifax and other firms to train their employees and raise awareness about proper "cyber hygiene . . . ensuring that your employees, your contractors, your vendors—those people that have access to your network and your data—understand their role in protecting the network and protecting the data."

The cyberattack on Equifax was potentially more dangerous than other hacks in recent history because credit-reporting agencies played a significant role in determining who received financing and ultimately, how much credit they received. The data collected by these agencies was needed for applying for credit cards, loans, and background checks. The attack was conducted in one major maneuver, which facilitated the hackers' ability to use the data for their own purposes.

This breach could lead to problems for small financial institutions, like community banks and credit unions, which typically relied on information collected by the credit-reporting firms to determine their loan decisions. Larger financial institutions were more likely to collect additional information from applicants, which made them less vulnerable.

Days after the company discovered the breach, CFO John Gamble and two other top Equifax executives reportedly sold a combined $1.8 million worth of shares of the company, but all three denied knowing of the hack when they made the transactions, despite evidence to the contrary. CEO Smith stepped down from his post following these events. Smith had been in charge since 2005. The Federal Bureau of Investigation investigated Equifax's handling of the situation as well as the actions of the top executives. When testifying before Congress, Smith downplayed the severity of the situation and the factors that facilitated the breach. He repeatedly blamed an IT worker who did not implement software remedies after Equifax executives had been warned of possible holes in Equifax's website security by the U.S. Department of Homeland Security.

Equifax hired FireEye's Mandiant group to investigate the breach. The Mandiant report determined that approximately 2.5 million additional U.S. consumers were potentially

impacted, for a total of 145.5 million. Mandiant did not identify any evidence of additional or new attacker activity or any access to new databases or tables. Instead, this additional population of consumers was confirmed during Mandiant's completion of the remaining investigative tasks and quality assurance procedures built into the investigative process. The review also has concluded that there is no evidence the attackers accessed databases located outside of the United States.

Equifax claimed they learned of hacking activity in May 2017, but the Mandiant report said the hack started two months earlier. Company executives did not formally disclose the breach until September 2017, however. They admitted that the hack was conducted from May through July 2017. The identity of the hackers was never disclosed.

Sources: "The Morning Risk Report: Equifax Breach Could Spur New Round of Training," *The Wall Street Journal,* September 11, 2017, *www.wsj.com*; "How to Explain the Equifax Breach? Start with the Culture," Georgetown University, September 15, 2017, *ses.georgetown.edu*; "Equifax CEO Richard Smith to Exit Following Massive Data Breach," *The Wall Street Journal,* September 26, 2017, *www.wsj.com*; "At the Center of the Equifax Mess: Its Top Lawyer," *The Wall Street Journal,* October 1, 2017, *www.wsj.com*; "2.5 Million More People Potentially Exposed in Equifax Breach," *The New York Times,* October 2, 2017, *www.nytimes.com*; "Equifax Announces Cybersecurity Firm Has Concluded Forensic Investigation Of Cybersecurity Incident," *Equifax website,* October 2, 2017, *investor.equifax.com*; and "Equifax Breach Caused by Lone Employee's Error, Former CEO Says," *The New York Times,* October 4, 2017, *www.nytimes.com.*

Discussion Questions

1. Do you think the company reacted appropriately upon learning about the breach?
2. What could Equifax have done differently to prevent the cyberattack?
3. What type(s) of ethical climate existed at Equifax, and did this contribute to the hacking issues there?
4. What changes should managers and the board of directors make now to reduce to likelihood of an incident like this from occurring in the future?
5. What types of ethics training would you recommend for Equifax employees in the future to prevent such corrupt behavior?

PART THREE

Business and Public Policy

CHAPTER SEVEN

Business–Government Relations

Governments seek to protect and promote the public good and in these roles establish rules under which business operates in society. Therefore, a government's influence on business through public policy and regulation is a vital concern for managers. Government's relationship with business can be either cooperative or adversarial. Various economic or social assistance policies significantly affect society, in which businesses must operate. Many government regulations also impact business directly. Managers must understand the objectives and effects of government policy and regulation, both at home and abroad, in order to conduct business in an ethical and legal manner.

This Chapter Focuses on These Key Learning Objectives:

- LO 7-1 Understanding why sometimes governments and business collaborate and other times work in opposition to each other.
- LO 7-2 Defining public policy and the elements of the public policy process.
- LO 7-3 Explaining the reasons for regulation.
- LO 7-4 Knowing the major types of government regulation of business.
- LO 7-5 Identifying the purpose of antitrust laws and the remedies that may be imposed.
- LO 7-6 Comparing the costs and benefits of regulation for business and society.
- LO 7-7 Examining the conditions that affect the regulation of business in a global context.

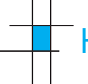
Uber Technologies, a U.S.–based international transportation network company founded in 2009, developed a mobile app that allowed consumers to submit a trip request, which was then routed to one of its drivers. By 2018, the service was available in 84 countries and nearly 800 cities worldwide. Yet, Uber encountered serious opposition when it attempted to expand into the European Union. The Employment Appeal Tribunal ruled in 2017 that the 50,000 Uber drivers in the United Kingdom must be considered employees, not independent contractors, as Uber had argued. This ruling meant that the drivers qualified for various employee rights such as paid vacations. Experts stated that this decision could serve as a bellwether for other employment lawsuits against Uber in the United States, Canada, and other countries, potentially jeopardizing the company's business model globally.[1]

In 2016, the U.S. Food and Drug Administration (FDA) created tough regulatory standards for the e-cigarette industry, including banning all sales to anyone under 18 years of age, requiring package-warning labels, and making all products—even those currently on the market—subject to government approval. This was seen as a devastating blow to the fast-growing $3.5 billion e-cigarette industry, which was largely unregulated and dominated by small manufacturers and vape shops. Most experts predicted that this was only the first step and that the FDA would soon move to regulate the e-cigarette industry further, targeting advertising and e-cigarette flavors, such as cotton candy and watermelon, which may appeal to youth.[2]

What prompted or compelled governments to become more involved in the status of employees or the sale of a consumer product? How do these governments' actions affect businesses and what they are permitted to do? How did these actions affect competition or society and the public's health? Did governments' involvement promote or harm companies or allow other firms to maintain their competitive advantage? Were these efforts by the governments necessary and effective, or can this only be answered in time?

Governments create the conditions that make it possible for businesses to compete in the modern economy. As shown in the opening examples, governments can act in dramatic ways to provide or limit opportunities for businesses and control business activities to better ensure the public's health. In good times and bad, government's role is to create and enforce the laws that *balance* the relationship between business and society. Governments also hold the power to grant or refuse permission for many types of business activity. Even the largest multinational companies, which operate in dozens of countries, must obey the laws and public policies of national governments.

This chapter considers the ways in which government actions impact business through the powerful twin mechanisms of public policy and regulation. The next chapter addresses the related question of actions business may take to influence the political process.



How Business and Government Relate

The relationship between business and government is dynamic and complex. Understanding the government's authority and its relationship with business is essential for managers in developing their strategies and achieving their organization's goals.

Seeking a Collaborative Partnership

In some situations, government may work closely with business to build a collaborative partnership and seek mutually beneficial goals. They see each other as key partners in the relationship and work openly to achieve common objectives.

[1] "Uber Suffers Setback as U.K. Court Rules Its Drivers Should Have Workers' Rights," *The Wall Street Journal,* November 10, 2017, *www.wsj.com.*

[2] "FDA to Regulate E-Cigarettes, Ban Sales to Minors," *The Wall Street Journal,* May 5, 2016, *www.wsj.com*.

The basis for this cooperation may be at the core of the nation's societal values and customs. In some Asian countries, society is viewed as a collective family that includes both government and business. Thus, working together as a family leads these two powers to seek results that benefit both society and business. In Europe, the relationship between government and business often has been collaborative. European culture includes a sense of teamwork and mutual aid. Unions, for example, are often included on administrative boards with managers to lead the organization toward mutual goals through interactive strategies. One example of government–business collaboration is shown next.

While many businesses were requesting and supporting While House directives to eliminate or decrease regulatory control, quite the contrary drone makers and operators were clamoring for more federal rules. They envisioned an increase in the regulatory climate as an opportunity to open up the skies for unmanned aircraft. These businesses pledged to cooperate with regulators to make that happen. In response to these pressures, the Federal Aviation Administration gave approval for small, remotely piloted aircraft weighing up to 55 pounds to operate during daylight hours, up to an altitude of 400 feet and within sight of operators on the ground. Drone maker and operators took this opportunity to expand their operations. Unlike some other businesses that did not welcome government oversight, "we want and need rules and regulations to understand how we can fly drones commercially for expanded operations," said Gretchen West, a senior legal advisor to the drone industry.[3]

In this instance, both the Federal Aviation Administration and drone makers agreed on the need for regulation, leading to collaboration between the government and business.

Working in Opposition to Government

In other situations, government's and business's objectives are at odds, and these conflicts result in an adversarial relationship where business and government tend to work in opposition to each other.[4]

On three difference occasions, Tesla released relevant information to the National Transportation Safety Board (NTSB) to assist the government agency in its investigation of the cause of a crash of its semiautonomous driving Tesla Model S vehicle. But a few weeks later, the company withdrew from its formal agreement to cooperate with the NTSB after the preliminary investigation appeared to target the driver in the car, who died from injuries sustained in the accident. "Today, Tesla withdrew from the party agreement with the NTSB because it requires that we not release information about Autopilot to the public, a requirement which we believe fundamentally affects public safety negatively," explained a Tesla company press release. Tesla seemed upset that it could be a year or longer before the government investigators reached their conclusions, and meanwhile the company would be subject to negative publicity without an opportunity to respond with their side of the story.[5]

In this instance, a business concluded that cooperation with the government was not in its best interest.

[3] "Unlike Most Industries, Drone Makers and Operators Clamor for Federal Regulation," *The Wall Street Journal,* September 17, 2017, *www.wsj.com.*

[4] The "collaborative partnership" and "in opposition" models for business–government relations is discussed in "Managing Regulation in a New Era," *McKinsey Quarterly,* December 2008, *www.mckinseyquarterly.com.*

[5] "Tesla Withdraws Formal Cooperation with Probe of Fatal Crash, Will Still Assist Investigators," *The Wall Street Journal,* April 12, 2018, *www.wsj.com.*

Why do businesses sometimes welcome government regulation and involvement in the private sector, and other times oppose it? Companies often prefer to operate without government constraints, which can be costly or restrict innovation. But regulations can also help business, by setting minimum standards that all firms must meet, building public confidence in the safety of a product, creating a fair playing field for competition, or creating barriers to entry to maintain a business's competitive advantage. How a specific company reacts to a specific government policy often depends on their assessment of whether they would be helped or hurt by that rule.

In short, the relationship between government and business can range from one of cooperation to one of conflict, with various stages in between. Moreover, this relationship is constantly changing. A cooperative relationship on one issue does not guarantee cooperation on another issue. The stability of a particular form of government in some countries may be quite shaky, while in other countries the form of government is static but those in power can change unexpectedly or government leaders can change on a regular basis. The business–government relationship is one that requires managers to keep a careful eye trained toward significant forces that might alter this relationship or to promote forces that may encourage a positive business–government relationship.[6]

Legitimacy Issues

When dealing with a global economy, business may encounter governments whose authority or right to be in power is questioned. Political leaders may illegally assume lawmaking or legislative power, which can become economic power over business. Elections can be rigged, or military force can be used to acquire governmental control.

Business managers may be faced with the dilemma of whether to do business in such a country, where their involvement would indirectly support this illegitimate power. Sometimes, they may choose to become politically active, or refuse to do business in this country until a legitimate government is installed.

Businesses can also influence the ability of a government leader or group of leaders to maintain political power. For example, companies can decide to withdraw operations from a country, as many U.S. firms did from South Africa in the 1970s to protest the practice of apartheid (institutionalized racial segregation). Some believe that the economic isolation of South Africa contributed to the eventual collapse of the apartheid regime. Governments may also order companies not to conduct business in another country because of a war, human rights violations, or lack of a legitimate government. These orders are called *economic sanctions.* As of 2018, the United States had imposed economic sanctions on the Balkans, Belarus, Myanmar, Cote D'Ivoire (Ivory Coast), Cuba, Democratic Republic of Congo, Iran, Iraq, Liberia, North Korea, Sudan, Syria, and Zimbabwe.[7]

Government's Public Policy Role

Government performs a vital and important role in modern society. Although vigorous debates occur about the proper size of programs government should undertake, most people agree that a society cannot function properly without some government activities. Citizens look to government to meet important basic needs. Foremost among these are safety and protection provided by the military, homeland security, police, and fire departments.

[6] See George Lodge, *Comparative Business–Government Relations* (Englewood Cliffs, NJ: Prentice Hall, 1990) and Tom Lehman, "Six Arguments against Government Regulations," *www.capitalism.com.*

[7] See the Treasury Department's Office of Foreign Asset Control, *www.treasury.gov.*

These are collective or public goods, which are most efficiently provided by government for everyone in a community. In today's world, governments are also expected to provide economic security and essential social services, and to deal with the most pressing social problems that require collective action, or public policy.

Public policy is a plan of action undertaken by government officials to achieve some broad purpose affecting a substantial segment of a nation's citizens. Public policy, while differing in each nation, is the basic set of goals, plans, and actions that each national government follows in achieving its purposes. Governments generally do not choose to act unless a substantial segment of the public is affected and some public purpose is to be achieved. This is the essence of the concept of governments acting in the public interest.

The basic power to make public policy comes from a nation's political system. In democratic societies, citizens elect political leaders who can appoint others to fulfill defined public functions ranging from municipal services (e.g., water supplies, fire protection) to national services, such as public education or homeland security. Democratic nations typically spell out the powers of government in the country's constitution.

Another source of authority is *common law*, or past decisions of the courts, the original basis of the U.S. legal system. In nondemocratic societies, the power of government may derive from a monarchy (e.g., Saudi Arabia), a military dictatorship (e.g., Eritrea), or religious authority (e.g., the mullahs in Iran). These sources of power may interact, creating a mixture of civilian and military authority. The political systems in Russia, Libya, Tunisia, and other nations have undergone profound changes in recent times. And democratic nations can also face the pressures of regions that seek to become independent nations exercising the powers of a sovereign state, as has Canada with the province of Quebec.

Elements of Public Policy

The actions of government in any nation can be understood in terms of several basic elements of public policy. These are inputs, goals, tools, and effects. They will be illustrated using the example of distracted driving.

Public policy inputs are external pressures that shape a government's policy decisions and strategies to address problems. Economic and foreign policy concerns, domestic political pressure from constituents and interest groups, technical information, and media attention all play a role in shaping national political decisions. For example, a growing recognition of the dangers of distracted driving has pressured many state and local governments to ban or regulate the use of various electronic devices by drivers. Distracted driving may occur when a driver's attention is diverted by personal grooming tasks, adjusting music or navigation settings, eating, reading, and assorted other activities. It has become an even greater threat to driver and passenger safety as technologies have advanced. More and more drivers are now able to make or receive calls, send text messages, and even browse the Internet—all while driving a car at high speeds, in heavy traffic, or during bad weather conditions.[8]

According to an annual National Safety Council study, for the first time since 2007 more than 40,000 people died in motor vehicle crashes in a single year. Experts point to numerous causes for this record-breaking data, but typically focus on one important potential contributor: distracted driving. According to a national *Consumer Reports* survey of 622 licensed drivers, 52 percent admitted to engaging in distracting activities while driving, even though they knew it was wrong. Of those drivers surveyed, 41 percent admitted using their hands to send a text, 37 percent to playing music on a smartphone, and 8 percent to watching videos on

[8] "Windshield Devices Bring Distracted Driving Debate to Eye Level," *The New York Times,* May 29, 2015, *www.nytimes.com.*

> their phone while driving. Teens were particularly vulnerable. According to data from the Insurance Institute for Highway Safety, 60 percent of teen drivers involved in fatal crashes were distracted immediately before the accident. In a survey conducted by Zendrive Research of 3 million drivers globally, they found that drivers used their phones during 88 percent of their trips. An Erie Insurance study found that 15 percent of drivers admitted they had engaged in "romantic encounters" while behind the wheel and 9 percent said they had changed clothes while driving.[9]

In response to this growing epidemic, government bodies—legislatures, town councils, regulatory agencies—need to consider all relevant inputs in deciding whether or not to act, and if so, how.

Public policy goals can be broad (e.g., full employment) and high-minded (equal opportunity for all) or narrow and self-serving. National values, such as freedom, democracy, and a fair chance for all citizens to share in economic prosperity, have led to the adoption of civil rights laws and economic assistance programs for those in need. Narrow goals that serve special interests are more apparent when nations decide how legislation will allocate the burden of taxes among various interests and income groups, or when public resources, such as oil exploration rights or timber cutting privileges, are given to one group or another. Whether the goals are broad or narrow, for the benefit of some or the benefit of all, most governments should ask, "What public goals are being served by this action?" For example, the rationale for a government policy to regulate distracted driving has to be based on some definition of public interest, such as preventing harm to others, including innocent drivers, passengers, and pedestrians.

> The goal of distracted driving regulation is to prevent deaths and serious injuries resulting from drivers being distracted while driving. The factual data appears to be overwhelming. However, some members of the public have insisted on their right to use their phones for texting and other activities in their vehicles. Traveling salespersons, for example, depend on their phones as an important tool of the job. Some regulations have addressed this by permitting drivers to use hands-free devices that permit them to keep their hands on the wheel. But some government safety experts have disagreed, saying, "When you are on a call, even if both hands are on the wheel, your head is in the call, and not your driving."

The issue of banning the use of cell phones, hand-held or hands-free, for the sake of making our roads a little safer for all, remains at the forefront, but new technology has created even greater distractions. Devices can project information and data streamed from a smartphone onto the car's windshield. Maps, speed, incoming texts, caller identification, and even social media notifications can be projected just above the dashboard of a car for the driver to read. The game Pokémon Go prompts drivers to search for virtual creatures on the highways or country roads. So, the goals of saving lives, reducing injuries, and eliminating health care costs are increasingly more urgent and the demand for regulation even more critical.

Governments use different *public policy tools* to achieve policy goals. The tools of public policy involve combinations of incentives and penalties that government uses to prompt

[9] "Rise in U.S. Traffic Deaths Reported for a Second Year," *The New York Times,* February 15, 2017, *www.nytimes.com;* "Consumer Reports Tackles Distracted Driving and Calls Traffic Deaths a Public Health Epidemic," *Forbes,* November 19, 2017, *www.forbes.com;* "Zendrive Research: Largest Distracted Driving Behavior Study," *The Fiscal Times,* April 18, 2017, *www.thefiscaltimes.com*; and "Study Asks Just How Distracted Are Motorists?" *Pittsburgh Post-Gazette,* March 30, 2015, *www.post-gazette.com*. For updated information on distracted driving, see *www.distraction.gov* and the *Insurance Institute for Highway Safety*'s website at *www.iihs.org*.

citizens, including businesses, to act in ways that achieve policy goals. Governmental regulatory powers are broad and constitute one of the most formidable instruments for accomplishing public purposes.

Federal action limiting cell phone use in the United States stalled, so state and local governments stepped in to ban the use of cell phones by drivers while operating their vehicles. By 2018, 16 states had completely banned the use of cell phones while driving unless using a hands-free device, 38 had banned cell phone use by novice drivers, and 47 had banned text messaging for all drivers. And this was not just a public policy issue for Americans. More than 45 nations, including Australia, China, France, Germany, India, Israel, Japan, Russia, Spain, Taiwan, and the United Kingdom, have banned calling while driving.[10]

Public policy effects are the outcomes arising from government regulation. Some are intended; others are unintended. Because public policies affect many people, organizations, and other interests, it is almost inevitable that such actions will please some and displease others. Regulations may cause businesses to improve the way toxic substances are used in the workplace, thus reducing health risks to employees. Yet other goals may be obstructed as an unintended effect of compliance with such regulations. For example, when health risks to pregnant women were associated with exposure to lead in the workplace, some companies removed women from those jobs. This action was seen as a form of discrimination against women that conflicted with the goal of equal employment opportunity. The unintended effect (discrimination) of one policy action (protecting employees) conflicted head-on with the public policy goal of equal opportunity.

Different groups disagreed over the possible effects of distracted driving laws. Proponents obviously argued that the ban on cell phone use reduced accidents and saved lives. In fact, from 2012 to 2013, the number of deaths attributed to distracted driving nationwide declined nearly 7 percent, possibly due to the bans enacted by many states. Yet, these gains were short-lived as estimated deaths attributed to distracted driving rose 14 percent in 2014 and another 6 percent in 2016. Opponents pointed to numerous other distractions that were not banned, such as drivers reading the newspaper, eating, putting on makeup, or shaving. "People have been driving distracted since cars were invented. Focusing on mobile phones isn't the same as focusing on distracted driving. Distraction is what has always caused car crashes and mobile phones don't appear to be adding to that," said a spokesperson for the Insurance Institute for Highway Safety.[11]

As the distracted driving examples illustrate, managers must try to be aware of the public policy inputs, goals, tools, and effects relevant to regulation affecting their business. As public issues emerge with significant negative consequences, such as death and injuries due to distracted driving, businesses should look for solutions. The automobile industry has increasingly done so, by introducing technologies that enable drivers to converse by phone or receive GPS directions and other notifications without removing their hands from the steering wheel or taking their eyes off the road.

[10] For a complete listing of states that have regulated cell phone use while driving see the *National Conference of State Legislators* at *www.ncsl.org.*

[11] Statistical information from "U.S. Motor Vehicle Deaths Surged 6% in 2016, NSC Says," *The Wall Street Journal,* February 15, 2017, *www.wsj.com;* and "Study: No Evidence Cell Phone Bans Reduce Crashes," *Fox News,* July 7, 2011, *www.foxnews.com.*

Types of Public Policy

Public policies created by governments are of two major types: economic and social. Sometimes these types of regulation are distinct from each other and at other times they are intertwined.

Economic Policies

One important kind of public policy directly concerns the economy. The term **fiscal policy** refers to patterns of government collecting and spending funds that are intended to stimulate or support the economy. Governments spend money on many different activities. Local governments employ teachers, trash collectors, police, and firefighters. State governments typically spend large amounts of money on roads, social services, and parkland. National governments spend large sums on military defense, international relationships, and hundreds of public works projects such as road building. During the Great Depression of the 1930s, public works projects employed large numbers of people, put money in their hands, and stimulated consumption of goods and services. Today, fiscal policy remains a basic tool to achieve prosperity, as the following example illustrates.

> In 2015, Chinese government leaders and economists were surprised by the country's sharp economic decline and were increasingly worried about the potential risk of job losses throughout the country. The world's second largest economy grew at 7 percent in the first quarter of 2015, the lowest rate since the global financial crisis in 2008–9. The leaders turned to fiscal stimulus to revive the growth of the country. The National Development and Reform Commission, China's top planning agency, infused large amounts of funding in an attempt to speed up investment projects in several key sectors, including water conservation, environmental protection, power grids, and health care. In explaining this government spending, the chairman of China's National Development and Reform Commission said, "China was on track to achieve its economic growth, employment, inflation, fiscal revenue as well as imports and exports targets, but the country was falling behind in its goals for investment and wooing foreign investors."[12]

Another important kind of economic policy is **trade policy**, the rules that govern imports from and exports to foreign countries. Governments sometimes favor free-trade policies, allowing the relatively unrestricted flow of goods and services across national borders, and at other times erect various barriers to this flow, such as tariffs and duties. In early 2018, President Trump reported that he was considering imposing widespread tariffs on imports of various goods in an effort to help protect ailing U.S. industries. While many U.S. manufacturers hailed these actions as necessary, other business groups in the U.S. were opposed. Forty-five trade associations, representing a wide range of the U.S. economy, petitioned Trump's administration to halt its plans to levy tariffs on China and to work instead with other nations to pressure China to end their trade restrictions. For the United States to impose heavy tariffs, said a letter written by the trade groups, "would trigger a chain reaction of negative consequences for the U.S. economy, provoking retaliation; stifling U.S. agriculture, goods, and service exports; and raising costs for businesses and consumers."[13]

[12] "China Hints at More Government Spending to Shore Up Economic Growth," *South China Morning Post,* August 30, 2017, *www.scmp.com.*

[13] "Trade Associations to Petition Trump Administration to Halt China-Tariff Plans," *The Wall Street Journal,* March 19, 2018, *www.wsj.com.*

By contrast, the term **monetary policy** refers to policies that affect the supply, demand, and value of a nation's currency. The worth, or worthlessness, of a nation's currency has serious effects on business and society. It affects the buying power of money, the stability and value of savings, and the confidence of citizens and investors about the nation's future. This, in turn, affects the country's ability to borrow money from other nations and to attract private capital. In the United States, the Federal Reserve Bank—known as the Fed—plays the role of other nations' central banks. By raising and lowering the interest rates at which private banks borrow money from the government, the Fed influences the size of the nation's money supply and the value of the dollar. During the Great Recession, the Fed's action to lower interest rates nearly to zero—an example of a monetary policy—was intended to stimulate borrowing and help the economy get moving again.

Other forms of economic policy include *taxation policy* (raising or lowering taxes on business or individuals), *industrial policy* (directing economic resources toward the development of specific industries), and *trade policy* (encouraging or discouraging trade with other countries).

Spurred by the president of the United States, Congress passed a $1.5 trillion tax cut in 2017. The most sweeping U.S. tax bill since 1986 cut the corporate tax rate from 35 to 21 percent, with the intent of stimulating the economy. In the first quarter of 2018, 108 of the nation's largest companies reported saving almost $13 billion in taxes, with nearly a third of the savings going to financial firms. AT&T and Comcast applauded the tax relief and promised to share the windfall by paying $1,000 bonuses to their more than 300,000 workers. Wells Fargo and Fifth Third Bancorp said they would raise their employees' minimum wage to $15 an hour. However, Michael Dell, CEO of Dell Technologies, discovered that the new tax bill would prevent his company from deducting nearly $2 million it pays annually in interest on the company's debt.[14]

Some thought that the tax reform would stimulate the economy, create jobs, and raise wages, but others cautioned that it would increase the national deficit, and that companies would be more likely use their windfalls to increase executive pay and shareholder dividends than to create jobs or pay workers more. According to economist Paul Krugman, while it is quite early to tell if the tax cut has been successful, "most voters say they haven't seen any boost to their paychecks. To deliver on [the tax cut] backers' promises, the tax cut would have to produce a huge surge in business investment—not in the long run, not five or 10 years from now, but more or less right away. And there's no sign that anything like that is happening."[15] Yet, both critics and supporters say it will take months or years to draw conclusions on the law's effects.

Social Assistance Policies

The last century produced many advances in the well-being of people across the globe. The advanced industrial nations have developed elaborate systems of social services for their citizens. Developing economies have improved key areas of social assistance (such as health care and education) and will continue to do so as their economies grow. International

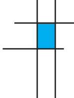
[14] "Trump Cheers GOP Tax Overhaul, Slams Democrats Who Opposed It," *The Wall Street Journal,* December 20, 2017, *www.wsj.com*; "Thankful for Massive Tax Cut, AT&T, Wells Fargo Promise to Share the Wealth," *The Wall Street Journal,* December 21, 2017, *www.wsj.com*; "For Heavily Indebted Firms Like Dell, Tax Bill Delivers a Downside," *The Wall Street Journal,* December 21, 2017, *www.wsj.com*; and "Corporate America Is Saving Boatloads on Trump Tax-Cut Windfall," *Bloomberg,* April 30, 2018, *www.bloomberg.com*.

[15] "How's That Tax Cut Working Out?" *The New York Times,* April 30, 2018, *www.nytimes.com.*

standards and best practices have supported these trends. Many of the **social assistance policies** that affect particular stakeholders are discussed in subsequent chapters of this book.

One area often addressed by social assistance policies is housing. Many governments have programs that subsidize rent payments, guarantee home loans, or provide housing directly for low-income citizens or military veterans. For example, Brazil's *Minha Casa, Minha Vida* ("My House, My Life") program has invested R$300 billion ($80.27 billion U.S.) in mortgages, provided by a government-affiliated bank, resulting in more than 4.2 million housing units authorized for construction and 2.6 million units delivered to low-income families since the program began in 2009. Many of the first units built by the program were intended to house families displaced by development for the World Cup and Olympic Games in Rio de Janeiro.[16]

One particularly important social assistance policy—health care—has been the focus for concern on the international front and for national and state lawmakers. As discussed later in this chapter, the United States government has wrestled with the need for better health care for its citizens and the challenge of how to pay for this care.



Government Regulation of Business

Societies rely on government to establish rules of conduct for citizens and organizations called *regulations*. **Regulation** is a primary way of accomplishing public policy, as described in the previous section. Because government operates at so many levels (federal, state, local), modern businesses face complex webs of regulations. Companies often require lawyers, public affairs specialists, and experts to monitor and manage the interaction with government. Why do societies turn to more regulation as a way to solve problems? Why not just let the free market allocate resources, set prices, and constrain socially irresponsible behavior by companies? There are a variety of reasons.

Market Failure

One reason is what economists call **market failure**, that is, the marketplace fails to adjust prices for the true costs of a firm's behavior. For example, a company normally has no incentive to spend money on product safety or pollution control equipment if customers do not demand it. The market fails to incorporate the cost of product safety or environmental harm into the business's economic equation, because the costs are borne by someone else. In this situation, government can use regulation to force all competitors in the industry to adopt a minimum safety or pollution standards. Companies that want to act responsibly often welcome carefully crafted regulations, because they force competitors to bear the same costs. This behavior is seen in the following example.

In 2008, the European Union set regulatory standards for certain contaminants in foods, including maximum levels for lead, cadmium, and mercury. The EU explained, "in order to protect public health, to keep contaminants at levels which do not cause health concerns, maximum levels for lead, cadmium and mercury must be safe and as low as reasonably achievable based upon good manufacturing and agricultural/fishery practices." These new regulatory standards affected food companies around the world that have business with or in Europe. Nestlé Purina

[16] "Minha Casa Minha Vida Housing Program to Expand in Brazil," *The Rio Times,* February 6, 2017, *riotimesonline.com*.

> Petcare, a pet food subsidiary of Nestlé, the Swiss-based and world's largest food and beverage company, welcomed these new standards, believing it provided them with a competitive advantage. The company released the following statement: "We use science to make quality and safe pet foods … We test for well over 150 substances, including arsenic, pesticides, lead, mercury and cadmium. … We do make an effort to source ingredients that contain lower levels of heavy metals. … We are committed to providing our consumers with accurate and transparent nutrition labelling based on sound science, regulation and law in a format that best helps them make informed, balanced and mindful product choice."[17]

Negative Externalities

Governments also may act to regulate business to prevent unintended adverse effects on others. **Negative externalities**, or spillover effects, result when the manufacture or distribution of a product gives rise to unplanned or unintended costs (economic, physical, or psychological) borne by workers, consumers, competitors, neighboring communities, or other business stakeholders. To control or reverse these costs, government may step in to regulate business action.

> In 2014 U.S. government regulators announced new rules to fight an increase in black lung disease, caused by breathing coal dust. These new regulations were the first major efforts since the 1969 Coal Mine Health and Safety Act, which established modern health and safety requirements in mines nationwide. Government health officials attributed increasing rates of the disease to new machinery that generated more dust, longer shifts for younger workers, and an increase in silica dust churned up when thinner coal seams were tapped after many years of mining at the same location.[18]

Natural Monopolies

In some industries, **natural monopolies** occur. The electric utility industry provides an example. Once one company has built a system of poles and wires or laid miles of underground cable to supply local customers with electricity, it would be inefficient for a second company to build another system alongside the first. But once the first company has established its natural monopoly, it can then raise prices as much as it wishes because there is no competition. In such a situation, government often comes in and regulates prices and access. Other industries that sometimes develop natural monopolies include cable TV, broadband Internet service, software, and railroads.

Ethical Arguments

There is often an ethical rationale for regulation as well. As discussed in Chapter 5, for example, there is a utilitarian ethical argument in support of safe working conditions: It is costly to train and educate employees only to lose their services because of preventable accidents. There are also fairness and justice arguments for government to set standards and develop regulations to protect employees, consumers, and other stakeholders. In debates about regulation, advocates for and against regulatory proposals often use both

[17] The European Commission legislation on heavy metals can be found at *ec.europa.eu/jrc/en/eurl/heavy-metals/legislation* and Nestlé Purina Petcare statement can be found at *wjla.com*, a report on company responses to the Washington, DC, ABC television station's report on heavy metals in foodstuff.

[18] "Black Lung Disease Spurs New Coal-Mine Rules," *The Wall Street Journal,* April 23, 2014, *online.wsj.com*.

economic and ethical arguments to support their views. Some issues have consequences that are so devastating that the government needs to step in and impose controls, as shown in the following example.

> In 2015 the U.K. government passed the Modern Slavery Act, the first piece of U.K. legislation focusing on the prevention and prosecution of modern slavery and the protection of victims. According to the International Labour Organisation (ILO), 25 million people around the world were trapped in some form of forced labor, including trafficking, debt bondage, and child labor. In the United Kingdom, instances of slavery were found in nail salons, the fishing industry, two London medical professional offices, and cannabis farms. The new law made businesses accountable for slavery and labor abuses occurring along their supply chain of operations. The goal was to ensure that there were no instances of slavery linked to any British products or services.[19]

Whether the actions are self-imposed by a company or forced on businesses by the government, the protection of the public is often the motivation for regulatory action.

Types of Regulation

Government regulations come in different forms. Some are directly imposed; others are more indirect. Some are aimed at a specific industry (e.g., banking); others, such as those dealing with job discrimination or pollution, apply to all industries. Some have been in existence for a long time—for example, the Food and Drug Act was passed in 1906—whereas others, such as the Wall Street Reform and Consumer Protection (or Dodd-Frank) Act of 2010, are of much more recent vintage. Just as public policy can be classified as either economic or social, so regulations can be classified in the same fashion.

Economic Regulations

The oldest form of regulation is primarily economic in nature. **Economic regulations** aim to modify the normal operation of the free market and the forces of supply and demand. Such modification may come about because the free market is distorted by the size or monopoly power of companies, or because the consequences of actions in the marketplace are thought to be undesirable. Economic regulations include those that control prices or wages, allocate public resources, establish service territories, set the number of participants, and ration resources. The decisions by the Federal Trade Commission (FTC) to prevent anticompetitive business practices illustrate one kind of economic regulation.

The U.S. Congress responded to the global recession, in part, by passing the **Dodd-Frank Act** in 2010. This legislation was heralded as the most comprehensive financial regulatory reform measure since the Great Depression and intended to revolutionize many business activities. Among other things, the Dodd-Frank Act affected the oversight and supervision of financial institutions, created a new agency responsible for implementing and enforcing compliance with consumer financial laws, introduced more stringent regulatory capital requirements, and implemented changes to corporate governance and executive compensation practices.[20] In 2017, President Trump signed two executive actions that scaled back some provisions of the Dodd-Frank Act with the intention of making it easier for businesses to borrow money.

[19] "The U.K.'s New Slavery Laws Explained: What Do They Mean for Business?" *The Guardian,* December 14, 2015, *www.theguardian.com*.

[20] "The Dodd-Frank Act: A Cheat Sheet," Morrison & Foerster, n.d., *www.mofo.com*.

Antitrust: A Special Kind of Economic Regulation

One important kind of economic regulation occurs when government acts to preserve competition in the marketplace, thereby protecting consumers. **Antitrust laws** prohibit unfair, anticompetitive practices by business. (The term *antitrust law* is used in the United States; most other countries use the term *competition law.*) For example, if a group of companies agreed among themselves to set prices at a particular level, this would generally be an antitrust violation. In addition, a firm may not engage in **predatory pricing**, the practice of selling below cost to drive rivals out of business. If a company uses its market dominance to restrain commerce, compete unfairly, or hurt consumers, then it may be found guilty of violating antitrust laws.

The two main antitrust enforcement agencies in the United States are the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission. Both agencies may bring suits against companies they believe to be guilty of violating antitrust laws. They also may investigate possible violations, issue guidelines and advisory opinions for firms planning mergers or acquisitions, identify specific practices considered to be illegal, and negotiate informal settlements out of court. Antitrust regulators have been active in prosecuting price fixing, blocking anticompetitive mergers, and dealing with foreign companies that have violated U.S. laws on fair competition. In Europe, the European Commission investigates antitrust violations for the European Union who may act to enforce EU laws, as seen in the Qualcomm example that follows.

> One example of the European Union's antitrust regulatory oversight was evident when they imposed a €997 million ($1.23 million) antitrust fine on the U.S.-technology giant Qualcomm. The EU antitrust regulators accused Qualcomm of paying Apple billions of dollars over a five-year span, from 2011 to 2016. These payments were made to restrict Apple from purchasing from Qualcomm's rivals, those firms that sold chips that connected smartphones and tablets to cellular networks. "These payments were not just reductions in price—they were made on the condition that Apple would exclusively use Qualcomm's baseband chipsets in all its iPhones and iPads," said Margrethe Vestager, EU antitrust chief.[21]

If a company is found guilty of antitrust violations, what are the penalties? The government may levy a fine—sometimes a large one, as the EU did against Qualcomm. In the case of private lawsuits, companies may also be required to pay damages to firms or individuals they have harmed. Sysco and U.S. Foods Holdings, two of the largest U.S. food distribution companies, joined retailer Winn-Dixie Stores, in filing lawsuits for undisclosed damages against the chicken industry, accusing Tyson Foods, Pilgrim's Pride, Sanderson Farms, and other poultry suppliers of manipulating wholesale chicken prices.[22] In addition, regulators may impose other, nonmonetary remedies. A *structural remedy* may require the breakup of a monopolistic firm; this occurred when (the old) AT&T was broken up by government order in 1984. A *conduct remedy,* more commonly used, involves an agreement that the offending firm will change its conduct, often under government supervision. For example, a company might agree to stop certain anticompetitive practices. Finally, an *intellectual property remedy* is used in some kinds of high-technology businesses; it involves disclosure of information to competitors. All these are part of the regulator's arsenal.

Antitrust regulations cut across industry lines and apply generally to all enterprises. Other economic regulations, such as those governing stock exchanges, may be confined to

[21] "Qualcomm Is Slapped with $1.23 Billion EU Fine for Illegal Payments to Apple," *The Wall Street Journal,* January 24, 2018, *www.wsj.com*.

[22] "U.S. Food Distributors Allege Tyson Foods, Rivals Fixed Chicken Prices," *Reuters,* January 31, 2018, *www.reuters.com*.

Exhibit 7.A

The AT&T–Time Warner Merger of 2018

In 2018, a federal judge handed down what many economists believed to be a sweeping victory against governmental antitrust regulation by approving AT&T's $85 billion acquisition of Time Warner. Judge Richard Leon ruled that the government—which had tried to block the merger—had failed to prove that the telecom company's acquisition of Time Warner would violate antitrust law by leading to fewer choices for consumers and higher prices for television and internet services. With this final roadblock removed, the merger was expected to create a media and telecommunications powerhouse, reshaping the landscape of those industries. The combined company would join Time Warner's library, including HBO's hit "Game of Thrones" and channels like CNN, with AT&T's vast distribution reach through wireless and satellite television services across the country.

Media executives supported the AT&T–Time Warner merger deal, arguing that content creation and distribution had to be combined to compete successfully against technology companies like Amazon and Netflix. Although those companies had just started producing their own shows during the past several years, they were now spending billions of dollars a year on original programming. Their users could stream the video on apps in homes and on mobile devices, putting pressure on traditional media businesses.

Yet, Makan Delrahim, the top antitrust official at the Justice Department said, "We continue to believe that the pay-TV market will be less competitive and less innovative as a result of the proposed merger between AT&T and Time Warner."

Antitrust experts predicted that the court ruling would lead to a flood of new merger proposals. Just days after the AT&T–Time Warner decision, Comcast bid to acquire 21st Century Fox, challenging Disney, which previously had bid for 21st Century Fox's assets. In response, Disney increased their offer to acquire 21st Century Fox. Both Comcast and 21st Century Fox made bids on acquiring Sky, a European media company.

Sources: "AT&T Wins Approval for $85.4 Billion Time Warner Deal in Defeat for Justice Department," *The New York Times,* June 12, 2018, *www.nytimes.com*; and "Judge Approves $85 Billion AT&T–Time Warner Deal," *CNNMoney,* June 13, 2018, *money.cnn.com*.

specific industries and companies. One recent example of a conflict over the application of antitrust laws to a proposed merger is discussed in Exhibit 7.A.

Social Regulations

Social regulations are aimed at such important social goals as protecting consumers and the environment and providing workers with safe and healthy working conditions. Equal employment opportunity, protection of pension benefits, and health care for citizens are other important areas of social regulation. Unlike the economic regulations mentioned above, social regulations are not limited to one type of business or industry. Laws concerning pollution, safety and health, health care, and job discrimination apply to all businesses; consumer protection laws apply to all relevant businesses producing and selling consumer goods.

> The Chilean government declared war on obesity in 2018. "They killed Tony the Tiger. They did away with Cheetos' Chester Cheetah. They banned Kinder Surprise, the chocolate eggs with a hidden toy," accounts *The New York Times* article. The Chilean government imposed multiple marketing restrictions, mandatory packaging redesigns, and labeling rules on the nation's food producers and retailers aimed at transforming the eating habits of 18 million Chilean residents. Nutrition experts said this was the world's most ambitious attempt to remake a country's food culture and could be a model for how to turn the tide on a global obesity epidemic that researchers say contributed to 4 million premature deaths a year.[23]

[23] "In Sweeping War on Obesity, Chile Slays Tony the Tiger," *The New York Times,* February 7, 2018, *www.nytimes.com*.

Exhibit 7.B The Affordable Care Act: Health Care Coverage Mandated for Americans

In 2010, led by President Obama, Congress passed the Affordable Care Act, often referred to as "Obamacare." The basic purpose of the law was to hold insurance companies accountable for their costs and services to their customers, lower the rising health care costs, provide Americans with greater freedom and control over their health care choices, and ultimately improve the quality of health care in America. Its provisions would be rolled out over 10 years. In 2010, the government began giving subsidies to small businesses that offered health coverage to employees, insurance companies were barred from denying coverage to children with preexisting illnesses, and children were permitted to stay on their parents' insurance policies until age 26.

The health care reform law aroused strong passions on both sides. Proponents of the law argued that the more than 5.1 million people on Medicare would save over $3 billion in prescription drugs costs, 105 million Americans would no longer have lifetime dollar limits on their health care coverage, and approximately 54 million Americans would receive greater preventative medical coverage. Health care fraud would decline by $4.1 billion annually due to new fraud detection measures, and 2.5 million young adults would retain health care coverage under their parents' plan. Most importantly, most Americans would now have health insurance coverage.

But, opponents challenged the new law as filled with myths, untruths, and harmful consequences. Some believed that the act would do nothing to bring down the cost of health care. Business leaders worried that the burden of providing their employees with health care insurance would result in bankruptcy or cause employers to reduce the level of health care coverage for their employees. Many worried that the mandate infringed on individual rights—including the right to go without health insurance if they chose. Several states sued, saying the law violated the constitution. In 2017, repeated attempts by Congress to repeal all or part of the Affordable Care Act failed.

By 2018, 11.8 million Americans had selected marketplace plans or been automatically enrolled under the act. Under the act, millions more Americans received preventive services, such as vaccines, cancer screenings, and annual wellness visits at no out-of-pocket cost, than ever before. In addition, Americans could no longer be denied or dropped from coverage because of preexisting conditions or because they hit an annual or lifetime cap in benefits. Josh Peck, co-founder of the pro-ACA group Get America Covered, said, "While enrollment remained steady because of high consumer satisfaction and more affordable premiums for those who qualify for tax credits, enrollment would have outpaced previous years' if the administration had focused on signing people up instead of derailing open-enrollment efforts."

Sources: "What's in the Bill," *The Wall Street Journal,* March 22, 2010, *online.wsj.com*; "Get the Facts Straight on Health Reform—A More Secure Future," *The White House,* n.d., *www.whitehouse.gov*; and "The Affordable Care Act Is Working," *Department of Health and Human Services, www.hhs.gov*. The quote by Josh Peck is from "Nearly 12 Million People Enrolled in 2018 Health Coverage under the ACA," *The Washington Post,* April 3, 2018, *www.washingtonpost.com*.

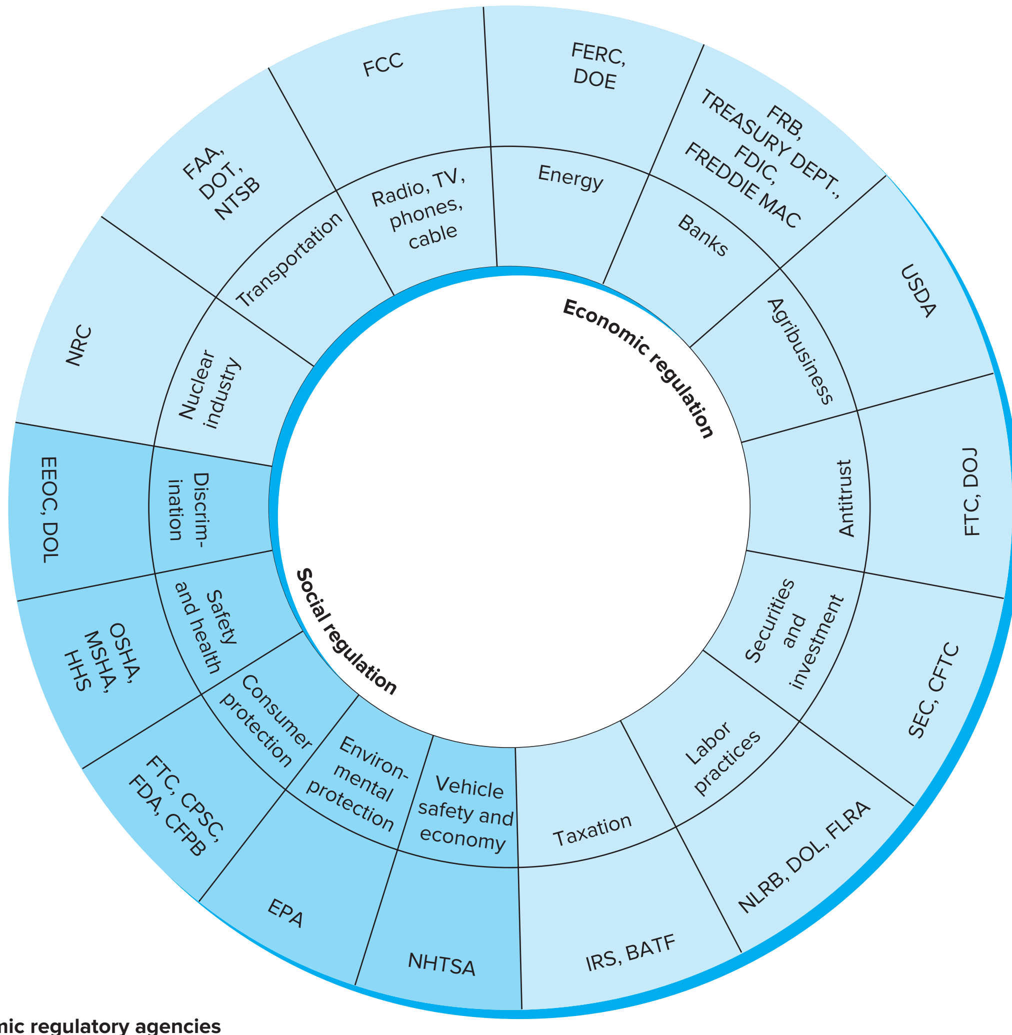
The most significant social regulation in the United States since the 1960s was the comprehensive reform of health care coverage passed by Congress in 2009. It is described in Exhibit 7.B.

Who regulates? Normally, for both economic and social regulation, specific rules are set by agencies of government and by the executive branch, and may be further interpreted by the courts. Many kinds of business behavior are also regulated at the state level. Government regulators and the courts have the challenging job of applying the broad mandates of public policy.

Figure 7.1 depicts these two types of regulation—economic and social—along with the major regulatory agencies responsible for enforcing the rules at the federal level in the United States. Only the most prominent federal agencies are included in the chart. Individual states, some cities, and other national governments have their own array of agencies to implement regulatory policy.

There is a legitimate need for government regulation in modern economies, but regulation also has problems. Businesses feel these problems firsthand, often because the regulations directly affect the cost of products and the freedom of managers to design their

FIGURE 7.1 **Types of Regulation and Regulatory Agencies**



Economic regulatory agencies

NRC	Nuclear Regulatory Commission
FAA	Federal Aviation Administration
FCC	Federal Communications Commission
FERC	Federal Energy Regulatory Commission
FRB	Federal Reserve Board
CFTC	Commodity Futures Trading Commission
FREDDIE MAC	Federal Home Loan Mortgage Corporation
DOT	Department of Transportation
USDA	Department of Agriculture
DOJ	Department of Justice
DOL	Department of Labor
FLRA	Federal Labor Relations Authority
FTC	Federal Trade Commission
SEC	Securities and Exchange Commission
NLRB	National Labor Relations Board
IRS	Internal Revenue Service
BATF	Bureau of Alcohol, Tobacco, Firearms and Explosives
FDIC	Federal Deposit Insurance Corporation
DOE	Department of Energy
NTSB	National Transportation Safety Board

Social regulatory agencies

EEOC	Equal Employment Opportunity Commission
OSHA	Occupational Safety and Health Administration
MSHA	Mine Safety and Health Administration
FTC	Federal Trade Commission
HHS	Department of Health and Human Services
CPSC	Consumer Product Safety Commission
FDA	Food and Drug Administration
EPA	Environmental Protection Agency
NHTSA	National Highway Traffic Safety Administration
CFPB	Consumer Financial Protection Bureau

business operations. In the modern economy, the costs and effectiveness of regulation, as well as its unintended consequences, are serious issues that cannot be overlooked. Each is discussed below.

The Effects of Regulation

Regulation affects many societal stakeholders, including business. Sometimes the consequences are known and intended, but at other times unintended or accidental consequences emerge from regulatory actions. In general, government hopes that the benefits arising from regulation outweigh the costs.

The Costs and Benefits of Regulation

The call for regulation may seem irresistible to government leaders and officials given the benefits they seek, but there are always costs to regulation. An old economic adage says, "There is no free lunch." Eventually, someone has to pay for the benefits created.

An industrial society such as the United States can afford almost anything, including social regulations, if it is willing to pay the price. Sometimes the benefits are worth the costs; sometimes the costs exceed the benefits. The test of **cost–benefit analysis** helps the public understand what is at stake when new regulation is sought.

Figure 7.2 illustrates the increase in costs of federal regulation in the United States since 1960. Economic regulation has existed for many decades, and its cost has grown more slowly than that of social regulation. Social regulation spending reflects growth in such areas as environmental health, occupational safety, and consumer protection. A rapid growth of social regulation spending occurred in the 1960s and again in the 2000s, but has slowed somewhat recently. The cost of regulation has its critics, especially when the costs to small businesses or manufacturing firms are considered.

In addition to paying for regulatory programs, it takes people to administer, monitor, and enforce these regulations. Although the numbers have gone up and down, depending on the approach of various administrations, the overall trend has been toward growth of the regulatory apparatus of government. In 1960, fewer than 60,000 federal employees monitored and enforced government regulations; by 2015, this number had grown to more than 277,000 employees. John J. DiIulio Jr., of the University of Pennsylvania and the

FIGURE 7.2

Budgetary Costs of Federal Regulation, 1960–2018

Source: Susan Dudley and Melinda Warren, "Regulators' Budget Increases Consistent with Growth in Fiscal Budget," *Regulatory Studies Center, The George Washington University and Weidenbaum Center, Washington University in Saint Louis,* May 2015, *regulatorystudies.columbian.gwu.edu*; and *regulatorystudies.columbian.gwu.edu*.

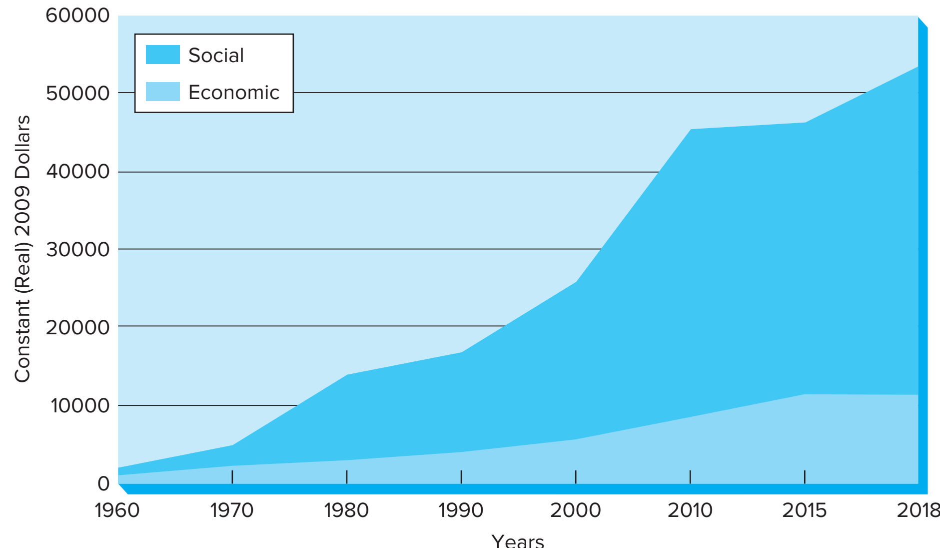


Exhibit 7.C

Deregulation in the United States, Starting in 2017

In 2017, the Trump Administration began a policy toward deregulation across many industries.

- The Office of Management and Budget suspended a rule that required wage reporting broken down by ethnicity and gender, claiming it was too costly to companies.
- The lessening of the Volcker Rules that restricted banking activities. This change permitted banks to conduct fewer audits of individual securities and derivative transactions, and generally to have more freedom to buy and sell securities.
- The Dodd-Frank Act of 2010, which attempted to guard against another financial crisis, had its restrictions seriously minimized when about two-dozen regional banks were released from strict rules requiring them to maintain large capital reserves.
- Under the leadership of the White House, the Republican-led Congress reversed a rule that made it easier for consumers to bring class action lawsuits against banks by requiring that consumers use arbitration to resolve disputes.
- President Trump froze the implementation of a rule that said contract poultry and livestock farmers would be able to sue dealers without having to prove that a practice harmed the entire industry, just showing harm to their specific business.
- The Transportation Department withdrew a rule proposed by the Obama Administration that would require airlines to disclose baggage fees to consumers along with fare and schedule information.
- The Labor Department froze a rule that would tighten standards for workplace exposure to beryllium, a lightweight metal used in manufacturing that is dangerous if inhaled via dust or fumes or if it is exposed to the skin.

Source: "How Donald Trump Has Remade the Rules for Business," *The Wall Street Journal,* January 17, 2018, *www.wsj.com*.

Brookings Institution, criticized the size of government regulation when he said, "Today's government is indeed big—3.5 times bigger than five and a half decades ago, but dispersed to disguise its size."[24]

Continuous Regulatory Reform

The amount of regulatory activity often is cyclical—historically rising during some periods and declining during others. Businesses in the United States experienced a lessening of regulation in the early 2000s—*deregulation,* then experienced a return of regulatory activity in the late 2000s and early 2010s—*reregulation.* The cycle continued as the pendulum swung back to deregulation in the late 2010s under the Trump administration.

Deregulation is the removal or scaling down of regulatory authority and regulatory activities of government. Deregulation is often a politically popular idea. President Ronald Reagan strongly advocated deregulation in the early 1980s, when he campaigned on the promise to "get government off the back of the people." Major deregulatory laws were enacted off and on in the United States from the 1980s to today, mostly dependent upon whether there was a Republican administration in power. Recently efforts to promote deregulation in the United States are described in Exhibit 7.C.

Proponents of deregulation often challenge the public's desire to see government solve problems. This generates situations in which government is trying to deregulate in some areas while at the same time creating new regulation in others. **Reregulation** is the increase or expansion of government regulation, especially in areas where the regulatory activities had previously been reduced. The scandals that rocked corporate America in

[24] 'Big Government' Is Ever Growing, On the Sly," *National Review,* February 25, 2017, *www.nationalreview.com*.

the 2000s—and the failure or near-failure of a number of big commercial and investment banks in the late 2000s—brought cries from many stakeholder groups for reregulation of the securities and financial services industries.

Regulation in a Global Context

International commerce unites people and businesses in new and complicated ways, as described in Chapter 4. U.S. consumers routinely buy food, automobiles, and clothing from companies located in Europe, Canada, Latin America, Australia, Africa, and Asia. Citizens of other nations do the same. As these patterns of international commerce grow more complicated, governments recognize the need to establish rules that protect the interests of their own citizens. No nation wants to accept dangerous products manufactured elsewhere that will injure its citizens, and no government wants to see its economy damaged by unfair competition from foreign competitors. These concerns provide the rationale for international regulatory agreements and cooperation. At times, the issues themselves cut across national borders, so international regulation is needed.

In 2016, the International Civil Aviation Organization, representing more than 190 countries, adopted The Aviation Plan, designed to reduce the climate impact of international jet travel, which accounted for about 2 percent of the world's emissions of greenhouse gases. The measure would require air carriers to take major steps to improve fuel economy in their routes and fleets, very likely accelerating the purchase of newer, more efficient planes. The plan was scheduled to take effect in 2021. "This measure addresses a growing source of global emissions, demonstrates the international community's strong and growing support for climate action in all areas and helps avoid a patchwork of potentially costly and overlapping regional and national measures," said John Kerry, then the U.S. Secretary of State.[25]

At other times, political conflicts spill over into economic regulatory actions, as described next.

In 2017, Iran, a long-time adversary of the United States, sanctioned 15 American companies in retaliation for restrictions imposed by the Trump administration on companies and people allegedly connected with Iran's ballistic-missile program. Iran's sanctions targeted American defense companies, including defense contractor Raytheon, and two firearms manufacturers, Magnum Research and Lewis Machine and Tool, for allegedly helping Israel and contributing to regional instability, according to the Islamic Republic News Agency. Future business dealings with these companies were prohibited by the Iranian government and their assets in the Islamic Republic were frozen, a common tactic used by the United States against companies from doing business with Iran.[26]

Whether at the local, state, federal, or international levels, governments exert their control seeking to protect society through regulation. The significant challenge involves balancing the costs of this form of governance against the benefits received or the prevention of the harms that might occur if the regulation is not in place and enforced. Businesses have long understood that managing and, if possible, cooperating with the government regarding regulation generally leads to a more productive economic environment and financial health of the firm.

[25] "EU Halts Carbon Emission Fees for Airlines," *The Hill,* November 12, 2012, *www.thehill.com*; and "Over 190 Countries Adopt Plan to Offset Air Travel Emissions," *The New York Times,* October 6, 2016, *www.nytimes.com*.

[26] "Iran Slaps Sanctions on 15 U.S. Companies as Animosity Grows," *The Wall Street Journal,* March 26, 2017, *www.wsj.com*.

Summary

- Government's relationship with business ranges from collaborative to working at arm's length. This relationship often is tenuous, and managers must be vigilant to anticipate any change that may affect business and its operations.
- A public policy is an action undertaken by government to achieve a broad public purpose. The public policy process involves inputs, goals, tools or instruments, and effects.
- Regulation is needed to correct for market failure, overcome natural monopoly, and protect stakeholders who might otherwise be hurt by the unrestricted actions of business.
- Regulation can take the form of laws affecting an organization's economic operations (e.g., trade and labor practices, allocation of scarce resources, price controls) or focus on social good (e.g., consumer protection, employee health and safety, environmental protection).
- Antitrust laws seek to preserve competition in the marketplace, thereby protecting consumers. Remedies may involve imposing a fine, breaking up a firm, changing the firm's conduct, or requiring the disclosure of information to competitors.
- Although regulations are often very costly, many believe that these costs are worth the benefits they bring. The ongoing debate over the need for and effectiveness of regulation leads to alternating periods of deregulation and reregulation.
- The global regulation of business often occurs when commerce crosses national borders or the consequences of unregulated business activity by a national government are so large that global regulation is necessary.

Key Terms

antitrust laws, *150*
cost–benefit analysis, *154*
deregulation, *155*
Dodd-Frank Act, *149*
economic regulation, *149*
fiscal policy, *145*
market failure, *147*
monetary policy, *146*
natural monopoly, *148*
negative externalities, *148*
predatory pricing, *150*
public policy, *142*
regulation, *147*
reregulation, *155*
social assistance policies, *147*
social regulation, *151*
trade policy, *145*

Internet Resources

www.cato.org	Cato Institute
www.consumerfinance.gov	U.S. Consumer Financial Protection Bureau
www.economywatch.com	Economy Watch
www.federalreserve.gov	Board of Governors of the Federal Reserve System
www.ftc.gov	U.S. Federal Trade Commission
www.mercatus.org	Mercatus Center, George Mason University
www.reginfo.gov	U.S. Office of Information and Regulatory Affairs
www.regulations.gov	Regulations.gov
www.un.org/en/law	International Law, United Nations
www.usa.gov	Online Guide to Government Information and Services

Discussion Case: *Should Facebook Be Regulated?*

In 2018, Facebook, the social media behemoth, faced public outrage over breaches of its users' privacy. A British political consulting firm hired by the Trump campaign, Cambridge Analytica, was accused of accessing the private data of 87 million Facebook users in an attempt to influence the 2016 presidential election. The consultants had partnered with a psychology professor at Cambridge University, who developed a Facebook app that offered a personality survey. When people responded, the app harvested private information from their profiles and those of their friends. The professor then shared this information with Cambridge Analytica, which used it to target political ads to Facebook users.

In the wake of these revelations, the U.S. Congress and European Parliament both held hearings on how to better protect the personal information of social media users. These hearings raised the question: Should Facebook, and other social media platforms, be more strictly regulated by the government to prevent future breaches of this kind?

While it was not publicly known how much revenue online political advertisements generated for Facebook in 2018, the firm made it clear that Facebook was spending so much money hiring moderators to review political ads that it would cancel out the revenue those ads were expected to generate in the 2018 election cycle. CEO Mark Zuckerberg explained, "We're essentially going to be losing money on running political ads, because the company is hiring 'thousands' in advance of the 2018 elections. … That cost is going to be greater than the money that we make."

Zuckerberg responded to the growing social outcry by making himself publicly available to legislators in both the United States and Europe. Zuckerberg was questioned for almost 10 hours by U.S. senators of the commerce and judiciary committees over the company's privacy and data mining policies. Zuckerberg explained,

> "I believe it's important to tell people exactly how the information that they share on Facebook is going to be used. … Every single time, there's a control right there about who you're going to be sharing it with. … It was my mistake, and I'm sorry. I started Facebook, I run it, and I'm responsible for what happens here. It's clear now that we didn't do enough to prevent these tools from being used for harm."

Two weeks later Zuckerberg appeared before the European Parliament, pledging to be more diligent in protecting his users' individual information. He explained, "Europeans make up a large and incredibly important part of our global community. Many of the values Europeans care most deeply about are values we share: from the importance of human rights and the need for community to a love of technology, with all the potential it brings." As in his congressional testimony, Zuckerberg admitted to making mistakes that needed to be corrected, but again argued against government regulation of the industry, claiming that companies could effectively address any problems themselves. "I believe deeply in what we're doing. And when we address these challenges, I know we'll look back and view helping people connect and giving more people a voice as a positive force here in Europe and around the world," stated Zuckerberg.

In response to the Cambridge Analytica incident, Facebook introduced a centralized system that enabled its users to control their privacy and security settings. The system, available globally, provided users with a single location where they could change their settings, rather than the old system, which was spread out across 20 separate locations on

the social media platform. Facebook's chief privacy officer said, "We've heard loud and clear that privacy settings and other important tools are hard to find, and that we must do more to keep people informed." Facebook also announced that it would curb information that it exchanged with companies that collected and sold consumer data for advertisers. It ended an ad-targeting option called Partner Categories that allowed data brokers to target specific groups of Facebook users—people who had bought a certain product, for example—on behalf of their ad clients. Graham Mudd, product marketing director at Facebook, posted that shutting that system down would "help improve people's privacy on Facebook."

Many thought Zuckerberg's pledge to do better was not enough and legislation was required. This was not the first time in recent years that the public turned to the government to protect their privacy. In 2010, the Do Not Track Bill, intended to give American consumers more control over what personal details companies collected from them and how the data was used, was introduced in Congress. In addition, in 2012 then-President Obama unveiled a comprehensive Consumer Privacy Bill of Rights, which would empower consumers to know what personal information was collected, stored, and possibly sold to other businesses. Neither of these efforts generated sufficient political support to become law.

In 2018, the European Union passed the General Data Protection Regulation. This regulation defined personal data as proprietary—that is, owned by the individual—and required that any use of that data by other parties had to be authorized by permission. A consumer would have to affirmatively "opt in" (rather than "opt out"), after receiving a request written in clear language, not legalese, from a business seeking to use their information.

In response to the Facebook-Cambridge Analytica incident, calls for new legislation in the United States appeared. Some of the potential legislative and regulatory strategies considered included

- Legislation could be passed to protect the data of individuals. These laws would focus on how companies collect, share, and use user data, like the European Union's 2018 General Data Protection Regulation.
- New regulation could restrict how consumer data was used, including the sale of this information to other businesses. It could require social media sites, like Facebook, to provide the government, or its users, with additional information on who purchased users' information. These steps would increase the transparency regarding the sale of consumers' information.
- New regulation might also target how the consumers' information in used for online political advertising. Facebook said it would support legislation to require large digital platforms to keep a public library of paid political ads that had appeared on their sites. Proposals suggested that tech companies be required to confirm the identities and locations of the sponsors of political advertisements on their sites.
- Facebook, Google, and other technology firms could be held responsible for the unethical or illegal behavior of those who used their platforms. This effort targeted the actions by organizations like Cambridge Analytica—or even foreign governments—that might try to influence political elections through advertisements on social media.
- Governmental investigations, likely by the nation's chief privacy regulator, the Federal Trade Commission (FTC), could be conducted, with the FTC given sweeping access and enforcement powers.

How did the public feel about these proposals? In a 2018 survey, only 37 percent of Americans said that Facebook, Twitter, and other social platforms were not regulated enough, and 14 percent of those polled said they were already regulated too much. While many were worried that a Cambridge Analytica-type incident might occur again, and that personal information was not well protected, they were uncertain if governmental regulation was the right answer.

Sources: "How Calls for Privacy May Upend Business for Facebook and Google," *The New York Times,* March 24, 2018, *www.nytimes.com;* "Facebook Introduces Central Page for Privacy and Security Settings," *The New York Times,* March 28, 2018, *www.nytimes.com;* "Facebook Limiting Information Shared with Data Brokers," *The Wall Street Journal,* March 28, 2018, *www.wsj.com;* "As Mark Zuckerberg Prepares to Testify, Here's How Washington Could Regulate Silicon Valley," *The Wall Street Journal,* April 9, 2018, *www.wsj.com;* "The Key Moments from Mark Zuckerberg's Testimony to Congress," *The Guardian,* April 11, 2018, *www.theguardian.com;* "No Overwhelming Support for More Online Regulation, Poll Finds," *The Wall Street Journal,* April 16, 2018, *www.wsj.com;* "Facebook Gears Up to Lose Money on Political Ads," *Ad Age,* May 2, 2018, *adage.com;* "Read Mark Zuckerberg's Prepared Remarks for his Meeting with EU Lawmakers," *CNBC,* May 22, 2018, *www.cnbc.com;* and "Facebook and Cambridge Analytica: What You Need to Know as Fallout Widens," *The New York Times,* March 19, 2018.

Discussion Questions

1. Do you believe the government (in the United States and other countries) should regulate Facebook to protect its users' privacy? Why or why not?
2. Do you believe that Facebook's actions so far exemplify working in collaboration with, or in opposition to, government? Why?
3. What elements of the public policy process are seen in this case: public policy inputs, goals, tools, and effects?
4. Of the reasons described in this chapter to justify government regulation: market failure, negative externalities, natural monopolies, and ethical arguments, which reasons are relevant in this case?
5. Since Facebook and other social media platforms are global in nature, is there a need for international regulation to protect consumers' privacy worldwide? If so, what organization could provide this global regulatory protection?
6. What level of responsibility do individuals who use Facebook and other social media sites have to protect their own personal information?

CHAPTER EIGHT

Influencing the Political Environment

Businesses face complicated issues in managing their relationships with politicians and government regulators. Managers must understand the political environment and be active and effective participants in the public policy process. They need to ensure that their company is seen as a relevant stakeholder when government officials make public policy decisions and must be familiar with the many ways that business can influence these decisions. The opportunities afforded businesses to participate in the public policy process differ from nation to nation. Sound business strategies depend on an understanding of these differences, enabling businesses to manage worldwide business–government relations effectively.

This Chapter Focuses on These Key Learning Objectives:

LO 8-1 Understanding the arguments for and against business participation in the political process.

LO 8-2 Knowing the types of corporate political strategies and the influences on an organization's development of a particular strategy.

LO 8-3 Assessing the tactics businesses can use to be involved in the political process.

LO 8-4 Examining the role of the public affairs department and its staff.

LO 8-5 Recognizing the challenges business faces in managing business–government relations in different countries.

In 2018, a group of U.S. senators proposed the Honest Ads Act. The proposal quickly gained bipartisan traction, and corporate executives, including as Mark Zuckerberg, also voiced support for this new proposed law. The goal of the Honest Ads Act was to provide more transparency for online political advertisements. This concern was sparked by revelations that Russian nationals had purchased political ads on social media networks, including Facebook, to attempt to influence voters in the 2016 presidential election.

The Honest Ads Act would require digital platforms with more than 50 million unique monthly visitors to maintain a complete record of advertisers who had spent more than $500 on ads during the previous year. These records would be available to the public and include a digital copy of the ads, as well as a description of the target audience—for example, women over 25 who were likely to vote Republican. The report would also include the ad rate, the name of the candidate or office that the ad was supporting, and the contact information of the ad's purchaser. Facebook and other digital platforms would make a reasonable effort to ensure that foreign nationals did not buy ads that attempted to influence elections. This last condition was something that Zuckerberg said in Congressional testimony that Facebook was already doing.[1]

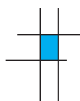
The National Cannabis Industry Association (NCIA), a trade group for legal marijuana businesses, hired two Washington lobbying firms, Heather Podesta + Partners, a firm with ties to the Democratic Party, and Jochum Shore & Trossevin, a firm with strong relationships with Republican lawmakers, to push for legislation to allow its members better access to banks. "We've gone from simply seeking to have our industry's issues taken seriously to bipartisan legislation introduced in both chambers," said Aaron Smith, the NCIA's executive director. By 2018, 29 states and the District of Columbia had legalized marijuana for medical use and nine states had passed laws permitting personal, recreational use. Yet, marijuana-related businesses were often forced to deal in cash-only business transactions because most banks refused to deal with them out of fear of federal prosecution, since marijuana possession was still illegal under federal law.[2]

As the first example above demonstrates, government and business must carefully monitor online political advertisements to ensure that the public is protected from deception, and information is transparently available. In the other opening example, businesses or an industry sometimes solicit lobbying firms to argue their case for a change in practices due to conflicting state and federal laws. In general, business recognizes the necessity of monitoring the political environment and addressing political issues as they arise. This is a constant challenge for businesses entrusted with managing the political environment, because new issues emerge and warrant intervention.

This chapter focuses on managing business–government relations and political issues. Businesses do not have an absolute right to exist and pursue profits. The right to conduct commerce depends on compliance with appropriate laws and public policy. As discussed in Chapter 7, public policies and government regulations are shaped by many actors, including business, special interest groups, and government officials. The emergence of public issues often encourages companies to monitor public concerns, respond to government proposals, and participate in the political process. This chapter discusses how managers can ethically and practically meet the challenge of managing the business–government relationship.

[1] "Facebook: What Is the Honest Ads Act?" *CBS News,* April 11, 2018, *www.cbsnews.com*.

[2] "Marijuana Industry Hires Lobbyists to Ease Bank Access," The *Wall Street Journal,* July 28, 2015, *www.wsj.com*.



Participants in the Political Environment

In many countries the political environment features numerous participants. These participants may have differing objectives and goals, varying access to political tools, and disparate levels of power or influence. The outcomes sought by businesses may be consistent, or at odds, with the results desired by interest groups. Participants may argue that their needs are greater than the needs of other political actors, or that one group or another group does not have the right to be involved in the public policy process. To better understand the dynamic nature of the political environment, it is important to explore who participates in the political process and their claims of legitimacy.

Business as a Political Participant

There is a serious debate between those who favor and those who oppose business involvement in governmental affairs. This debate involves the question of whether, and to what extent, business should legitimately participate in the political process. As shown in Figure 8.1, some people believe business should stay out of politics, while others argue that business has a right to be involved.

Proponents of business involvement in the political process often argue that since other affected groups (such as special interest groups) are permitted to be involved, it is only fair that business should be, too. This justice and fairness argument becomes even stronger when one considers the significant financial consequences that government actions may have on business.

An Irishman walks into a bar. This may sound like the opening line of a joke, but it actually is the beginning of a television advertisement about responsible drinking, developed by British beverage maker Diageo. The company-sponsored ads promoting moderation in drinking, the first of their kind in the United Kingdom, were aired during prime time to maximize their impact. A Diageo spokesperson admitted that while the company wanted to discourage binge drinking by young people, a growing concern, it also hoped its campaign would help Diageo avoid possible governmental regulation of their product and its advertisements.[3]

Businesses see themselves as countervailing forces in the political arena and believe that their progress, and possibly survival, depends on influencing government policy and regulations. But sometimes efforts to do so can become controversial.

In early 2017, several dozen CEOs joined two advisory councils established as part of the White House's "Open Door" policy for the country's top business leaders.

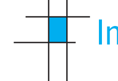
FIGURE 8.1
The Arguments for and against Political Involvement by Business

Why Business Should Be Involved	Why Business Should Not Be Involved
A pluralistic system invites many participants.	Managers are not qualified to engage in political debate.
Economic stakes are high for firms.	Business is too big, too powerful—an elephant dancing among chickens.
Business counterbalances other social interests.	Business is too selfish to care about the common good.
Business is a vital stakeholder of government.	Business risks its credibility by engaging in partisan politics.

[3] "Promoting Moderation," *Ethical Performance Best Practices,* Winter 2007/2008, p. 8.

They were the Manufacturing Jobs Initiative and the Strategic Policy Forum, both established to advise President Trump on economic growth and job creation. But the two advisory councils were short-lived. Trump's comments regarding a violent conflict between white supremacist groups and counterprotesters in Charlottesville, Virginia—in which he said there were "some very fine people on both sides"—offended some of the executives. Under pressure from many of the companies' stakeholders, top executives at J.P. Morgan Chase, IBM, PepsiCo, Walt Disney, Uber, Merck, Tesla, 3M, and others resigned from the two councils. Douglas McMillon, Walmart's CEO, expressed many of their concerns when he said, "As we watched the events and the response from President Trump over the weekend, we too felt that he missed a critical opportunity to help bring our country together by unequivocally rejecting the appalling actions of white supremacists." A few minutes later Trump posted on Twitter that he had dissolved the councils: "Rather than putting pressure on the businesspeople of the Manufacturing Council & Strategy & Policy Forum, I am ending both. Thank you all!"[4]

Although the debate continues over whether businesses should be involved in politics, and if so how, the facts are that in many countries businesses are permitted to engage in political discussions, influence political races, and introduce or contribute to the drafting of laws and regulations, as discussed later in this chapter. (Some of these organizations are mentioned later in Figure 8.4.)[5]



Influencing the Business–Government Relationship

Most scholars and businesspeople agree: Business must participate in politics. Why? Quite simply, the stakes are too high for business not to be involved. Government must and will act upon many issues, and these issues affect the basic operations of business and its pursuit of economic stability and growth. Therefore, businesses must develop a corporate political strategy.[6]

Corporate Political Strategy

A **corporate political strategy** involves the "activities taken by organizations to acquire, develop, and use power to obtain an advantage."[7] These strategies might be used to further a firm's economic survival or growth. Alternatively, a corporate political strategy might target limiting a competitor's progress or ability to compete. Strategies also may be developed simply to exercise the business's right to a voice in government affairs, as intended by participation in the presidential advisory councils discussed earlier. Organizations differ in how actively they are involved in politics on an ongoing basis. Some companies essentially wait for a public policy issue to emerge before building a strategy to address that issue. This is likely when they believe the threat posed by unexpected public issues is relatively small.

[4] "Trump's Business Councils Disband after CEOs Defect," *The Wall Street Journal,* August 16, 2017, *www.wsj.com*; and "Morning Agenda: Trump Bites Back against C.E.O.s Who Rebuked Him," *The New York Times,* August 16, 2017, *www.nytimes.com*.

[5] All data from *OpenSecrets.org*.

[6] For a contrarian view, see Miguel Alzola, "Corporate Dystopia: The Ethics of Corporate Political Spending," *Business & Society,* 52 (2013), pp. 388–426.

[7] The quotation is from John F. Mahon and Richard McGowan, *Industry as a Player in the Political and Social Arena* (Westport, CT: Quorum Press, 1996), p. 29. Also see Jean-Philippe Bonardi, Amy J. Hillman, and Gerald D. Keim, "The Attractiveness of Political Markets: Implications for Firm Strategy" *Academy of Management Review* 30 (2005), pp. 397–413, for a thorough discussion of this concept.

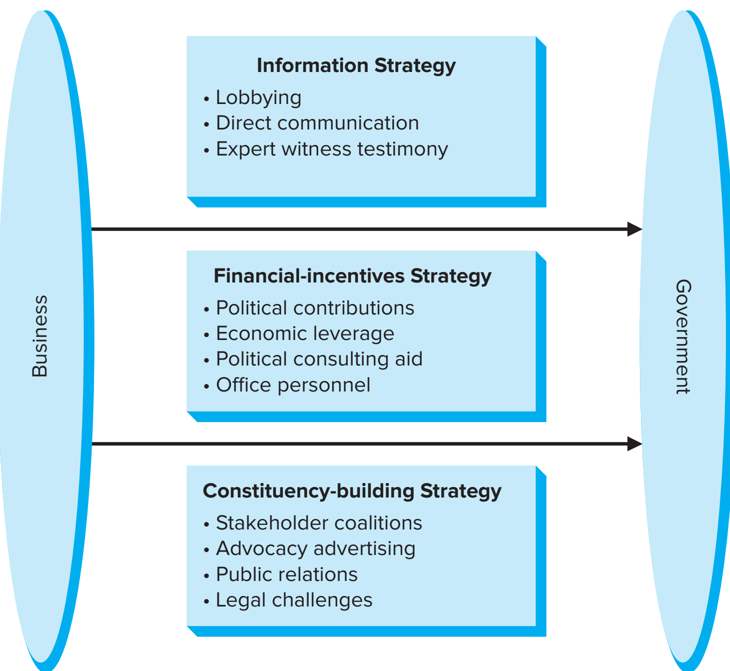


FIGURE 8.2
Business Strategies for Influencing Government

Source: Adapted from Amy J. Hillman and Michael A. Hitt, "Corporate Political Strategy Formulation: A Model of Approach, Participation, and Strategy Decisions" *Academy of Management Review* 24 (1999), Table 1, p. 835.

On the other hand, other companies develop an ongoing political strategy, so that they are ready when various public issues arise. Firms are most likely to have a long-term political strategy if they believe the risks of harm from unexpected public issues are great, or when the firm is a frequent target of public attention. For example, firms in the technology industry realized that online political advertising created a new challenge and might require them to support passage of the Honest Ads Act, as discussed at the beginning of this chapter.

Political actions by businesses often take the form of one of the following three strategic types, also shown in Figure 8.2:

- *Information strategy* (where businesses seek to provide government policymakers with information to influence their actions, such as lobbying).
- *Financial-incentives strategy* (where businesses provide incentives to influence government policymakers to act in a certain way, such as supporting a political action committee that contributes to a policymaker's campaign).
- *Constituency-building strategy* (where businesses seek to gain support from other affected organizations to better influence government policymakers to act in a way that helps them).

The various tactics used by businesses when adopting each of these political strategies are discussed next in this chapter.

Political Action Tactics

The tactics or tools used by business to influence the public policy process are often similar to those available to other political participants. Sometimes business may have an advantage since it might have greater financial resources, but often it is how tactics are used—not the amount of money spent—that determines their effectiveness. This section

Exhibit 8.A

Lobbyist for Hire: Access to the President

In 2017, as President Trump was sworn into office, Trump's personal attorney Michael Cohen saw an opportunity. Cohen pitched his close association with Trump to potential corporate clients. He showed photos of himself with Trump, mentioned how frequently they spoke, and inferred that he was the president's "fixer." Through his personal business, Essential Consultants, Cohen was seeking to sell his services to companies eager to gain insights in how to navigate the new Trump administration. A rapid flow of millions of dollars to Cohen's consulting firm suggested that some corporations no longer wished to rely on traditional lobbying tactics when dealing with the new "outsider" president, and rather sought an "inside" tack through Trump's personal attorney.

A Korean defense company, competing for a U.S. government contract, paid Cohen $150,000 to advise it on accounting practices. Novartis AG, a global pharmaceutical company, paid Cohen $1.2 million to provide insights into health care policy. Later the firm realized that it had "made a mistake," according to its CEO, since Cohen "had little to offer the firm," but allowed Cohen to retain the consulting fee. AT&T's CEO Randall Stephenson also recognized that "the company made a mistake" after hiring Cohen to provide advice on federal policy, including how the administration might view the telecommunication giant's deal to buy Time Warner.

Eventually Cohen's business activities came under investigation by special counsel Robert Mueller and the U.S. attorney for the Southern District of New York, resulting in raids on Cohen's office, home, hotel room and safe-deposit box. Cohen would not comment on the investigation, but his friends said that he had so many potential clients after Trump's election that he had to turn many down. "An entrepreneur always understands their opportunities. And Michael has always been an entrepreneur," explained a friend who spoke to *The Washington Post* under the condition of anonymity.

Source: "I'm Crushing It: How Michael Cohen, Touting His Access to President Trump, Convinced Companies to Pay Millions," *The Washington Post,* May 9, 2018, *www.washingtonpost.com*; "Novartis CEO Calls Hiring of Trump Lawyer Michael Cohen a 'Mistake'," *The Wall Street Journal,* May 10, 2018, *www.wsj.com*; and "AT&T Chief Says It Made a 'Big Mistake' Hiring Michael Cohen," *The New York Times,* May 11, 2018, *www.nytimes.com*.

will discuss tactics used by business in the three strategic areas of information, financial incentives, and constituency building.

Promoting an Information Strategy

As shown in Figure 8.2, some firms pursue a political strategy that tries to provide government policymakers with information to influence their actions. Lobbying is the political action tool most often used by businesses when pursuing this type of political strategy, but some firms also use various forms of direct communication with policymakers. These various information-strategy approaches are discussed next.

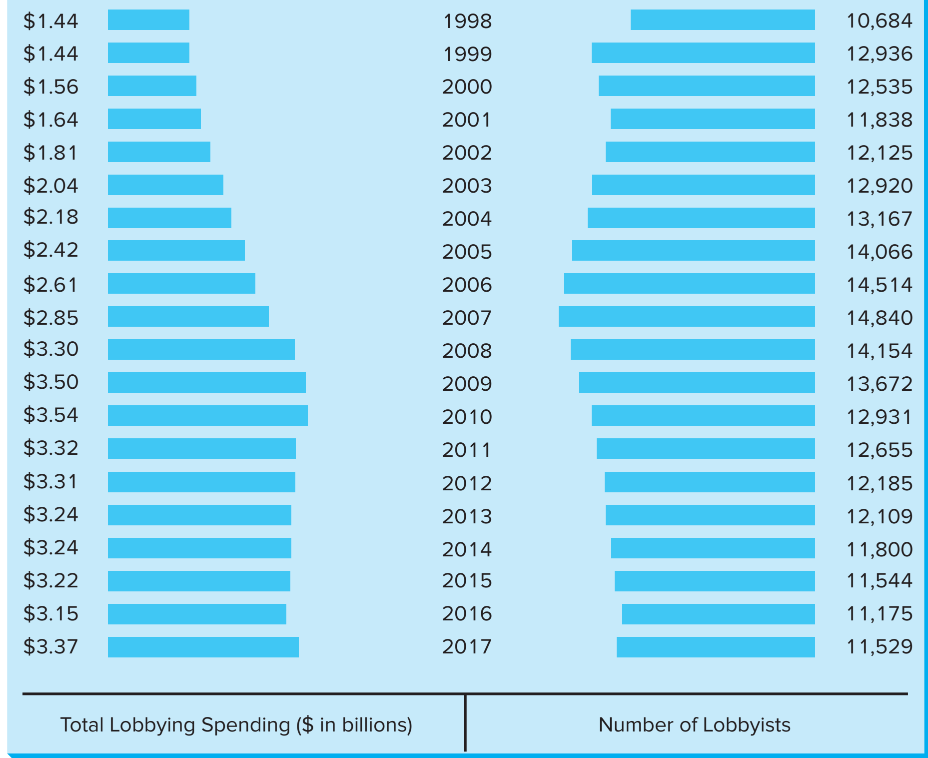
Lobbying

An important tool of business involvement in politics is **lobbying**. Many companies hire full-time representatives in Washington, DC, state capitals, or local cities (or the national capital in other countries where they operate) to keep abreast of developments that may affect the company and, when necessary, to communicate with government officials. These individuals are called lobbyists. Their job is to represent the business before the people and agencies involved in determining legislative and regulatory outcomes. Lobbying involves direct contact with a government official to influence the thinking or actions of that person on an issue or public policy. Lobbyists communicate with and try to persuade others to support an organization's interest or stake as they consider a particular law, policy, or regulation. Google and Alphabet, created when Google was restructured, spent more than $18 million on lobbying activities and hired more than 110 lobbyists in 2018.[8] One example of businesses engaging a lobbyist is discussed in Exhibit 8.A.

[8] "Growing Persuasion," *The Wall Street Journal,* June 21, 2018, *www.wsj.com*; data from Center for Responsive Politics.

FIGURE 8.3
Total Federal Lobbying Spending and Number of Lobbyists, 1998–2017, by U.S. Business

Source: Center for Responsive Politics at www.opensecrets.org.



Businesses, trade associations, and other groups spend a great deal on lobbying. Figure 8.3 shows the total number of lobbyists and the amount spent on lobbying activity from 1998 to 2017. As illustrated, the number of lobbyists peaked in 2010 and has held relatively constant since then. Similarly, the amount spent on lobbying rose to more than $3 billion annually by 2008 and has declined slightly since that time. The organizations spending the most on lobbying in 2018 were the U.S. Chamber of Commerce ($23,095,000), the National Association of Realtors ($13,085,136), and the Pharmaceutical Research and Manufacturers of America ($10,073,750). Corporations also spent money on lobbying, as indicated by the following information from the 2018 election cycle: Alphabet ($5,100,000), Pfizer ($4,650,000), DowDuPont ($4,496,570), Northrop Grumman ($4,400,000), Comcast ($4,242,000), and AT&T ($4,140,000).[9]

Under U.S. law and EU directive (and in other nations as well), lobbying activities are severely limited and must be disclosed publicly.[10] Lobbying firms and organizations employing in-house lobbyists must register with the government. They must also file regular reports on their earnings (lobbyists) or expenses (organizations), and indicate the issues and legislation that were the focus of their efforts. These rules are supposed to guarantee that politicians are free from undue influence and represent the public interest. However, they are not always effective, as the following report indicates.

The Transparency International's report entitled "Lobbying in Europe: Hidden Influence, Privileged Access" reported that in most European countries, the

[9] For a complete listing of lobbyists and their expenses by organization and by industry, see *www.opensecrets.org/lobby*.

[10] For a detailed account of lobbying regulations in the United States, see Lobbying Disclosure Act Guidance at *lobbyingdisclosure.house.gov,* and for a description of rules governing the EU, see "Regulation of Lobbying across the EU," *European Parliament,* December 2016, *www.europarl.europa.eu*.

influence of lobbyists was shrouded in secrecy and lacked the overall transparency founds in other countries. This European practice led to a major cause for concern among its citizens. When political lobbying activities are undertaken with integrity and transparency, lobbying was viewed by the citizenry as a legitimate avenue for special interest groups to be involved in the deliberative process of lawmaking. Yet, when lobbying was not transparent and unregulated, concerns rose over the potential for political corruption. The lobbying activities conducted by businesses, in particular, raised serious concerns among Europeans. They were fearful of the vast sums at their disposal of large companies and how these resources could be used to develop close relationships with lawmakers, and thus gain undue political influence. A Eurobarometer report revealed that 81 percent of Europeans agreed that overly close links between business and politics in their country had led to corruption, and more than half believed that the only way to succeed in business in their country was through political connections.[11]

Businesses sometimes hire former government officials as lobbyists and political advisors. These individuals bring with them their personal connections and detailed knowledge of the public policy process. This circulation of individuals between business and government is often referred to as the **revolving door**. Some examples of this revolving door phenomenon are shown in Exhibit 8.B.

While it is perfectly legal for government officials to seek employment in industry, and vice versa, the revolving door carries potential for abuse. Although it may be praised as an act of public service when a business executive leaves a corporate position to work for a regulatory agency, that executive may be inclined to act favorably toward his or her former employer. Such favoritism would not be fair to other firms also regulated by the agency. Businesses can also seek to influence public policy by offering jobs to regulators in exchange for favors, a practice that is considered highly unethical. "Is it any wonder that the public holds such a low esteem for Congress?" said Joel Hefley, who served as chairman of the House ethics committee before he retired from Congress. "You can dance around these rules in so many ways it really does not accomplish much of anything."[12]

Despite the public's strong concerns, lobbying—as well as hiring former government officials for positions in the corporate world—is normally legal, but great care must be exercised to act ethically.

Direct Communications

Businesses can also promote an information strategy through direct communication with policymakers, another kind of information strategy.

Democracy requires citizen access and communication with political leaders. Businesses often invite government officials to visit local plant facilities, give speeches to employees, attend awards ceremonies, and participate in activities that will improve the officials' understanding of management and employee concerns. These activities help to humanize the distant relationship that can otherwise develop between government officials and the public.

One of the most effective organizations promoting direct communications between business and policymakers is **The Business Roundtable**. Founded in 1972, the Roundtable is an organization of chief executive officers (CEOs) of leading corporations representing $7.2 trillion in annual revenues and more than 16 million employees. The organization studies various public policy issues and advocates for laws that it believes "foster vigorous

[11] "Lobbying in Europe: Hidden Influence, Privileged Access," *Transparency International,* 2014, *www.transparency.org*.

[12] "Law Doesn't End Revolving Door on Capitol Hill," *The New York Times,* February 1, 2014, *dealbook.nytimes.com*.

Exhibit 8.B The Revolving Door of Political Influence

What job opportunities are available for politicians after they decide to retire from Congress or lose a reelection campaign? Lucrative positions await many of them just months after leaving Congress.

- Charlie Dent served seven years in the Pennsylvania House of Representatives and six years in the Pennsylvania State Senate before moving on to the U.S. Congress for 14 years in the House of Representatives. Immediately after retiring from Congress, Dent was hired as a senior policy advisor by DLA Piper, a lobbying firm. DLA had over 40 clients; among its largest were Brookfield Asset Management, Booz Allen Hamilton, Discover Financial Services, Coca-Cola, and Comcast.
- Lawrence Linden was a White House staffer before serving in the U.S. House of Representatives for six years. After his political career, Linden was hired as the senior manager of federal government affairs by Walmart.

Of the 61 members of the 114th Congress who stepped down from their political offices in January 2017, 26 had found new employment within a year, most serving their new employer as a lobbyist on Capitol Hill. Of the 75 members of the 113th Congress who did not return, 41 found employment as lobbyists.

Source: See *OpenSecrets.org/revolving*.

economic growth and a dynamic global economy." Some issues the Roundtable has taken a position on in recent years include corporate governance, job creation and training, sustainability, health care, international trade, immigration, and cybersecurity.[13]

Expert Witness Testimony

A common method of providing information to legislators is for CEOs and other executives to give testimony in various public forums. Businesses may want to provide facts, anecdotes, or data to educate and influence government leaders. One way that government officials collect information in the United States is through public congressional hearings, where business leaders may be invited to speak. These hearings may influence whether legislation is introduced in Congress, or change the language or funding of a proposed piece of legislation, or shape how regulation is implemented. In some cases, the very future of the firm or industry may be at stake. An example of this political activity is provided in the discussion case at the end of Chapter 7, which describes the 2018 testimony of Facebook CEO Mark Zuckerberg before the U.S. Congress and the European Parliament. Another example is provided next.

> The top executives of five of the nation's largest prescription drug distributors, McKesson, Cardinal Health, AmerisourceBergen, Miami-Luken, and H.D. Smith, all testified before a Congressional committee investigating the opioid crisis. The investigation targeted the massive amounts of opioid painkillers shipped to small-town pharmacies in southern West Virginia. Joseph Mastandrea, CEO of Miami-Luken, told the committee that his company played a role in the opioid crisis, but executives from the other four drug distributors downplayed their responsibility arguing that drug prescribers and pharmacists were to blame. Carinal Health CEO George Barrett apologized for not doing more to stop large shipments of prescription painkillers from flooding into rural communities in West Virginia. "I want to express my personal regret for our judgements that we'd make differently today, with regard to two pharmacies. With the benefit of hindsight I wish we would have

[13] More information about the Business Roundtable is available at *www.businessrountable.org*.

Exhibit 8.C Campaign Finances in Malaysia

In 2015 Malaysian Prime Minister Najib was fighting for his political life. The media revealed that almost $700 million from an undisclosed source were in Najib's personal bank accounts. While not initially proven to be illegal, this flood of money raised many ethical questions. Najib explained that the funds were not used for his personal enrichment. They were, instead, channeled to politicians or into spending on projects aimed at helping the country and the ruling party (of which he was a member) win elections.

It was never revealed where the $700 million came from or where it went, even after a six-month *Wall Street Journal* investigation. The investigation concluded that the payments were not illegal but did represent a new chapter in Malaysia's "freewheeling electoral system." The prime minister justified the contributions since the money boosted Malaysia's economy by attracting foreign capital necessary to offset the more than $11 billion in government debt. Najib reported he funneled at least $140 million to charity projects, such as schools and low-income housing. He also admitted to writing checks from his personal bank accounts to lawmakers, who used the money as they saw fit.

Although investigations revealed nothing illegal, Najib did pledge to change the system, setting up a bipartisan panel to look at campaign financing and possible reforms. "There is an urgent need to regulate political financing to ensure accountability and transparency," said Najib. But by the time the 2018 elections were held in Malaysia, no new campaign financing laws had been passed. Shortly after Najib's surprising election defeat, Najib was arrested on anticorruption charges.

Sources: "1MDB and the Money Network of Malaysian Politics," *The Wall Street Journal,* December 28, 2015, *www.wsj.com*; "Your Guide to Malaysia's Upcoming General Election," *Bloomberg,* May 7, 2018, *www.bloomberg.com*; and "Najib Razak, Malaysia's Fallen Leader, Is Arrested in 1MDB Corruption Scandal," *The Wall Street Journal,* July 3, 2018, *www.wsj.com*.

moved faster and answered a different set of questions. … today I am confident we would have reached different conclusions."[14]

The role of drug distributors in the opioid crisis is further discussed in a case that appears at the end of this book.

Promoting a Financial-Incentive Strategy

A major method businesses use to influence government policymakers is to provide financial incentives. They can do this by contributing to a politician's election campaign, in order to persuade him or her—once in office—to support certain policies or to vote in a manner favorable to the firms' interests. In recent years, a series of Supreme Court and lower court decisions have dramatically expanded the ability of corporations to make campaign contributions. This section will describe the various mechanisms businesses can now use to influence the outcome of elections, including political action committees, Super PACs, tax-exempt organizations, and direct contributions by both corporations and their executives and employees. While most examples and data in this section are from the United States, Exhibit 8.C describes political campaign funding in Malaysia.

Political Action Committees

One of the oldest political action tools used by business is to form and support **political action committees (PACs)**, independently incorporated organizations that can solicit contributions and then channel those funds to candidates seeking public office. Since the mid-1970s, companies have been permitted to spend company funds to organize and administer political action committees. (They cannot give directly to PACs, however.)

[14] "Major Drug Distributors Downplay Contribution to Opioid Crisis in Testimony before Congress," *CBS News,* May 8, 2018, *www.cbsnews.com*.

FIGURE 8.4 **Political Action Committee Activity**

Sources: "Top PACs" for 2007–2008, 2011–2012, and 2017–2018, Center for Responsive Politics, *www.opensecrets.org*.

	PAC Name	2007–2008	PAC Name	2011–2012*	PAC Name	2017–2018
1.	AT&T Inc.	$1,911,500	National Association of Realtors	$4,020,900	Honeywell International	$1,768,562
2.	National Beer Wholesalers Association	$1,911,000	International Brotherhood of Electrical Workers	$3,344,650	National Beer Wholesalers Association	$1,491,500
3.	National Air Traffic Controllers Association	$1,804,000	AT&T, Inc.	$3,108,200	AT&T Inc.	$1,360,000
4.	Lockheed Martin	$1,783,500	American Bankers Association	$2,918,143	American Association for Justice	$1,298,500
5.	Prosperity Action	$1,740,000	National Beer Wholesalers Association	$2,869,000	International Brotherhood of Electrical Workers	$1,293,150
6.	American Crystal Sugar	$1,583,500	National Auto Dealers Association	$2,864,000	Lockheed Martin	$1,271,500
7.	Northrup Grumman	$1,553,000	International Association of Fire Fighters	$2,734,900	American Bankers Association	$1,182,750
8.	Operating Engineers Union	$1,483,925	Operating Engineers Union	$2,704,067	Credit Union National Association	$1,168,000
9.	Honeywell International	$1,466,127	American Association for Justice	$2,700,500	Every Republican Is Crucial PAC	$1,101,000
10.	American Association for Justice	$1,433,500	Laborers Union	$2,555,850	Boeing	$1,069,000

PAC contributions to political campaigns are limited to certain amounts per candidate and per election. Multicandidate PACs could give up to $5,000 per candidate per election and $15,000 per national party per calendar year; for non-multicandidate PACs, these limits were $2,700 and $33,900, respectively. The amounts that could be donated *to* a PAC were also limited.

PACs are particularly active in industries that are highly regulated or are the target of proposed regulations, such as the telecommunications, financial services, and defense contractors industries. Figure 8.4 lists the top political action committees by contribution, comparing data from different time periods. It shows that the labor unions that dominated the top 10 PAC list in 2007–2008 (with four of the top ten spots) have been replaced by a growing number of business organizations and business trade groups in 2017–2018.

Business PACs have recently favored Republican candidates. For example, the following companies, through political action committee contributions, have generally supported Republican candidates over Democrat candidates: AT&T (62%–38%), Lockheed Martin (62%–37%), Northrup Grumman (57%–43%), Honeywell International (58%–42%), United Parcel Service (67%–33%), Boeing Company (64%–36%), Comcast (61%–38%), and Deloitte LLP (61%–39%).[15]

[15] For a more comprehensive listing of business contributions by political party, see *www.opensecrets.org/pacs*.

Although companies have continued to operate PACs, this mechanism has some disadvantages, from a business perspective. Contributions to candidates are capped at fairly low levels, and companies cannot give money directly to their affiliated PACs. For these reasons, companies have turned increasingly to other mechanisms of political influence that have recently become available, as described next.

Super PACs

In 2010, a federal district court ruling in a lawsuit filed by *SpeechNow.org* opened the door for the creation of another mechanism of political influence. The court ruled that as long as PACs did not contribute directly to candidates, parties, or other PACs, they could accept *unlimited* contributions from individuals, unions, or corporations. This decision led the rise of **super PACs**, technically known as independent expenditure-only committees. Because contribution limits had been removed by the court, these organizations were able to raise and spend vast amounts of money, so long as they were not actually affiliated with any campaigns.

By 2018, nearly 2,400 groups had organized as super PACs. They reported total contributions of nearly $1.8 billion during the last president election cycle of 2015–2016 and over $420 million in the 2017–2018 election cycle. Super PACs spent more than $1 billion during the 2016 presidential election cycle and nearly $100 million during the 2017–2018 election cycle. Although super PACs were technically independent, they often worked to support particular candidates or parties, such as the two largest super PACs, the Senate Majority PAC, with strong ties to the Democratic Party and spending nearly $16 million in 2017–2018, and the Congressional Leadership Fund, which generally supported conservative candidates and causes and contributed nearly $13 million in 2017–2018. But many super PACs represented a group of potential voters or a political stance, such as the Club for Growth Action, a free-enterprise advocacy group, and Women Vote!, in support of electing female candidates.

While some individuals and companies were eager to take advantage of the new opportunity to be involved in super PACs, others found that doing so could be risky.

> With John Bolton set to officially become President Trump's national security adviser (in March 2018), two government watchdog groups filed a criminal complaint demanding an investigation into whether Bolton's Super PAC wittingly conspired with the scandal-ridden British data firm, Cambridge Analytica, to commit "very serious" violations of U.S. election laws. The complaint calls for a Justice Department probe and argued that Bolton's Super PAC violated federal laws prohibiting foreign nationals from "directly or indirectly" participating in the decision-making process of American political campaigns. "What's worse than the fact that it apparently happened in this case is that the people involved apparently knew they were breaking the law and continued to do it anyway," said Noah Bookbinder, executive director at the Citizens for Ethics and Responsibility.[16]

Tax-Exempt Organizations

A third mechanism businesses can use to direct money to election campaigns is tax-exempt organizations, such as 527, 501(c)4, or 501(c)6 organizations, each named after the relevant section of the tax code. These organizations are political campaign groups officially unaffiliated with individual parties or candidates, and therefore not liable for campaign spending restrictions. 527 committees may raise unlimited money for general political

[16] "Alleging 'Very Serious' Violations, Groups File Complaint against John Bolton Super PAC over Ties to Cambridge Analytica," *Common Dreams*, March 30, 2018, *www.commondreams.org*.

activities, such as voter mobilization efforts, but are prohibited from directly supporting or opposing a specific candidate. They gained prominence after the passage of the Bipartisan Campaign Reform Act (BCRA) of 2002, which prohibited **soft money** —unlimited contributions to the national political parties by individuals or organizations for party-building activities. As a way to get around these restrictions, some companies turned to tax-exempt organizations as vehicles for their political contributions. In the 2016 and 2018 election cycle, Act Blue was one of the most active 527 organizations.

> Act Blue, headquartered in Massachusetts, is considered a liberal 527 organization. During the 2016 and 2018 election cycles, Act Blue raised more than $56 million and nearly $16 million, respectively, and spent $45 million and $14.5 million during these election cycles. Two of its largest contributors in 2016 were Bernie 2016, with nearly $48 million, and the Democratic Congressional Campaign Committee, with more than $3 million.[17]

The term **dark money** was used to describe contributions made to 527 organizations since the donors' names and amount of their contributions were not reported to the Federal Election Commission. Contributions to these organizations are often used for various advocacy tactics, such as telephone calls, television or radio announcements, and social media messages to bring attention to a political issue. These types of organizations have no contribution or spending limits.

Direct Contributions by Corporations

Until 2010 corporations were not permitted by law to make direct contributions to political candidates for national and most state offices. As noted above, companies could organize PACs and contribute to super PACs or tax-exempt organizations, but they could not simply write a check from their own corporate treasuries to support a candidate, say, for president. But that all changed with the 2010 Supreme Court ruling in *Citizens United v. the Federal Election Commission.* As further explained in Exhibit 8.D, this decision allowed companies for the first time to contribute directly to political campaigns.

In 2012, the first full election cycle after the *Citizens United* decision, outside spending for all political campaigns tripled from the previous four-year cycle to more than $1 billion. Super PACs accounted for more than $600 million of that spending. In 2014, the Supreme Court, in a separate case called *McCutcheon v. Federal Election Commission,* abolished all limits on election spending by corporations, as well as other organizations such as unions. The amount of campaign contributions continued to rise, as seen in the 2016 presidential races. Hillary Clinton had raised more than $563 million from traditional sources—the Democratic Party, established PACs, and individual donors—and an additional $231 million from other sources, generally considered "dark money." Donald Trump had raised $333 million from the Republican Party, established PACs, and donors, and an additional $75 million from dark money sources.[18]

Executive and Employee Personal Contributions

A final way that companies can influence elections is by encouraging their executives or employees to make personal contributions to the campaigns of candidates whose views they feel are aligned with their interests. The *McCutcheon v. Federal Election Commission* decision, mentioned earlier, also struck down the cap on the total amount any individual

[17] See *Opensecrets.org/527s* and the Center for Responsive Politics.

[18] See *opensecrets.org/pres16* and the Center for Responsive Politics.

Exhibit 8.D

The *Citizens United* Case

In a 5-to-4 decision in 2010 the U.S. Supreme Court upheld the argument made by Citizens United, a conservative nonprofit political organization, that its First Amendment right to free speech was violated by the Federal Election Commission's restrictions on campaign contributions. Justice Anthony Kennedy wrote for the majority opinion, "if the First Amendment has any force, it prohibits Congress from fining or jailing citizens, or associations of citizens, for simply engaging in political speech." Republican campaign consultant Ed Rollins stated that the decision added transparency to the election process and would make it more competitive.

The ***Citizens United* decision** sent shock waves through the world of campaign financing since it allowed corporations, and also labor unions, for the first time in the history of the United States to directly contribute to candidates for public office. Critics said it would "corrupt democracy" by allowing corporate funds to flow directly into campaigns. At the time of the decision, 80 percent of Americans surveyed opposed the *Citizens United* ruling, and 65 percent strongly opposed it. Nearly three out of four Americans supported an effort by Congress to reinstate limits on corporate and union spending on election campaigns.

In 2015, the End Citizens United PAC was established, funded by grassroots donors dedicated to countering what they call the disastrous effects of *Citizens United* and reforming the American campaign finance system. The End Citizens United PAC's mission was "To end Big Money in politics and fix our rigged political system by electing campaign finance reform champions, passing state ballot measures, and elevating this issue in the national conversation." Those running the PAC were committed to working in partnership with others to overturn *Citizens United* and end undisclosed money in politics. They sought to do this by electing pro-reform candidates, raising the issue of money in politics as a national priority, working with ballot measure campaigns to pass pro-reform laws in the states, and using grassroots membership to demonstrate political power on the issue of money in politics.

Sources: "Summary *Citizens United v. Federal Election Commission* (Docket No. 08-205)," Cornell University School of Law, n.d., *topics.law.cornell.edu/supct/cert/08-205*; "Money Grubbers: The Supreme Court Kills Campaign Finance Reform," *Slate,* January 21, 2010, *www.slate.com*; "Justices, 5–4, Reject Corporate Spending Limit," *The New York Times,* January 21, 2010, *www.nytimes.com*; "*Citizens United v. Federal Election Commission,*" IIT Chicago—Kent College of Law, June 1, 2012, *www.oyez.org*; and *End Citizens United* website, *endcitizensunited.org*. Also see David Silver, "Business Ethics after *Citizens United:* A Contractualist Analysis," *Journal of Business Ethics* 127 (2015), pp. 385–97.

can contribute to federal candidates in a two-year election cycle. Given the multiple mechanisms for campaign financing and the lack of caps on the amount contributed, individuals are able to significantly influence the political process if they have enough money. One example of the potential for political power through contributions is described next.

> By June 2015, fewer than 400 families were responsible for almost half of the money raised for the 2016 presidential campaign, a concentration of political donors that was unprecedented in the modern era. The vast majority of the $388 million backing presidential candidates by these families was channeled to groups that could accept unlimited contributions in support of candidates from almost any source. The concentration of donors was greatest on the Republican side, according to a *New York Times* analysis of Federal Election Commission reports. Just 130 families and their businesses provided more than half of the money raised through June 2015 by Republican candidates and their super PACs to support their presidential campaigns bids. "In the donor world, it is primarily a love of economic freedom," said Chart Westcott, a Dallas private equity investor. "That's the biggest drive for most donors—more prosperity for the country as a whole, as well as for themselves."[19]

[19] "Small Pool of Rich Donors Dominates Election Giving," *The New York Times,* August 1, 2015, *www.nytimes.com*.

Generally, recent court decisions have expanded the mechanisms available to corporations, as well as labor unions, other organizations, and individuals to use their resources to influence politics. To some, these developments represent a confirmation of individual or organizational free speech rights. To others, they represent a distortion of the political process in favor of organizations and individuals with money to spend.

Economic Leverage

Another political action tool often used by businesses when pursuing a financial incentive strategy is to use their economic leverage to influence public policymakers. **Economic leverage** occurs when a business uses its economic power to threaten to leave a city, state, or country unless a desired political action is taken. Economic leverage also can be used to persuade a government body to act in a certain way that would favor the business, as seen in the following story.

> When the state of Pennsylvania was considering legalizing slot machines at racetracks, the owners of a National Hockey League team located in the state, the Pittsburgh Penguins, were lobbying for a new ice hockey arena to be built with public funds. Government leaders were hesitant to use public funds for a new arena unless substantial private funds were also available. Ted Arneault, owner of the Mountaineer Racetrack and Gaming Resort and part owner of the Pittsburgh Penguins, offered a deal. He said his company would contribute $60 million to build the new ice hockey arena if the state would approve the use of slot machines at Pennsylvania racetracks, including his proposed racetrack facility near Pittsburgh. Legislators agreed.[20]

In this example, the business owner successfully used economic leverage. By committing his own private money to help support the construction of a new ice hockey arena, he was able to persuade politicians to vote in favor of legislation to approve the use of slot machines at racetracks in the state.

Promoting a Constituency-Building Strategy

The final strategy used by business to influence the political environment is to seek support from organizations or people who are also affected by the public policy or who are sympathetic to business's political position. This approach is sometimes called a *grassroots strategy,* because its objective is to shape policy by mobilizing the broad public in support of a business organization's position, or a *grasstops strategy,* because its objective is to influence local opinion leaders. Firms use several methods to build support among constituents. These include advocacy advertising, public relations, and building coalitions with other affected stakeholders. Increasingly, firms have turned to social media as a grassroots tool, as the following example shows.

> During the 2016 presidential elections, politicians and their staffers used Twitter messages, Facebook posts, Instagram photos, and Snapchats that steadily flowed into voters' inboxes and social media feeds in the digitized, pixelated, endlessly streaming election world. Yet, most avoided using text messages until Senator Bernie Sanders, a candidate in the Democratic presidential primary, directed his digital organizing director, Claire Sandberg, to ask each of his more than 100,000 followers to send a quick text. Over a video hookup, Sandberg told Sanders' supporters, "Everyone, please, take out your smartphones right now and text the word 'work'."

[20] "Penguins, Arneault Make $107 Million Private Funding Proposal for New Arena Project," *Pittsburgh Post-Gazette,* June 24, 2003, p. A1.

Within hours, the Sanders campaign received nearly 50,000 responses. Other presidential hopefuls quickly followed, asking voters to text them during speeches. Republican presidential candidate Rand Paul texted his supporters, encouraging them to sign petitions and support him online. "A text is almost a sacred thing," said Vincent Harris, digital director for Paul's campaign. "This space is reserved for your closest friends, your family, people who know you well enough to have your number and bypass a voice mail or email. I think it's taken several years for the electorate to warm up to this."[21]

Stakeholder Coalitions

Businesses may try to influence politics by mobilizing various organizational stakeholders—employees, stockholders, customers, and the local community—to support their political agenda. If a political issue can negatively affect a business, it is likely that it also will negatively affect that business's stakeholders. If pending regulation will impose substantial costs on the business, these costs may result in employee layoffs, or a drop in the firm's stock value, or higher prices for the firm's customers. Businesses may use a variety of tactics to appeal to a wide range of stakeholder groups, as described next.

As the 2016 election primaries approached, Patagonia wanted to remind their customers, employees, and the communities to exercise their right to vote on election day. Patagonia contributed $200,000 to nonprofit advocacy groups NextGen Climate and HeadCount, hosted a series of educational events in its apparel stores, and launched the "Vote Our Planet" online campaign to encourage everyone to vote and to educate potential voters on issues important to the company. "We are very concerned that the ugliness and the divisiveness of this election has left voters feeling disenfranchised with politics, and they might sit this one out," said Patagonia's vice president of environmental activism Lisa Pike Sheehy. "It's imperative that this doesn't happen."[22]

Thus, businesses have an opportunity to build partnerships with various stakeholder groups, encourage them to vote, and hopefully support the causes important to the businesses in elections.

Advocacy Advertising and Public Relations

A common method of influencing constituents is **advocacy advertising**. Advocacy ads focus not on a particular product or service, like most ads, but rather on an organization's or company's views on controversial political issues. Advocacy ads, also called *issue advertisements,* can appear in newspapers, on television, or in other media outlets. They have been legal in the United States since 1978, but greater involvement by businesses and other nonprofit (advocacy) organizations in the political process resulted in their use to dramatically increase after the *Citizens United v. FEC* U.S. Supreme Court decision, discussed earlier. A media expert reported that since the *Citizens United* decision, television and radio stations revenue each year from issue advertisements has nearly tripled. (Examples of advocacy advertisements are provided in Chapter 19.)

Another constituency-building tactic is the use of public relations firms to promote the company's message to various stakeholders.

In 2016, the American Petroleum Institute (API), which represents more than 650 oil and gas companies accounting for 9.8 million jobs in the United States and

[21] "Presidential Campaigns See Texting as a Clear Path to Voters," *The New York Times,* August 18, 2015, *www.nytimes.com*.

[22] "Big Corporate Ad Campaigns Promote Voting," *NPQ,* September 27, 2016, *nonprofitquarterly.org*.

8 percent of the U.S. economy, launched a multi-faceted Renewable Fuel Standard advocacy campaign program in anticipation of the 2016 elections. The program included television and online advertising focusing on how higher ethanol mandates can hurt consumers and threaten to reverse America's energy renaissance, where the United States had become the number one oil and gas producer in the world. A poll taken at the time of this advertising campaign showed that 77 percent of registered voters were concerned about government requiring increased amounts of ethanol in gasoline and 73 percent agreed that federal regulations could contribute to increase costs at the gasoline pump. "These new ads will help further inform voters about the potential dangers of the broken ethanol mandate, and increase calls on Congress to fix the RFS [Renewable Fuel Standard]," said Frank Macchiarola, API executive.[23]

However, this political tactic can also be a high-risk strategy, as described next.

In 2017, marketing consultants warned business that diving into the political fray with their messaging was risker than ever, given widespread political upheaval or uncertainty in the United States and Europe. Many marketing experts provided a single, clear message: steer clear of politics altogether. While they acknowledged that it was tempting for companies to weigh in on political issues, they also pointed out that the Internet backlash against possible missteps was quicker and fiercer than ever. "The implications for corporations that get sucked into this are not good. You want to stay as far removed from politics as possible," said Mark Penn, a market researcher.[24]

Trade Associations

Many businesses work through **trade associations**—coalitions of companies in the same or related industries—to coordinate their grassroots mobilization campaigns, such as the National Realtors Association (real estate brokers), National Federation of Independent Businesses (small businesses), the National Association of Manufacturers (manufacturers only), or the U.S. Chamber of Commerce (broad, diverse membership).[25]

The U.S. Chamber of Commerce represents more than 3 million businesses of all sizes, sectors, and regions. The chamber has a multimillion-dollar budget, publishes a widely circulated magazine, and operates a satellite television network to broadcast its political messages. Its agenda includes advocating for pro-business policies that create jobs and grow our economy, and to support smart tax policy, regulatory relief, legal reform, and trade promotion to the benefit of all U.S. businesses. The U.S. Chamber of Commerce organization has one overarching mission—to strengthen the competitiveness of the U.S. economy.[26]

Businesses focus on various trade associations for promoting their political activities. The Center for Public Integrity reported that trade associations spent more than $16 million on political campaigns in 2016, compared to only $5 million in 2014 and $3.2 million in

[23] "API Launces New RFS Advocacy Campaign Focused on Consumers," *API,* August 9, 2016, *www.api.org*.

[24] "Marketing Experts to Advertisers: Steer Clear of Politics," *The Wall Street Journal,* June 20, 2017, *www.wsj.com*.

[25] The classic discussion of corporate political action can be found in Edwin Epstein, *The Corporation in American Politics* (Englewood Cliffs, NJ: Prentice Hall, 1969). A more recent handbook of current strategies in American political activity is in Kenneth A. Gross, Lawrence M. Noble, Ki P. Hong, and Patricia M. Zweibel, *Corporate Political Activities Deskbook* (New York: Practicing Law Institute, 2014).

[26] See the U.S. Chamber of Commerce website, *www.uschamber.com*.

the previous presidential election cycle. This spending was decidedly biased, with 92 percent of the contributions supporting Republican candidates or conservative issues.[27]

Activities of trade associations may include letters, telephone calls, tweets, blogs, e-mails, and other Internet communications to register approval or disapproval of a government official's position on an important issue.

Legal Challenges

A political tactic available to businesses (and other political participants) is the use of legal challenges. In this approach, business seeks to overturn a law or portions of a law after it has been passed or threatens to challenge the legal legitimacy of the new regulation in the courts. Such an approach is shown in the following example.

> A few years after Congress passed the Affordable Care Act, many organizations legally challenged the provision that required employers to provide employees with contraceptive coverage in their health plans. Many of those filing lawsuits were churches and religious-affiliated businesses, like Hobby Lobby and its owners David and Barbara Green. The Greens argued that the contraceptive requirement directly challenged their faith, which was the foundation of their business. Based on strong, traditional Christian values, Hobby Lobby stores were not open on Sunday, and the owners and employees supported various Christian charities with their time and financial contributions. Hobby Lobby's owners also were strongly opposed to any form of birth control based on their religious convictions. According to CEO David Green, "Our family is now being forced to choose between following the laws of the land that we love or maintaining the religious beliefs that have made our business successful and have supported our family and thousands of our employees and their families." In 2014, the U.S. Supreme Court ruled, in a 5 to 4 decision, in favor of Hobby Lobby, exempting the company from the Affordable Care Act requirements and citing the legal principle that one can maintain their religious beliefs even when acting as a business owner.[28]

Levels of Political Involvement

Business executives must decide on the appropriate level of political involvement for their company. As shown in Figure 8.5, there are multiple levels of involvement and many ways to participate. To be successful, a business must think strategically about objectives and how specific political issues and opportunities relate to those objectives.

Organizations often begin at the lowest level of political participation, *limited organizational involvement.* Here managers of the organization are not ready or willing to become politically involved by giving their own time or getting their stakeholders involved, but they want to do something to influence the political environment. Organizations at this level may show their political interest, for example, by writing out a check to a trade association to support an industry-backed political action, such as hiring a lobbyist on a specific issue.

When the organization is ready for *moderate political involvement,* managers might directly employ a lobbyist to represent the company's political strategy in Washington or the state capital to push the firm's political agenda. This is a more active form of political involvement since the lobbyist is an employee of the organization. Getting the organization's

[27] For more information, see *OpenSecrets.org* or the Center for Public Integrity, *www.publicintegrity.org*.

[28] "Businesses Sue Government over Birth Control Mandate," *National Public Radio,* January 11, 2013, *www.npr.org*; and for a detailed timeline and analysis of the lawsuit see *www.hobbylobbycase.com*.

FIGURE 8.5
Levels of Business Political Involvement

Level 3 Aggressive Organizational Involvement—direct and personal

- Executive participation
- Involvement with industry working groups and task forces
- Public policy development

Level 2 Moderate Organizational Involvement—indirect yet personal

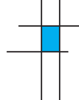
- Organizational lobbyist
- Employee grassroots involvement
- Stockholders and customers encouraged to become involved

Level 1 Limited Organizational Involvement—indirect and impersonal

- Contribution to political action committee
- Support of a trade association or industry activities

stakeholders involved is another way a firm can increase its political involvement. Employees can write letters or send e-mails or tweets to their congressperson or become involved in a political campaign. Senior executives might communicate with stockholders or customers on particular issues that might affect the firm and its stakeholders and encourage them to write letters, blog, or otherwise voice their concerns. Some firms have sent letters to their shareholders soliciting their political contributions for a particular candidate or group of candidates but have asked that the contributions be sent to the company. Then the company takes all of the contributions to the candidate or candidates, clearly indicating that the contributions are from the firm's shareholders. This technique is called **bundling**.

The most direct and personal involvement in the political environment is achieved at the third level—*aggressive organizational involvement*—where managers become personally involved in developing public policy. Some executives are asked to sit on important task forces charged with writing legislation that will affect the firm or the firm's industry. When state legislatures were writing laws limiting the opportunities for corporate raiders to acquire unwilling companies in their states, the legislators turned to corporate general counsels, the company attorneys, to help draft the laws. Another example of aggressive organizational involvement is provided by The Business Roundtable, described earlier in this chapter.



Managing the Political Environment

In many organizations, the task of managing political activity falls to the department of public affairs or government relations. The role of the **public affairs department** is to manage the firm's interactions with governments at all levels and to promote the firm's interests in the political process. (*Public relations,* discussed in Chapter 19, is a different business function.) The creation of public affairs units is a global trend, with many companies in Canada, Australia, and Europe developing sophisticated public affairs operations.[29] As shown in Exhibit 8.E, nearly all of the most frequently performed activities by public affairs officers or departments involve a political action tactic and the use of most of these tactics has remained relatively stable since 2005.

[29] The global patterns of public affairs practice are documented in *Journal of Public Affairs,* published by Henry Stewart Publishing beginning in 2001. For a practical guide to public affairs, see *Public Affairs in Practice: A Practical Guide to Lobbying,* Stuart Thomson and Steve John (London, U.K.: Kogan Page, 2007).

Exhibit 8.E Corporate Public Affairs Activities

Activities Conducted within the Public Affairs Department	Percent of Companies, 2005	Percent of Companies, 2017
Federal government relations	95%	93
State government relations	85	89
Issues management	82	94
Local government relations	79	81
Business/trade association oversight	75	96
Political action committee	83	74
Coalitions	71	92
Grassroots/grasstops	75	76

Source: Foundation for Public Affairs, *The State of Corporate Public Affairs, 2017–2018 (2017)*, based on a survey of 105 companies.

Most companies have a senior manager or executive to lead the public affairs department. This manager is often a member of the company's senior management committee, providing expertise about the company's major strategy and policy decisions. The size of the department and the support staff varies widely among companies, but more than half have reported an increase in budget and staffing since 2011. Many companies assign employees from other parts of the business to work on public affairs issues and to help plan, coordinate, and execute public affairs activities. In this way, the formulation and implementation of the policies and programs developed by a company's public affairs unit are closely linked to the primary business activities of the firm.

Over one-third of the heads of public affairs departments report directly to the CEO, chairperson, or president of the company, while others report to the firm's general counsel. Most work out of company headquarters; most of the rest—particularly those whose work focuses on government relations—work in Washington, DC. Eighty-five percent of those leading the public affairs department are typically an executive vice president, senior vice president, or vice president. The typical public affairs executive spends most of the day direct lobbying with federal or state politicians, hosting visits by politicians to the company's locations, attending funding raising activities, or participating in coalition building. Over 56 percent of the public affairs officers reported that funding for public affairs activities increased over the past three years, with 44 percent of the companies reporting an increase in funding for international public affairs.[30]

Business Political Action: A Global Challenge

Most of the discussion so far in the chapter has focused on business political activity in the United States. As more companies conduct business abroad, it is critical that managers

[30] Foundation for Public Affairs, *The State of Corporate Public Affairs, 2017–2018* (Washington, DC: Foundation for Public Affairs, 2017).

be aware of the opportunities for and restrictions on business involvement in the political processes in other countries. Other societies and governments also struggle with issues of participation in the political environment, campaign financing, and maintaining a fair ethical climate throughout the public policy process. The following example focuses on lobbying and constituency-building tactics.

> In 2015, Google was embroiled in an escalating EU antitrust case and the "right to be forgotten" controversy (the subject of a case study at the end of this book and also discussed in Chapter 12). The firm doubled its direct lobbying expenditures in Europe in 2013 to nearly €4 million (about $4.3 million). By comparison, Google spent $16.8 million lobbying in the United States. Other U.S. technology firms also increased their political activities in Europe. Microsoft belonged to 33 European trade associations. By comparison, Deutsche Telekom, a German telecommunications company, maintained 13 trade association memberships, while Axel Springer, the leading digital publisher in Europe, belonged to only four.

StandWithUs, a pro-Israel American advocacy group closely tied to the Israeli government, opened up an office in China in 2015. Announcing that China was "a country in which we can make a difference," StandWithUs set about correcting what it characterized as "misinformation in the Chinese media about Israel." Their approach was focused on "utilizing social media, university programs, and networking events" to better connect with the next generation of Chinese political leadership and the Chinese media.[31]

In contrast to China, Japan has a more pluralistic public policy process. The major actors in the Japanese political environment are representatives of big business, agriculture, and labor, which are quite powerful and influential. Some of the largest interest groups support hundreds of candidates in each important election and provide them with large financial contributions. The *Kiedanren,* or federation of economic organizations, is mostly concerned with big business, but other interest groups promote the concerns of small and medium-sized businesses, such as barbers, cosmeticians, dry cleaners, innkeepers, and theater owners. Some political influence is in the hands of smaller groups, such as the teachers' union (*Nikkyoso*), Japan Medical Association, employers association (*Nikkeiren*), and a labor union (*Rengo*).[32]

Although political alliances and favoritism appears around the world, in varying degrees, some have made efforts to promote fairness in the electoral process, control the rapid rise in the costs of campaigning, enhance the role of political parties in elections, and encourage grassroots participation by various societal groups.

> Since 1999, the Global Electoral Organization (GEO) has brought together more than 300 of the world's top election officials and democracy advocates to celebrate "transparency in the election process." The GEO-7 meeting, held in 2016, focused on the use of data and technology to improve transparency and accountability in elections. GEO partners included the Association of European Election Officials, the International Foundation for Electoral System, the International Institute for Democracy and Electoral Assistance, the Electoral Institute for Sustainable Democracy in Africa, Mexico's National Electoral Institute, the United Nations Electoral Assistance Division, and the United Nations Development Programme. One

[31] "U.S. Tech Firms Increase EU Lobbying Efforts," *The Wall Street Journal,* April 29, 2015, *www.wsj.com*; and "An Israeli Lobby in China?" *The Diplomat,* April 30, 2015, *thediplomat.com*.

[32] Ryan Beaupre and Patricia Malone, "Interest Groups and Politics in Japan," *alpha.fdu.edu/~woolley/JAPANpolitics/Beaupre.htm*.

conference delegate explained, "I think standards are changing and politicians will have to recognize this—that as we are now in the 21st century, public opinion is applying different standards to politics, to politicians, to political parties. They're not allowed to do things they were doing in the 19th and 20th centuries. People have high expectations, high demands, and they will keep politicians accountable."[33]

Political action by business—whether to influence government policy or the outcome of an election—is natural in a democratic, pluralistic society. In the United States, business has a legitimate right to participate in the political process, just as consumers, labor unions, environmentalists, and others do. One danger arising from corporate political activity is that corporations may wield too much power. As businesses operate in different communities and countries, it is important that ethical norms and standards guide managers as they deal with political issues. If corporate power tips the scales against other interests in society, both business and society may lose. Whether it is in the media-rich arena of electoral politics or the corridors of Congress where more traditional lobbying prevails, business leaders must address the issues of how to manage relationships with government and special interests in society in ethically sound ways. Ultimately, business has an important long-term stake in a healthy, honest political system.

Summary

- Some believe that businesses should be involved in politics because their economic stake in government decisions is great and they have a right to participate, just as do other stakeholders in a pluralistic political system. But others believe that businesses are too big, powerful, and selfish, and that they wield too much influence in the political arena.
- There are three political strategies: information, financial incentives, and constituency-building. Some firms implement strategies as needed, on an issue-by-issue basis, while other firms have a long-term, ongoing political strategy approach.
- Some of the political action tactics available for business include lobbying, direct communications, expert witness testimony, political action committee contributions, economic leverage, advocacy advertising and public relations, trade association involvement, legal challenges, and encouraging the involvement of other stakeholders. Businesses are increasingly turning to social media to promote their political strategies.
- Businesses manage their government interactions through a public affairs department. Most public affairs officers report to the CEO, chairperson, or president of the company, although how these departments are structured is widely varied.
- The differing national rules and practices governing political activity make business's political involvement complex in the global environment. Many governments have debated whether to restrict lobbying or political contributions or to make the political process more transparent.

[33] See "The Seventh Global Elections Organization Conference (GEO-7)" at *ifes.org/GEO*. The quote is from "Credible Elections for Democracy," *Institute for Democracy and Electoral Assistance, www.idea.int*.

Key Terms

advocacy advertising, *176*
bundling, *179*
Citizens United decision, *174*
corporate political strategy, *164*
dark money, *173*
economic leverage, *175*
lobbying, *166*
political action committees (PACs), *170*
public affairs departments, *179*
revolving door, *168*
soft money, *173*
super PACs, *172*
The Business Roundtable, *168*
trade associations, *177*

Internet Resources

www.businessroundtable.org	The Business Roundtable
www.commoncause.org	Common Cause
lobbyingdisclosure.house.gov	Lobbying Disclosure, U.S. House of Representatives
www.endcitizensunited.org	End Citizens United
www.nfib.com	National Federation of Independent Businesses
www.opensecrets.org	Opensecrets.org
www.politico.com	Politico
www.politics.co.uk/	Politics.co.uk
pac.org	Public Affairs Council
www.pdc.wa.gov	Public Disclosure Commission
www.fec.gov	U.S. Federal Election Commission

Discussion Case: *Political Action by the U.S. Steel Industry, 2015–2018*

Often regarded as the backbone of American manufacturing, the steel industry is essential to the world's water and food supply, energy generation, and national security. The U.S. military uses steel extensively, in applications including aircraft carriers, nuclear submarines, missiles, armor plate, and every major military aircraft. There are many reasons to be concerned with the health of the U.S. steel industry. However, in the 2010s, the American steel industry began to suffer from an unprecedented surge of foreign-produced steel flooding into the United States. In many cases, these imports were nearly 50 percent cheaper than U.S.–made steel, since the Chinese and some other governments subsidized their steel industries, and foreign steel companies used nonunion, low-wage workers.

Production at domestic steel mills dropped to as low as 60 percent of capacity, an unsustainable level for a capital-intensive steel producer. American steel companies began to close down major facilities or reduce production. More than 12,000 steel jobs were lost in 2014 and 2015, as foreign steel imports took a record 29 percent of the U.S. steel manufacturing market.

Almost one in three tons of steel sold in the United States were produced by foreign companies. The Chinese government owned almost half of the world's steelmaking capacity. Between 2000 and 2014, Chinese steel production increased an astonishing

540 percent, with additional surges in steel production in South Korea and Turkey. With the rising tide of cheap imports entering the U.S. market from these and other countries, the U.S. steel industry knew it had to do something dramatic and quickly.

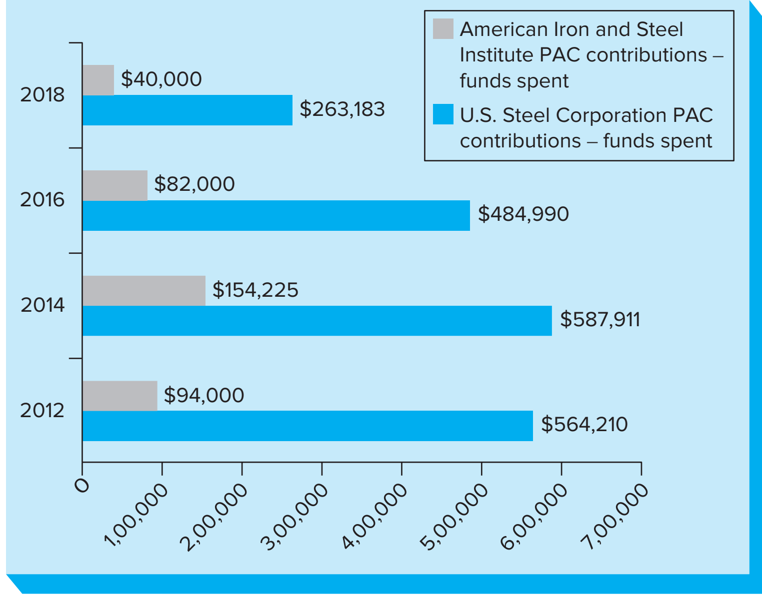
In 2015, the steel companies launched a multi-faceted and well-funded political strategy to seek governmental protection from the onslaught of cheap steel imports coming into the country. Their main objective was the imposition of import tariffs, or an additional fee or tax, to boost the price of foreign-made steel sold in the United States. Some political activities focused on articulating a clear message to Congress and the White House. Steel executives arranged for opportunities to testify before numerous congressional committees focusing on the economy, trade, and national security. Steel companies provided "white papers," short briefs emphasizing key points, sent to congressional members and their staff, seeking to ensure that everyone with any political power knew of the steel industry's policy views.

Other efforts targeted political candidates' campaigns and funneled significant dollars to key politicians and political parties to gain influence. As shown in Figure 8.6, the American Iron and Steel Institute, the industry's trade association, and the United States Steel Corporation, a domestic integrated steel producer, increased their levels of political action committee (PAC) campaign contributions, especially during the 2014 political election cycle.

Domestic steel producers sought economic relief by filing a complaint with the U.S. Commerce Department. The steel industry was aware that Congress gave the Commerce Department new tools in 2015 when it enacted legislation that changed the trade remedy laws, and steel executives argued that it was critical that the department aggressively use them. The U.S. Steel Corporation turned to the U.S. International Trade Commission (ITC), an independent federal agency with broad investigative responsibilities on matters of trade. The U.S. Steel Corporation filled a complaint with the ITC alleging that Chinese steel producers and distributors conspired to fix prices, stole trade secrets, and falsely label steel products on the market. "We have said that we will use every tool available to fight

FIGURE 8.6
PAC Contributions by the Steel Industry, 2012–2018

Source: OpenSecrets.org.



for fair trade. With today's [ITC] filing, we continue the work we have pursued through countervailing and antidumping cases and pushing for increased enforcement of existing laws," said U.S. Steel Corporation CEO Mario Longhi.

The steel industry also worked in coalition with others to promote their interests. It joined with other manufacturers from the aluminum, textile, fabric, fiber, and resin industries to form the Manufacturers for Trade Enforcement coalition to raise awareness of their concerns about China's market status. Company executives encouraged their employees to sign petitions calling on Congress to protect the steel industry by enacting tariffs, an additional fee imposed on all tonnage of steel coming into the country. Not all other manufacturers agreed to join this effort, however. For example, Daniel Cosio of Ball Metal Food Container said that restricting Chinese steel imports would "lead to short supplies, higher prices and fewer alternatives for companies like ours. The products we buy from China are not available from U.S. producers in the quality and quantity provided by the Chinese. The level of service that Chinese producers provide is superior to the service provided by domestic steel producers."

Some steel executives launched publicity campaigns to educate Americans about the industry's economic crisis. Lakshmi Mittal, CEO of ArcelorMittal, the world's leading integrated steel and mining company, said that he "was counting on tariff protection to help save his U.S. [steel] mills, heavily concentrated in northern Indiana. [This protection] will help prices." ArcelorMittal announced that it would lay off 150 of the 207 workers at its Philadelphia plant early the following year. Kimberly Allen, a steelworker and single parent who had worked at the ArcelorMittal plant for more than 22 years, said, "I told my son, 'Christmas is going to be kind of severe, because Mommy's going to lose her job soon.'"

The steel industry's multi-faceted political strategy seemed to pay off in 2017 when President Trump announced he would impose steep—25 percent—global tariffs on steel imports, making good on his campaign promise to aggressively pursue his "America First" trade policy. "You're going to see a lot of good things happen. You're going to see expansion of the [domestic steel] companies," said Trump. However, countries impacted by these tariffs were expected to bring complaints before the World Trade Organization (WTO), discussed in Chapter 4, saying the tariffs violated WTO rules prohibiting protective tariffs under most circumstances.

News of the tariffs caused a negative reaction on Wall Street, where investors fled stocks following Trump's announcement. The Dow Jones Industrial Average declined 264 points, or 1.1 percent, the Standard and Poor's 500 fell 0.5 percent, and the Nasdaq Composite dropped 0.4 percent. Analysts argued that the new tariffs on imports would boost steel prices in the United States, offering a lifeline to beleaguered American steel makers, but also raising costs for manufacturers of goods made from steel, ranging from oil pipes to factory equipment to automobiles. Steve Handschuh, head of the Motor Equipment Manufacturers Association, said, "Tariffs limit access to necessary specialty products, raise the cost of motor vehicles to consumers, and impair the industry's ability to compete in the global marketplace."

Sources: "The Crisis Facing the U.S. Steel Industry," *CNN,* March 23, 2016, *www.cnn.com*; "U.S. Steel Fires New Salvo in War against Chinese Imports," *Pittsburgh Business Times,* April 26, 2016, *www.bizjournals.com*; "U.S. Steel Complaint Opposed by Steel Users," *Pittsburgh Post-Gazette,* May 14, 2016, *www.post-gazette.com*; "U.S. Steel Tariffs Create a Double-Edged Sword," *The Wall Street Journal,* May 31, 2016, *www.wsj.com*; "Trump Promised to Protect Steel, Layoffs Are Coming Instead," *The New York Times,* December 22, 2017, *www.nytimes.com*; "Trump Will Approve Aluminum, Steel Tariffs Next Week," *The Wall Street Journal,* March 1, 2018, *www.wsj.com*; and "U.S. Stocks Trade Sharply Lower," *The Wall Street Journal,* March 2, 2018, *www.wsj.com*.

Discussion Questions

1. Did the steel industry act appropriately as a participant in the political environment when it sought economic protection from foreign steel imports?
2. What political strategies, as shown in Figure 8.2, did the steel industry use to gain tariff protections?
3. What other political strategies could the steel industry have used to promote their interests and how?
4. What levels of corporate political involvement, as shown in Figure 8.5, are evident in the case?
5. Should Chinese and other country's steel producers be permitted to engage as a political participant in the U.S. political environment to protect their economic interests?

PART FOUR

Business and the Natural Environment

CHAPTER NINE

Sustainable Development and Global Business

The world community faces unprecedented ecological challenges in the 21st century, including climate change, resource scarcity, and threats to biodiversity. Many political and business leaders have embraced the idea of sustainable development, calling for economic development without depleting the natural capital on which future generations depend. A critical task in coming decades for government policymakers, civil society organizations, corporate leaders, and entrepreneurial innovators will be to find ways to meet simultaneously both economic and environmental goals.

This Chapter Focuses on These Key Learning Objectives:

LO 9-1 Understanding how business and society interact within the natural environment.

LO 9-2 Defining sustainable development.

LO 9-3 Recognizing the ways in which population growth and economic development interact with the world's ecological crisis.

LO 9-4 Examining common environmental issues, including climate change, that are shared by all nations and businesses.

LO 9-5 Analyzing the steps both large and small businesses can take globally to reduce ecological damage and promote sustainable development.

LO 9-6 Describing the leading global codes of environmental conduct.

In 2015, representatives of 193 of the world's nations gathered at the United Nations in New York City to adopt the Sustainable Development Goals, also known as Agenda 2030 because of the deadline for meeting them. The goals were broad and aspirational, covering many aspects of economic and social development. But all shared a vision of a sustainable future in which humanity could thrive without destroying the environmental basis for life on Earth. Agenda 2030 called, for example, for clean drinking water, renewable energy, responsible consumption and production, protecting the oceans, halting deforestation, and aggressive action on climate change. "We are determined," said the United Nations statement, "to take the bold and transformative steps which are urgently needed to shift the world onto a sustainable and resilient path."[1]

Meeting these ambitious goals will surely require the involvement of businesses, both large and small, from all over the globe, in the pursuit of sustainability. Companies of all types have embraced the challenges of operating within the limits of the Earth's natural systems. Many have recognized the cost savings associated with operating more efficiently, the opportunities to serve consumer markets in emerging economies, the benefits of reducing regulatory risk, and the competitive advantages of innovation in sustainable technology. Consider the following examples:

- In 2018, McDonald's, the world's largest restaurant chain, announced that by 2025 one hundred percent of customer packaging—at all locations across the globe—would come from renewable, recycled, or certified sources. It would also offer recycling receptacles for patrons to use at all locations to dispose of their waste. At the time of the announcement, about half of the company's packaging met this standard, and only 10 percent of its locations offered recycling. Because of its enormous size—37,000 restaurants in more than 100 countries—McDonald's commitment promised a huge impact. "We look forward to doing more and continuing to raise the bar," said the company's chief sustainability officer.[2]
- Taylor Guitars makes high-end acoustic and electric guitars, played by such well-known musicians as Taylor Swift, Jason Mraz, and Dave Matthews. To assure its supply of ebony, a hardwood that grows in tropical rain forests and is used to make fret boards, the company bought a saw mill in Cameroon, West Africa. Taylor Guitars quickly ended the wasteful practice of cutting down 10 ebony trees to find one with solid black wood, which had stressed the forest and endangered remaining supplies. Instead, they began using all the ebony they harvested, and educated their customers that the wood naturally came in many hues other than black. "Our vision was to transform the way that ebony is harvested, processed, and sold," said Bob Taylor, the president of the company. "To accomplish this, we assumed the role of guardian of the forest, and we operate with the philosophy to use what the forest gives us."[3]
- Airbus Group is a European multinational corporation that makes aircraft, including the world's largest passenger jet. The company has endorsed Agenda 2030 and has pledged to support carbon-neutral growth in the aviation industry. In support of this goal, the company has partnered with farmers, energy companies, and researchers to develop new biofuels that can be "dropped in" to today's aircraft as part of a fuel blend, cutting

[1] "U.N. Adopts Ambitious Global Goals After Years of Negotiations," *The New York Times,* September 25, 2015. The full text of the Agenda 2030 is available at https://sustainabledevelopment.un.org/post2015/transformingourworld.

[2] "By 2025, All of McDonald's Packaging to Come from Renewable, Recycled, or Certified Sources; Goal to Have Recycling Available in All Restaurants," January 16, 2018, *press release,* at *http://news.mcdonalds.com*.

[3] "The Crelicam Mill in Cameroon," *www.taylorguitars.com/about/sustainable-ebony*; and Bob Taylor, "Remarks at the Remarks at the 15th Annual Awards for Corporate Excellence," *www.state.gov/secretary/remarks/2014/01/220756.htm*.

carbon emissions. Since 2016, Airbus has offered its customers, such as Cathy Pacific Airlines, the option of having their new aircraft delivered from the factory using the sustainable fuel. "This is a major step for Airbus," said the company's head of new energies. "It enables us to demonstrate that aviation biofuels are today a reality."[4]

These examples suggest some of the great creativity that businesses were bringing to the ecological challenges of the 21st century. Can businesses, governments, and society, working together, put the global economy on a more sustainable course? This chapter will describe the major sustainability challenges facing society and both the risks and opportunities these challenges present to businesses globally. The following chapter will focus on specific areas of government regulation and the ways in which businesses, in the United States and other countries, have sought to manage for sustainability.

Business and Society in the Natural Environment

Business, society, and the environment are deeply interrelated. Business and society operate within, and depend on, the natural environment. The extraordinary planet on which we live provides the abundant resources humans use to thrive, but it also imposes constraints. We have only one Earth, and its resources are finite. **Natural capital** refers to the world's stocks of natural assets, including its geology, soil, air, water, and all living things.[5] The United Nations has estimated that the value of natural capital to society is as high as $72 trillion per year.[6] These assets make human life possible. For human society to survive over time it must operate *sustainably,* in a way that does not destroy or deplete these natural resources for future generations. This fundamental truth confers on business leaders both great challenges and great opportunities.

Chapter 1 introduced the idea of systems theory and explained how businesses cannot be understood in isolation, but only in relationship to the broader society in which they operate. This idea can be extended to the relationship between business and society, on one hand, and the natural environment, on the other. In this view, business and society can be most fully understood in relationship to the broader *natural environment* in which they are embedded and with which they interact. This relationship is illustrated in Figure 9.1.

The well-known image of the Earth as seen from space—a blue-and-green globe, girdled by white clouds, floating in blackness—dramatically shows us that we share a single, unified natural system, or **ecosystem**. Preserving our common ecosystem and assuring its continued use is an urgent imperative for governments, business, and society. As KPMG International stated in its report, *Expect the Unexpected,* "The central challenge of our age must be to decouple human progress from resource use and environmental deterioration."[7]

Sustainable Development

The need for balance between economic progress and environmental protection is captured in the concept of **sustainable development**. This term refers to development that "meets the needs of the present without compromising the ability of future generations to meet their

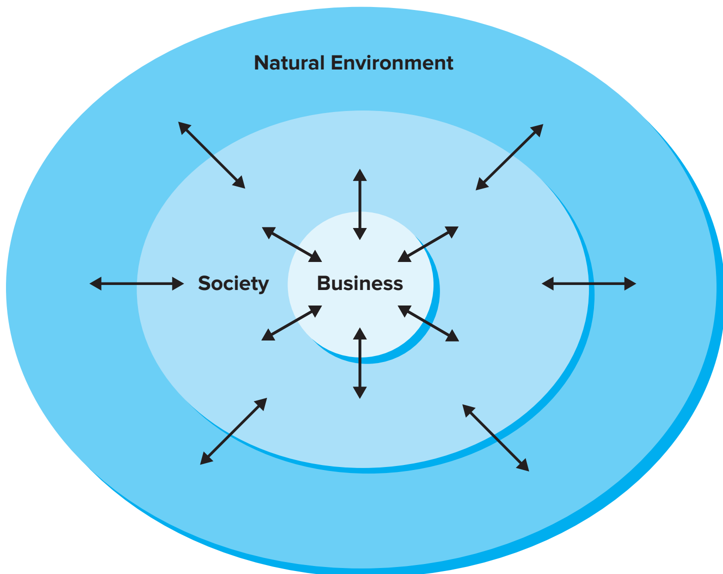
[4] KPMG (in partnership with the U.N. Global Compact), "Sustainable Development Goals Industry Matrix," at *www.kpmg.com*; and "Airbus Demonstrates Regular Customer Delivery Flights with Sustainable Jet Fuel," June 1, 2017, at *www.airbus.com/newsroom*.

[5] "What is Natural Capital," *www.naturalcapitalforum.com*. See also Paul Hawken, Amory Lovins, and L. Hunter Lovins, *Natural Capitalism: Creating the Next Industrial Revolution* (Boston: Little, Brown, 1999).

[6] "The State of Green Business Report 2018," at *www.greenbiz.com*.

[7] *"Expect the Unexpected: Building Business Value in a Changing World,"* KPMG International, 2012.

FIGURE 9.1
Business, Society, and the Natural Environment: An Interactive System



own needs" or, more simply, "ensuring a better quality of life for everyone, now and for generations to come."[8] At its core, sustainable development is about fairness—a central tenet of ethics, as explained in Chapter 5. Fairness requires that the benefits and burdens of an action be distributed equitably, according to an accepted rule. Sustainable development requires an equitable distribution of the benefits gained from the use of natural resources for both current generations (the developing world countries should receive its fair share along with the countries in the developed world) and across generations (the present generation should not gain at the expense of future generations). This can only occur if governments and business leaders work to promote economic development that does not further degrade the environment. The very nature of consumption itself will need to change as people come to emphasize the quality of their lives over the quantity of goods they own, and innovation in a dynamic market economy will need to find new ways to meet human aspirations in a more resource-efficient manner.

What would a sustainable society look like? Of course, there are many paths to sustainability, and there is no way to know for sure what the future will hold. But, some cities have set out to demonstrate what might be possible. One such city is Curitiba, Brazil, which is profiled in Exhibit 9.A.

Threats to the Earth's Ecosystem

Humanity has entered a new geological era, called the *Anthropocene* (the period in which human activity has been the dominant influence on climate and the environment). Since the Industrial Revolution, humans have become a powerful force, altering the face of the planet and rivaling the forces of nature herself—glaciers, volcanoes, asteroids, and earthquakes—in impact. Human beings have literally rerouted rivers, moved mountains, and burned vast forests. By the early part of the 21st century, human society had transformed about half of the Earth's ice-free surface and made a major impact on most of the rest. In many areas, as much land was used by transportation systems as by agriculture.

[8] World Commission on Environment and Development, *Our Common Future* (Oxford: Oxford University Press, 1987), p. 8; "Sustainable Development: The UK Government's Approach," *http://sd.defra.gov.uk*.

Exhibit 9.A Curitiba: Brazil's Sustainable City

The world is becoming increasingly urbanized. By 2050, two-third's of the world's people are expected to be living in cities, as rural migrants pore into urban areas from the surrounding countryside. How cities grow will therefore have a great impact on society's future sustainability.

Curitiba, Brazil, has been called the "greenest city on earth." The capital of the state of Paraná, this city of almost 2 million has long embraced innovation in urban planning. Eighty-five percent of the population uses public transit rather than cars, with speedy buses moving along dedicated express lanes, stopping at tube stations where people can get on and off without using stairs. The city boasts 150 square feet of green space per resident, four times the World Heath Organization standard, and has planted 1.5 million trees. Buildings are repurposed rather than torn down and rebuilt: the planning department, for example, is in an old furniture factory. Nine out of ten residents recycle their paper, metal, glass, and plastic; and many participate in a program in which they can exchange trash for tokens, good for bus tickets and vegetables. "Curitiba is not a paradise," said the mayor. "But it is a model for many cities in the world."

According to Arcadis, a global design and engineering firm, the most sustainable cities in the world—ranked by their impact on the planet—now include Zurich, Wellington, and Singapore. The factors considered include the use of renewable energy, recycling, clean drinking water, and low air pollution and greenhouse gas emissions.

Sources: "Story of Cities #37: How Radical Ideas Turned Curitiba into Brazil's 'Green Capital,'" *The Guardian,* May 6, 2016; "The Five Greenest Cities in the World," *Huffington Post,* August 30, 2016; World Economic Forum, "Inspiring Future Cities and Urban Services," April, 2016; Bill McKibben, *Hope, Human and Wild* (Minneapolis, MN: Milkweed Editions, 2007); and Arcardis, *Sustainable Cities Index 2016, www.arcadis.com*.

The climate itself had been profoundly altered by emissions of global warming gases. Although significant natural resources—fresh water, fertile land, and forest—remained, exploding populations and rapid economic development had reached the point where, by most measures, the demands of human society had already exceeded the carrying capacity of the Earth's ecosystem.

These rapid changes pose severe threats to many businesses. They face limited supplies of critical resources, unpredictable weather changes, and increased political risk, among many other challenges. Yet the environmental problems faced by society also present business with great opportunities. Established firms and innovative entrepreneurs who can figure out, for example, how to build offices and houses that are more energy-efficient, produce energy without irreversibly altering the climate, or devise systems to recycle and reuse obsolete electronics, can both help society and enjoy great commercial success.

Forces of Change

Pressure on the Earth's resource base is becoming increasingly severe. Two critical factors have combined to accelerate the ecological crisis facing the world community and to make sustainable development more difficult: population growth and the rapid industrialization of many developing nations.

The Population Explosion

A major driver of environmental degradation is the exponential growth of the world's population. A population that doubled every 50 years, for example, would be said to be growing exponentially. Many more people would be added during the second 50 years than during the first, even though the rate of growth would stay the same. Just 10,000 years ago, the Earth was home to no more than 10 million humans, scattered in small settlements. For many thousands of years, population growth was gradual. Around 1950, the world

population reached 2.5 billion. World population crossed the 6 billion mark in 1999 and the 7 billion mark in late 2011. The United Nations estimates that the population will reach slightly more than 11 billion by 2100. To gain some perspective on these figures, consider that a baby born in 2015 who lives to be 85 years old will see the world's population increase by more than 3 billion people.

Population growth in the coming decades will not be distributed equally. In the industrialized countries, especially in Europe, population growth has already slowed. Almost all the world's population growth over the next century is predicted to be in less developed countries, especially in Africa, as shown in Figure 9.2.

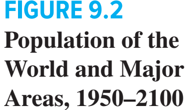
The world's burgeoning population will put increasing strain on the Earth's resources. Each additional person uses raw materials and adds pollutants to the land, air, and water. The world's total industrial production would have to quintuple over the next 40 years just to maintain the same standard of living that people have now, if technology remains unchanged.

Economic Development

A second source of pressure on the Earth's resource base is the rapid industrialization of many countries. Many parts of Africa, Asia, and Latin America are developing at a rapid pace. This is positive because it is reducing poverty and slowing population growth. But economic development has also contributed to the growing ecological crisis. Industry requires energy, much of which comes from burning fossil fuels, releasing pollutants, and disrupting the climate. The agricultural "green" revolution, although greatly increasing crop yields in many parts of the world, has caused contamination by pesticides, herbicides, and chemical fertilizers. Development is often accompanied by rising incomes, bringing higher rates of both consumption and waste. In many instances, environmental regulations have lagged the pace of development.

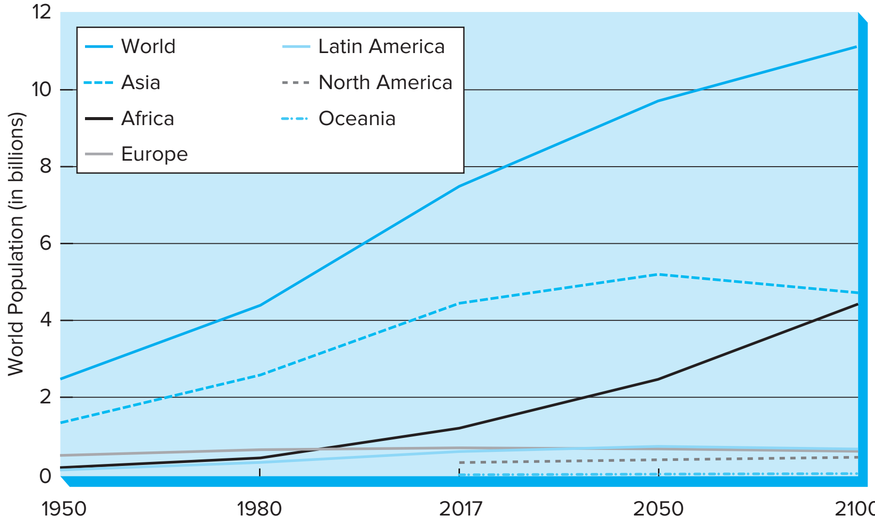
China dramatically illustrates the tight connection between rapid economic development and environmental risk. China is one of the fastest-growing economies in the world, expanding at a rate approaching 10 percent annually on average over the past 30 years (although its economy has recently slowed somewhat). The evidence of industrialization is everywhere, from skyscrapers under construction, to cars crowding

FIGURE 9.2



Population of the World and Major Areas, 1950–2100

Source: United Nations Population Division, "World Population Prospects: The 2017 Revision: Key Findings and Advance Tables," 2017. The projections represent the medium-range scenario. Other estimates are higher and lower. All estimates are available at *www.un.org/development/desa*.



the streets, to factories operating 24/7 to produce goods for export. Yet a major consequence has been increased pollution. By the mid-2010s, 90 percent of China's cities failed to meet air quality standards, and residents routinely wore face masks and stayed indoors to protect themselves from choking smog. In 2013, the government finally changed course, adopting a five-year plan to drastically limit coal burning, car emissions, and construction dust. By 2018, most of the plan's goals had been met, although at the cost of many factory and mine closures. Said the Chinese president Xi Jinping, "Clear waters and green mountains are as good as mountains of gold and silver."[9]

China and other fast-growing developing nations challenge business and society to "leapfrog" stages and move directly to cleaner technologies and methods of production.

The Earth's Carrying Capacity

The Earth's rapid population growth, together with economic development of many of the world's poorer nations and people's rising expectations, are on a collision course with a fixed barrier: the limited **carrying capacity** of the Earth's ecosystem. The world's resource base, the air, water, soil, minerals, and so forth, is essentially finite, or bounded. We have only one Earth; the ecosystem itself is not growing. If human societies use up resources faster than they can be replenished, and create waste faster than it can be dispersed, environmental devastation will be the inevitable result.[10] Human society is already overshooting the carrying capacity of the Earth's ecosystem. Just as it is possible to eat or drink too much before your body sends you a signal to stop, so too are people and businesses using up resources and emitting pollution at an unsustainable rate. But because of delays in feedback, society may not understand the consequences of its actions until the damage has been done.

One method of measuring the Earth's carrying capacity, and how far human society has overshot it, is called the **ecological footprint**. This term refers to the amount of land and water a human population needs to produce the resources it consumes and to absorb its wastes, given prevailing technology. According to the Global Footprint Network, which maintains a public data set that is updated as new information becomes available, for each living human being, the Earth contains 4.2 acres of biologically productive area—farmland, forest, fresh water, and so forth. At the same time, each person has, on average, an ecological footprint of 7.1 acres. What that means is that human society is using resources and producing waste at a rate greater than one and a half times above what the Earth's ecosystem can sustainably support. (Overshooting the Earth's carrying capacity is possible in the short run because people can consume resources without allowing them to regenerate, and generate waste at a rate higher than can be absorbed or recycled.) Historical data show that human society first exceeded world ecological capacity in the 1970s, and the gap between the two has been widening steadily since then.

Not surprisingly, some nations and individuals have bigger ecological footprints than others. For example, in the United States the average citizen has an ecological footprint of about five times his or her share of the world's resources. By contrast, citizens of Bangladesh use less than half of their share; citizens of Honduras use exactly their share.[11] These differences

[9] "Why China's Good Environmental Policies Have Gone Wrong," *The New York Times*, January 14, 2018; "China's Pollution Curbs Hit Growth as Policy Priorities Shift," *Financial Times*, December 13, 2017; and "Hundreds of Chinese Cities Not Meeting Air Quality Standards," *The New York Times*, April 21, 2015.

[10] James Gustave Speth, *The Bridge at the Edge of the World* (New Haven: Yale University Press, 2008); and Herman E. Daly, *Beyond Growth: The Economics of Sustainable Development* (Boston: Beacon Press, 1996).

[11] The most recent data are available from the Global Footprint Network, *www.footprintnetwork.org*. Individuals can estimate their own ecological footprint by taking a quiz available at the "personal footprint" link at this website.

reflect the higher levels of consumption and less efficient use of resources in some countries, relative to others.

Acting together, how can human society bring the Earth's carrying capacity—and the demands placed on it—back into balance? This is without a doubt one of the great challenges now facing the world's people. Any solution will require change on many fronts.

- *Technological innovation.* One approach is to develop new technologies to produce energy, food, and other necessities of human life more efficiently and with less waste. Vast solar arrays in the desert, offshore wind turbines, or state-of-the-art utilities could power homes and businesses. For example, an innovative Swiss company called Climeworks partnered with a publicly-owned power plant in Iceland to capture carbon dioxide and inject it underground, where it was absorbed by rock—trapping emissions for thousands of years.[12] Genetic engineering could create more nutritious and productive crops. (Some concerns about genetic engineering are explored in Chapter 11.) Energy-efficient homes and commercial buildings could allow people to go about their lives while using fewer of the Earth's resources. Technological innovation in support of sustainability is further discussed later in this chapter and in Chapter 10.
- *Changing patterns of consumption.* Individuals and organizations concerned about environmental impact could decide to consume less or choose less harmful products and services, or to buy from companies committed to sustainability in their own operations. Mobile applications, such as those developed by goodguide.com, now allow individuals to scan a product's barcode in a store with their smartphones and receive instant information on its environmental impact. They can modify their purchasing decisions, based on this knowledge. Light Bulb Finder, named one of the best "green apps" by the U.S. Environmental Protection Agency, enabled users to compare bulbs by energy usage, cost, style, and light quality; create shopping lists; and buy online—making it easy than ever to make an environmentally-informed choice.[13] In a consumer society, when many people decide to reduce their personal footprints by shopping thoughtfully for products like light bulbs, society's overall footprint becomes smaller. Homes, workplaces, and places of entertainment could be built closer to each other and to public transit, so people could get where they needed to go with less wasted energy.
- "*Getting the prices right.*" Some economists have called for public policies that impose taxes on environmentally harmful products or activities. For example, when an individual bought gasoline—or a utility burned coal to make electricity—they would be charged an added carbon tax. Because prices would reflect true environmental costs, individuals and firms would have an incentive to make less harmful choices. For example, in 2017 the province of Alberta, Canada, levied a tax of $20 a ton on carbon dioxide emissions from fossil fuels used for heating and transportation. The government returned most of the money raised to households and small businesses in the form of rebates and tax cuts. The objective was to encourage individuals and companies to switch to more efficient vehicles and heating fuels.[14]

Some contemporary thinkers have gone even further and suggested that what is needed is nothing less than a completely new set of values about what is truly important. In this view, society needs a new narrative in which, as scholar Sandra Waddock has put it, "the

[12] "The World's First 'Negative Emissions' Plant Has Begun Operation—Turning Carbon Dioxide into Stone," October 12, 2017, *Quartz,* at *https://qz.com*.

[13] "The Top Eco-Friendly Smartphone Apps," *The Spruce,* June 13, 2017.

[14] "Here's How Alberta's Carbon Tax Increase Will Affect You in 2018," December 28, 2017, at *www.cbc.ca*.

goals shift from wealth creation toward well-being and dignity in an economy that works for all, that is, creating more equity rather than less and fostering sustainability for all living beings and ecosystems, rather than simply exploiting nature for human gain."[15] Such a narrative would view the quality of life—not the quantity of things—as the worthiest goal of human aspiration.

Technological innovation, smart consumption, and accurate accounting all hold the promise of helping human society realize this vision of the future.

Global Environmental Issues

A **commons** is a shared resource, such as land, air, or water that a group of people use collectively. The *paradox of the commons* is that if all individuals attempt to maximize their own private advantage in the short term, the commons may be destroyed, and all users, present and future, lose. The only solution is restraint, either voluntary or by mutual agreement.[16] The *tragedy of the commons*—that freedom in a commons brings ruin to all—is illustrated by the following parable.

> There was once a village on the shore of a great ocean. Its people made a good living from the rich fishing grounds that lay offshore, the bounty of which seemed inexhaustible. Some of the cleverest fishermen began to experiment with new ways to catch more fish, borrowing money to buy bigger and better equipped boats. Since it was hard to argue with success, others copied their new techniques. Soon fish began to be harder to find, and their average size began to decline. Eventually, the fishery collapsed, bringing economic calamity to the village. A wise elder commented, "You see, the fish were not free after all. It was our folly to act as if they were."[17]

In a sense, we live today in a global commons, in which many natural resources, like the fishing grounds in this parable, are used collectively. Some environmental problems are inherently global in scope and require international cooperation. Typically, these are issues pertaining to the *global commons,* that is, resources shared by all nations. Five global problems that will have major consequences for business and society are climate change, ozone depletion, resource scarcity, decline of biodiversity, and threats to the world's oceans.

Climate Change

A critically important challenge facing the world community is **climate change**. This term refers to changes in the Earth's climate caused by increasing concentrations of carbon dioxide and other pollutants produced by human activity. These have caused the average surface temperature of the Earth to rise over time, a phenomenon known as **global warming**. But because these gases also have a variety of other complex effects on the climate, scientists often prefer the more general term *climate change.*

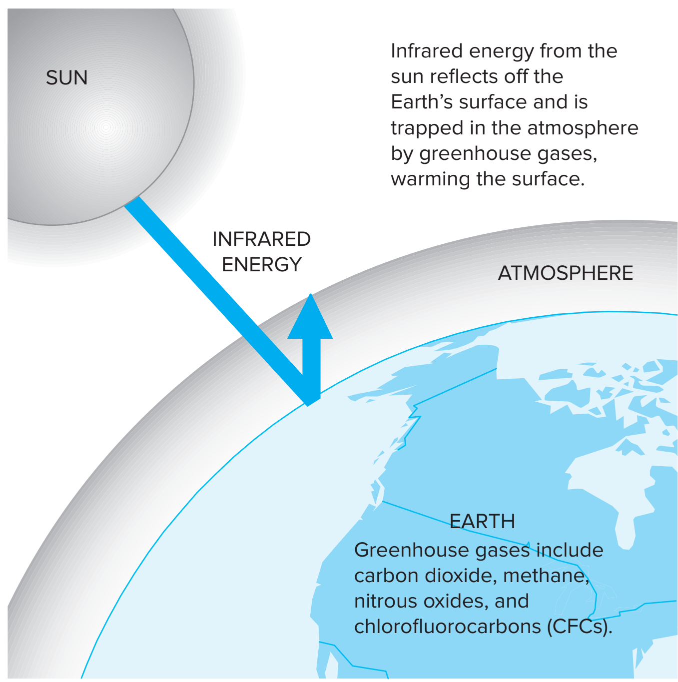
The Earth's atmosphere contains carbon dioxide and other trace gases that, like the glass panels in a greenhouse, prevent some of the heat reflected from the Earth's surface from escaping into space, as illustrated in Figure 9.3. Without this so-called greenhouse

[15] Sandra Waddock, "Beyond CSR to System Change," in James Weber and David M. Wasieleski (eds.), *Stakeholder Management, Business and Society 360: Volume 2,* pages 394–95 (Bingley, United Kingdom: Emerald Publishing Ltd., 2018).

[16] Garrett Hardin, "Tragedy of the Commons," *Science* 162 (December 1968), pp. 1243–48.

[17] Source: Abridgment of "The Story of a Fishing Village," from *1994 Information Please Environmental Almanac*.

FIGURE 9.3
Global Warming



effect, the Earth would be too cold to support life. Since the Industrial Revolution, the concentration of carbon dioxide in the atmosphere has increased by more than 40 percent, largely due to the burning of fossil fuels such as oil, natural gas, and coal. According to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC), a group of the world's leading atmospheric scientists, since 1880 the Earth has warmed by between 0.7 and 1.1 degrees Celsius. (One degree Celsius equals 1.8 degrees Fahrenheit, the unit commonly used in the United States.) Each of the past three decades has been the warmest of any in the last century and a half. The IPCC found that climatic warming was "unequivocal" and "extremely likely" due to human-generated greenhouse gases, which were at their highest atmospheric levels in at least 800,000 years.[18]

The possible causes of global warming are numerous. The burning of fossil fuels, which releases carbon dioxide, is the leading contributor. Increased emissions of nitrous oxides, resulting in part from the manufacture and use of synthetic fertilizers, also contributes. But consider the following additional causes.

- *Black carbon.* Recent scientific research has shown that black carbon—the sooty smoke that is created by the incomplete combustion of diesel engines, wildfires, and cookstoves fueled by dung, wood, and charcoal—is the second largest contributor to climate change, responsible for as much as 18 percent of global warming. Black carbon, which can travel thousands of miles in the atmosphere, absorbs heat and settles on glaciers, speeding up melting. A global alliance to reduce black carbon and simultaneously reduce global warming and advance economic development by promoting the use of clean cookstoves in developing nations is described in the discussion case at the end of this chapter.

[18] Intergovernmental Panel on Climate Change, "Climate Change 2014: Synthesis Report—Summary for Policymakers," 2014. A complete set of materials may be found at IPCC's website, *www.ipcc.ch*. The next IPCC assessment report is scheduled for release in 2022.

- *Deforestation.* Trees and other plants absorb carbon dioxide, removing it from the atmosphere. Deforestation—cutting down and not replacing trees—thus contributes to higher levels of carbon dioxide. Scientists have estimated that about half of all original forests have already been cut. Burning forests to clear land for grazing or agriculture also releases carbon directly into the atmosphere as a component of smoke. And when trees are removed, their leaves do not shade the ground, leading to still more warming. Large-scale deforestation thus contributes in several ways to climate change.
- *Beef production.* Cattle ranching contributes to global warming in several ways. Methane, a potent greenhouse gas, is produced as a by-product of the digestion of ruminants, and feed production and manure processing have additional climate impacts. According to the Food and Agriculture Organization of the United Nations, livestock are responsible for 15 percent of greenhouse gas emissions, measured in carbon equivalents; beef and dairy production account for three-fifths of this amount. As the world's economies develop, people tend to eat more meat; the world's beef consumption is projected to nearly double by 2050.[19]

If global warming continues, the world may experience extreme heat waves, air pollution crises, violent storms, and damaging wildfires in the 21st century. The polar ice caps may partially melt, raising sea levels and causing flooding in low-lying coastal areas such as Florida, Bangladesh, and the Netherlands. It may become as difficult to grow wheat in Iowa as it is now in arid Utah. Such climate change could harm peoples' health, leading to breathing problems, epidemics of tropical diseases, and injuries from extreme weather events. It could devastate many of the world's economies and destroy the habitats of many species.[20]

The most important international treaty on global warming is the **Convention on Climate Change**, first negotiated in 1992. The United Nations hosts an annual Conference of the Parties (COP), where representatives of virtually all the world's nations meet to hammer out agreements to cut the fossil fuel emissions that cause global warming. The first major breakthrough occurred in 1997, when the Kytoto Protocol (named after the city in Japan where representatives met) set limits aimed at stabilizing the concentration of greenhouse gases in the atmosphere. In 2015, the COP negotiated a second major breakthrough, known as the **Paris Agreement**, which aimed to limit the rise in the average global temperature to well below 2 degrees Celsius above preindustrial levels. Individual nations would voluntarily determine their own contributions to this goal. By late 2017, *all* of the world's nations had signed the agreement, although the Trump Administration had announced its intention to withdraw the United States as soon as legally possible.[21]

Many companies—whether or not required by treaty to do so—have acted to reduce their impact on climate change.

> CSX, a railroad, has worked aggressively to reduce its carbon emissions, investing more than $1.5 billion to lower its use of fuel. The company has adopted new technology to provide auxiliary power to its locomotives, allowing their diesel engines to shut down while idling. It has also trained its engineers to use the most fuel-efficient throttle settings and lubricated its rails to reduce friction. These steps, among others, now allow CSX to move a ton of freight 500 miles on just one gallon of diesel fuel. Commented the Carbon Disclosure Project's CEO, "Business must

[19] *Tackling Climate Change Through Livestock: A Global Assessment of Emissions and Mitigation Opportunities* (Rome: United Nations Food and Agriculture Organization, 2013); and *Creating a Sustainable Food Future* (World Resources Institute, 2013).

[20] Photographs of observable evidence of global warming may be found on the website of *National Geographic, http://environment.nationalgeographic.com/environment/global-warming*.

[21] "Syria Joins Paris Climate Accord, Leaving Only U.S. Opposed," *The New York Times,* November 7, 2017.

continue to forge ahead, innovate and seek out opportunities by doing more with less. The decisions that perpetuate a legitimate, low carbon and high growth economy will bring considerable value to those that have the foresight to make them."[22]

Ozone Depletion

Another global environmental challenge is ozone depletion. **Ozone** is a bluish gas, composed of three bonded oxygen atoms, that floats in a thin layer in the stratosphere between 9 and 28 miles above the planet. Although poisonous to humans in the lower atmosphere, ozone in the stratosphere is critical to life on Earth by absorbing dangerous ultraviolet light from the sun. Too much ultraviolet light can cause skin cancer and damage the eyes and immune systems of humans and other species.

Since the 1970s, scientists have understood that chlorofluorocarbons (CFCs), manufactured chemicals formerly widely used as refrigerants, insulation, solvents, and propellants in spray cans, could react with and destroy ozone in the upper atmosphere. This has caused a thin spot, or hole, in the Earth's ozone layer, particularly over Antarctica and in the northern latitudes over Europe and North America during the summer, when the sun's ultraviolet rays are the strongest and pose the greatest danger. In addition to destroying the ozone, CFCs are also greenhouse gases.

In 1987, world leaders negotiated the *Montreal Protocol,* agreeing to cut CFC production; the agreement was later amended to ban CFCs, along with several other ozone-depleting chemicals. Participating countries will have until 2030 to phase out chlorofluorohydrocarbons (HCFCs), related chemicals also damaging to the ozone layer. As of 2018, 197 countries, all but a tiny handful, had signed the protocol. Scientists believe that if the agreement is honored, the ozone layer will recover by 2050.[23]

An ongoing problem is that HCFCs, often used as substitutes for CFCs, are themselves powerful greenhouse gases. (In fact, one pound of some HCFCs released into the atmosphere has more than 2,000 times the warming impact as the same amount of carbon dioxide.)

The Coca-Cola Company, PepsiCo, and Red Bull, normally fierce competitors, collaborated to find a substitute for fluorinated gases, including HCFCs, in refrigeration units such as vending machines and convenience-store coolers. Working in a partnership called Refrigerants Naturally!, these firms and others experimented with a variety of natural refrigerants, energy-efficient fans, intelligent controllers, and insulated glass. By 2016, they had replaced 5.5 million older units with ones using natural refrigerants. "Competitors working together to help address environmental issues is definitely a strong message to the industry," said a representative of Coca-Cola.[24]

Resource Scarcity: Water and Land

The Earth also faces serious challenges of resource scarcity involving both fresh water and arable land.

Fresh Water Resources

Only 2.5 percent of the water on the Earth is fresh, and most of this is underground or locked up in ice and snow. Only about one-tenth of 1 percent of the Earth's water is in

[22] Carbon Disclosure Project, *CDP Global 500 Report 2011: Accelerating Low Carbon Growth,* available online at *www.cdproject.net*. CSX's most recent report on its environmental initiatives is at *www.csx.com/index.cfm/responsibility*.

[23] The text of the Montreal Protocol and its various amendments and a list of signatories may be found at *http://ozone.unep.org*.

[24] The website of the coalition is *www.refrigerantsnaturally.org*.

lakes, rivers, and accessible underground supplies, and thus available for human use. Water is, of course, renewable: Moisture evaporates from the oceans and returns to Earth as freshwater precipitation, replenishing used stocks. But in many areas, humans are using up or polluting water faster than it can be replaced or naturally purified, threatening people and businesses that depend on it. In 2018, for example, officials of Cape Town, South Africa, announced they would turn off the water taps on what they called "Day Zero," leaving its 4 million residents without access. Facing a severe drought, Cape Town—which drew its supplies from local reservoirs fed by rain—had run dangerously low. At the last moment, officials cancelled Day Zero, saying that recent rains had eased the shortage somewhat, but warned that the city could still run out of water if residents did not continue strict conservation practices.[25]

One step businesses can take to address water scarcity is to institute recycling in their offices and factories. In 2018, Salesforce opened a 61-story office tower in San Francisco, which boasted the largest water recycling system in a commercial high-rise building in the United States. The system was designed to collect "black-water" from the roof, cooling equipment, dishwashers, showers, sinks, and toilets and treat it on-site for reuse as "gray water" in toilets and irrigation, reducing overall water use by 76 percent and saving enough to supply 16,000 households annually—a welcome move in a chronically drought-stricken area. "Offices can be an expression of our values," said the director of sustainability for Salesforce.[26]

All four of the world's leading irrigators—China, India, Pakistan, and the United States—are using groundwater faster than it is being replenished on crop-producing land.[27] By one estimate, if society were able to eliminate all pollution, capture all available fresh water, and distribute it equitably—all of which are unlikely—demand would exceed the supply within a hundred years. By the 2010s, water shortages had already caused the decline of local economies and in some cases had contributed to regional conflicts. In Africa, for example, water disputes had flared among Egypt, Ethiopia, and Sudan, the three countries traversed by the world's longest river, the Nile. In the Middle East, disagreement over access to water from the River Jordan had exacerbated conflict between Israel and Palestine. By 2030, an estimated 3.9 billion people will be living under conditions of water scarcity.[28]

Arable Land

Arable (fertile) land is necessary to grow crops to feed the world's people. Land, if properly cared for, is a renewable resource. Although the productivity of land increased through much of the 20th century, by the 2010s much of the world's arable land was threatened with decline from soil erosion, loss of nutrients, and water scarcity. Worldwide, one-fifth of irrigated land required reclamation because of salinization (excess salt) or poor drainage.[29] In many areas, overly intensive farming practices and climate change have caused previously arable land to turn into desert (this process is called *desertification).* The United

[25] "On Day Zero, Cape Town Will Run Out of Water," *The Washington Post,* February 5, 2018; and "Cape Town Confident of Beating Water Crisis Next Year," *Financial Times,* June 28, 2018.

[26] "Inside Salesforce Tower's Water Recycling System," MIT Sloan School of Management, February 12, 2018; and "Salesforce Dives Headfirst into Water Recycling with New HQ," *www.greenbiz.com*.

[27] Sandra Postel, "Sustaining Freshwater and its Dependents," in WorldWatch Institute, *State of the World, 2013: Is Sustainability Still Possible.*

[28] "Increasing Water Stress," in World Economic Forum, *Outlook on the Global Agenda 2015*.

[29] The most recent statistics may be found at the website of the United Nations Environmental Program, *www.unep.org*.

Nations has estimated that 12 million hectares of arable land are lost every year to desertification (one hectare equals about two and a half acres).[30] This will prompt migration and the potential for civil unrest.

Syngenta, a Swiss company that sells seeds and agricultural chemicals, committed to support the sustainable development goals of Agenda 2030 and set specific targets to rescue farmland from degradation and improve soil fertility. The firm partnered with the United Nations to launch the Soil Leadership Academy. Together with local nongovernment organizations (NGOs), it trained growers of soybeans in Brazil, wine grapes in Hungary, and maize in Vietnam, among others, to reduce soil erosion by planting cover crops and limiting tillage. In 2016, the company reported in its annual review that its efforts had had a positive impact on 5 million hectares of land, preventing and reversing degradation. "I think sustainability, over time, will be the driving force for everybody's business," said Syngenta's CEO.[31]

Decline of Biodiversity

Biodiversity refers to the number and variety of species and the range of their genetic makeup. To date, approximately 1.7 million species of plants and animals have been named and described. Many scientists believe these are but a fraction of the total. According to recent research, the total number may be closer to 9 million, but no one knows for sure. Scientists estimate that species extinction is now occurring at 100 to 1,000 times the normal, background rate, mainly because of pollution and the destruction of habitat by human society. A 2016 study by the World Wildlife Fund found that populations of vertebrate species (mammals, birds, reptiles, amphibians, and fish) were more than half of what they were in 1970.[32] Biological diversity is now at its lowest level since the disappearance of the dinosaurs some 65 million years ago. Genetic diversity is vital to each species' ability to adapt and survive and has many benefits for human society as well. By destroying this biological diversity, we are undermining our survivability as a species.

A major reason for the decline in the Earth's biodiversity is the destruction of rain forests, particularly in the tropics. They are the planet's richest areas in terms of biological diversity. Rain forests cover only about 7 percent of the Earth's surface but account for somewhere between 40 and 75 percent of the Earth's species. At the rate that the original tropical rain forests are currently being cut, all will be gone or severely depleted within 30 years. The reasons for destruction of rain forests include commercial logging, cattle ranching, and conversion of forest to plantations to produce cash crops such as palm oil and soybeans for export. Overpopulation also plays a part, as landless people clear forest to grow crops, raise livestock, and cut trees for firewood.

The destruction is ironic because rain forests may have more economic value standing than cut. Rain forests are the source of many valuable products, including foods, medicines, and fibers. The pharmaceutical industry, for example, each year develops new medicines based on newly discovered plants from tropical areas. Moreover, rain forests absorb carbon dioxide from the atmosphere, so their destruction worsens climate change.

Some businesses have taken important steps to conserve tropical rain forests. Members of the Consumer Products Forum, an alliance of 400 leading companies

[30] The most recent statistics may be found at the website of the United Nations Convention to Combat Desertification, *www.unccd.int/en*.

[31] "The Good Growth Plan," in *Annual Review 2016,* at *www.syngenta.com*.

[32] World Wildlife Fund, *Living Planet Report: Risk and Resilience in a New Era* (2016).

including Coca-Cola, Unilever, and Walmart, have adopted a goal of "zero net deforestation" by 2020 and agreed not to buy any raw materials—such as beef, soybeans, palm oil, timber, and paper—whose production requires the destruction of forest. In another initiative, Archer Daniels Midland (ADM), a major trader of agricultural commodities, partnered with the Forest Trust to assure it purchased no soybeans from threatened ecosystems. This was important because much of the world's soybean crop came from Brazil, where Amazonian rain forests were being cleared for farming. "We're at a critical juncture now to break the link between agriculture, especially for soy production, and deforestation in Latin America," said a representative of the activist group Forest Heroes. "ADM's announcement is a major step forward for the soy industry."[33]

The Convention on Biological Diversity, an international treaty first negotiated in 1992, addresses many of these issues. By 2018 all U.N. member countries except for the United States had ratified it. The treaty commits these countries to draw up national strategies for conservation, to protect ecosystems and individual species, and to take steps to restore degraded areas. It also allows countries to share in the profits from sales of products derived from their biological resources.

Threats to Marine Ecosystems

A final issue of concern is threats to the world's **marine ecosystems**. This term refers broadly to oceans and the salt marshes, lagoons, and tidal zones that border them, as well as the diverse communities of life that they support. Salt water covers 70 percent of the Earth's surface and is home to a great variety of species, from tiny plankton to the giant blue whale, from kelp beds to mangrove forests. Marine ecosystems are important to human society in many ways. Fish, marine mammals, and sea plants provide food and other useful products such as fertilizer, animal feed, cooking and heating oil, medicines, clothing, and jewelry. Healthy coastal zones protect coastlines from erosion and filter runoff from the land. Many communities have survived for centuries off the bounty of the sea.

Today, the health of these ecosystems is increasingly threatened. Some of the key issues include the following:

Fish populations. Oceans provide 90 percent of the world's fish catch. The United Nations has estimated that of the world's marine fisheries, 90 percent are fully exploited or overexploited, and some fisheries—such as those for cod off the Grand Banks (eastern United States and Canada) and for anchovies off Peru—have probably been permanently destroyed by overfishing.[34] Active management, such as limiting the number of fishing boats, establishing fish quotas, or banning fishing for periods of time, has allowed fish to regenerate in some areas.

Coral reefs. Coral reefs are limestone structures that develop from the skeletons of aquatic life and are host to great biological diversity. Today, however, they are in decline from pollution, oceanic warming, damage from ships, and cyanide and dynamite fishing. The Nature Conservancy estimates that at their current rate of decline, 70 percent of coral reefs will be gone by 2050.

Coastal development. Much of the world's population growth is now concentrated in coastal areas, often in ecologically fragile areas. In the United States, for example,

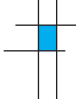
[33] "Agribusiness Giant Adopts Historic No-Deforestation Policy," *Climate Progress,* April 1, 2015. The commitments of the Consumer Goods Forum are reported at *www.theconsumergoodsforum.com*.

[34] "The State of World Fisheries and Aquaculture, 2016," *www.fao.org*.

50 percent of the population lives in counties bordering the ocean—which comprise just 17 percent of the land. Inappropriate development can put pressure on ecologically fragile areas.[35]

Ocean acidity. One effect of increased concentrations of greenhouse gases in the atmosphere has been gradual acidification of the oceans, as seawater has absorbed excess carbon dioxide (which becomes carbonic acid). The result has been the destruction of aquatic life, which is often highly sensitive to acidity.[36]

A young entrepreneur in Denmark, Boyan Slat, has launched a company called The Ocean Cleanup to remove some of the 8 million tons of plastic waste that enters the oceans every year. Plastics are chemical pollutants; they despoil coastlines and also kill marine life when inadvertently ingested. Slat's idea was to float solid curved barriers, 60 or more miles long, near enormous accumulations of floating trash such as the Great Pacific Garbage Patch. Boats would then pick up the gathered detritus and ferry it back to land where it could be properly recycled, generating funds to continue the process. By 2018, the Ocean Cleanup had hired more than 70 staff members, raised more than $40 million, and conducted its first rounds of testing in preparation for deploying its barriers and boats in the open ocean.[37]



Response of the International Business Community

Since so many ecological challenges cross national boundaries, the international business community has a critical role to play in addressing them. This section describes some of the important voluntary initiatives undertaken by companies around the world to put the principle of sustainable development into practice. Other actions by business to address environmental challenges will be explored in Chapter 10.

Life-cycle analysis (LCA), also called *life-cycle assessment,* involves collecting information on the lifelong environmental impact of a product, all the way from extraction of raw material to design, manufacturing, distribution, use, and ultimate disposal. The aim of life-cycle analysis is to minimize the adverse impact of a product at all stages, from *cradle to grave.* Having this information can permit companies to make informed choices about how to reduce a product's footprint. For example, a Procter & Gamble life-cycle analysis of its Tide detergent brand found that its greatest environmental impact occurred in the home—when customers washed their clothes in hot water. The company subsequently introduced Tide Coldwater as a more environmentally friendly alternative. Walmart, Dell, Alcoa, and other companies work through the Sustainability Consortium to advance LCA for thousands of products.[38]

Industrial ecology refers to designing factories and distribution systems as if they were self-contained ecosystems. For example, businesses can save materials through closed-loop recycling, use wastes from one process as raw material for others, and make use of energy generated as a by-product of production.

An example of industrial ecology may be found in the town of Kalundborg, Denmark, where several companies have formed a cooperative relationship that

[35] Pew Charitable Trusts, "Coastal Sprawl: The Effects of Urban Development on Aquatic Ecosystems in the United States," *www.pewtrusts.org*.

[36] "How Will Ocean Acidification Impact Marine Life?" *Science Daily,* February 3, 2015.

[37] "It's Important at Least to Try: Can This 23-Year-Old Clear the Oceans of Plastic Waste?" *The Telegraph (U.K.),* August 4, 2017. The website of the organization is at *www.theoceancleanup.com*.

[38] For more information on the Sustainability Consortium, see *www.sustainabilityconsortium.org*.

produces both economic and environmental benefits. The local utility company sells excess process steam, which had previously been released into a local fjord (waterway), to a local pharmaceutical plant and oil refinery. Excess fly ash (fine particles produced when coal is burned) is sold to nearby businesses for use in cement making and road building. Meanwhile, the oil refinery removes sulfur in the natural gas it produces to make it cleaner burning and sells the sulfur to a sulfuric acid plant. Calcium sulfate, produced as a residue of a process to cut smoke emissions, is sold to a gypsum manufacturer for making wallboard. The entire cycle both saves money and reduces pollution.[39]

Extended product responsibility refers to the idea that companies have a continuing responsibility for the environmental impact of their products or services, even after they are sold. This implies, for example, that firms pay close attention to the energy efficiency of their products when used by the consumer. It also implies that companies design products for disassembly, that is, so that at the end of their useful life they can be disassembled and recycled. At Renault, the French carmaker, engineers design cars for eventual reuse. At a plant near Paris, the company remanufactures used engines, transmissions, and injection pumps for resale. Other components, such as steel body parts and upholstery fabric, are separated and recycled.[40] This is sometimes called *cradle to cradle,* because materials that are used to create one product are later reused to create another. The efforts of one company, HP, to reduce its carbon impact through extended product responsibility is profiled in Exhibit 9.B.

Recently, the ideas of life-cycle analysis, industrial ecology, and extended product responsibility have been captured by a new concept: the **circular economy**. The term refers to a production system that is regenerative by design, that is, it restores rather than wastes its inputs. In contrast, with a linear model, where a production system proceeds from raw materials, to product, to use, to disposal, the circular economy uses a circular model, where a production system proceeds after use to recycling and reuse.[41]

Carbon neutrality is when an organization or individual produces net zero emissions of greenhouse gases. Since virtually all activity produces some atmospheric warming, this is usually accomplished by a combination of energy efficiencies (to reduce their own emissions) and carbon offsets (to reduce others' emissions). **Carbon offsets** (sometimes called *carbon credits*) are investments in projects that remove carbon dioxide (or its equivalent in other climate-warming pollutants, such as black carbon) from the atmosphere. This can be done, for example, by paying others to plant trees, produce clean energy, or sequester (bury underground) earth-warming gases. Some organizations now broker carbon offsets to businesses and individuals wishing to reduce their climate impact.

In 2017, the British retailer Marks & Spencer launched the second phase of its ambitious sustainability initiative, Plan A 2025 (so-called because, as their chief executive explained, "there is no Plan B"). The company had already met a prior commitment to become carbon neutral. To achieve this ambitious goal, the company had built an experimental "learning store" in the United Kingdom as well as an "eco-factory" in partnership with a supplier in Sri Lanka, to try out new approaches that could be diffused through its system. It had installed solar panels

[39] Information about Kalunborg's industrial ecology initiative is available at *www.symbiosis.dk/en*.

[40] Renault's environmental report is available at *https://group.renault.com*.

[41] "Remaking the Industrial Economy," *McKinsey Quarterly,* February 2014. Additional articles on the circular economy may be found at *www.ellenmacarthurfoundation.org*.

Exhibit 9.B

From Moonshot to The Machine: Reducing Carbon Impact through Extended Product Responsibility

In an analysis of its carbon impact, Hewlett Packard (HP) learned that more than three-fifths of the company's greenhouse gas emissions were caused by its product portfolio—that is, by its products in use once they were in the customers' hands. Reducing the climate impacts of its own operations, manufacturing, and transportation could only fix part of the problem, the company reasoned. So, in 2014, HP announced a new goal of reducing the emissions intensity in use of all of its high-volume products, including printers, computers, and mobile devices, by 40 percent overall by 2020, compared with 10 years earlier.

A major part of this effort was the creation of a new generation of energy-efficient servers—the powerful computers that store, share, and route data on behalf of customers in enormous data centers. Astonishingly, humans today produce more data in 12 hours than they did in all of history up to 2003. Handling and storing this volume of data requires more energy than the entire nations of Germany and Japan combined. HP's first answer was the Moonshot, a high-volume server that used up to 90 percent less energy. Hewlett Packard Enterprise (which took over HP's server business after the company split in 2015) followed up in 2017 with another energy-saving innovation: The Machine, a high-efficiency computer capable of using just 1 percent of the energy required per calculation compared with others then available. "We must take swift and bold action to address the root causes of climate change," said the company's CEO, Meg Whitman. "This means disrupting the status quo."

Sources: CDP, *Global Climate Change Report 2015, www.cpd.net*; "HPE Unveils Computer Built for the Era of Big Data," HPE press release, May 16, 2017; and "HP Announces Goal to Reduce Greenhouse Gas Emissions of Product Portfolio," HP press release, September 24, 2014.

and radically cut energy use at its stores and warehouses, improved the fuel efficiency of its delivery fleet, and reduced the number of business flights taken by employees. It also introduced new products, such as the "first ever carbon neutral bra," part of its Autumn Leaves lingerie collection. Marks & Spencer offset the remainder of its carbon emission by investing in carbon reduction projects. (Mark's & Spencer's partnership to promote less polluting cook stoves—mitigating their climate impacts—is described in the discussion case at the end of this chapter.)[42]

Other companies that have achieved—or pledged to achieve—carbon neutrality include Salesforce, Nike, News Corporation, Timberland, and Van City.[43]

Sustainable development will also require **technology cooperation** through long-term partnerships between companies in developed and developing countries to transfer technology, as shown in the following example.

In 2017, Microsoft invested $50 million in a 5-year program called AI for Earth. The goal was the share the company's expertise in artificial intelligence with other businesses, governments, and researchers across the world to address a wide variety of environmental problems. These included pollution modeling, crop yield optimization, and animal migration tracking. Microsoft provided support, for example, to the Jane Goodall Institute for its work in chimpanzee conservation and to the International Centre for Tropical Agriculture in its efforts to predict climate changes

[42] "Marks & Spencer Launches Plan A 2025," press release, June 1, 2017; and Marks & Spencer, *Plan A Report 2017, http://planareport.marksandspencer.com*.

[43] A list of companies that have pledged or achieved carbon neutrality may be found in "Who's Going 'Carbon Neutral,'" at *www.bsr.org*.

that could impact food crops in developing countries. "AI is not a panacea for environmental problems," said Microsoft's chief environmental scientist. "But history will judge the success of the Information Age by our ability to deploy its resulting technology in service of the planet."[44]

The idea of sustainable development is not only widely accepted in the business community; many firms are increasingly viewing it as a core business issue. A 2017 global survey of almost 3,000 business leaders, for example, reported that six in ten were more engaged with sustainability than they had been two years earlier, and the top reason for doing so was "to align sustainability with [their] goals, mission, or values." The following chapter explores in more detail the steps companies are taking to do so.[45]

Codes of Environmental Conduct

Earlier chapters of this text have discussed the emergence of standards and codes of conduct in the areas of ethics and global corporate citizenship. Similarly, several national and international organizations have developed *standards and codes of environmental conduct.* Some are designed to be universally applicable, while others are tailored to specific industries. All, however, share the characteristic that they are private and voluntary: corporations choose to comply with these codes to show customers, investors, regulators, and others that they have met certain environmental standards in their operations.

Some of the leading universal codes and standards include the following:

- The International Chamber of Commerce has developed the *Business Charter for Sustainable Development,* eight guiding principles that identify key elements of environmental leadership and call on companies to recognize sustainable development as among their highest corporate priorities.[46]
- The *CERES Roadmap,* developed by the Coalition for Environmentally Responsible Economies (CERES), contains 20 expectations for corporate sustainability leadership, divided into four areas of activity—governance, stakeholder engagement, disclosure, and performance.[47]
- *ISO 14000* is a series of voluntary standards developed by the ISO, an international group based in Geneva, Switzerland, that permit companies to be certified as meeting global environmental performance standards.[48]
- The *Greenhouse Gas Protocol* is a tool developed by the World Resources Institute and the World Business Council for Sustainable Development to help businesses measure and manage their greenhouse gas emissions.[49]

Codes of environmental conduct have also been developed by and for specific industries.

A prominent example is the Equator Principles, a set of environmental standards for the financial services industry. Their focus is specific to banking: they commit signatories to determine, assess, and manage environmental risk in project financing. In other words, when a bank considers whether to lend money, for example, for the

[44] "The Case for Technology Investments in the Planet," December 19, 2017, *www.nature.com*.

[45] "Sustainability's Deepening Impact," December 2017, *www.mckinsey.com*.

[46] "Inspire and Grow Your Business in the 21st Century: Business Chapter for Sustainable Development, at *https://cdn.iccwbo.org/content/uploads/sites/3/2015/01/ICC-Business-Charter-for-Sustainable-Development.pdf*.

[47] "The CERES Roadmap for Sustainability," *www.ceres.org/roadmap*.

[48] *www.iso.org*.

[49] *www.ghgprotocol.org*.

construction of an oil pipeline, it must examine the environmental impact of the project and whether its sponsors have systems in place to mitigate adverse impacts. If borrowers are unable to comply, the bank will not loan them money. The Equator Principles, launched in 2003 and most recently reviewed in 2013, have spread widely in the financial industry. By 2018, 92 financial institutions around the world had signed on, ranging from huge institutions such as Citigroup to regional banks such as Egypt's Arab African International Bank, China's Industrial Bank Company, and Uruguay's Banco de la Republica Oriental.[50]

Other industry-specific standards include the Forest Stewardship Council Principles in the forest products industry, the Marine Stewardship Council in the fishing industry, and the Leadership in Energy and Environmental Design (LEED) standards in the commercial and residential construction industry.

Protecting the environment and the well-being of future generations is not only a necessity, but also an opportunity for business. Companies operate in a resource-constrained world, where climate change and scarcity of fresh water, arable land, and healthy forests pose pressing challenges. Environmental regulations are getting tougher, consumers want cleaner products, and employees want to work for environmentally responsible companies. Finding ways to reduce or recycle waste saves money. Many executives are championing the idea that corporations have moral obligations to future generations. The most successful global businesses in coming years may be those, like the ones profiled in this chapter, that recognize the imperative for sustainable development as an opportunity both for competitive advantage and ethical action.

Summary

- Business and society operate within a finite natural environment. This reality confers constraints but also provides opportunities.
- Many world leaders have supported the idea of sustainable development, that is, development that meets the needs of the present without hurting the ability of future generations to meet their own needs. Governments, businesses, and civil sector organizations are engaged in a range of innovations in an effort to reach this goal.
- Population growth and rapid economic development in many parts of the world have contributed to these ecological problems. Human society is now using resources and producing waste at a rate well above what the Earth's ecosystem can sustainably support.
- Five environmental issues—climate change, ozone depletion, resource scarcity, declining biodiversity, and threats to the marine ecosystem—are shared by all nations. International treaties, including the Paris Agreement, are addressing some of these issues, although more remains to be done.
- Global businesses have begun to put the principles of sustainable development into action through such innovative actions as life-cycle analysis, extended product responsibility, carbon neutrality, and technology cooperation.
- Nationally and internationally, businesses and nongovernmental organizations have worked together to develop voluntary codes of environmental conduct to promote sustainability.

[50] The website of the Equator Principles is *www.equator-principles.com*.

Key Terms

biodiversity, *201*
carrying capacity, *194*
carbon neutrality, *204*
carbon offsets, *204*
circular economy, *204*
climate change, *196*
commons, *196*
Convention on Climate Change, *198*
ecological footprint, *194*
ecosystem, *190*
extended product responsibility, *204*
global warming, *196*
industrial ecology, *203*
life-cycle analysis, *203*
marine ecosystems, *202*
natural capital, *190*
ozone, *199*
Paris Agreement, *198*
sustainable development, *190*
technology cooperation, *205*

Internet Resources

www.ipcc.ch	Intergovernmental Panel on Climate Change
www.unep.org	United Nations Environmental Program
newsroom.unfccc.int	United Nations Framework Convention on Climate Change
www.wbcsd.org	World Business Council on Sustainable Development
www.iclei.org	Local Governments for Sustainability
www.triplepundit.com	New media company that covers sustainable business practices
www.worldwatch.org	The Worldwatch Institute
www.wri.org	World Resources Institute

Discussion Case: *Clean Cooking*

In a small village in rural Kenya, a woman bent over an open fire pit in the center of her hut cooking the evening meal. That morning, she had spent two hours collecting wood, animal dung, and scrap paper to use as fuel. Now, as she stirred the pot, the cook fire gave off a steady stream of sooty, acrid smoke, which filled the room despite a ventilation hole in the roof. The woman's young son played dangerously close to the open flame, while her daughter, coughing from the smoke, tried to read by the weak light of the fire.

In 2018, a similar scene was repeated in households with around 3 billion people every day across the developing world, with devastating effects on human health, the environment, and economic development.

Indoor air pollution from open cookstoves is a killer. The World Health Organization has estimated that soot, particles, and smoke from cooking is one of the worst risk factors for health in developing countries, causing 4.3 million premature deaths a year, mostly from lung and heart disease. Open cookstoves also lead to disfiguring burns, asthma, eye damage, and pregnancy complications. The effects are greatest on women and young children, who spend the most time near the hearth.

Women and girls also suffer from head and back injuries, animal attacks, and sexual violence while searching for and carrying heavy loads of fuel, often far from home. Time spent collecting fuel is time not spent attending school, working at a paid job, or running a small business.

Primitive cooking methods also harm the environment. Cutting trees to produce wood or charcoal leads to deforestation, loss of biodiversity, and watershed degradation. Moreover, the combustion of biomass in cooking produces more than a quarter of the world's black carbon, or soot. Scientists now believe that soot is second only to carbon dioxide in its overall contribution to global warming. Policymakers have been intrigued by the fact that while carbon dioxide stays in the atmosphere for decades, black carbon washes out within days or weeks. Reducing soot in the atmosphere would thus have a much more immediate effect on global warming than cutting carbon emissions.

In 2010, the United Nations Foundation, in collaboration with several governments (including the United States), launched the Global Alliance for Clean Cookstoves, with the ambitious goal of "100 by 20"—that 100 million households worldwide adopt clean and efficient cookstoves and fuels by 2020. The alliance recognized that reaching this goal would require more than money; it would require technical innovation in fuels and stove design, new mechanisms of financing, and on-the-ground campaigns to engage users from a wide range of cultures and cooking traditions. It would also require the support of businesses—large and small.

Many companies saw an opportunity in the Global Alliance for Clean Cookstoves. CEMEX, a global building products company based in Mexico, developed and contributed $2 million worth of clean-burning concrete cookstoves. Marks & Spencer, the British retailer, joined the Alliance and committed to helping employees of its suppliers of products such as coffee and textiles to cook more efficiently; and it had already partnered with UNICEF (the United Nations Children's Fund) to install 40,000 clean cookstoves in Bangladesh. Dow Corning, a Midland, Michigan–based maker of silicon-based materials, donated both money and expertise in manufacturing and material science to the Alliance.

At the same time, motivated by greater attention to the issue, social entrepreneurs across the globe began generating innovative ideas about how to design, manufacture, and finance more efficient and cleaner cookstoves—potentially a "win–win" for the environment and human health and well-being.

For example, in the west African country of Ghana, Suraj Wahab founded a small business, Toyola Energy Ltd., to produce a cookstove he invented called the *gyapa* ("good fire"). His company constructed the stove from locally sourced materials—scrap metal from construction sites and fired clay liners. Because it was designed to burn charcoal, a fuel used by 30 percent of Ghanaian households, twice as efficiently as in an open fire, each stove over the course of its life would prevent the release of global-warming emissions equivalent to the amount generated by a Honda Civic driven for one year.

Wahab had difficulty obtaining needed capital until he partnered with E+Co, a clean energy nonprofit that invested $270,000. E+Co helped Toyola calculate the carbon offset value of its cookstoves, which was then monetized and sold to the investment banking firm Goldman Sachs. Within a short period, Toyola employed 150 people and had sold more than 150,000 cookstoves to eager Ghanaians, who welcomed the cost savings and health benefits they provided. More than a quarter of the company's revenue came from the sale of carbon offsets, helping keep the price to consumers as low as $7.

Similar stories of creative partnerships were occurring around the globe.

The nonprofit Trees, Water, & People, based in Fort Collins, Colorado, teamed with local partners to build and distribute 75,000 cookstoves in Guatemala, El Salvador, Honduras, and Nicaragua. Their stove was an insulated combustion chamber topped by a removable steel griddle adapted to cooking tortillas and a chimney pipe to vent smoke through a roof hole, reducing indoor air pollution by more than 80 percent. Other organizations, such

as Solar Cookers International, experimented with ways to harness the power of the sun—a completely renewable, clean, and free source of energy—to boil water and cook food.

By 2017, 80 million cookstoves had been distributed, and the Alliance was closing in on its ambitious goal. "As we build a cookstoves market to the scale necessary to combat and defeat this silent killer," said its executive director, "the strong support and unique expertise of our partners and champions will be invaluable."

Sources: Global Alliance for Clean Cookstoves, *2017 Progress Report: Driving Demand, Delivering Impact,* at *www.cleancookstoves.org*; "Putting Clean Cooking on the Front Burner," December 21, 2017, *www.worldbank.org*; World Health Organization, "Household Air Pollution and Health," February 2016, *www.who.it*; "How Marks & Spencer is Cooking Its Way to a Cleaner Future," March 30, 2015, *www.greenbiz.com*; "Forest Saving Stoves Program," *www.treeswaterpeople.org*; "Case Study: Toyola Energy Limited, Ghana," *www.cleancookstoves.org*; and "Clean Cookstoves: Dow Corning's Path to Public-Private Partnership," *http://dowcorningcitizenservicecorps.wordpress.com*, February 28, 2012; and personal correspondence with staff of Trees, Water, & People.

Discussion Questions

1. In what ways would the widespread adoption of clean cookstoves address the global environmental issues discussed in this chapter?
2. In what ways would the widespread adoption of clean cookstoves address the issues of economic development and poverty discussed in this chapter?
3. Which sectors (e.g., government, business, civil society) would need to be involved in a successful campaign to promote clean cookstoves in the developing world, and what would be the contributions of each?
4. What would be the benefit to multinational corporations, such as CEMEX, Marks and Spencer, and Dow Corning, of participating in this effort? What distinctive contributions can social entrepreneurs make to promoting clean cookstoves?

CHAPTER TEN

Managing for Sustainability

Growing public concern about sustainability has prompted political, corporate, and civil society leaders to become increasingly responsive to environmental issues. In the United States and other nations, government policymakers have moved toward greater reliance on economic incentives, rather than command and control regulations, to achieve environmental goals. At the same time, many businesses have become increasingly proactive and have pioneered new approaches to effective sustainability management, sometimes in partnership with advocacy organizations. These actions have often given firms a competitive advantage by cutting costs, gaining public support, and spurring innovation.

This Chapter Focuses on These Key Learning Objectives:

LO 10-1 Knowing the main features of environmental laws in the United States and other nations.

LO 10-2 Understanding the advantages and disadvantages of different regulatory approaches.

LO 10-3 Assessing the costs and benefits of environmental regulation.

LO 10-4 Defining an ecologically sustainable organization and the stages through which firms progress as they become more sustainable.

LO 10-5 Understanding how businesses can best manage for sustainability.

LO 10-6 Analyzing how effective sustainability management makes firms more competitive and improves their financial performance.

Levi Strauss & Company was widely recognized as a sustainability leader in the apparel industry. The maker of the iconic Levi's jeans had worked with cotton farmers to reduce their use of water and pesticides, integrated recycled plastic from soda bottles into their fabric, and worked with the World Bank to provide low-cost loans to suppliers that met sustainability goals. The company encouraged its customers to wash their jeans less often and to keep them longer and provided grants to early career designers to help them adopt eco-friendly practices. The company aimed for a day when all Levi's apparel would be recycled in a closed loop, worn for many years and then returned to be made into new garments. "What would happen if we could change culture in such a way that consumers imagined the end of life of the product they bought?" asked the company's head of global product innovation.[1]

Even as the Trump administration in 2017 announced its intention to pull the United States out of the international climate change agreement negotiated in Paris, several Canadian provinces and U.S. states were joining forces in their efforts to reduce carbon emissions. The Western Climate Initiative (WCI) was a nonprofit corporation that managed a common cap-and-trade market for Quebec, Ontario, British Columbia, and California. These subnational governments had established limits on greenhouse gas emissions and set up a system that allowed companies that had cut their emissions to sell permits to others that had exceeded their quota. This provided these companies with a financial incentive to reduce pollution below their quota. "Having a larger number of emitters, power plants, factories, [and] fuel increases the diversity of opportunities to reduce emissions at a lower cost than [a single province or state] would be able to do on [its] own," explained a former WCI board member.[2]

The Environmental Defense Fund (EDF), a leading environmental advocacy organization, has formed partnerships with several companies, including McDonald's, DuPont, Starbucks, and FedEx, to improve environmental performance and gather information. In its most recent effort, EDF partnered with Google Earth Outreach to find, measure, and map natural gas leaks in selected cities across the United States. Specially equipped Street View cars, which Google uses to photograph streetscapes for its map application, gathered data on even small gas leaks. Escaping gas—mostly from aging pipes—was a problem because it cost customers money, heightened the risks of explosion, and worsened climate change. This information enabled utilities, such as PSE&G of New Jersey and New York, to prioritize the replacement of leaking gas mains, focusing on the worst offenders. The partnership later expanded its scope to create detailed maps of health-damaging pollutants such as nitrous oxides and particulates. "Seeing pollution mapped this way makes us better advocates for cleaner air and smart development choices," said a representative of EDF.[3]

In the early years of the 21st century, many businesses, governments, and environmental advocacy organizations became increasingly concerned that old strategies for promoting environmental protection were failing and new approaches were necessary. Government policymakers moved toward greater reliance on economic incentives to

[1] "Levi's Is Radically Redefining Sustainability," *Fast Company,* February 9, 2017. The company's sustainability initiatives are described at *www.levistrauss.com/sustainability. www.levistrauss.com/unzipped-blog.*

[2] "Will Other States Join California's International Climate Pact?" *The Atlantic,* August 10, 2017. The website of the Western Climate Initiative is at *www.wci-inc.org.*

[3] "Methane to Its Madness," *Fast Company,* October 27, 2017. "Google Uses Street View Cars to Collect Pollution Data," June 5, 2017, at *www.money.cnn.com,* and "Mapping Pollution with Mobile Sensors." Google's efforts are described at *www.google.com/earth.* The methane maps are available at *http://edf.org/methanemaps.* More information about EDF's corporate partnerships is available at *www.edf.org/approach/partnerships/corporate.*

achieve environmental goals. Environmentalists engaged in greater dialogue and cooperation with industry leaders. Many businesses pioneered new approaches to sustainability, such as developing products with fewer adverse environmental impacts.

The challenge facing government, industry, and environmental advocates alike, as they tried out new approaches and improved on old ones, was how to promote ecologically sound business practices in an increasingly integrated world economy.

Role of Government

In many nations, government is actively involved in regulating business activities to protect the environment. Business firms have few incentives to minimize pollution if their competitors do not. A single firm acting on its own to reduce discharges into a river, for example, would incur extra costs. If its competitors did not do the same, the firm might not be able to compete effectively and could go out of business. Government, by setting a common standard for all firms, can take the cost of pollution control out of competition. It can also provide economic incentives to encourage businesses, communities, and regions to reduce pollution, and offer legal and administrative systems for resolving disputes. Government cannot accomplish environmental goals by itself; its role, rather, is to make a critical contribution to a collective effort, together with business and civil society, to move toward sustainability.

In the United States, government has been involved in environmental regulation since the late 19th century, when the first federal laws were passed protecting navigable waterways. The government's role began to increase dramatically, however, in 1970, when Congress passed the National Environmental Policy Act (NEPA). The **Environmental Protection Agency (EPA)**, the nation's main environmental regulatory agency, was created shortly afterwards. Figure 10.1 summarizes the major federal environmental laws enacted by the U.S. Congress since then. It is organized into four categories: air; water; solid and hazardous waste; and cross-media (referring to the regulation of forms of pollution that have multiple impacts on air, water, and land). Various regional, state, and local agencies also have jurisdiction over some environmental issues in their respective areas, as one of the opening examples shows.

Major Areas of Environmental Regulation

In the United States, the federal government regulates in three major areas of environmental protection: air pollution, water pollution, and solid and hazardous waste (land pollution). This section will review the major environmental issues and the U.S. laws pertaining to each, with comparative references to similar initiatives in other nations and examples of how businesses have responded.

Air Pollution

Air pollution occurs when more pollutants are emitted into the atmosphere than can be safely absorbed and diluted by natural processes. Some pollution occurs naturally, such as smoke and ash from volcanoes and forest fires. But most air pollution today results from human activity, especially industrial processes and motor vehicle emissions. Air pollution degrades buildings, reduces crop yields, mars the beauty of natural landscapes, and harms people's health. The American Lung Association (ALA) estimated in 2017 that 125 million Americans, nearly four in ten people, were breathing unsafe air for at least part of each year. Fully 70 percent of the cancer risk from air pollution is due to diesel exhaust from trucks, farm and construction equipment, marine vessels, and electric generators. People

FIGURE 10.1
Leading U.S. Environmental Protection Laws

AIR

- CLEAN AIR ACT (1970) Established national air quality standards and timetables.
- CLEAN AIR ACT AMENDMENTS (1977) Revised air standards.
- CLEAN AIR ACT AMENDMENTS (1990) Required cuts in urban smog, acid rain, and greenhouse gas emissions; promoted alternative fuels.

WATER

- WATER POLLUTION CONTROL ACT (1972) Established national goals and timetables for clean waterways.
- SAFE DRINKING WATER ACT (1974 and 1996) Authorized national standards for drinking water.
- CLEAN WATER ACT AMENDMENTS (1987) Authorized funds for sewage treatment plants and waterways cleanup.

SOLID AND HAZARDOUS WASTE

- HAZARDOUS MATERIALS TRANSPORT ACT (1974) Regulated shipment of hazardous materials.
- RESOURCE CONSERVATION AND RECOVERY ACT (1976) Regulated hazardous materials from production to disposal.
- TOXIC SUBSTANCES CONTROL ACT (1976) Established national policy to regulate, restrict, and, if necessary, ban toxic chemicals.
- COMPREHENSIVE ENVIRONMENTAL RESPONSE COMPENSATION AND LIABILITY ACT (SUPERFUND) (1980) Established Superfund and procedures to clean up hazardous waste sites.
- SUPERFUND AMENDMENTS AND REAUTHORIZATION ACT (SARA) (1986) Established toxics release inventory.

CROSS-MEDIA POLLUTION

- PESTICIDE CONTROL ACT (1972) Required registration of and restrictions on pesticide use.
- POLLUTION PREVENTION ACT (1990) Provided guidelines, training, and incentives to prevent or reduce pollution at the source.
- OIL POLLUTION ACT (1990) Strengthened EPA's ability to prevent and respond to catastrophic oil spills.
- CHEMICAL SAFETY INFORMATION, SITE SECURITY, AND FUELS REGULATORY RELIEF ACT (1999) Set standards for the storage of flammable chemicals and fuels.

living near busy highways and workers in occupations that use diesel equipment are particularly at risk.[4]

One approach to reducing diesel pollution is a service called IdleAir, operated by Convoy Solutions of Knoxville, Tennessee. IdleAir provides an alternative for long-haul truck drivers who idle their engines at truck stops in order to provide power to the cab during rest breaks. An inexpensive window-mounted adapter allows drivers to hook up to a service module, so they can continue to enjoy heating, cooling, cable TV, and Internet access with their engines off. The solution is less expensive

[4] American Lung Association, "State of the Air: 2017," *www.lung.org;* and "Health Effects of Diesel Exhaust," *http://oehha.ca.gov.*

for truckers because it uses one-tenth the energy of idling, and reduces pollution by completely eliminating diesel emissions during rest breaks.[5]

The major law governing air pollution is the Clean Air Act, passed in 1970 and amended in 1990. The 1990 amendments toughened standards in several areas, including stricter restrictions on emissions of acid rain–causing chemicals.

The EPA has identified six criteria pollutants, relatively common harmful substances that serve as indicators of overall levels of air pollution. These are lead, carbon monoxide, particulate matter, sulfur dioxide, nitrogen dioxide, and ozone. (Ozone at ground level is a particularly unhealthy component of smog.) In addition, the agency also has identified a list of toxic air pollutants that are considered hazardous even in relatively small concentrations. These include asbestos, benzene (found in gasoline), dioxin, perchloroethylene (used in some dry-cleaning processes), methylene chloride (used in some paint strippers), and radioactive materials. Emissions of toxic pollutants are strictly controlled. In 2014, the Supreme Court ruled that the EPA could regulate emissions of carbon dioxide (one of the main contributors to climate change) at facilities it already regulated for other pollutants.[6]

In 2017, Volkswagen, the German carmaker, pleaded guilty to charges of violating the Clean Air Act and agreed to pay $4.3 billion in fines. The company had programmed its diesel cars to switch on emissions controls when the vehicle was undergoing smog testing and then switch them off when the vehicle was on the road, to boost performance and gas mileage. The result was that the cars emitted up to 40 times the allowed levels of nitrogen oxides, a toxic mixture including nitrogen dioxide, which causes health problems and contributes to smog.[7] (This situation is further discussed in the discussion case at the end of Chapter 14.)

A special problem of air pollution is **acid rain.** Acid rain is formed when emissions of sulfur dioxide and nitrogen oxides, by-products of the burning of fossil fuels by utilities, manufacturers, and motor vehicles, combine with natural water vapor in the air and fall to earth as rain or snow that is more acidic than normal. Acid rain can damage the ecosystems of lakes and rivers, reduce crop yields, and degrade forests. Structures, such as buildings and monuments, are also harmed. Within North America, acid rain is most prevalent in New England and eastern Canada, regions that are downwind of coal-burning utilities in the Midwestern states.[8]

Water Pollution

Water pollution, like air pollution, occurs when more wastes are dumped into waterways, lakes, or oceans than can be naturally diluted and carried away. Water can be polluted by organic wastes (untreated sewage or manure), by chemicals from industrial processes, and by the disposal of nonbiodegradable products (which do not naturally decay). Heavy metals and toxic chemicals, including some used as pesticides and herbicides, can be particularly persistent. Like poor air, poor water quality can harm ecosystems, decrease crop yields, threaten human health, and degrade the quality of life. Failure to comply with clean water laws can be very expensive for business, as the following example shows.

In 2010, a wellhead blowout at a deepwater drilling platform operated on behalf of BP (formerly British Petroleum) in the Gulf of Mexico caused the largest marine

[5] The company's website is *www.idleair.com*.

[6] PBS Newshour, "Supreme Court Limits EPS's Authority to Regulate Carbon Dioxide Emissions," June 23, 2014, *www.pbs.org/newshour*.

[7] "Volkswagen Set to Plead Guilty and to Pay U.S. $4.3 Billion in Deal," *The New York Times,* January 10, 2017.

[8] More information about acid rain may be found at *www.epa.gov/acidrain*.

oil discharge in U.S. history. For three months, as crews struggled to cap the well, more than three 3 million barrels of oil gushed into the waters of the Gulf of Mexico, causing extensive damage to marine life and devastating the coastal economies of adjacent states. Subsequent government investigations found that BP's relentless cost cutting and inadequate safety systems had contributed to the disaster. In 2015, BP agreed to pay more than $20 billion to settle claims by federal, state, and local governments arising from the spill, the largest environmental settlement in U.S. history. BP estimated that the *total* cost of the spill—including the actual cleanup, payments to individuals and shareholders, criminal fines, and other costs not included in the settlement—would be more than $66 billion.

The impacts of the BP disaster on business, society, and the environment are profiled in a case at the end of this book.

In the United States, regulations address both the pollution of rivers, lakes, and other surface bodies of water and the quality of the drinking water. The main U.S. law governing water pollution is the Water Pollution Control Act, also known as the Clean Water Act. This law aims to restore or maintain the integrity of all surface water in the United States. It requires permits for most *point* sources of pollution, such as industrial emissions, and mandates that local and state governments develop plans for *nonpoint* sources, such as agricultural runoff or urban storm water. The Pesticide Control Act specifically restricts the use of dangerous pesticides, which can pollute groundwater. The quality of drinking water is regulated by another law, the Safe Drinking Water Act of 1974, amended in 1996. This law sets minimum standards for various contaminants in both public water systems and aquifers that supply drinking water wells.

The impacts of hydraulic fracturing, a method for extracting natural gas from underground shale formations, on the quality of drinking water—and how these impacts should be regulated—is explored in the discussion case at the end of this chapter.

Solid and Hazardous Waste

The third major focus of environmental regulation is the contamination of land by both solid and hazardous waste. The United States produces an astonishing amount of solid waste, adding up to more than four pounds per person per day. Of this, 47 percent is recycled, composted, or incinerated, and the rest ends up in municipal landfills.[9] Many businesses and communities have tried to reduce the solid waste stream by establishing recycling programs.

Sweden is one of the world's leaders in reducing solid waste. Astonishingly, less than 1 percent of the country's household waste ends up in landfills. Swedes sort their trash, separating paper, plastics, metal, glass, food waste, light bulbs, and batteries. All residential areas have convenient recycling stations, and special trucks pick up electronics and other hazardous waste. About half of these materials are recycled and reused in some way, and the other half are burned to generate energy. Sweden's waste incineration plants have become so efficient that the country routinely imports waste from its neighbors. Swedish companies have joined the effort, too; the retailer H&M, for example, accepts used clothing from customers in exchange for coupons. "Zero waste, that's our slogan," said the CEO of the Swedish Waste Management and Recycling Association.[10]

[9] Environmental Protection Agency, "Advancing Sustainable Materials Management: 2014 Fact Sheet," *www.epa.gov*.

[10] "The Swedish Recycling Revolution," March 29, 2017, *https://sweden.se/nature/the-swedish-recycling-revolution/*.

The safe disposal of hazardous waste is a special concern. Several U.S. laws address the problem of land contamination by hazardous waste. The Resource Conservation and Recovery Act of 1976 (amended in 1984) regulates hazardous materials from "cradle to grave." The Toxic Substances Control Act (TSCA) of 1976 (amended in 2016) requires the EPA to inventory the thousands of chemicals in commercial use, identify which are most dangerous, and, if necessary, ban them or restrict their use.

In 2014, an aging and rusty storage tank holding toxic chemicals used to wash coal leaked, spilling 7,500 gallons into the nearby Elk River near Charleston, West Virginia. Three hundred thousand people who relied on the river for their water supply were told not to drink or bathe with it for several weeks afterwards. (The owner of the tank, Freedom Industries, shortly afterwards declared bankruptcy and shut down.) This frightening incident led Congress to strengthen the almost 40-year-old TSCA, and several states, including West Virginia, passed new laws requiring the inspection of chemical storage tanks.[11]

As this example illustrates, states can pass regulations that are stricter than federal rules. (They can also regulate industries that do not engage in interstate commerce.)

Some studies have suggested that hazardous waste sites are most often located near economically disadvantaged African American, Hispanic, and Native American communities. Since 1994, the EPA has investigated whether state permits for hazardous waste sites violate civil rights laws and has blocked permits that appear to discriminate against minorities. The effort to prevent inequitable exposure to risk, such as from hazardous waste, is sometimes referred to as the movement for **environmental justice**.[12] For example, Native American tribes in Utah, Nevada, and New Mexico have organized to block the construction of nuclear waste disposal facilities on their land, saying the facilities would threaten their health, culture, and economic viability.[13]

The major U.S. law governing the cleanup of existing hazardous waste sites is the Comprehensive Environmental Response, Compensation, and Liability Act, or **CERCLA**, popularly known as **Superfund**, passed in 1980. This law established a fund, supported primarily by a tax on petroleum and chemical companies that were presumed to have created a disproportionate share of toxic wastes. The EPA was charged with establishing a National Priority List of the most dangerous toxic sites; around 1,700 sites were eventually designated as Superfund sites. Where the original polluters could be identified, they would be required to pay for the cleanup; where they could not be identified or had gone out of business, the federal government would pay. One of the largest hazardous waste sites on the Superfund list was an almost 200-mile long stretch of the Hudson River, which GE factories had contaminated with cancer-causing chemicals called PCBs. In 2018, GE said it had completed its cleanup of the site, at a total cost of around $2 billion, but was still awaiting final EPA approval.

The Houston metropolitan area has one of the largest concentrations of Superfund sites in the nation. When Hurricane Harvey devastated the city in 2017, many of these sites flooded, and some were damaged. At the San Jacinto River Waste Pits, for example, toxic waste from a long-since closed paper mill was released when

[11] "Obama Set to Sign Bipartisan Update of 1976 Toxic Substance Law," *The New York Times,* June 22, 2016; and "A Year after West Virginia Chemical Spill, Some Signs of Safer Water," *National Geographic,* January 10, 2015.

[12] Robert D. Bullard, "Environmental Justice in the 21st Century," Environmental Justice Resource Center, available at *www.ejrc.cau.edu/ejinthe21century.htm;* and Christopher H. Foreman, Jr., *The Promise and Perils of Environmental Justice* (Washington, DC: Brookings Institution, 2000).

[13] Nuclear Information and Resource Service, "Environmental Racism, Tribal Sovereignty, and Nuclear Waste," at *www.nirs.org.*

Exhibit 10.A

Rule-Making to Weaken Environmental Protections

During the year and a half of the Trump administration, regulators overturned or announced their intention to overturn more than 70 environmental rules. (Some rules were reversed, but then put back in effect after legal challenges.) Among other actions, regulators

- Proposed to open more than 90 percent of offshore areas to oil and gas drilling, giving energy companies access to lease areas off the coasts of California, the Arctic, and the Eastern Seaboard.
- Suspended clean water rules that required farmers, ranchers, and developers to limit pollution in streams running across land they owned that fed larger bodies of water. These bodies of water, such as the Chesapeake Bay and Puget Sound, provided drinking water for one in three Americans.
- Revoked a rule that prevented coal companies from dumping mining waste into local streams. This rule had made a big impact in Central Appalachia, where debris from mountaintop surface mining often ended up in valleys, where it polluted running water.
- Reversed a ban on the use of lead ammunition and fishing tackle on public lands (lead is toxic to wildlife and humans).
- Proposed changes that would weaken fuel-efficiency standards for cars and trucks made between 2021 and 2025.
- Ended a requirement that oil and gas companies report their emissions of methane (a potent greenhouse gas).

Some welcomed these rollbacks as releasing businesses and individuals from burdensome regulations, but others thought they represented dangerous attacks on protections of the nation's air, water, and land.

Sources: "Environmental Rules on the Way Out Under Trump," *The New York Times,* July 6, 2018; "Trump Moves to Open Nearly All Offshore Waters to Drilling," *The New York Times,* January 4, 2018; and "EPA Blocks Obama-Era Clean Water Rule," *The New York Times,* January 31, 2018.

floodwaters damaged a concrete cap that had covered the pits. An EPA dive team that visited the site soon afterwards found dioxin, a dangerous carcinogen, in high concentrations, and the agency fast-tracked a $115 million cleanup. But some criticized the agency for its past inaction. "Superfund sites are known to be the most dangerous places in the country," and they should have been protected against flooding," said one environmental activist.[14]

Remarkably, nearly one in six U.S. residents now lives within three miles of a Superfund site. As of 2016, cleanup had been completed at around 380 of them.[15]

Since 2000, most changes in federal regulatory oversight have come through agency rulemaking and executive action rather than legislation. In the first year of the Trump administration, the EPA changed or proposed changes to dozens of rules, with the cumulative effect of weakening environmental regulations. Some of these changes are described in Exhibit 10.A.

Alternative Policy Approaches

Governments can use a variety of policy approaches to control air, water, and land pollution. The most widely used method of regulation historically has been to impose environmental standards. Increasingly, however, government policymakers have relied more on market-based and voluntary approaches, rather than command and control regulations, to achieve environmental goals. These different approaches are discussed next.

[14] "Toxic Waste Sites Flooded in Houston Area," September 3, 2017, at *https://apnews.com;* and "EPA Oks Plan to Rid Toxics from Waste Pits," *Houston Chronicle,* October 11, 2017.

[15] "Polluted Sites Linger Under U.S. Cleanup Program," *Chemical and Engineering News,* April 3, 2017.

Command and Control Regulation

The traditional method of pollution control is through environmental standards. Standard allowable levels of various pollutants are established by legislation or regulatory action and applied by administrative agencies and courts. This approach is called **command and control regulation**, because the government commands business firms to comply with certain standards and often directly controls their choice of technology.

One type of command-and-control regulation is an *environmental-quality standard.* In this approach a given geographical area is allowed to have no more than a certain amount or proportion of a pollutant in the air. Polluters, such as utilities and factories, are required to control their emissions to maintain the area's standard of air quality. For example, in 2014, the EPA issued new, more stringent standards for air concentrations of ground-level ozone, which the agency called the "most pervasive and widespread pollutant in the country."[16] A second type is an *emission standard.* For example, the law might specify that manufacturers could release into the air no more than 1 percent of the ash (a pollutant) they generated. Sometimes, the EPA mandates that companies use the *best available technology,* meaning a specific process that the agency determines is the best economically achievable way to reduce negative impacts on the environment.

Market-Based Mechanisms

In recent years, regulators have begun to move away from command and control regulation, favoring increased use of **market-based mechanisms**. This approach is based on the idea that the market is a better control than extensive standards that specify precisely what companies must do.

One approach that has become more widely used is to allow businesses to buy and sell the right to pollute, in a process known as **cap-and-trade**. California's *tradable permit* program for carbon emissions, described in one of the opening examples of this chapter, illustrates this approach. The U.S. Clean Air Act of 1990 also incorporated the concept of tradable permits. The law established emission levels (called "caps") and permitted companies with emissions *below* the cap to sell ("trade") their rights to the remaining permissible amount to firms that faced penalties because their emissions were above the cap. Over time, the government would reduce the cap, thus gradually reducing overall emissions, even though individual companies might continue to pollute above the cap. Companies could choose whether to reduce their emissions—for example, by installing pollution abatement equipment—or to buy allowances from others. One study showed that the tradable permit program for acid rain may have saved companies as much as $3 billion per year, by allowing them the flexibility to choose the most cost-effective methods of complying with the law.[17]

Another market-based type of pollution control is establishment of *emissions charges* or *fees.* Each business is charged for the undesirable waste that it emits, with the fee varying according to the amount of waste released. The result is, "The more you pollute, the more you pay." In this approach, polluting is not illegal, but it is expensive, creating an incentive for companies to clean up. In recent years, governments have experimented with a variety of so-called *green taxes* or *eco-taxes* that levy a fee on various kinds of environmentally destructive behavior. In addition to taxing bad behavior, governments may also offer various types of positive incentives to firms that improve their environmental performance. For example, it may decide to purchase only from those firms that meet a certain pollution

[16] "E.P.A. Ozone Rules Divide Industry and Government," *The New York Times,* November 26, 2014.

[17] For more on the tradable permit system for acid rain, see *www.epa.gov/acidrain.*

standard or offer aid to those that install pollution control equipment. Tax incentives, such as faster depreciation for pollution control equipment, also may be used. Governments may also levy eco-taxes on individuals.

> Norway has declared that to meet its obligations under the 2015 Paris climate accord, it will reduce its carbon emissions by 40 percent. One way it has done so is by offering both positive and negative incentives. The government imposes high taxes on new car purchases, except for nonpolluting electric cars. Operators in Norway's North Sea oil fields are required to capture carbon dioxide discharged during drilling and pump it back underground or pay a stiff fee per ton. Companies have responded by developing technology to do so.[18]

In short, the trend has been for governments to use more flexible, market-oriented approaches—tradable allowances, pollution fees and taxes, and incentives—to achieve environmental objectives where possible.

Information Disclosure

Another approach to reducing pollution is popularly known as *regulation by publicity,* or *regulation by embarrassment.* The government encourages companies to pollute less by publishing information about the amount of pollutants individual companies emit each year. In many cases, companies voluntarily reduce their emissions to avoid public embarrassment.

The major experiment in regulation by publicity has occurred in the area of toxic emissions to the air and water. The 1986 amendments to the Superfund law, called SARA, included a provision called the Community Right-to-Know Law, which required manufacturing firms to report, for a list of specified toxic chemicals, the amount on site, the number of pounds released, and how (if at all) these chemicals were treated or disposed of. The EPA makes this information available to the public in the *Toxics Release Inventory,* or *TRI,* published annually. Evidence shows that at least initially, reporting manufacturers in the United States cut their releases and disposal of these chemicals to the air, water, and land, apparently fearing negative publicity. Recently, however, the TRI numbers have been quite stable.[19]

The advantages and disadvantages of alternative policy approaches to reducing pollution are summarized in Figure 10.2.

Civil and Criminal Enforcement

Companies that violate environmental laws are subject to stiff civil penalties and fines, and their managers can face prison if they knowingly or negligently endanger people or the environment. Proponents of this approach argue that the threat of fines and even imprisonment can be an effective deterrent to corporate outlaws who would otherwise degrade the air, water, or land. In 2017, the EPA brought criminal charges against 137 defendants. Companies can also be charged, as the following example shows.

> Anadarko Petroleum, an oil and gas exploration company, paid more than $5 billion to settle charges of widespread environmental contamination and to pay for cleanup. Anadarko had purchased Kerr-McGee, a company responsible for dumping radioactive uranium, rocket fuel, wood creosote, and other contaminants at 2,000 sites in

[18] "Sucking Up Carbon, Combatting Climate Change," *The Economist,* November 18, 2017; and "Both Climate Leader and Oil Giant? A Norwegian Paradox," *The New York Times,* June 17, 2017.

[19] TRI data are available at *www2.epa.gov/toxics-release-inventory-tri-program.* Maps showing the geographical distribution of chemical releases reported under TRI are available at *http://toxmap.nlm.nih.gov.*

FIGURE 10.2
Advantages and Disadvantages of Alternative Policy Approaches to Reducing Pollution

Policy Approach	Advantages	Disadvantages
Command-and-control regulation	• Enforceable in the courts • Compliance mandatory	• Across-the-board standards not equally relevant to all businesses • Requires large regulatory apparatus • Older, less-efficient plants may be forced to close • Can retard innovation • Fines may be cheaper than compliance • Does not improve compliance once compliance is achieved
Market-based mechanisms		
Cap-and-trade systems	• Gives businesses more flexibility • Achieves goals at lower overall cost • Saves jobs by allowing some less-efficient plants to stay open • Permits the government and private organizations to buy allowances to take them off the market • Encourages continued improvement	• Gives business a license to pollute • Permit levels are hard to set • May cause regional imbalances in pollution levels • Enforcement is difficult.
Emissions fees and taxes	• Taxes bad behavior (pollution) rather than good behavior (profits)	• Fees are hard to set • Taxes may be too low to curb pollution
Government incentives	• Rewards environmentally responsible behavior • Encourages companies to exceed minimum standards	• Incentives may not be strong enough to curb pollution
Information disclosure	• Government spends little on enforcement • Companies able to reduce pollution in the most cost-effective way	• Does not motivate all companies
Civil and criminal enforcement	• May deter wrongdoing by firms and individuals	• May not deter wrongdoing if penalties and enforcement efforts are perceived as weak

11 states over an 85-year period. Kerr-McGee had tried to spin off its environmental liabilities before selling its remaining assets to Anadarko, but the court had rejected that argument. "Today's settlement is a just resolution of an historic injustice to the American people and our environment," said one of the prosecutors.[20]

European regulators and prosecutors have also actively pursued corporate environmental lawbreakers. For example, the EU standardized its laws against marine pollution and

[20] "United States Announces $5.15 Billion Settlement of Litigation Against Subsidiaries of Anadarko Petroleum Corp.," press release, U.S. Department of Justice, April 3, 2014.

raised maximum penalties after a series of oil tanker wrecks fouled the coasts of France, Spain, and Portugal. Europe is the world's largest importer of oil, and 90 percent is transported to the continent by seagoing ships.[21]

The U.S. Sentencing Commission, a government agency responsible for setting uniform penalties for violations of federal law, has established guidelines for sentencing environmental wrongdoers. (These guidelines are also discussed in Chapter 5.) Under these rules, penalties would reflect not only the severity of the offense but also a company's demonstrated environmental commitment. Businesses that have an active compliance program, cooperate with government investigators, and promptly assist any victims would receive lighter sentences than others with no environmental programs or that knowingly violate the law. These guidelines provide an incentive for businesses to develop active compliance programs to protect themselves and their officers from high fines or even prison if a violation should occur.

Costs and Benefits of Environmental Regulation

One central issue of environmental protection is how costs are balanced by benefits. In the four decades or so since the modern environmental era began, the nation has spent a great deal to clean up the environment and keep it clean. Some have questioned the value choices underlying these expenditures, suggesting that the costs—lost jobs, reduced capital investment, and lowered productivity—exceeded the benefits. Others, in contrast, point to significant gains in the quality of life and to the economic payoff of a cleaner environment.

Businesses in the United States have invested heavily in environmental protection. Manufacturers have spent billions of dollars on both capital expenditures (e.g., installing pollution controls) and operating costs (e.g., paying for wages and supplies) to comply with environmental regulations. Business spending to comply with environmental regulation has diverted funds that might otherwise have been invested in new plants and equipment or in research and development, and strict rules have sometimes led to plant shutdowns and loss of jobs. Some regions and industries have especially been hard hit by environmental regulation, especially those with high abatement costs, such as paper and wood products, chemicals, petroleum and coal, and primary metals. Inevitably, many of these costs are passed on to customers. On the other hand, emissions of nearly all pollutants have dropped significantly since the beginning of the modern environmental era. These improvements have benefited human health and the environment.

For any specific regulation, weighing the costs and benefits—called a *regulatory impact analysis*—is mandated by law. For example, the EPA estimated that its recent regulations on ozone, mentioned earlier in this chapter, would cost businesses $15 billion in 2025, when the rule would be fully implemented (based on the middle of three possible scenarios). However, the estimated benefits were even bigger: $19 to $38 billion, the valuation the EPA calculated for fewer premature deaths, heart attacks, asthma attacks, and other adverse impacts on human health. Not surprisingly, reactions differed among stakeholders. "We're facing a series of regulations, and the cumulative cost of compliance . . . is significant," said the president of the American Chemistry Council, which had vigorously opposed the new rules. But the American Lung Association praised them, saying, "The science is

[21] "The Community Framework for Cooperation in the Field of Accidental or Deliberate Marine Pollution," at *http://ec.europa.eu/echo/civil_protection/civil/marin/mp01_en_introduction.htm.*

clear. A more protective standard is needed to protect the health of millions of Americans breathing polluted air every day."[22]

As this example illustrates, whether a specific regulation is worthwhile depends on the stakeholder's point of view, since its costs and benefits often accrue to different parties.

More broadly, environmental regulations stimulate some sectors of the economy. While jobs are lost in industries such as forest products and high-sulfur coal mining, others are created in areas like recycling, environmental consulting, wind turbine and solar panel production and installation, waste management equipment, and air pollution control. For example, operators of coal-fired power plants predicted that big required cuts in mercury emissions, adopted in 2012, would cost thousands of jobs. But trade groups said that the regulations could add 300,000 jobs a year through 2017 in companies that make equipment to reduce emissions.[23] Jobs are saved or created in industries such as fishing and tourism when natural areas are protected or restored. Moreover, environmental regulations can stimulate the economy by compelling businesses to become more efficient by conserving energy, and less money is spent on treating health problems caused by pollution.

Sectors of the economy that produce goods and services with an environmental benefit are known as the **clean economy**. A 2018 study by the International Labor Organization estimated that the clean economy would be a major source of job growth in the future. Although the transition to a more sustainable society would lead to job loss in carbon-intensive industries, these would be more than offset by jobs created in clean sectors such as alternative energy, electric vehicles, and energy-efficient construction. The report concluded that if the long-term goals of the Paris Agreement were reached, the net impact would be the creation of 18 million jobs.[24]

Because of the complexity of these issues, economists differ on the net costs and benefits of environmental regulation. In some respects, government controls hurt the economy, and in other ways they help, as summarized in Figure 10.3. What is clear is that choices in environmental regulation reflect underlying values, expressed in a democratic society

FIGURE 10.3
Costs and Benefits of Environmental Regulations

Costs	Benefits
• Manufacturers, mining companies, and utilities spend billions of dollars annually to comply with environmental regulations.	• Emissions of pollutants drop.
• Some jobs are lost in particularly polluting industries.	• Air and water quality improves; toxic-waste sites are cleaned up; and natural beauty is preserved or enhanced.
• Competitiveness of some capital-intensive, "dirty" industries is impaired.	• People live longer and healthier lives in less polluted environments.
• Consumers pay more when companies pass along increased costs of regulations.	• Jobs are created in the clean economy sector, such as environmental products and services, alternative energy, and tourism.

[22] EPA, "Regulatory Impact Analysis of the Proposed Revisions to the National Ambient Air Quality Standards for Ground-Level Ozone," November 2014, *www.epa.gov;* "Health Professionals across the Nation Urge EPA to Finalize Most Protective Ozone Air Quality Standard," March 17, 2015, *www.lung.org;* and "EPA Ozone Rules Divide Industry and Environmentalists," *The New York Times,* November 26, 2014.

[23] "Regulations Create Jobs, Too," *Bloomberg Businessweek,* February 9, 2012.

[24] *World Employment Social Outlook 2018: Greening with Jobs* (Geneva: International Labour Organization, 2018).

through an open political process. Just how much a society is prepared to pay and how "clean" it wants to be are political choices, reflecting the give and take of diverse interests in a pluralistic society.

Managing for Sustainability

Environmental regulations, such as the laws governing clean air, water, and land described in this chapter, establish minimum legal standards that businesses must meet. Most companies try to comply with these regulations, if only to avoid litigation, fines, and, in the most extreme cases, criminal penalties. But many firms are now voluntarily moving beyond compliance to improve environmental performance in all areas of their operations and to manage proactively for sustainability. This section describes the stages of corporate environmental responsibility and discusses the organizational approaches companies have used to manage environmental issues effectively. The following section explains why managing for sustainability can improve a company's strategic competitiveness.

Stages of Corporate Environmental Responsibility

Although environmental issues are forcing all businesses to manage in new ways, not all companies are equally proactive in their response. One widely used model identifies three main stages of corporate environmental responsibility.

According to this model, companies pass through three distinct stages in sustainability management.[25] The first stage is *pollution prevention,* which focuses on "minimizing or eliminating waste before it is created." The second stage is *product stewardship.* In this stage, managers focus on "all environmental impacts associated with the full life cycle of a product," from the design of a product to its eventual use and disposal. HP, for example, has designed its laser printer ink cartridges so they can be refurbished and reused, and provides a mailing label for customers to return them free of charge. Finally, the third and most advanced stage is *clean technology,* in which businesses develop innovative new technologies that support sustainability—that provide actual environmental benefits, rather than simply prevent harm.

General Electric, a company long associated with pollution, from building coal-fired power plants to dumping toxic chemicals in the Hudson River, took a dramatic turn in 2005 when it announced a new strategy dubbed "ecomagination." GE pledged to double its investment in developing renewable energy, fuel cells, efficient lighting, water filtration systems, and cleaner jet engines, which it viewed as a huge commercial opportunity. In 2017, a dozen years into the initiative, GE reported that it had invested $20 billion in clean tech research and development and had earned $270 billion in revenues from its ecomagination portfolio of products and services.[26]

Evidence suggests that many companies are now moving quickly toward the final stage in this model. Surveys of senior executives by McKinsey & Company document a notable shift from 2012, when the main reason cited for addressing sustainability was to "improve operational efficiency and cut costs," to 2017, when the main reason cited was to "align with [the] company's business goals, mission, or values."[27]

[25] Stuart Hart, "Beyond Greening: Strategies for a Sustainable World," *Harvard Business Review,* January–February 1997. All quotes in this paragraph are taken from this article. An alternative stage model may be found in Dexter Dunphy, Suzanne Benn, and Andrew Griffiths, *Organisational Change for Corporate Sustainability* (New York: Routledge, 2003).

[26] "Ecomagination Progress," *www.gesustainability.com.*

[27] McKinsey & Company, "Sustainability's Deepening Impact," December 2017.

The Ecologically Sustainable Organization

An **ecologically sustainable organization (ESO)** is a business that operates in a way that is consistent with the principle of sustainable development, as presented in Chapter 9. In other words, an ESO could continue its activities indefinitely, without altering the carrying capacity of the Earth's ecosystem. Such businesses would not use up natural resources any faster than they could be replenished, or substitutes found. They would make and transport products efficiently, with minimal use of energy. They would design products that would last a long time and that, when worn out, could be disassembled and recycled. They would not produce waste any faster than natural systems could absorb and disperse it. They would work with other businesses, governments, and organizations to meet these goals.[28]

Of course, no existing business completely fits the definition of an ecologically sustainable organization. The concept is what social scientists call an ideal type; that is, a kind of absolute standard against which real organizations can be measured. A few visionary businesses, however, have embraced the concept and begun to try to live up to this ideal.

One such business is Interface, a $1 billion company based in Atlanta, Georgia, the world's largest maker of commercial carpet tiles. In 1994, CEO Ray C. Anderson announced, to many people's surprise, that Interface would seek to become "the first sustainable corporation in the world." Anderson and his managers undertook hundreds of initiatives. For example, the company started a program by which customers could *lease,* rather than *purchase,* carpet tile. When tile wore out in high-traffic areas, Interface technicians would replace just the worn units, reducing waste. Old tiles would be recycled, creating a closed loop. The company later adopted a goal of "Mission Zero"—no negative impact on the environment—by 2020. Another initiative was to tag all products with a special label called an *environmental product declaration (EPD).* Like a nutrition label on packaged food, the third-party verified EPD listed the raw materials, energy use, emissions, and waste generation associated with each product, allowing Interface customers to make environmentally informed decisions. In 2017, Interface was selected by a panel of experts as one of world's most sustainable companies, the only company to do so for each of the 20 years the survey had been taken.[29]

No companies, including Interface, have yet become truly sustainable businesses, and it will probably be impossible for any single firm to become an ESO in the absence of supportive government policies and a widespread movement among many businesses and other social institutions. However, many companies are demonstrating leadership in responding to environmental challenges. The next section will describe actions leading companies are taking now to operate their businesses as sustainably as possible.

Sustainability Management in Practice

Companies that have begun to move toward sustainability have learned that new structures, processes, and incentives are often needed.

An emerging role at many leading firms is the **chief sustainability officer (CSO)**. In 2004, DuPont was the first company to appoint a chief sustainability officer; a 2014 survey found

[28] Mark Starik and Gordon P. Rands, "Weaving an Integrated Web: Multilevel and Multisystem Perspectives of Ecologically Sustainable Organizations," *Academy of Management Review,* October 1995.

[29] GlobeScan/SustainAbility, "The 2017 Sustainability Leaders: Celebrating 20 Years of Leadership," 2017. Interface's sustainability initiatives are described at *www.interfaceglobal.com/sustainability.* Ray Anderson's story is told in Ray C. Anderson with Robin White, *Business Lessons from a Radical Industrialist* (New York: St. Martin's Press, 2011).

36 CSOs at large U.S. firms. Most of these CSOs reported directly to the CEO or to an individual who did. They often supervised staffs of specialists and coordinated the work of managers across many functional areas, including research and development, marketing, facilities, and supply chain management, whose work was related to the firm's sustainability mission.[30]

> An example is Justin Whitmore, appointed chief sustainability officer at Tyson Foods, the world's second-largest processor and marketer of chicken, beef, and pork, in 2017. The newly created position reported directly to the CEO. Whitmore quickly set out to establish science-based targets for Tyson in the areas of greenhouse gas emissions, water conservation, animal welfare, and food transparency. He also worked on ways to reduce meat waste during processing and on the development of vegetarian meat alternatives. Whitmore described the challenges facing Tyson: "There are more people in the world, and more of them are rising themselves out of poverty, so that's driving protein consumption. You have to set targets for companies that will continue to grow."[31]

Sustainability managers reported that when they first took the job, they thought that the most important determinant of success would be their subject-matter expertise—how much they knew about pollutants, energy efficiency, regulations, and the like. But after serving in the position, these managers changed their minds, saying that interpersonal skills—being able to work effectively with people across the organization—were the most critical. "[CSOs] must typically work across the organization to implement their change initiatives," explained the chief sustainability officer for the clothing maker Reformation. "That means they must be very effective at influencing others."[32]

Chief sustainability officers may be based in departments with a variety of names, such as sustainability, citizenship, and corporate affairs. But wherever they are located, recent research shows that effective sustainability management shares several common characteristics:[33]

> *Top management commitment.* The most environmentally proactive companies almost all have CEOs and other top leaders with a strong espoused commitment to sustainability. Paul Polman, the CEO of Unilever, a firm that was judged the world's most sustainable in 2017, told an interviewer that a different executive team could come into the company, shut down all sustainability initiatives, wring out costs, and drive the share price up—at least in the short term. But he favored the long-term view. "I would like to be remembered for leaving the place a little bit better than I found it," he said. Boards of directors have also become involved, overseeing the implementation of environmental policies and assessing environment-related risks. For example, Prudential Financial, a financial services company that sells insurance as well as other products, now requires candidates for the board to have sustainability expertise.[34] Thirty-one percent of firms integrate sustainability into board committee charters.

[30] *CSO Back Story II: The Evolution of the Chief Sustainability Officer* (Weinreb Group, 2014).

[31] Meat Industry Must Grow Sustainably, Tyson Executive Says," February 8, 2018, *www.bloomberg.com;* and "The Science Behind Tyson's Meaty New Sustainability Agenda," February 26, 2018.

[32] "Who's in Charge of Sustainability at Your Favorite Brand?" November 23, 2016, www.*racked.com.*

[33] Data in this section are drawn from "Turning Point: Corporate Progress on the CERES Roadmap for Sustainability," February 2018, *www.ceres.org,* unless otherwise noted. The CERES study was based on a survey of executives of 600 companies, representing 80 percent of the total market capitalization of all publicly traded companies in the United States.

[34] CERES, "Lead from the Top: Building Sustainability Competence on Corporate Boards," 2017.

Clear goals and metrics. Another characteristic of leading companies is that they set measurable, science-based sustainability goals and regularly assess and report their performance. A 2017 report by Pivot Goals found that 94 percent of the world's 200 largest firms had measurable sustainability goals, and 33 percent had adopted science-based goals.[35] By setting specific goals, these firms hold themselves accountable (and allow their stakeholders to do so). A particularly dramatic example is the German sportswear firm Puma, one of the first firms to release an environmental profit-and-loss statement, covering all significant environmental impacts from the production of raw materials to the final sale. After the company learned that most adverse impacts occurred during the production of raw materials, it introduced new products made from recycled content or that could themselves be recycled.[36]

Employee engagement. Sustainability leaders have found they are most effective when they involve line managers and employees from across the organization in the process of change. Thirty-eight percent of large firms engage their employees on sustainability issues. In 2016, for example, Cisco Systems launched an internal engagement platform called GreenHouse, on which employees could learn about ways to reduce their environmental footprint and inspire others. In its first six months, 1,750 employees had participated. One group started a "bring your own cup" campaign and gave out Starbucks cards to others who registered their reusable cup. They calculated that this action had diverted 2,900 pounds of waste in one year.[37]

Alignment of rewards and incentives. Businesspeople are most likely to consider the environmental impacts of their actions when their organizations acknowledge and reward this behavior. The most sustainable organizations tie the compensation of their managers, including line managers, to environmental achievement and take steps to recognize these achievements publicly. In 2018, 24 percent of U.S. companies linked executive compensation to sustainability metrics, but only 8 percent of companies linked pay to meeting goals that went beyond legal and regulatory requirements. For example, at Xcel Energy, a utility that is a leading supplier of wind power, a portion of the CEO's bonus was linked to meeting specific sustainability goals set annually by the board, including reductions in energy use by customers. A study of U.S., Canadian, and German firms found those companies that did link pay to sustainability metrics boosted their performance in this area.[38]

Environmental Auditing and Reporting

As noted earlier, leading companies not only organize themselves to achieve sustainability goals; they also closely track their progress toward meeting them. Chapter 3 introduced the concept of corporate social reporting and presented evidence on what proportion of companies report results to their stakeholders. In the 1990s, in a parallel development, many companies began to audit their environmental performance. More recently, many firms have moved to integrate their social and environmental reporting into a single **sustainability report**. In 2017, as reported in Chapter 3, 93 percent of the world's largest companies issued a corporate responsibility report; most of these covered both social and environmental issues. A significant trend is toward the inclusion of corporate responsibility data in the

[35] "The Rise of Corporate Sustainability Goals: Some Hard Data," December 1, 2017, *www.sustainblebrands.com.* The dataset is available at *www.pivotgoals.com.*

[36] For information about Puma's Environmental Profit & Loss Account and other sustainability initiatives, see *www.puma.com.*

[37] "A Look Back at Cisco's Recent Sustainability Accomplishments," February 13, 2017, at *https://blogs.cisco.com;* and "Changing the Way We Waste, One Cup at a Time," September 7, 2016, at *http://weare.cisco.com.*

[38] "It's Time to Tie Executive Compensation to Sustainability," *Harvard Business Review,* August 17, 2017.

annual financial report; this rose from 44 percent of these companies in 2011 to 78 percent in 2017. This is called *integrated reporting* (also discussed and defined in Chapter 3).[39]

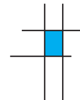
An example of a company that was an early leader in integrated reporting is Novozymes, a Danish biotechnology firm. The company produced its first environmental report in 1993 and its first combined social and environmental report six years later. Since 2002, it has produced a single report to stakeholders that integrates its financial, social, and environmental results. The company acknowledges the challenge of preparing a single report "in accordance with more than one set of rules and guidelines," but says that the process improves transparency and accurately reflects its commitment to sustainability.[40]

As discussed earlier in Chapter 3, the movement to audit and report on social and environmental performance—and to integrate these efforts with financial auditing and reporting—has gained momentum in recent years in many regions of the world.

Environmental Partnerships

Many businesses that are seeking to become more sustainable have formed voluntary, collaborative partnerships with environmental organizations and regulators to achieve specific objectives, as illustrated by the Google Earth Outreach example at the beginning of this chapter. These collaborations, called **environmental partnerships**, draw on the unique strengths of the different partners to improve environmental quality or conserve resources.

Starbucks Corporation is the largest coffeehouse company in the world, with more than 27,000 stores in 75 countries. For more than 15 years, the company has partnered with Conservation International (CI) to promote coffee farming methods that protect biodiversity, mitigate climate change, and reduce harm from pesticides and fertilizers. For example, in Chiapas, Mexico, and Sumatra, Indonesia, the partners have worked with local farmers to develop coffee varieties that thrive in the shade of native trees, conserving habitat and sequestering carbon. The company has also worked with CI to develop a set of purchasing guidelines based on sustainability and has committed to paying a premium price to suppliers who meet the standards. The two organizations also joined the Sustainable Coffee Challenge, an industrywide initiative to make coffee the world's first completely sustainable agricultural product. Conservation International noted that it viewed Starbucks "as a natural partner to our work because of shared geographies: most of the world's key coffee-growing regions are the same areas where biological diversity is richest and most threatened."[41]



Sustainability Management as a Competitive Advantage

Some researchers believe that by moving toward sustainability, business firms gain a competitive advantage. That is, relative to other firms in the same industry, companies that proactively manage environmental issues will tend to be more successful than those that do

[39] *The Road Ahead: The KPMG Survey of Corporate Social Responsibility Reporting 2017,* at *www.kpmg.com.* The figures reported here are for the G250 companies.

[40] Novozymes' website and integrated reports are at *http://novozymes.com/en.* For a full discussion of the movement toward triple bottom line reporting, see Robert G. Eccles and Michael P. Krzus, *The Integrated Reporting Movement: Meaning, Momentum, Motives, and Materiality* (Hoboken, NJ: John Wiley & Sons, 2014).

[41] The partnership's progress can be followed at *www.conservation.org/partners/Pages/starbucks* and *www.starbucks.com/responsibility/sourcing/coffee.*

not. Effective sustainability management confers a competitive advantage in five different ways, as follows. [42]

Cost Savings

Companies that reduce pollution and hazardous waste, reuse or recycle materials, and operate with greater efficiency can reap significant cost savings. An example is Subaru's automobile assembly plant in Lafayette, Indiana, which has gone to great lengths to reduce waste, saving a great deal of money in the process.

> Subaru's 3.5 million square foot Indiana factory has achieved its goal of "zero waste": it sends no waste at all to landfills. The company returns packaging materials—including the Styrofoam used to protect engines in transit—to suppliers, to be used again. Cafeteria scraps go to a nearby waste-to-energy power plant. The company processes and reuses solvent and oil. Dried paint sludge is shipped to other companies that use it to make railroad ties, parking lot bumpers, and bicycle helmets. Used lightbulbs are used to make reflective road striping. Leftover metal slag goes to a company that extracts the copper it contains. These initiatives not only reduce the plant's environmental impact, they also save the company more than $2 million a year.[43]

Many companies have found they are able to obtain significant cost savings by more efficiently managing their real estate portfolios. How some companies have managed the built environment to save money and improve their environmental performance is described in Exhibit 10.B. One company that has benefited from this trend is Autodesk, a maker of software for architects and other designers. The company has developed specialized software that enables architects to calculate the energy and water usage of proposed designs, and to make the most efficient use of daylight and shadows. "Autodesk is committed to helping designers and engineers create a future where we all live well and within the limits of our planet," said the company on its website.[44]

Brand Differentiation

Companies that develop a reputation for environmental excellence distinguish their brand and attract like-minded customers. Sustainable products and services can attract environmentally aware customers. For example, shoppers might select cell phones with power-saving features, such as "unplug charger" reminders, or cleaning products formulated with ingredients that are not environmentally harmful. Services can also be marketed based on their environmental attributes, as the following example illustrates.

> One company that has benefited from its reputation for sustainability is Intrepid Travel. Founded in Australia in 1989, the tour operator now offers itineraries for adventurous travelers on seven continents. Early on, Intrepid Travel embraced the principle of sustainable development and committed to reducing its environmental footprint, so its travel destinations could be enjoyed for many generations to come.

[42] Daniel C. Esty and Andrew S. Winston, *Green to Gold: How Smart Companies Use Environmental Strategy to Innovate, Create Value, and Build Competitive Advantage* (New Haven, CT: Yale University Press, 2006); and Sanjay Sharma and J. Alberto Aragon-Correa, eds., *Corporate Environmental Strategy and Competitive Advantage* (Northampton, MA: Edgar Elgar Academic Publishing, 2005).

[43] "The Zero-Waste Factory," *Scientific American,* July 13, 2017. The website of Subaru Industries of America is at *www.subaru-sia.com.*

[44] The Autodesk website is at *www.autodesk.com.*

Exhibit 10.B

Greening the Built Environment

For most companies, their buildings—the offices, factories, stores, and warehouses where their employees work—account for a huge share of their overall environmental impact. The U.S. Energy Information Administration has estimated that commercial buildings and industrial facilities together account for slightly more than half of the nation's energy consumption (most of the rest comes from transportation and residential use). Many companies have realized that improving operating efficiencies in their real estate holdings can yield tremendous savings, as well as reduce their environmental footprint.

One approach is to design buildings from the ground up to conserve resources both in their construction and use. The U.S. Green Building Council has developed a certification process called LEED (Leadership in Energy and Environmental Design) for both new and retrofitted buildings. Adopting these standards has brought companies many benefits. For example, Adobe, the maker of digital authoring tools, has obtained 25 LEED certifications, including for corporate headquarters in San Jose, California, which was completely retrofitted. Adobe introduced scores of improvements—from motion sensors that turned off lights when people left their offices to landscape irrigation linked to weather satellites, so sprinklers did not operate when it was raining. The improvements cost a total of $1.4 million but saved Adobe $1.2 million per year. "I was one of the naysayers saying, no, green costs money, it doesn't save money. [But] once I started seeing the cost savings, [I jumped] right up on that bandwagon . . . because it works," said the company's director of global facilities services.

Sources: Rocky Mountain Institute, "Adobe Systems Corporate Headquarters" [case study], and "Green Building for a Profitable Future." The website of the U.S. Green Building Council is at *www.usgbc.org.* Adobe's sustainable building initiatives are described at *www.adobe.com/corporate-responsibility/sustainability/green-building.*

The company employed local guides, used public transit, offset the carbon emissions of its air travel, and gave back to local communities through its foundation. In the past 10 years, the company has grown at an annual compound rate of 25 percent. Said one of the company's founders: "We became known as a responsible company, and responsible travel became a selling feature for Intrepid."[45]

In general, promoting specific products or services based on their environmental attributes, a practice sometimes known as *green marketing,* has not been particularly effective. Evidence shows that most consumers select products and services based on price, convenience, and quality—not "greenness." However, what consumers *do* respond to is a company's overall reputation for environmental responsibility and the credibility of its communications with stakeholders. A study of 30,000 consumers in 60 countries found that almost half were more likely to purchase a product or services from a company known as being environmentally friendly. This was especially true of young people. Only ten percent, however, had purchased products specifically labeled as eco-friendly.[46] Joel Makower, an expert on environmental marketing, concluded that "It's at the company or brand level that this [environmental marketing] makes sense: Why offer a few good, eco-labeled products if the organization behind them is headed in the wrong direction?" In his view, consumers generally do not seek out "green" products, but they do buy from companies they perceive as responsible.[47]

Technological Innovation

Environmentally proactive companies are often technological leaders, as they seek imaginative new methods for reducing pollution and increasing efficiency. In many cases, they

[45] Geoff Manchester, "Why We Must Act Now on Sustainability," May 1, 2014 [blog post], at *www.travelweekly.com.au.* For Intrepid Travel's reports on its progress on sustainability, see *www.intrepidtravel.com/rb-our-progress-sustainability-policy.*

[46] "The Sustainability Imperative: New Insights on Consumer Expectations," Nielsen, October 2015.

[47] Joel Makower, "Five Reasons Green Marketing is Going Nowhere," March 12, 2013, *www.linkedin.com.*

produce innovations that can win new customers, penetrate new markets, or even be marketed to other firms as new regulations spur their adoption.

> IBM's semiconductor chip-making plant in Burlington, Vermont, uses vast quantities of ultrapure water to clean its products. The water bill for this single facility has been as high as $10,000 *a day*. To reduce costs, IBM managers devised an elaborate system of electronic sensors to track the movement of water at every point and used the data to drive greater efficiencies—nearly doubling the "water productivity" of the plant over 10 years. "We did fifty different things," reported the plant's operation manager. "Angles of usage, treatment, energy capture, using less pump capacity, capturing internal pressure that comes with the water in the line—fifty different things." In the process, IBM had the startling revelation that it had done more than save money on water; it had created an entirely new business of consulting with other organizations on how to do the same thing. IBM later created a robust business called "Intelligent Water," which helped governments, utilities, and businesses use advanced data analytics to conserve water and save money.[48]

Reduction of Regulatory and Liability Risk

Another benefit for companies that are proactive with respect to their environmental impacts is that they are often better positioned than their competitors to respond to new government mandates. For example, when new rules went into effect in Europe that banned all electronics products that included six toxic substances, including lead, cadmium, and mercury, companies that had learned how to make their products free of these substances prior to the ban suddenly had a big advantage in winning European accounts. When the United Kingdom announced that all large British companies would be required to report annually on their greenhouse gas emissions, the companies that had taken earlier steps to measure and report on carbon voluntarily were better prepared for compliance. Similarly, proactively managing for sustainability can avoid expensive fines and lawsuits, such as those experienced by Anadarko, in the example mentioned earlier in this chapter.

Strategic Planning

Companies that cultivate a vision of sustainability must adopt sophisticated strategic planning techniques to allow their top managers to assess the full range of the firm's effects on the environment. The complex auditing and forecasting techniques used by these firms help them anticipate a wide range of external influences on the firm, not just ecological influences. Wide-angle planning helps these companies foresee trends—new markets, materials, technologies, and products. For example, Toyota, well known for its ability to anticipate market trends, was among the first to produce a commercially successful hybrid vehicle, the Prius. As U.S. car makers struggled—and some went into bankruptcy—in the deep recession of the late 2000s, Toyota fared relatively well. The same sophisticated planning that enabled Toyota to weather the recession had also contributed to its ability to meet the public's increased interest in less polluting, more efficient transportation.[49] McKinsey & Company found in the survey mentioned earlier in this chapter that 44 percent of companies have formally integrated sustainability into their strategic planning process.[50]

[48] "IBM Intelligent Water," at *www-935.ibm.com/services/multimedia/Intelligent_Water.pdf;* and Charles Fishman, *The Big Thirst: The Secret Life and Turbulent Future of Water* (New York: Free Press, 2011), Chapter 5, "Money in the Pipes."

[49] Information on Toyota's sustainability initiatives is at *www.toyota.co.jp/en/environment.*

[50] McKinsey & Company, "Sustainability's Deepening Impact," December 2017.

FIGURE 10.4 Corporate Leaders in Integrating Sustainability into Their Business Strategy
Question: *What specific companies do you think are leaders in integrating sustainability into their business strategy?*

Source: Globe Scan/SustainAbility, *The 2017 Sustainability Leaders,* p. 13. Based on a survey of more than 1,000 qualified sustainability experts from government, NGOs, academia, corporations, and the media from 79 countries. Respondents were asked to list a maximum of three companies. The numbers shown are the percentage of respondents who named that specific company.

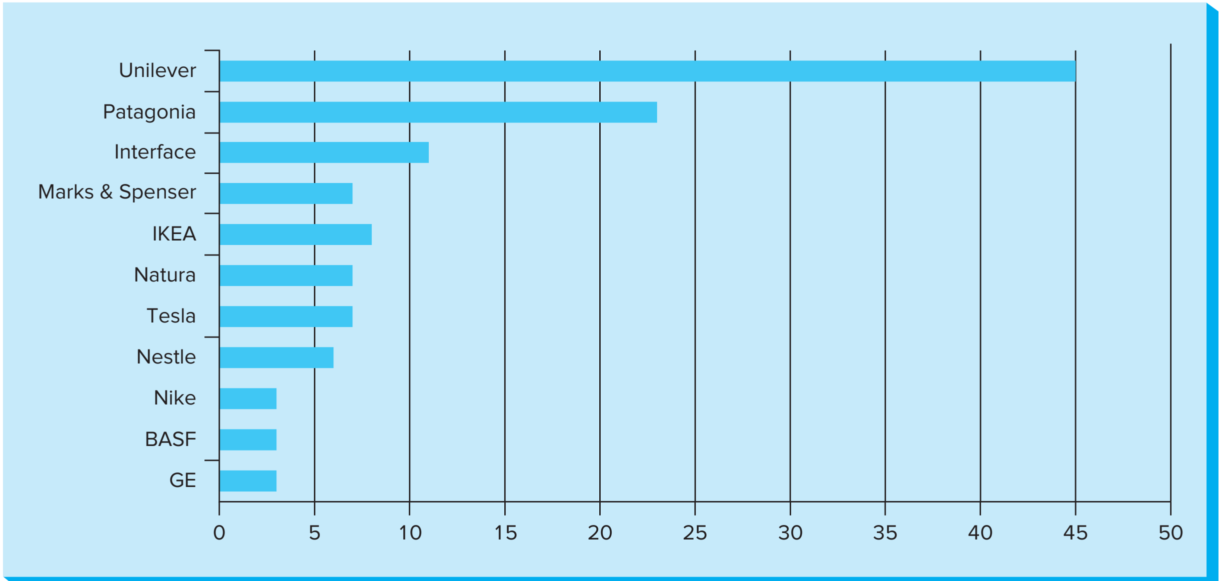


Figure 10.4 lists the companies viewed by a panel of experts as the world's leaders in integrating sustainability into their business strategy.

If managing for sustainability confers a competitive advantage, it follows that it should have a measurable impact on financial performance. Scholars have begun to study this relationship. A comprehensive examination of almost two decades of data on U.S. companies by Robert Eccles and colleagues at the Harvard Business School concluded that "high-sustainability firms" significantly outperformed others, as measured by both financial and stock market returns.[51] The most recent work on this topic has focused on **material sustainability issues**. To explain, the term *material* in financial reporting refers to issues that are relevant to evaluating a firm's financial condition; the law requires that firms report to investors and the public not *all* information, but *material* information. In the same way, material sustainability issues refer to those that are particularly relevant to an evaluation of a specific company or industry's sustainability management. For example, greenhouse gas emissions are highly material in the transportation industry, but of lower materiality in the financial services industry. Building on this concept, recent research shows that firms with good performance on material sustainability issues significantly outperform firms with poor performance on these issues. A 2018 study of large U.S. firms found that 32 percent had conducted a materiality assessment.[52]

[51] Robert G. Eccles, Ioannis Ioannou, and George Serafeim, "The Impact of a Corporate Sustainability on Organizational Processes and Performance," *Management Science* 60(11), 2014.

[52] Mozaffar Khan, George Serafeim, and Aaron Yoon, "Corporate Sustainability: First Evidence on Materiality," November 9, 2016, *The Accounting Review,* Vol. 91, No. 6; and CERES (2018), op. cit.

A theme of this chapter is that achieving a sustainable economy and society will require a collaborative effort among government, business, and civil society. The U.S. government, like that of many other countries, has adopted many environmental laws and regulations constraining business behavior. These are critically important, as they assure that minimum standards are met by all. But many proactive companies are moving beyond compliance, recognizing that operating sustainably will help them become more competitive in the global marketplace by cutting costs, attracting environmentally aware customers, spurring innovation, reducing regulatory and liability risk, and encouraging long-range strategic planning. Recent research shows that managing for sustainability pays off for companies in the long run.

Summary

- Government environmental laws and regulations focus on protecting the ecological health of the air, water, and land, and limiting the amount of pollution that companies may emit.
- Environmental laws have traditionally been of the command and control type, specifying standards and results. New laws, in both the United States and Europe, have added market incentives to induce environmentally sound behavior.
- Environmental laws have brought many benefits. Air, water, and land pollution levels are in many cases lower than in 1970. A continuing challenge is to find ways to promote a clean environment and sustainable business practices without impairing the competitiveness of the U.S. economy.
- Companies pass through three distinct stages in the development of green management practices. Many businesses are now moving from lower to higher stages. An ecologically sustainable organization is one that operates in a way that is consistent with the principle of sustainable development.
- Effective environmental management requires an integrated approach that involves all parts of the business organization, including top leadership, sustainability managers, and employees in many functional areas, as well as strong partnerships with stakeholders and effective auditing.
- Many companies have found that proactive environmental management can confer a competitive advantage by saving money, attracting customers, promoting innovation, reducing regulatory risk, and developing skills in strategic planning. Emerging evidence shows a positive relationship between sustainability practices and stock market and financial performance.

Key Terms

acid rain, *215*
cap-and-trade, *219*
chief sustainability officer (CSO), *225*
clean economy, *223*
command and control regulation, *219*
ecologically sustainable organization (ESO), *225*
environmental justice, *217*
environmental partnerships, *228*
Environmental Protection Agency (EPA), *213*
market-based mechanisms, *219*
material sustainability issues, *232*
Superfund (CERCLA), *217*
sustainability report, *227*

Internet Resources

www.epa.gov	Environmental Protection Agency
www.envirolink.org	Environmental organizations and news
www.GreenBiz.com	Green Business Network
www.sustainablebusiness.com	Network of sustainable small businesses
www.environmentalleader.com	Briefing for executives
www.sustainability.com	SustainAbility (consultancy)
www.sustainablog.org	Blogs on green and sustainable businesses
www.theguardian.com/us/sustainable-business	*The Guardian* [newspaper] coverage of sustainable business

Discussion Case: *Hydraulic Fracturing—Can the Environmental Impacts Be Reduced?*

Hydraulic fracturing—or *fracking,* as it is sometimes known—has been called the gold rush of the 21st century because so many companies and people are rushing to make their fortunes by extracting oil and natural gas from underground shale formations. What are the environmental impacts of fracking, and what can business, government, and society do to reduce them?

In recent years, technology has evolved to make possible the economic extraction of crude oil and natural gas from vast underground shale formations. In hydraulic fracturing, a vertical well is drilled as deep as 7,000 feet before turning horizontally into the oil- or gas-bearing layer. Operators then pump in vast quantities of water, sand, and chemicals under high pressure to break up the shale and release hydrocarbons, which are then brought back up the drill hole. By rotating the horizontal turns in successive passes, a single well can reach a large area underground.

Hydraulic fracturing grew rapidly in the United States in the first two decades of the century. In 2016, more than 1 million oil and gas wells were operating in 31 states. The biggest fracking booms were underway in several shale formations: the Baaken (North Dakota), Marcellus (Pennsylvania, West Virginia, New York, Ohio, and Maryland), Barnett (Texas), and Permian (western Texas and eastern New Mexico).

Hydraulic fracturing has several benefits. In 2012, the United States became the leading natural gas producer in the world, overtaking Russia, and in 2013, became the leading oil producer, overtaking Saudi Arabia. At current rates of growth, the United States will be energy self-sufficient by 2030. The fracking boom has created jobs, tax revenue, and royalties to property owners who lease their mineral rights. Natural gas burns cleaner than either coal or oil, providing a possible bridge to a future economy based on renewable energy.

But fracking also carries serious environmental risks. Trucks and heavy equipment cause noise and air pollution in and around drilling sites. The process uses vast quantities of water—at least 239 billion gallons since 2005, according to some estimates—depleting supplies available for drinking and irrigation. Chemicals injected underground include a host of toxins. Fluid that returns to the surface—called *flowback*—is often further contaminated by radioactive substances, heavy metals, and volatile organic compounds from deep in the Earth. Improper disposal of this wastewater can contaminate land, wells, and rivers—and even cause earthquakes in such normally quiescent places as Oklahoma and

Kansas. Methane can be released at multiple stages in the fracking process, powerfully contributing to climate change. Wildlife habitat is destroyed as forests and fields give way to industrial drilling sites.

In 2017, the Trump administration cancelled federal regulations, issued two years earlier, governing hydraulic fracturing on public and tribal lands. These regulations would have required companies to disclose the chemicals they used and set stricter rules for the storage and disposal of wastewater. States, which had jurisdiction over fracking on private and state-owned land, had taken a wide range of approaches. At one extreme, three states—Vermont, New York, and Maryland—had banned fracking outright; some cities had as well. In announcing the decision, the health commissioner of New York said, "The potential risks are too great. In fact, they are not even known." At the other extreme, government oversight in North Dakota—site of a huge oil boom—was considered highly permissive; in fact, the state's top environmental regulator described himself on a radio show as "not a regulations guy." Some states had charted a middle course; California, for example, implemented regulations in 2015 that allowed fracking but required strict monitoring of groundwater and air quality near wells. Most states taxed fracking operations.

As the practice of hydraulic fracturing spread, some companies experimented with new technologies to extract oil and gas with less environmental damage. Halliburton developed solar-powered storage silos and natural gas fueled pumps, reducing on-site emissions. Southwestern Energy installed infrared cameras to detect fugitive methane emissions, so leaks could be plugged. General Electric tested a system that enabled water to be treated and reused on site, and GasFrac, a Canadian company, introduced a fracking method that used no water at all.

Said a professor who studied these trends, "[It is] the same as with any industry—if you come out with a game-changing technology, you can get in the market first and ride that."

Sources: "The World's Top Oil Producers of 2017," Investopedia, February 19, 2018; "To Round Out a Year of Rollbacks, the Trump Administration Just Repealed Key Regulations on Fracking," *The Washington Post,* December 29, 2017; "Fracking by the Numbers: The Damage to Our Water, Land, and Climate from a Decade of Dirty Drilling," Environment America, April 2016; "New Federal Rules are Set for Fracking," *The New York Times,* March 20, 2015; "Citing Health Risks, Cuomo Bans Fracking in New York State," *The New York Times,* December 17, 2014; "The Downside of the Boom," [series of articles], *The New York Times,* various dates starting November 22, 2014; "Green Fracking? 5 Technologies for Cleaner Shale Energy," *National Geographic,* March 21, 2014. Maps showing the distribution of fracking wells in the United States are available online at *www.fractracker.org/map*.

Discussion Questions

1. What is hydraulic fracturing, or fracking, and what are its costs and benefits?
2. Using the classification system presented in this chapter, what type(s) of pollution is (are) generated by fracking?
3. Using the classification system presented in this chapter, what type(s) of government regulation has (have) been used to address the concerns you identified in question 1, and which do you think would be most effective?
4. What are the benefits to companies of moving beyond compliance and developing more sustainable methods of fracking?
5. What factors might influence a company to use more or less environmentally responsible methods of fracking?

PART FIVE

Business and Technology

CHAPTER ELEVEN

The Role of Technology

Technology is an unmistakable economic and social force in both business and the world where we live. Global and local communications, business exchanges, the science that affects the quality of our lives, and the simple tasks that make up our daily lives are all significantly influenced by technology. Whether we are at home, in school, or in the workplace, emerging technological innovations have dramatically changed how we live, play, learn, work, and interact with others, raising important social and ethical questions for business.

This Chapter Focuses on These Key Learning Objectives:

LO 11-1 Defining technology and its characteristics.

LO 11-2 Recognizing how technology has evolved throughout history.

LO 11-3 Analyzing and assessing how technology impacts individuals in society.

LO 11-4 Understanding the potential for unwanted threats arising from individuals' use of the Internet and other social media platforms.

LO 11-5 Examining inequalities in public access to technology.

LO 11-6 Assessing the ethical challenges posed by new technologies.

LO 11-7 Identifying how some governments act to control or censor the use of technology by its citizens.

LO 11-8 Evaluating the benefits and risks of recent breakthroughs in science and medicine.

Three Russian companies and 25 Russian citizens were indicted on charges of engaging in a widespread effort to interfere in the 2016 U.S. presidential election. The indictment alleged that Russians planted social-media messages, invented fake personas, and staged rallies with the "strategic goal to sow discord in the U.S. political system." Facebook estimated that 87 million of its users had been targeted to view political ads based on their race, political preference, religion, and personal interests, such as gun ownership. Facebook estimated that 470 Russian-backed accounts connected to a single pro-Kremlin firm, the Internet Research Agency, churned out 80,000 Facebook posts over a 30-month period before the election.[1]

Imagine taking a pill and information is communicated to your physician. In 2017 the U.S. Food and Drug Administration approved the world's first digital drug, an anti-psychotic pill that signals smartphones once it reaches the stomach, so doctors can track whether patients are taking their medication. Japan's Otsuka Pharmaceutical implanted a tiny chip containing minerals, such as silicon, magnesium, and copper, inside tablets of Abilify, used to treat schizophrenia, bipolar disorder, and other mental illnesses. Once swallowed, the chip mixes with stomach acids and sends a heartbeat-like signal to an adhesive patch worn on the patient's torso. The patch records the dosage and time of ingestion and relays this information to a smartphone app for patients to monitor and share with doctors and caretakers. The chip ultimately passes through the digestive tract normally.[2]

Just a decade earlier, interference by a foreign government in the U.S. elections was considered unlikely. But the use of social media had spread rapidly across the United States, connecting people as never before. Likewise, innovative medical procedures, like a pill communicating with a physician, only imagined until now, have become real. In recent decades, the rate of technology change has been extraordinary, encompassing the wireless revolution, the ability to process enormous amounts of data, and the application of artificial intelligence (discussed in the next chapter) to both manufacturing and service delivery. Today, processing power and data storage are virtually free in the cloud, and a simple handheld iPhone has the same computing power as the room-sized IBM mainframe computer of the 1970s.

Technology is a major factor in our lives, helping us communicate with others around the world and across town, providing new opportunities for business to promote its activities, and improving the quality of our lives. But what are the consequences of the extraordinarily rapid pace of technological change? Has technology replaced human contact and, if so, what are the consequences of this change in how we relate to others? Who decides what technology should emerge and dramatically affect our lives? Should businesses be allowed to use technology freely or should there be some constraints on its use by business? Who should determine what these constraints are?

Technology Defined

Technology is a broad term referring to the practical applications of science and knowledge to commercial and organizational activities. The dominant feature of technology is *change and then more change.* As discussed at the beginning of this chapter, new technological breakthroughs are again changing our lives. Sometimes the pace of change is so fast and furious that it approaches the limits of human tolerance, and people lose their ability to cope with it successfully. Although technology is not the only cause of change in society, it

[1] "Russians Charged With Interfering in U.S. Election," *The Wall Street Journal,* February 16, 2018, *www.wsj.com*; and "12 Russian Agents Indicted in Mueller Investigation," *The New York Times,* July 14, 2018, *www.nytimes.com*.

[2] "Digital Pills That Talk to Your Doctor Are Here," *The Wall Street Journal,* November 13, 2017, *www.wsj.com*.

is a primary cause. It is either directly or indirectly involved in most changes that occur in society, as noted in an article in *Foreign Affairs:*

> "Technology has sped globalization forward, dramatically lowering communication and transaction costs and moving the world much closer to a single, large global market for labor, capital, and other inputs to production. Even though labor is not fully mobile, the other factors increasingly are. As a result, the various components of global supply chains can move to labor's location with little friction or cost."[3]

Another feature of technology is that *its effects are widespread,* reaching far beyond the immediate point of technological impact in unpredictable ways. Technology ripples through society until every community is affected by it.

A final feature of technology is that it is *self-reinforcing.* As stated by Alvin Toffler, "Technology feeds on itself. Technology makes more technology possible."[4] This self-reinforcing feature means that technology acts as a multiplier to encourage its own faster development. It acts with other parts of society so that an invention in one place leads to a sequence of inventions in other places. Thus, invention of the microprocessor led rather quickly to successful generations of the modern computer, which led to new banking methods, electronic mail, bar-code systems, global tracking systems, and so on.

Phases of Technology in Society

Seven broad phases of technology have developed, as shown in Figure 11.1. Societies have tended to move sequentially through each phase, beginning with the lowest technology and moving higher with each step, so the seven phases roughly represent the progress of civilization throughout history. The first phase was the nomadic-agrarian, in which people hunted wild animals for meat and gathered wild plants for food. The second was the agrarian, corresponding with the domestication of animals and plants. The first two used manual labor exclusively. The third was the industrial, characterized by the development of powered machinery, first in the textile industry and later in many other forms of manufacturing. The fourth was the service phase, marked by the rise of service industries and intellectual labor. The fifth was the information phase. This phase emphasized the use and transfer

FIGURE 11.1 Phases in the Development of Technology

Technology Level	Phases in the Development of Technology	Approximate Period	Activity	Primary Skill Used
1	Nomadic-agrarian	Until 1650	Harvesting	Manual
2	Agrarian	1650–1900	Planting and harvesting	Manual
3	Industrial	1900–1960	Building material goods	Manual and machine
4	Service	1960–1975	Providing services	Manual and intellectual
5	Information	1975–2000	Thinking and designing	Intellectual and electronic
6	Semantic	2000–today	Relevance and context	Intellectual and networking
7	Biotechnology	2016–today	Application of engineering and biological sciences	Networking and artificial creation

[3] Erik Brynjolfsson, Andrew McAfee, and Michael Spence, "New World Order: Labor, Capital, and Ideas in the Power Law Economy," *Foreign Affairs,* July/August 2014, *www.foreignaffairs.com*.

[4] Alvin Toffler, *Future Shock* (New York: Bantam, 1971), p. 26.

of knowledge and information rather than manual skill. Businesses of all sizes, including the smallest firms, explored the benefits of the information age through the availability of nanotechnology and similar inventions. These inventions catapulted societies into cyberspace, where information is stored, ideas are described, and communication takes place in and through an electronic network of linked systems. The technology developed in this age provided the mechanisms for more information to be produced in a decade than in the previous 1,000 years.

The semantic phase, which began around 2000, saw the development of processes and systems to enable organizations and people to navigate through the expanding amount of links and information available on the Internet. Search engines, such as Google, employed massive clusters of computers to analyze the *metadata* or descriptive information embedded within web pages, documents, and files. A Google search for a specific airline flight, for example, might return links to a flight-tracking website, an estimated time of departure or arrival for that day's flight, weather forecasts, and airport maps. Social interaction is an important part of the semantic phase. Services such as Facebook, Twitter, and LinkedIn analyzed the transactions and metadata from each user's activity to suggest new contacts, entertainment, and links.

Scientists suggest that society is now in the midst of a seventh, phase dominated by *biotechnology*. **Biotechnology** uses biological processes in the development or manufacture of a product or in the technological solution to a problem. While the term biotechnology first appeared in 1919, the principles of engineering and biological sciences have recently been applied in such wide-ranging uses as food alterations, genetic research and cloning, human and animal health care, pharmaceuticals, and the natural environment.[5]

The Role of Technology in Our Daily Lives

Technology has been intertwined in our daily lives since the Industrial Revolution. The connection between the two became even stronger in the information, semantic, and biotechnology phases. Today, technology has the potential to influence every aspect of every individual's global activity—driving innovation, affecting collaborative partnerships, and changing business–stakeholder relationships. It has created great opportunities for people—but also serious ethical and social challenges. This section will explore some ways in which major technologies have presented both opportunities and challenges for people in their daily lives.

The Presence of the Internet

More people have more access to technology than ever before. Residents of developing countries increasingly enjoy energy-powered appliances, entertainment devices, and communications equipment. Individuals in developed countries in North America, Europe, portions of Asia, and the Middle East more than ever are dependent on electronic communication devices for access to information and for interactions with others and businesses. In today's environment, nearly every individual in a developed country has a desktop or laptop computer, tablet, mobile phone, and a host of other electronic devices to connect them with others in their family, neighborhood, country, or world and this is becoming true for more and more people in developing countries as well.

One of the most visible and widely used technological innovations over the past decade has been the Internet. Springing to life in 1994, this conduit of information revolutionized

[5] For more information see *The Industry Handbook: Biotechnology* at *www.investopedia.com;* and Ashish Swarup Verma, Shishir Agrahari, Shruti Restogi, and Anchal Singh, "Biotechnology in the Realm of History," *Journal of Pharmacy and BioAllied Sciences,* July–September 2013, pp. 321–3, *www.ncbi.nlm.nih.gov/pmc/articles*.

how business was conducted, students learned, and households operated. The *Wall Street Journal* reported that Generation Z, individuals born after 2000, access most of their video entertainment from Internet streaming services, such as YouTube (34 percent) and Netflix (27 percent), compared to traditional TV (27 percent).[6]

Any estimate of the number of Internet users is quickly out of date but some important trends have emerged. In 2008, China surpassed the United States with the most Internet users by country. By 2017, India surpassed the United States and Japan to become the country with the second largest number of Internet users. Indonesia, with 50.4 percent of its population using the Internet, moved up from eleventh place to fifth place based on number of Internet users by country by 2017. The top 10 countries by Internet usage in 2017 are shown in Figure 11.2.

This figure also shows the emerging markets for Internet usage: Africa (more than 8,000 percent growth since 2000), the Middle East (more than 4,000 percent growth), and Latin America/Caribbean (more than 2,000 percent growth). Developing countries, especially in the Southern Hemisphere, are catching up with developed countries in the integration of Internet usage into the lives of managers and citizens.

Thousands of new Internet users each day demonstrate the power of this technology as a force in our lives. The Internet is increasingly being used as a place for interpersonal communication, social networking, and shopping, as described later. Yet, technology experts are warning of the potentially negative impacts on our lives of dependence on technology.

Social psychologist Adam Alter warns that many children, teenagers, and adults are behaviorally addicted to modern digital products, indicated by the significant amount of time they are engaged in using their cellphones or other devices. Unlike a physical dependence on a habit-forming chemical substance such as heroin or nicotine, **behavioral addiction** refers to a compulsion to engage in rewarding behaviors, such as checking one's Facebook feed, despite negative consequences. Alter says that some teenage boys spend weeks alone in their rooms paying video games, and Snapchat boasted that young users open their app more than 18 times a day.[7]

Technology manufactures are accused of contributing to the increasing behavioral addiction to technology. Some of the games available on an individual's smartphone require that users pay money as they play. Obviously, the game producers want users to keep playing, and they often pretest different versions of a game before release to see which version is the hardest to resist or will keep users' attention the longest. South Korea and China are considering legislative proposals, called Cinderella laws, to protect children from playing certain games after midnight. In China, there are camps where parents commit their children for months so that therapists can treat them for their technology addiction.[8]

When Facebook founder, Mark Zuckerberg, was challenged with the accusation that Facebook users were spending far too much time on the social network platform, he responded that he wanted his company and its product "to encourage meaningful social interactions." He added, "time spent is not a goal by itself."

Yet, a 2017 study conducted by the Royal Society for Public Health in the United Kingdom evaluated five of the most frequently used social networks, (Facebook, Twitter, Snapchat, Instagram, and YouTube), and concluded that all but one, YouTube, had a negative effect on the user's mental health. In another study, Tel Aviv

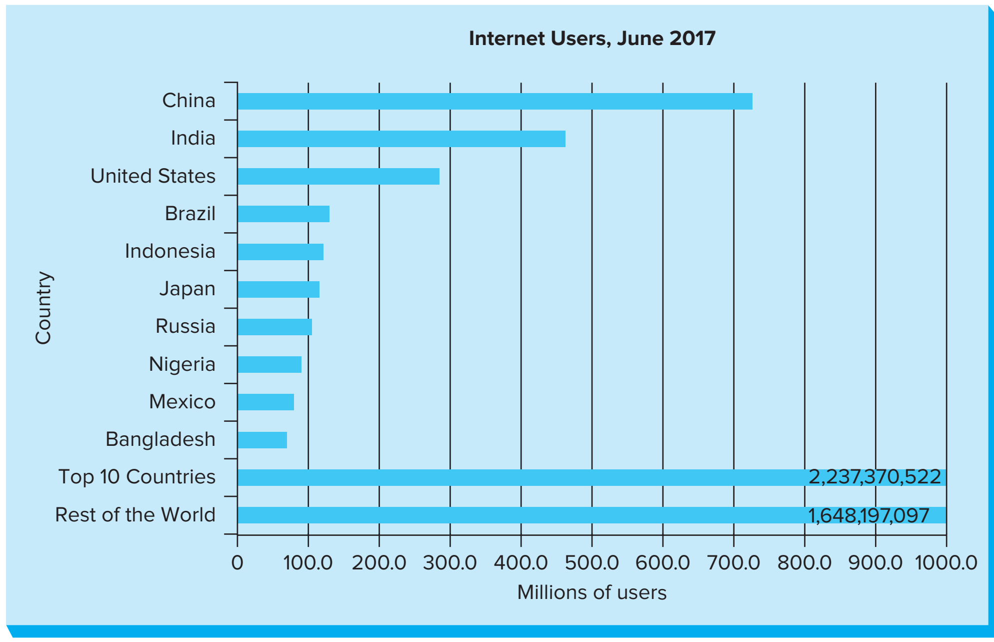
[6] "How Gen Z Watches," *The Wall Street Journal,* November 27, 2017, *www.wsj.com*.

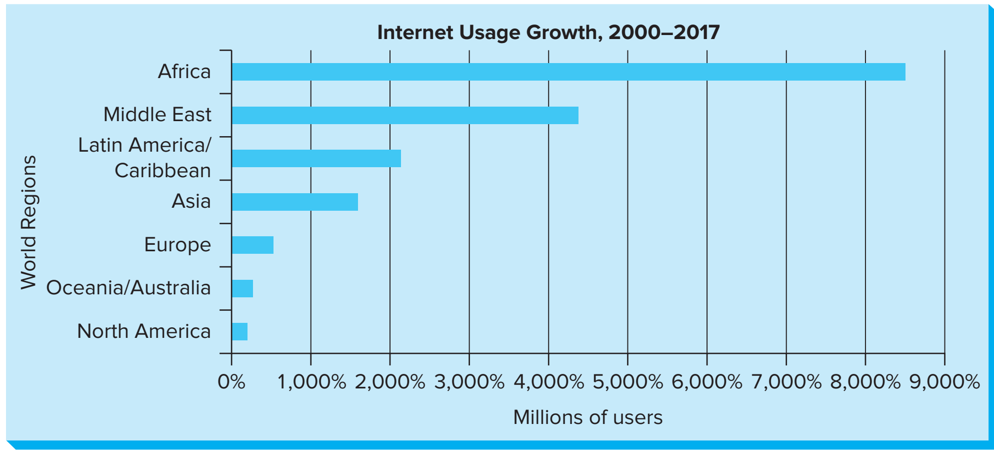
[7] "Why We Can't Look Away from Our Screens," *The New York Times,* March 6, 2017, *www.nytimes.com*.

[8] "Why We Can't Look Away from Our Screens," *The New York Times,* March 6, 2017, *www.nytimes.com*.

FIGURE 11.2 **Top 10 Internet Use by Country, 2017, and Growth in World Internet Usage by Region, 2000–2017**

Sources: "Top 20 Internet Countries—2017" and "World Internet Usage and Population Statistics June 30, 2017—Update" Internet World Statistics, *www.internetworldstats.com*.





University researchers found that people using Facebook can begin to feel that their own lives do not measure up to those of others, causing depression, especially among young people.[9]

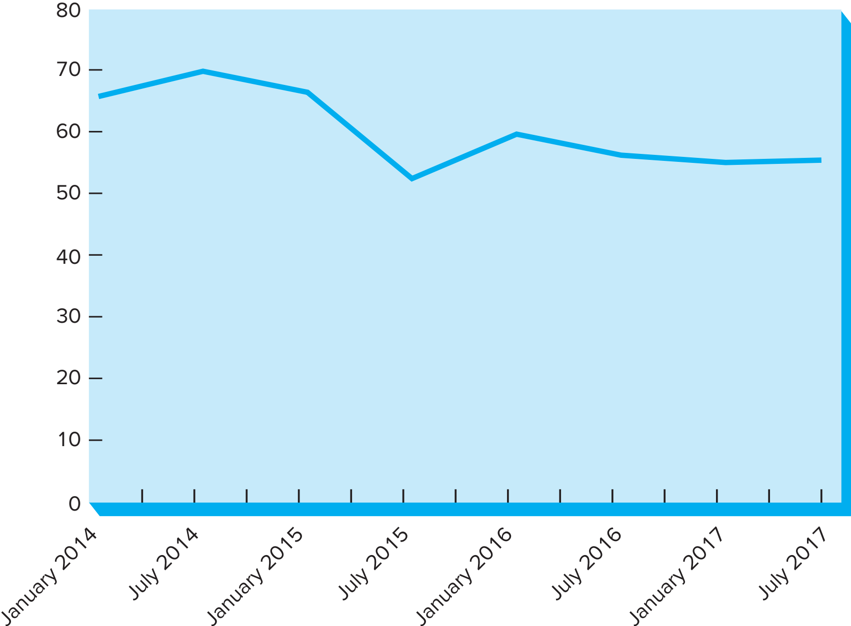
Unwanted Technology Threats

The presence of the Internet in our lives is a welcomed benefit, but it has also opened the door to various threats, such as *spam* and *phishing*. **Spam** refers to unsolicited commercial e-mails (also called *junk e-mail*) sent in bulk to valid e-mail and mobile accounts. These messages

[9] "Zuckerberg's Dilemma: When Facebook's Success Is Bad for Society," *The Wall Street Journal,* January 7, 2018, *www.wsj.com*.

FIGURE 11.3
Global Spam Volume as Percentage of Total E-Mail Traffic from January 2014 to July 2017

Source: "Global Spam Volume as Percentage of Total E-mail Traffic from January 2014 to July 2017," *The Statistics Portal,* accessed February 1, 2017, *www.statista.com/statistics/420391/spam-email-traffic-share*.



can vary from harmless advertisements for commercial products to offensive material and finance scams. Spam has created problems for users as it has caused extra network traffic and wasted time sorting through the irrelevant or unwanted e-mails to access desired messages. By the early 2010s, spam began to infiltrate e-mail accounts on mobile or cell phones.

As shown in Figure 11.3, the volume of spam messages around the world, as a percentage of all e-mail traffic, began to fall somewhat, from nearly 70 percent in July 2014 to around 55 percent in 2017. The main reason was the overall heightened level of antispam protection, according to a spokesperson at Kaspersky Labs, the world's largest antivirus and Internet security software company. Spam filters are now in place on just about every e-mail system, reducing the amount of spam reaching both personal and corporate user accounts. Also, aggressive action taken by governments, especially in the United Kingdom and United States, have created strong penalties for spammers caught sending out malicious e-mails.

Compounding the problem of spam or unsolicited commercial e-mail is **phishing**. This involved the practice of stealing consumers' personal identity data and financial account credentials by using fake e-mails that appeared to be from legitimate businesses to trick users into divulging identifying personal data such as usernames and passwords, or to open attachments that installed viruses or malware (malicious software). A 2017 report from the Anti-Phishing Working Group (APWG), a U.S. industry association, reported a consistent stream of phishing activity, with several hundred companies targeted regularly. Phishing attacks occurred most frequently in the payment, financial, and webmail sectors. Of the nearly 8,000 attacks reported, many were spread via Facebook and half were hosted in the United States.[10]

Although Internet users were more aware of potential problems that might be encountered when using their e-mail and smartphones and were taking precautions to prevent unwanted spam or phishing, new intrusions emerge, particularly through unwanted solicitation calls to cell phones. These threats continue, and users need to remain vigilant.

[10] "Phishing Activities Trends Report," *Anti-Phishing Working Group,* published October 2017, *www.antiphishing.org/reports*.

Public Access to and Use of Technology

Overall, the public has more access to and uses more technology than ever before. Yet, inequalities remain in individuals' ability to access technology, whether within the United States or around the world. Certain technological devices, including mobile telephones, a new form of currency called bitcoin, and social media platforms, are more readily available to some than others. These issues are discussed in greater depth in this section.

The Digital Divide in the United States and Worldwide

The gap between those who have access to the Internet through technology and those who do not is called the **digital divide**. Some people have Internet access through computers, cell phones, and other devices; others do not. People in developing countries often have less Internet access than people in developed countries; and within developed countries, persons of color and the less affluent often have less access. The presence of a digital divide is a problem because less advantaged individuals and societies may not enjoy the same benefits of technology as others.

In the United States, the government has acted to break down the digital divide. The U.S. government launched a $7 billion effort to expand access, chiefly thorough grants to build wired and wireless systems in the most technologically neglected areas of the country. This government effort subsidized Internet upgrades for schools and libraries and provided digital textbooks in poor and rural areas.[11]

By 2013, reports claimed that nearly 98 percent of American homes were able to access the Internet on some sort of high-speed broadband network, either at home or work. Yet, in 2017, the *MIT Technology Review* pointed out that "the U.S. has 'a persistent, embarrassing digital divide' that needs to be addressed at the highest levels." Moreover, the report emphasized that, "mobile broadband access isn't the same as at-home connectivity," even though some people in the Federal Communication Commission and the executive branch of the federal government are making that case. Access to high-speed Internet services remains "uneven" for many Americans.[12]

> Microsoft announced plans in 2017 to address the digital divide in the United States by harnessing the unused channels between television broadcasts, known as white spaces, to help get more of rural America online. The initiative targeted twelve states, including Arizona, Kansas, New York, and Virginia, to provide two million rural Americans with access to high-speed Internet by 2022. Microsoft's president Brad Smith explained, "[white spaces are] the best solution for reaching over 80 percent of people in rural America who lack broadband today." Microsoft also reached out to federal and state regulators to guarantee the use of unused television channels and investments in promoting the technology in these rural areas.[13]

The digital divide also persists globally. According to a United Nations report, by 2017, more than 52 percent of people on the planet still did not have Internet access, despite efforts by some technology companies. Many businesses saw providing Internet access at the bottom of the pyramid as a lucrative business opportunity.

[11] "F.C.C. Chief Aims to Bolster Internet for Schools," *The New York Times,* November 17, 2014, *www.nytimes.com*.

[12] "The 2017 Digital Divide," *MIT Initiative on the Digital Economy,* September 1, 2017, *medium.com*.

[13] "To Close Digital Divide, Microsoft to Harness Unused Television Channels," *The New York Times,* July 11, 2017, *www.nytimes.com*.

> Smartphone maker BlackBerry unveiled a new model, the Aurora, exclusively targeting mobile phone users in Indonesia. Its low-cost touch-screen model retailed for 2.2 million rupiah, or about $190, and contained a number of special applications for Indonesian users, including local banking and travel services and a directory of halal food outlets, critical in the world's largest Muslim-majority country. A few years later, BlackBerry shifted the manufacturing of the Aurora to Indonesia.[14]

Despite efforts undertaken by BlackBerry, as well as other programs launched to boost the digitally developing economies around the world, the United Nations reported "massive disparities in connection speeds in different countries." With average global Internet speeds at 7.7 megabits per second (Mbps), South Korea had an average broadband speed of 28.6 Mbps, but Nigeria had a slow 1.5 Mbps on average. Based on a 40-metric score, the average increase in broadband speed among developed countries was 4.7 points in the last 12 months [2016–2017], but only 2.4 points in developing countries.[15]

Mobile Telephones

Mobile telephones, or cell phones, use radio technology to enable users to place calls from a mobile device, with transmission over a service area divided into small "cells," each with its own low-power radio transmitter. The first generation of cell phones, introduced in the 1980s, were clumsy analog devices; today's digital smartphones, by contrast, provide a range of applications, including e-mail and Internet access, voice communications, video recording, and many more.

Coca-Cola and Nokia first installed vending machines in Finland in 1997 that accepted payment via text message, or SMS as it was called then. In North America, mobile phones usage was initially mainly as a communications tool. But American cell phone users, and users in developing countries, have joined Europeans and Asians to embrace using their mobile phones for commerce. **M-commerce**, commerce conducted via mobile or cell phones, allows consumers to use their mobile phones as an electronic wallet. In a 2017 study conducted in nine countries, Mobile Ecosystem Forum found that 78 percent of the 6,000 individuals surveyed had made M-commerce purchases in the last six months. The report also showed what consumers were purchasing using mobile payments, where mobile payments were being used, and how consumers were using mobile payments, as shown in Figure 11.4.[16]

Mobile devices can be used for more than making calls or shopping. These devices can run apps and GPS systems, access the Internet, send text messages and photos, and stream music and videos. Use of mobile devices is the norm for the newest generation of consumers. Rytis Vitkauskas, founder and CEO of YPlan, said: "There's an expectation that any transaction will take a minimum amount of effort. The Gen-Y person doesn't really think about buying something as a transaction any more. It's an act of consumption where payment is an afterthought and must be seamless."[17] As Rimma Perelmuter, CEO of Mobile Ecosystem Forum, observed,

> "The adoption of mobile money continues to advance. In developed markets, mobile payments and banking are driving a revolution in convenience. In growth

[14] "BlackBerry Unveils Low-Cost Smartphone with Indonesia in Mind," *The New York Times,* May 13, 2014, *www.nytimes.com;* and "BlackBerry Happy with Indonesian Market," *The Jakarta Post,* October 25, 2017, *www.thejakartapost.com*.

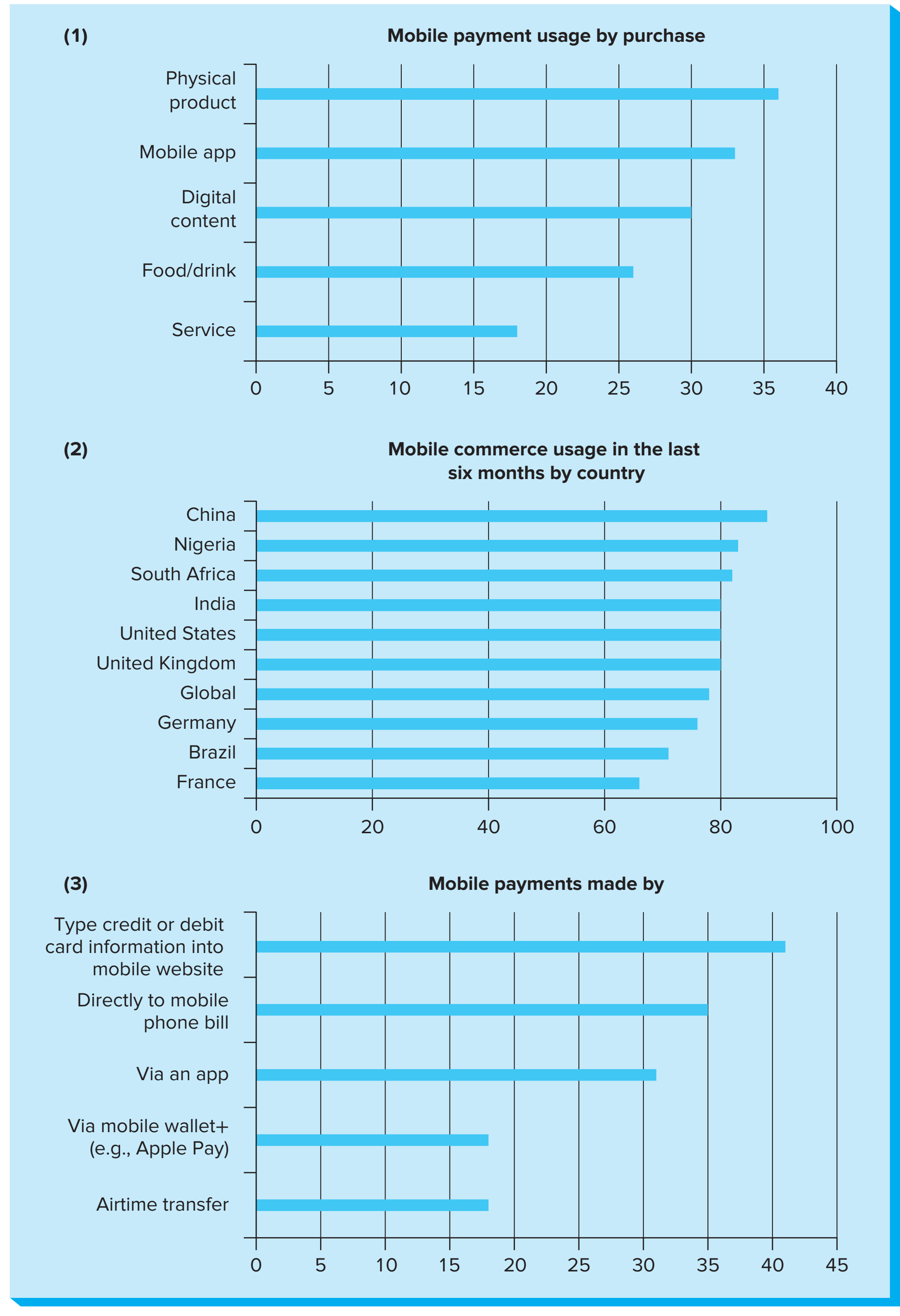
[15] "The UN Says the Global Digital Divide Could Become a Yawning Chasm," *MIT Technology Review,* September 15, 2017, *www.technologyreview.com*.

[16] "Mobile Commerce, Payments and Banking: 7 Key Facts," *Wirecard.com,* April 27, 2017, *blog.wirecard.com*.

[17] "One-click Checkouts and Pay-by-Selfie: The Rise of Mobile Commerce," *The Guardian,* June 23, 2016, *www.theguardian.com*.

FIGURE 11.4
Use of Mobile Payments, by Country, 2017

Source: "Mobile Commerce, Payments and Banking: 7 Key Facts," *Wirecard.com,* April 27, 2017, *blog.wirecard.com*.



markets, they are giving millions of people access to financial services for the first time. It's important that the industry builds on this momentum. But overall, the news is good: mobile remains the key driver of online commerce."[18]

[18] "Mobile Commerce, Payments and Banking: 7 Key Facts," *Wirecard.com,* April 27, 2017, *blog.wirecard.com*.

Exhibit 11.A

Want to Pay at KFC? You Don't Need Cash or a Credit Card

When customers walk into a Kentucky Fried Chicken store in Hangzhou, China, they encounter a modern, high-technology fast-food restaurant. An open design allows customers to look into the kitchen to see how their food is being prepared. Hanging plants create a friendly atmosphere. The expanded menu includes tuna-and-pesto paninis and quinoa-and-corn salads. When customers make their food selections, they have three options for payment: via smartphone, using QR codes printed on tables, or through a facial-recognition system that matches the consumer's image to their Alipay digital wallets.

Muktesh "Micky" Pant, CEO of Yum China, conceded he was skeptical of the emphasis on apps for payment in the store, telling his team they were too complicated. His employees told him to "just hang on, and I'm glad I didn't interfere. People have far more apps on their phone, and they are able to navigate them effectively."

Yum China collaborated with Alibaba Group Holding, the world's largest retailer operating in over 200 countries. This partnership helped create a self-serve kiosk for customers to select their food items on a screen and then pay by looking into a camera, provided they have enabled their facial-recognition on their Alipay app. Customers can also use their smartphone to pay for their meal using a variety of apps, including Apple Pay, WeChat, Android Pay, Samsung Pay, and others. Mobile payments at Yum China's 7,700 KFC and Pizza Hut restaurants represented 45 percent of sales by 2016.

Source: "Fast Food Gets a Reboot in China: Tuna-Pesto Paninis, Paid for by Facial Recognition," *The Wall Street Journal,* November 6, 2017, *www.wsj.com*.

The ability of a consumer to pay for products and services continues to be easier and easier, as discussed in Exhibit 11.A, as facial recognition and other technologies surfaced in the world of consumer purchasing.

But with the potential for greater mobile device activity worldwide, some stakeholder groups warned that increased usage would be accompanied by increased frustration. Critics predicted more unwanted and unsolicited mobile text messages and incidents of malware and spyware.

Another emerging technology that more and more people around the world are using in significant numbers is bitcoin. A **bitcoin** is a digital currency that operates independently of the banking system and uses encryption techniques to verify the transfer of funds. Some believe that the software that brought bitcoin into existence may also enable a fundamentally new way of transacting and maintaining records online—allowing people and banks to directly exchange money and assets like stocks and bonds without having to rely on expensive intermediaries. This innovation is discussed in detail in Exhibit 11.B.

Social Networking

Social networking, a system using technology to enable people to connect, explore interests, and share activities around the world, exploded onto the technology scene in the 2000s, altering many social and human interactions.

As with estimating the number of Internet users, any estimate on the number of people using social media is quickly outdated the moment the calculations are completed. What is undeniable is that the number of individuals using social media continues to rise, as shown in Figure 11.5. Facebook is the most frequently used social network, with more than 2.1 billion active users by 2018, with YouTube, WhatsUp, Facebook Messenger, and WeChat among the most popular social networks, all with around 1 billion users by 2018.[19]

[19] "Most Popular Social Networks Worldwide as of January 2018, Ranked by Number of Active Users," *The Statistics Portal,* accessed January 30, 2017, *www.statista.com/statistics/272014*.

Exhibit 11.B

Bitcoin: The Currency of the Future?

Initially many people thought a bitcoin was science fiction or something used by drug dealers and shadowy hackers looking to evade authorities. Starting in 2017, bitcoins emerged as a legitimate digital currency and quickly became the darling of Wall Street investors. In less than two days in December 2017, the price of one unit of the digital currency jumped to $16,000, briefly hitting $19,000 on some exchanges. Then, a week later, the value of the bitcoin plummeted 25 percent. By February 2018, bitcoin had plunged below $8,000, and four months later the value of a bitcoin was around $6,500.

Peoples' confidence in the security of bitcoin was shaken when it was reported that nearly $70 million worth of the currency had been stolen from a cryptocurrency-mining service called NiceHash following a security breach. Two weeks later, Korean-based Youbit went out of business after experiencing a second hack where digital thieves stole one-fifth of its clients' bitcoin holdings.

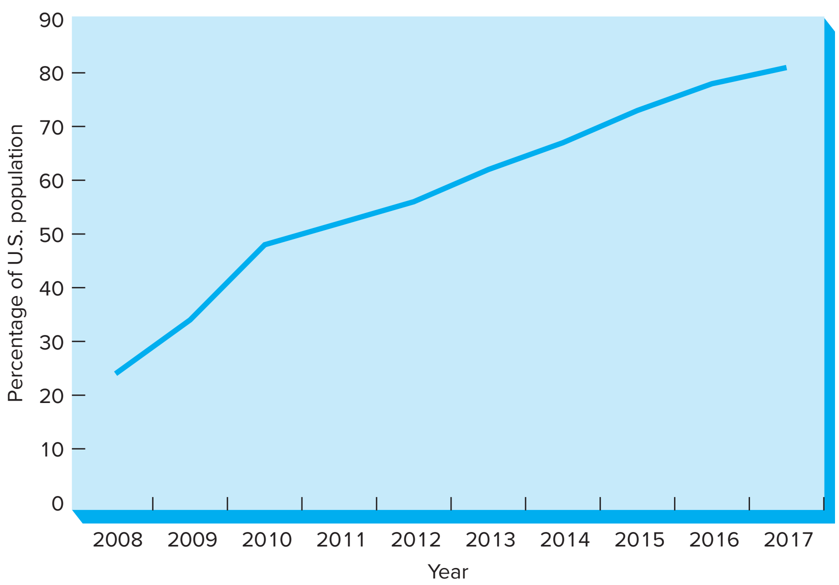
Yet, despite these risks, bitcoins continue to hold considerable potential as a new form of currency. Because bitcoin functions on a technology called *blockchain,* a relatively secure, non–record-based ledger form of accounting using cryptography, it offers a quicker and cheaper option for processing financial transactions. Bitcoin is considered desirable since the blockchain technique protects against things like identity theft and payment fraud more thoroughly than a credit-card transaction ever could.

Others argue that bitcoin is riddled with problems, including the potential for tax evasion or to support illegal or unethical transactions. Perhaps the biggest issue with bitcoin is the general lack of understanding surrounding the cryptocurrency. Several studies have shown that people, including bitcoin users, do not really understand how bitcoin works and whether or not it is secure, as the incidents of cyberhacking attest.

Sources: "Bitcoin's Wildest Ride: Up 40% in 40 Hours," *The Wall Street Journal,* December 7, 2017, *www.wsj.com;* "Hackers Steal $70 Million in Bitcoin," *The Wall Street Journal,* December 7, 2017, *www.wsj.com;* "Bitcoin Exchange Goes Bust After Hack," *CNN,* December 20, 2017, *money.cnn.com;* "Bitcoin Is Falling Fast, Losing More Than Half Its Value in Six Weeks," *The Wall Street Journal,* February 2, 2018, *www.wsj.com;* and "The Pros and Cons of Bitcoin," *Investor Place,* May 7, 2018, *www.investorplace.com*.

FIGURE 11.5
Americans with a Social Profile, 2008–2017

Source: Extracted from "Percentage of U.S. Population with a Social Media Profile from 2008 to 2017," *The Statistics Portal,* accessed January 30, 2017, *www.statista.com/statistics/273476*.



Clearly the dramatic rise in social networking has taken the world by storm and has become a central aspect of individuals' lives. With these new ways to interact with others comes additional responsibilities to ensure that the interactions are ethical and socially beneficial as individuals and businesses began to realize.

Recently individuals discovered that their social media sites were accessed by various companies, especially when seeking employment. Carnegie Mellon University researchers

examined Google's ad-targeting system and found that male web users were six times more likely than female users to be shown ads for high-paying jobs. Veterans learned that they were automatically disqualified for civilian jobs because human resources software used by employers did not recognize the skills they had acquired in the military. Researchers believed that programmers had embedded biases into the software without realizing it.[20]

As social networking sites become more and more embedded in the lives, businesses and users need to ensure that the social network sites enhance our lives, not lead to serious mental or physical problems.

Ethical Challenges Involving Technology

With each new technological innovation comes the important ethical question: *Should* we develop and offer the new technological application? At present, many inventors, computer programmers, and business managers appear only to be asking: *Can* we develop and offer the new technological application? Both questions are paramount as technology continues to influence individuals, businesses, and society interactions in the world in which we live. Some of the most profound ethical issues involve privacy and free speech.

The Loss of Privacy

The **right to privacy**, as introduced in Chapter 5 and also discussed in Chapters 14 and 15, refers to a person's entitlement to protection from invasion of his or her private life by the government, business, or other persons. In many respects, the rise of the Internet and the Information Age have led to a loss of privacy. According to Richard Clarke, former senior White House cybersecurity adviser:

> "Over time there will be few people who recall pre-Information Age privacy, more people who will have grown up with few expectations of privacy. While a backlash against the erosion of privacy is possible, it is more likely that people acting on their fear of big government and big corporate data will be a minority."[21]

Individuals are indeed under a technology microscope with vast amounts of data collected each minute and available to be analyzed in great detail, sometimes by people with the individuals' interests in mind, such as marketers, job recruiters, and loan grantors, but also by others who have criminal motives. Facebook announced in 2018 a data partnership with four Chinese electronics firms, bringing the number to 60 different data sharing partnerships since 2007.[22]

This dramatic increase in data sharing has led to some users to ask: Can what I post online or store on my electronic devices be used against me if accessed by government enforcement agencies? Recently, this issue arose when the FBI sought to compel Apple to unlock the phone of a man involved in a terrorist attack, the focus of the discussion case at the end of this chapter. But online activity can be used as evidence in everyday legal proceedings, too.

> According to an online transparency report, Facebook received 14,274 requests involving 21,731 accounts from U.S. law enforcement agencies in just six months. That is far more than companies like Twitter, which received just 1,622 requests

[20] "How Social Bias Creeps Into Web Technology," *The Wall Street Journal,* August 21, 2015, *www.wsj.com*.

[21] "Will Privacy Be a Thing of the Past?" *The Wall Street Journal,* July 8, 2014, *blogs.wsj.com*.

[22] "Facebook Confirms Data-Sharing Deals with Chinese Tech Firms," *The Wall Street Journal,* June 5, 2018, *www.wsj.com*.

> during the same period. Facebook provided information for nearly 80 percent of those requests. Nevertheless, the practice remains controversial, especially when law enforcement casts a wide net.[23]

Invasions of individual privacy come from many different directions. Automobiles are becoming smarter, with global positioning systems, Internet connections, data recorders, and high-definition cameras. While automakers say they are only responding to consumer demands, these new technologies increase the number of people with access to individuals' data. In 2014 a law was introduced in the United States that would enable car owners to control the data collected on the in-car device called the *event data recorder,* commonly known as a black box. The legislation was spurred by the clash over the use of personal data by law enforcement agencies and insurance companies, seeking to use the information against the car owners.

Ethical challenges on how this information is collected and analyzed, and by whom, are becoming increasingly salient.

Free Speech Issues

Another important ethical issue posed by advances in technology involves free speech. As discussed in Chapter 5, individuals have certain ethical rights, including the right to free speech. However, this right is not absolute and must be weighed against its consequences for the community. For example, an individual is not permitted to yell "fire" in a crowded movie theater, even though some might see this as an expression of free speech, since the potential harms caused by panicked moviegoers outweighs the right of free expression. The issue of free speech was at the core of *Elonis v. United States* in 2015.

> Anthony Elonis was accused of threatening his estranged wife based on a series of Facebook posts. Elonis likened the posts to Eminem's Grammy-winning songs "Kim" and "Kill You," which included threats of violence. He argued that he was only venting frustration after a run of personal setbacks, including the collapse of his marriage and loss of his job. He thought, like the artist Eminem, that he was just expressing his thoughts to a crowd, those accessing his Facebook page, as the singer had to his concert audience. The Justice Department argued that Elonis's posts indicated a "clearly sinister meaning of a threat" and were meant as expressions of his intent to harm his wife. The Supreme Court overturned Elonis' earlier conviction arguing that criminal threats cannot be based solely on whether a reasonable person would regard communications posted on social media or elsewhere as threatening.[24]

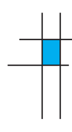
Other controversial issues involving free speech have appeared recently, such as when Facebook shutdown a popular anonymous discussion board used by Facebook employees in 2016. *FB Anon* was a discussion forum that featured conservative political views that some claimed generated into racist or sexist comments. Facebook defended their actions by saying, "A cornerstone of our culture is being open. The *FB Anon* internal Facebook group violated our terms of service, which require people who use Facebook, including our employees, to use an authentic identity on our platform." Facebook reminded their employees that there were other forums where they could discuss confidential matters, but not anonymously. Some employees disagreed with Facebook's actions, saying that free

[23] "Surveillance Society: Throw the (Face)book at 'em," *Pittsburgh Post-Gazette,* July 20, 2015, *www.post-gazette.com*.

[24] "In Social-Media Era, When Is Free Speech Illegal?" *The Wall Street Journal,* November 23, 2014, *online.wsj.com;* and "Supreme Court Overturns Conviction for Threats on Facebook," *The Wall Street Journal,* June 1, 2015, *www.wsj.com*. Also see *Elonis v. United States* at *www.scotusblog.com/case-files/cases/elonis-v-united-states*.

speech was paramount and this forum provided “lots of information that you would not have had otherwise.”[25]

Undoubtedly, the debate over free speech versus censorship will continue and likely intensify as the frequency of using public forums on Facebook and other social network mediums also increases. In many countries around the world, the government has stepped in to control the Internet or social media sites under the banner of national security. These actions directly pit government interests against individual rights. This conflict is discussed next.



Government Censorship of Free Speech

Governments play various and sometimes conflicting roles with respect to an individual’s free speech. In some countries, particularly in nondemocratic regimes, governments censor and restrict citizen’s free speech. In democratic countries, the role of government is more likely to look out for the public good and protect intellectual property; that is, the private ownership of certain kinds of information and a citizens’ right to express themselves. What is the appropriate role of government in controlling use of the Internet and of citizens’ free speech? Does the government overstep its authority, for example, when imposing censorship on social media sites? These various government approaches to free speech are addressed next.

In some nondemocratic or authoritarian societies, governments have attempted to limit their citizens’ access to the Internet based on political, security, and religious grounds. These efforts have become increasingly more common and more sophisticated in recent years.

- *China.* In 2017, China announced it would impose new rules controlling its citizens’ use of instant-messaging apps, video streaming, and other content platforms. The government argued that these platforms were being used to engage in illegal behavior and must be stopped. The Cyberspace Administration of China said, “the new technologies can be used by criminals to spread illegal information and undertake criminal activity, harming the lawful interests of citizens, legal persons, and other organizations.”[26] These rules affected the 700 million Internet users in China.
- *Pakistan.* During the past decade, the Pakistani government, with the support of conservative Islamic groups, broadened an existing ban on social networking sites. In 2016, the Pakistani legislature passed the Pakistan Electronic Crimes Act (PECA). PECA allows the government to issue social media takedown notices for any material deemed to be “in the interest of the glory of Islam or the integrity, security or defense of Pakistan . . . or public order, decency or morality.”[27] Within a year after the law came into effect, at least 147 people had been arrested and 194 cases registered under the law for various offences, including online sexual harassment, according to the Pakistani interior ministry. Many of those accused were told their social media activities were being closely monitored, leading to their detention or arrest.
- *Iran.* Since 2009, after contentious presidential elections that pitted various religious groups against each other, the elected Iranian government banned Facebook, Twitter, YouTube, and later Instagram. Based on the ruling party’s religious-political stance and the country’s official philosophy: “the media should be used as a forum for healthy encounter of different ideas, but they must strictly refrain from diffusion and propagation of destructive and anti-Islamic practices.” When protests broke out in December

[25] “Facebook Shut Down Employee Chat Room Over Harassing Messages,” *The Wall Street Journal,* August 16, 2017, *www.wsj.com*.

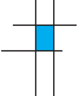
[26] “Chinese Internet Regulators Target Social Media Use,” *The Wall Street Journal,* October 30, 2017, *www.wsj.com.*

[27] “Social Media Crackdown Stifles Dissent in Pakistan” *Aljazeera,* November 24, 2017, *www.aljazeera.com*.

2017 in opposition to the government's economic policies, the regime renewed its ban of mobile Internet access and blocked apps including Telegram and Instagram.[28]

- *North Korea.* North Korea is one of the world's most notorious censors of the Internet. In 2013 the Korean government adopted a policy that only foreigners could conduct Internet searches on mobile devices and laptops; its citizens could not. In 2016, the North Korean government went further, formally blocking all access by its citizens to Facebook, Twitter, YouTube, and other social media platforms. These actions made it more difficult for its citizens to post real-time information about conditions in North Korea.[29]

In each of these instances, governments intervened to restrict their citizens' access to information and various Internet and social media sites, generally to suppress political dissent or to impose particular religious or ideological views. In most democratic, Western nations, such interventions would not be tolerated. Sometimes a government accesses information for the public good and limits individual rights; while at other times, governments support individuals' control over their personal information.



The Impact of Scientific Breakthroughs

Dramatic advances in the biological sciences have propelled the impact of technology on our lives. Recent unprecedented applications of biological science have made possible new, improved methods of agricultural food production as well as medical care, but they have also posed numerous ethical challenges regarding safety and the quality of life. Four of the most profound impacts on our lives come from the scientific breakthroughs in genetically modified (GM) or engineered foods; the sequencing of the human genome and the use of genetic information; the advent of biotechnology and the resulting stem cell research; and the development of radically new medical procedures, delivery, and record keeping. These topics are discussed in this section.

> As Bill Joy of Sun Microsystems warns, speaking of biotechnology as well as other innovative applications of science, "21st century technologies . . . are so powerful that they can spawn whole new classes of accidents and abuses. Most dangerously, for the first time, these accidents and abuses are widely within the reach of individuals or small groups. They will not require large facilities or rare raw materials. Knowledge alone will enable the use of them."[30]

Genetically Engineered Foods

The biotechnological revolution resulted in applications for use by the agricultural industry and brought promises of larger than ever crop production through advances in genetic engineering of food. *Genetic engineering* involves altering the natural makeup of a living organism and allows scientists to insert virtually any gene into a plant and create a new crop or a new species.

Genetically modified foods, or GM foods, are foods that are processed from genetically modified crops. The explosion of GM foods into our food chain in just a few decades was remarkable. In 1982 the first tomato plant was genetically engineered. Corn was genetically modified to develop a resistance to insects, and soybeans were genetically modified to resist the weed-killer Roundup, enabling farmers to spray for weeds without harming

[28] "Iran Moves to Block Social Media Apps, Mobile Networks as Protests Spread," *Gizmodo,* December 31, 2017, *gizmodo.com*.

[29] "North Korea Announces Blocks on Facebook, Twitter and YouTube," *The Guardian,* April 1, 2016, *www.theguardian.com*.

[30] Bill Joy, "Why the Future Doesn't Need Us," *Wired,* April 2000, *www.wired.com*.

the crop. At first, expectations were high that these changes would increase crop yields per acre. However, results have been disappointing.

A *New York Times* report, using United Nations data, reported that there has been no discernable advantage in crop yields in the United States and Canada—measured by food per acre—when measured against Western Europe crop production, where significant genetically modified food controls are in place. A study by the National Academy of Sciences confirmed this finding when it stated that there was little evidence that the introduction of genetically modified crops in the United States has led to yield gains beyond those seen in conventional crops.[31]

Some critics charged that consuming genetically modified crops would harm humans. Despite a lack of scientific evidence that GM foods are harmful to humans, social advocates in Europe led the charge against genetically modified foods, calling GM foods "Frankenstein foods."

In the late 2000s, both France and Germany passed national bans on the use of various kinds of GM seeds. Despite French and German farmers' protests that the ban would inflict great economic harm on them and their countries' economies, the German agriculture minister said, "The decision is not a political decision, it's a decision based on the facts." He affirmed the government's commitment to protect the safety of consumers and the environment. Austria and Hungary also passed their own national bans on growing GM crops. While Europe continued to allow each nation to decide whether to allow the planting or sale of GM foods, the European Union passed a GM food labeling law so that all European consumers can also make their own decisions to purchase this type of food or not.[32]

By contrast with Europe, GM foods became quite common in grocery stores in the United States. Although most GM corn grown in the United States was made into animal feed or ethanol, it was also processed into food industry staples such as corn syrup or tortilla chips. GM food has its advocates. Over one hundred Nobel laureates, individuals honored for their contributions to science, the arts, or global social issues, drafted a letter in 2016 that touted the value of GM foods for a ballooning global population. This group took specific aim at a global non-profit organization: Greenpeace.

In the Nobel Laureates' letter, they wrote: "Greenpeace has spearheaded opposition to Golden Rice, which has the potential to reduce or eliminate much of the death and disease caused by a vitamin A deficiency (VAD), which has the greatest impact on the poorest people in Africa and Southeast Asia." Greenpeace countered by explaining: "Corporations are overhyping 'Golden' rice to pave the way for global approval of other more profitable genetically engineered crops." Dr. Richard J. Roberts, a Nobel Prize winner in 1993 for physiology and medicine, replied, "There's been a tremendous amount of misinformation being put out by Greenpeace."[33]

The debate over the human nutritional value of GM foods versus the potential for businesses to profit from their development and distribution of these foods rages on.

It appears that the tide against GMO food in the United States was gaining momentum by the 2010s. In 2013, Ben & Jerry's Homemade initiated a plan to eliminate GM ingredients from its ice cream. In 2015, Chipotle Mexican Grille became the first major restaurant

[31] "Doubts about the Promised Bounty of Genetically Modified Crops," *The New York Times,* October 29, 2016, *www.nytimes.com*.

[32] "Europe to Allow Two Bans on Genetically Altered Crops," *The New York Times,* March 3, 2009, *www.nytimes.com*.

[33] "Stop Bashing G.M.O. Foods, More Than 100 Nobel Laureates Say," *The New York Times,* June 30, 2016, *www.nytimes.com*.

chain to serve only food free of genetically engineered ingredients. Whole Foods stores were on track to be free of all GMO products by 2018, and Walmart vastly expanded its selection of organic foods, free from genetic alternation.[34]

> In contrast, Campbell Soup, makers of Pepperidge Farms, Prego, Plum Organics, and V8, in addition to its well-known soup lines, announced in 2016 that it would become the first major food company to disclose GMO ingredients. Some felt that Campbell's action would risk a backlash by alienating consumers who believed that GM foods had adverse health effects, while others saw the company bowing to pressure to comply with increasingly popular GM food labeling laws. In July 2016, Vermont required disclosure of genetically engineered ingredients, a measure opposed by most major food companies.[35]

Sequencing of the Human Genome

When Celera Genomics Group announced that it had finished the first sequencing of a **human genome**, the achievement was hailed as the most significant scientific breakthrough since landing a man on the moon. Strands of human deoxyribonucleic acid, or DNA, are arrayed across 23 chromosomes in the nucleus of every human cell, forming a unique pattern for every human. These strands are composed of four chemical units, or letters, used over and over in varying sequences. These replicated letters total 3 billion and form the words, or genes—our unique human signature—that instruct cells to manufacture the proteins that carry out all of the functions of human life.[36] The identification of human genes is critical to the early diagnosis of life-threatening diseases, the invention of new ways to prevent illnesses, and the development of drug therapies to treat a person's unique genetic profile.

Over a decade later, the Human Genome Project had fueled the discovery of more than 1,800 disease genes and more than 2,000 genetic tests for human conditions were ongoing. These tests enabled a countless number of patients to learn their genetic risks for disease and also helped health care professionals to diagnose disease. One major step forward was taken in 2005 with the creation of the HapMap, which catalogs common genetic variation, or haplotypes, in the human genome. By 2010, the third phase of the HapMap project was published, with data from 11 global populations, the largest survey of human genetic variation performed to date.[37]

However, in addition to the remarkable advances in understanding DNA, touted as one of humanity's greatest achievements, numerous ethical challenges emerged in private and public research focusing on genetics.

> One family, afflicted by a rare genetic heart disease called Brugada syndrome, wondered how others might react if they learned of the family's medical condition. Would employers want to hire someone who might die prematurely or require an expensive implantable defibrillator? Would they be eligible for individual health care coverage or be able to afford life insurance if their condition were known? The underlying fear for this family and others with genetic conditions was whether they would be treated fairly if their genetic fingerprints became public.

The debate over whether advances in human genome sequencing and genetic research outweigh the risks or harms will continue for years. What is clear is that our scientific

[34] "The GMO Fight Ripples Down the Food Chain," *The Wall Street Journal,* August 7, 2014, *online.wsj.com;* and "Chipotle to Stop Serving Genetically Altered Food," *The New York Times,* April 26, 2015, *www.nytimes.com*.

[35] "Campbell Labels Will Disclose G.M.O. Ingredients," *The New York Times,* January 7, 2016, *www.nytimes.com*.

[36] "Genetic Secrets of Malaria Bug Cracked at Last" *The Wall Street Journal,* January 18, 2002, pp. B1, B6.

[37] Unfortunately, a computer security audit revealed flaws in its site that required it to be taken down.

understanding of the human body and its makeup has changed, and significant technological innovations are on the horizon. What is not clear is who, if anyone, can manage these changes to better ensure the improvement of the quality of our lives and society.

Biotechnology and Stem Cell Research

Complementing the discovery of DNA sequencing were numerous medical breakthroughs in regenerative medicine. Tissue engineering, the growth of tissue in a laboratory dish for experimental research, and **stem cell research**, research on nonspecialized cells that have the capacity to self-renew and to differentiate into more mature cells, were two such breakthroughs. Both offered the promise that failing human organs and aging cells could be rejuvenated or replaced with healthy cells or tissues grown anew. While the promise of immortality may be overstated, regenerative medicine provided a revolutionary technological breakthrough for the field of medicine.

Supported by private and government funding, hundreds of biotechnology companies and university laboratories were actively pursuing new approaches to replace or regenerate failed body parts. New discoveries were occurring quickly. Some promising breakthroughs included the following: researchers were able to insert bone growth factors or stem cells into a porous material cut to a specific shape, creating new jaws or limbs; genetically engineered proteins were successfully used to regrow blood vessels that might repair or replace heart valves, arteries, and veins; and the process to regrow cartilage was used to grow a new chest for a boy, and a human ear was grown on a mouse. A truly remarkable advancement in stem cell research occurred in China in 2018.

> Chinese scientists announced they had cloned two monkeys by transplanting donor cells into eggs, an achievement that scientists predicted could lead to genetically engineered primates for drug testing, gene editing, and brain research. The technique used to clone the monkeys was based on the somatic cell nuclear transfer technique pioneered 20 years ago by Scottish scientists to clone a sheep, named Dolly. Qiang Sun, director of the Nonhuman Primate Research Facility said, "For the cloning of a primate species, including humans, the technical barrier is now broken.[38]

Medical Breakthroughs

As discussed in one of the chapter's opening examples, breakthroughs in pharmaceutical care and medicine are occurring at a breathtaking pace. Innovations abound and seem limited only by our imagination.

> Anita Roy had an impaired blood flow to the left side of her brain. Dr. David Langer, chair of neurosurgery at Lennox Hill Hospital in New York, was about to perform bypass surgery on slender, delicate arteries to restore the circulation and prevent Anita from having a stroke. But, oddly, everyone in the operating room was wearing 3-D glasses and Langer was using a videomicroscope. The images of Anita's brain were shown on a 55-inch monitor and the scissors and scalpel used by Langer seems extraordinarily large and popped out of the screen vividly. The equipment produced magnified, high-resolution, three-dimensional digital images of surgical sites. Dr. Charles Branch, of Wake Forest Baptist Medical Center, praised 3-D surgery: "It's like being in the Imax [Theatre]. It lets not only the surgeon but everybody else in the room see what's going on. Instead of having to lean up against the microscope and strain my neck or back, I can stand comfortably, look at the big screen in front of me and work with my hands."[39]

[38] "China Breaks a Cloning Barrier: Primates," *The Wall Street Journal,* January 24, 2018, *www.wsj.com*.

[39] "Brain Surgery in 3-D: Coming Soon to the Operating Theatre," *The New York Times,* January 8, 2018, *www.nytimes.com*.

Medical revolutions are not only occurring in the operating room but in remote villages in Africa. Technology has entered the world of delivering medical supplies using drones, an innovation adopted by UPS, the world's largest package delivery company employing more than 434, 000 people globally.

> In 2016, UPS announced a partnership with drone startup Zipline and Gavi, the Vaccine Alliance, to deliver blood for transfusions by drones throughout Rwanda. While Amazon, Domino's Pizza, and other businesses speculated about drone delivery systems, UPS was experimenting with drone delivery and took a decidedly humanitarian approach. Piloting a program with the American Red Cross in 2016, UPS discovered that it could provide disaster relief through drone delivery. The new partnership with Zipline and Gavi enabled UPS to deliver life-saving medical supplies in Rwanda. The initial plan was for UPS-Zipline to make 150 blood deliveries a day from its central base in western Rwanda to 21 transfusing facilities within a 37-mile radius resulting in a 30-minute delivery commitment. "This is an elegant solution to a difficult problem," said Dr. Seth Berkley, CEO of Gavi. "This would have been great in the Ebola outbreak, when we actually had a boat delivering vaccines because of the poor road infrastructure."[40]

According to the World Health Organization, rural Africa's two billion people lack adequate access to essential medical care due to challenging terrain and roads. Zipline announced that it had plans to expand its delivery systems into Tanzania and other African nations within the next few years.

Technological breakthroughs in medicine bring challenges as well as benefits. Many in the health care field were overjoyed with the advances in electronic medical records, or EMR. By implementing EMR, patient data can be tracked over an extended period by multiple health care providers. It can help identify patients who are due for preventive checkups and vaccinations, or flag those whose vital signs like blood pressure are out of the normal range. EMRs are designed to help organizations provide efficient and precise care. Perhaps the most significant difference is that EMR records are universal, meaning that instead of having different charts at different health care facilities, a patient will have one electronic chart that can be accessed from any healthcare facility using EMR software.

> However, EMRs also offer attractive data appealing to hackers, putting health care systems at the top of the list for cybercriminals. While hacking is discussed in more detail in the next chapter, the hacking of medical records places important information into the hands of those seeking to make money from their thievery. Hackers often use legitimate-looking e-mail attachments as a common way to acquire a patient's login name and password information. This enables hackers to acquire sensitive information, such as credit card information, Social Security number, or driver's license number, leading to identity theft. It is estimated that the average cost of cybercrime in 2017 reached $12.5 million per health care organization, a 69 percent increase from hacking costs reported in 2016.[41]

The controversies that emerge over scientific breakthroughs from advancements in technology—GM food production, the sequencing of the human genome, stem cell research, and medicine—raise serious ethical and social issues. How to maximize the benefits to individuals and society yet minimize or eliminate the negative consequences regarding these technological developments must continue to be addressed, as new innovations appear on the horizon.

[40] "UPS Wants To Be a Player in Drone Delivery, Starting in Rwanda," *Marketwatch,* May 9, 2016, *www.marketwatch.com*.

[41] "Medical Records: The Holy Grail of Data for Cybercriminals," *Pittsburgh Post-Gazette,* January 15, 2018, *www.post-gazette.com*.

Summary

- Technology is the practical application of science and knowledge that is rapidly changing and spreading across societies.
- Societies have sequentially moved through distinct phases of technology, always incorporating a greater reliance on technology.
- Technology has exponentially increased its potential to influence every aspect of our lives—driving innovation, affecting collaborative partnerships, and changing business–stakeholder relationships. It also has contributed to behavioral addiction among some technology users.
- The presence of the Internet is a welcomed benefit, but also has opened the door to various threats, such as spam and phishing.
- Gaps between those who have access to the Internet through technology and those who do not is called the digital divide. This is a problem as the less-advantaged individuals and societies do not enjoy the same benefits of technology as others.
- With significant advances in technology come numerous ethical challenges, such as the loss of privacy and free speech. Citizens and consumers look to governments and businesses to protect these ethical rights.
- Governments play various and sometimes conflicting roles with respect to an individual's free speech.
- Genetically modified foods, sequencing the human genome, biotechnology and stem cell research, and other medical breakthroughs carry great promise for individuals in society, but have also raised serious concerns.

Key Terms

behavioral addiction, *242*
bitcoin, *248*
biotechnology, *241*
digital divide, *245*
genetically modified foods, *253*
human genome, *255*
m-commerce, *246*
mobile telephones, *246*
phishing, *244*
right to privacy, *250*
social networking, *248*
spam, *243*
stem cell research, *256*
technology, *239*

Internet Resources

www.antiphishing.org	Anti-Phishing Working Group
www.monsanto.com/innovations/modern agriculture	Monsanto: What Is Modern Agriculture?
www.bio.org	Biotechnology Industry Organization
www.digitaldivide.org	Digital Divide Institute
www.ecommercetimes.com	E-Commerce Times
www.eff.org	Electronic Frontier Foundation
genomics.energy.gov	Genome Projects of the U.S. Department of Energy, Office of Science
isscr.org	International Society for Stem Cell Research
www.internetsociety.org	Internet Society
socialmediatoday.com	Social Media Today
www.whatissocialnetworking.com	Social Networking
www.statisticbrain.com	Statistic Brain Research Institute

Discussion Case: *To Lock or Unlock Your Phone: Personal Privacy or National Security*

In 2015, Syed Rizwan Farook and Tashfeen Malik, a married couple, opened fire at an office party in San Bernardino, California, killing 14 people and injuring 22. Law enforcement officials believed these were acts of ideologically motivated terrorism. A few hours later, Farook and Malik died in a shootout with police. The subsequent Federal Bureau of Investigation (FBI) probe led them to Farook's iPhone 5C, which had been issued by his employer, the county government. Although county officials gave the FBI permission to examine the phone, they did not have Farook's passcode. The phone had a feature that would automatically erase all stored data after 10 unsuccessful password attempts.

The FBI then asked Apple, maker of the iPhone, to help them circumvent the customer's data encryption. But the company refused. Apple CEO Tim Cook claimed that consumer privacy must be respected. He argued that compliance with the FBI request "would violate [Apple's] First and Fifth Amendment rights: it would compel Apple to write computer code that undermines the company's views on consumer security and privacy."

The FBI maintained that the government had an overriding interest in obtaining information on the phone to protect the public from further acts of terrorism. During the Farook investigation, FBI director James Comey explained, "There has to be some solution that will allow us with lawful authority to be able to have the company unlock the device. [W]e have to find a way to help these companies understand what we need, why we need it, and how they can help, while still protecting privacy rights and providing network security and innovation." A harsh critic of Apple's position, Senator Tom Cotton of Arkansas, expressed the opinion that "Apple chose to protect a dead terrorist's privacy over the security of the American people."

Apple's refusal was based on the opinion that to comply with the FBI's wishes would require Apple to create a separate operating system for Farook's phone and all future versions of the iPhones. The new system, which would run parallel with the existing software, would not have the same level of security and privacy protections. Once the parallel operating system was created, contended Apple, criminals and foreign governments could circumvent the security of any phone simply by typing in the device's identification number. Apple's CEO (unlike his predecessor Steven Jobs, who had avoided weighing in on political or controversial issues) said that the company saw privacy as a fundamental human right and one of its core values. "We will not shrink from this responsibility. We need to decide as a nation how much power the government should have over our data and over our privacy," said Cook.

Nearly all the world's smartphones run on software developed by Google or Apple. According to court records, Google had been ordered to help federal agents open cellphones in seven different states. Although the outcomes of these specific cases were not publicly known, federal prosecutors said that until late in 2015, when Apple began resisting such efforts, it was routine for judges to approve such requests.

Eventually, the FBI's request came before the courts. The Justice Department argued that its request was limited to Farook's phone and it was not trying to set a legal precedent, but it also admitted that there were 13 other pending cases in which the government was seeking court orders to force Apple to help it extract data from iPhones.

In February 2016, a federal judge ordered Apple to help the FBI circumvent the passcode protection system on Farook's phone based on a broad application of the All Writs Act of 1789. This act afforded the federal government widespread authority to access information based on national security. Apple's Cook said the company would oppose the

order. In a strongly worded letter to Apple customers posted to the company's website, Cook called the order "an unprecedented step which threatens the security of our customers" with "implications far beyond the legal case at hand." In a court filing, Apple claimed, "This isn't a case about one isolated iPhone. No court has ever authorized what the government now seeks, no law supports such unlimited and sweeping use of the judicial process, and the Constitution forbids it."

The day before the FBI director and Apple's top lawyers were to testify before Congress, a federal judge in New York sided with Apple in a related case. Magistrate Judge James Orenstein rejected the Justice Department's argument that the 18th century All Writs Act gave prosecutors the authority to compel Apple to help investigators bypass the passcode-protection system on an Apple iPhone seized in a drug investigation. He said the critical issues of 21st century privacy and technology should be decided by today's lawmakers, rather than by reinterpreting an old law.

Around this time, the media reported that an outside party had demonstrated to the FBI a possible method for unlocking Farook's iPhone that, if successful, would eliminate the need for assistance from Apple. "This suggests that the very thing that Apple feared already exists in some form and it exists outside the walls of Cupertino [Apple's home]," said attorney Edward McAndrew.

A month later, the FBI announced that it had cracked Farook's iPhone and was dropping its legal case against Apple. A Justice Department spokesperson said, "While this particular phone is no longer an issue, the broader fight over encryption-protected technology is likely to continue. It remains a priority for the government to ensure that law enforcement can obtain crucial digital information to protect national security and public safety."

And the controversy may intensify in the future. FBI director Comey announced in April 2016 that the secret technique used to unlock Farook's iPhone 5C, for which the FBI reportedly paid more than $1 million, would not work on newer iPhone models. Two years later, Apple announced that it was planning an iPhone update that would effectively disable the phone's charging and data port—the opening where users plug in headphones, power cables, and adapters—an hour after the phone is locked. This change was seen a direct response to government efforts to unlock phones without the owner's permission. "If we go back to the situation where we again don't have access, now we know directly all the evidence we've lost and all the kids we can't put into a position of safety," said Chuck Cohen of the Indiana State Police task force on Internet crimes against children.

Sources: "FBI Director: Apple, Google Active 'Above the Law' By Locking Users' Phones," *Daily Caller,* November 3, 2014, *dailycaller.com;* "U.S. and Apple Dig In for Court Fight Over Encryption," *The Wall Street Journal,* February 17, 2016, *www.wsj.com;* "Apple Files Motion Opposing Order to Unlock iPhone," *The Wall Street Journal,* February 25, 2016, *www.wsj.com;* "Judge Sides With Apple in N.Y. Drug Case Involving Locked Phone," *The Wall Street Journal,* February 29, 2016, *www.wsj.com;* "U.S. Says 'Outside Party' Could Unlock Terrorist's iPhone," *The Wall Street Journal,* March 22, 2016, *www.wsj.com;* "U.S. to Keep Pushing Apple to Unlock iPhone in New York Case," *The Wall Street Journal,* April 8, 2016, *www.wsj.com;* and "Apple to Close iPhone Security Hole That Police Use to Crack Devices," *The New York Times,* June 13, 2018, *www.nytimes.com*.

Discussion Questions

1. In the dispute between the FBI and Apple, which side do you support and why?
2. How would you counter the arguments offered by those on the other side of this debate?
3. Are there any circumstances in which you think the government's right to information should take precedence over an individual's right to privacy?
4. Should any technology firm be allowed to create a privacy protection system that is so impenetrable that it could never be overridden, regardless of the government's need for this information?

CHAPTER TWELVE

Regulating and Managing Technology

The rapid advances in technology in just the past few decades have radically changed how business operates. More information than ever before—about individuals, organizations, and governments—is located on servers or in "the cloud," and businesses increasingly include technology in their daily operations through e-business, robotics, artificial intelligence, and much more. These extraordinary developments challenge businesses and governments to manage information while protecting both data security and individuals' privacy. What actions have governments and businesses taken, and what are the ethical implications of their actions?

This Chapter Focuses on These Key Learning Objectives:

LO 12-1 Identifying the various interventions undertaken by governments to regulate technology.

LO 12-2 Exploring how business accesses stakeholders' personal information and understanding possible limits to this access.

LO 12-3 Understanding the increasing role of e-business in the global marketplace.

LO 12-4 Examining challenges businesses face in managing and adopting new technologies, such as the use of robotics and artificial intelligence, in business operations.

LO 12-5 Assessing the emerging role and responsibilities of the organization's chief information officer and other organizational functions that are responsible to ensure information security and privacy.

LO 12-6 Understanding the threat of cybercrime, and the magnitude of the costs and possible causes of the increase in cybercrime.

LO 12-7 Identifying business responses and government efforts to combat cybercrime.

Over an 18-month period in 2017 and 2018, at least 15 separate cybersecurity breaches occurred at major retailers in the United States. Many of these attacks were caused by flaws in the company's payment systems, either online or in stores. According to a KPMG study, 19 percent of consumers said they would completely stop shopping at a retailer after a breach, and 33 percent would take a break from shopping there for an extended period. The retailers hit by a cyberattack during these 18 months were Macy's, Adidas, Sears, Kmart, Delta, Best Buy, Saks Fifth Avenue, Lord & Taylor, Under Armour, Panera Bread, Forever 21, Sonic, Whole Foods, Gamestop, and Arby's.[1]

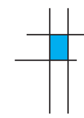
Many restaurant customers look forward to the creation of their personalized salad at a well-stocked salad bar. Yet, as most nutritionists warn, the food, and even the serving utensils, at salad bars are magnets for bacteria and viruses. Chowbotics, a Silicon Valley start-up, devised a partial solution to protect salad-bar customers: Sally the Salad Robot. Customers simply touch a screen to place their orders, choosing from a menu of recipes or designing their own salads. "Sally" calculates the number of calories per salad and drops the selected ingredients into a bowl in less than a minute. Despite "her" critics, Chowbotics' executives argue that "Sally" will be good for job creation. There is going to be the need for "logistics companies, cleaning companies, service companies, robot repair companies," said Charlie Ayers, Chowbotics' executive chef, "Human interaction with Sally is not going away."[2]

Who should protect people from attacks on the theft of their personal data, as shown in the example above? How can technology users guard against the inappropriate use of personal information? Are jobs protected as technology takes over more and more activities in the workplace? What role do governments or businesses need to play to protecting individuals' privacy and job security?

As we experience more and ever-newer technologies in our lives, Elon Musk, CEO of Tesla and SpaceX, warned of the dangers of one such technology, artificial intelligence (AI):

> "The least scary future I can think of is one where we have at least democratized AI because if one company or small group of people manages to develop godlike digital superintelligence, they could take over the world. At least when there's an evil dictator, that human is going to die. But for an AI, there would be no death. It would live forever. And then you'd have an immortal dictator from which we can never escape. If AI has a goal and humanity just happens to be in the way, it will destroy humanity as a matter of course without even thinking about it. No hard feelings."[3]

As this quotation implies, developments in technology and innovation need to be carefully monitored. Artificial intelligence, for example, can be used to free individuals from tedious or dangerous tasks. But, as Musk argued, it also has the potential to turn on and harm humanity.



Government Regulation of Technology

With the increased use of the Internet and cloud storage of personal information, some governments have stepped in to protect their citizens. In 2014, an important legal case in Europe raised the issue of the **right to be forgotten**, meaning an individual's right to have their personal information removed from online search results upon request.

[1] "If You Shopped at These 15 Stores in the Last Year, Your Data Might Have Been Stolen," *Financial Times,* July 10, 2018, *www.ft.com*.

[2] "A Robot Makes a Mean Caesar Salad, but Will It Cost Jobs?" *The New York Times*, October 6, 2017, *www.nytimes.com*.

[3] "Elon Musk Warns A.I. Could Create an Immortal Dictator from Which We Can Never Escape," *CNBC,* April 6, 2018, *www.cnbc.com*.

The right to be forgotten concept was upheld when the European high court ruled against Google in a dispute with an individual user, a Spanish attorney. The attorney had sued, asking that Google remove from its search results some personal information about him that he believed was damaging. The court agreed with the attorney and ordered Google to set up a system to respond to requests from European customers. This case and its ramifications are further explored in a case at the end of this book.

By 2018, the European Union passed the **General Data Protection Regulation (GDPR)**, regulating the processing of personal information of EU residents by an individual, a company, or an organization. It gives people more control over their personal data and forces companies to make sure the way they collect, process, and store data is safe.[4]

Governments also have protected individuals and companies' ideas. With advances in technology, protecting the ownership of these ideas have become more challenging than ever. The ideas, concepts, and other symbolic creations of the human mind are often referred to as **intellectual property**. In the United States, intellectual property is protected through a number of special laws and public policies, including copyrights, patents, and trademark laws. Not all nations have policies similar to those in the United States.

The illegal copying of copyrighted software, or **software piracy**, is a global problem. According to the Business Software Alliance (BSA), in a survey of more than 20,000 consumers and PC users in 110 national and regional economies, 37 percent of the software installed on personal computers around the world in 2018 was not properly licensed. This problem is critical for businesses, who spend nearly $359 billion a year worldwide to prevent hacking vulnerabilities due to unlicensed software used by employees.[5]

In 1998, the United States passed the **Digital Millennium Copyright Act**, making it a crime to circumvent antipiracy measures built into most commercial software agreements between the manufacturers and their users. In 2015, six people pleaded guilty to charges related to more than $100 million in stolen software, in one of the largest such piracy schemes prosecuted by the U.S. government. The theft including about 170,000 access codes for Adobe Systems and Microsoft products, including Windows 7 and Windows XP.[6]

In China, the government announced that computer makers must ship all their product with licensed operating systems preinstalled, and inspected all government computer systems for licensed software. To emphasize its commitment to the enforcement of this law, China sent 11 people to prison for manufacturing and distributing pirated Microsoft software throughout the world. Microsoft called the group part of "the biggest software counterfeiting organization we have ever seen, by far" and estimated its global sales at more than $2 billion.[7] Laws attempting to stem software piracy and reinforce intellectual property rights exist in many other countries, including Saudi Arabia, the United Arab Emirates, Vietnam, and India.[8] As expected, some laws are more rigorously enforced and more successful in stemming the use of pirated software than others.

[4] "2018 Reform of EU Data Protection Rules," *European Commission,* n.d., *ec.europa.eu*; and "What Is GDPR? Everything You Need to Know about Europe's New Data Law," *CNN Tech,* May 21, 2018, *money.cnn.com*.

[5] "Software Management: Security Imperative, Business Opportunity," *2018 BSA Global Software Survey,* 2018, *gss.bsa.org*.

[6] "Six Plead Guilty in $100 Million Software Piracy Case," *The Mercury News,* December 18, 2015, *www.mercurynews.com*.

[7] "Chinese Court Jails 11 in Microsoft Piracy Ring," *New York Times,* January 1, 2009, *www.nytimes.com*.

[8] For additional information on the U.S. Digital Millennium Copyright Act, see "About the Digital Millennium Copyright Act," *Knowledge Base,* Indiana University, May 14, 2018, *kb.iu.edu/d/alik*; and, for information on India's Copyright Amendment Act, see "The Indian Copyright (Amendment) Act, 2012 and Its Functioning So Far," *Intellectual Property Watch,* October 23, 2014, *www.ip-watch.org*.

Exhibit 12.A

Net Neutrality: Repeal or Retain?

Net neutrality rules were created in 2015 under the Obama Administration, when the Democratic-controlled Congress voted to ensure that Internet providers treat all web traffic equally. Regulators, consumer advocates, and Internet companies were worried that broadband companies might wield their increasing power by restricting pathways to the Internet—blocking or slowing down apps owned or operated by their Internet providers. For example, under the net neutrality rules, the Internet provider Comcast could not charge Netflix users more for a faster path to Netflix programming than it could charge its own customers. This was generally how the Internet had worked since its inception.

In 2017, the Federal Communications Commission, controlled by Republican commissioners, voted 2-to-1 to open debate over the need for net neutrality rules. A few months later, Congress voted along party lines to overturn these rules. Within weeks, the attorneys general for 21 states had filed suits to challenge the FCC and Congress's decisions launching a legal battle that could go on for years. Two months later, Washington became the first state to enact its own net-neutrality requirements. "We know when D.C. fails to act, Washington state has to do so," said Governor Jay Inslee.

Nearly 800 technology-user companies sent a letter to the FCC challenging its decision and said they were "deeply concerned" about this action. "Our companies should be able to compete . . . on the quality of our products and services, not our capacity to pay tolls to Internet-access providers." Other businesses, such as Alphabet's Google and Facebook, supported this regulatory change. These companies' activities were regulated by the Federal Trade Commission, which imposed less stringent standards. With net neutrality gone, Internet service providers were free to offer a website faster and more reliable delivery of its content in exchange for a fee. A broadband provider could also raise the transmission speed of its own content relative to that of its competitors. Broadband providers would also be free to block sites they find objectionable, which could open them up to political and public pressure.

Sources: "FCC Votes to Scale Down Net Neutrality Rules," *The Wall Street Journal,* May 18, 2017, *www.wsj.com*; "The End of Net Neutrality: What It All Means," *CNN Tech,* December 14, 2017, *money.cnn.com*; "What You Need to Know about Net Neutrality," *Politifact,* December 14, 2017, *www.politifact.com*; "States, Activists Challenge FCC Rollback of Net-Neutrality Rules," *The Wall Street Journal,* January 16, 2018, *www.wsj.com*; and "Tech Firms, Cable Companies Take Sides in Net-Neutrality Battle," *The Wall Street Journal,* April 26, 2018, *www.wsj.com*.

Should the government regulate individual access to the Internet and services delivered online? Exhibit 12.A describes government rules on **net neutrality**, which refers to the principle that Internet service providers should give customers equal access, that is, they should not favor or block particular content and applications.

Next the focus shifts to business organizations and their collection of confidential information and the potential for invasions of privacy or lack of security measures. How much information about the company's stakeholders should be acquired or shared? How much protection is necessary to safeguard individual and corporate confidential information?

The Role of Technology in Business

In the course of conducting ordinary business, all companies utilize technology in their operations. Technology provides access to various types of information, the opportunity for electronic transactions, the use of robotics or automation, and the assimilation of artificial intelligence into business practices. Many businesses have designated an information, security, or technology officer to oversee and manage the use of technology in their workplace. The benefits from these technological innovations and their challenges for business are discussed in this section.

Some businesses increasingly acquire large amounts personal information from various stakeholders and are then faced with the challenge of using it appropriately. Technology gives businesses access to a great deal of information-sometimes called **big data**. Yet, with

large amounts of data come challenges of how to use that data in practical and useful ways. As Victor Nilson, senior vice president of big data at AT&T explains,

> "We always start with the customer experience. That's what matters most. . . . So how do we simplify the process for both the customer-care agent and the customer at the same time, whenever there's an interaction? We've used big data techniques to analyze all the different permutations to augment that experience to more quickly resolve or enhance a particular situation. We take the complexity out and turn it into something simple and actionable."[9]

Access to Stakeholders' Personal Information

Two major market stakeholders targeted by business organizations for the collection of information are employees and consumers. Examples of many companies' inability to protect the information about their customers was profiled at the beginning of this chapter.

The employer–employee relationship, discussed in Chapter 15, is changing due to technological advances. Some employees are embracing these changes; others are more hesitant.

> More than 50 of the 80 employees at Three Square Market, a technology company in Wisconsin, voluntarily agreed to have the company implant a microchip under their skin between their thumb and index finger. The microchip allowed employees to enter the building by swiping a scanner at the front door or pay for food in the employee cafeteria. Sam Bengston, a software engineer at Three Square, volunteered because "in the next five to ten years, this is going to be . . . normal. I like to jump on the bandwagon with these kinds of things early, just to say that I have it." Others at Three Square were more cautious. "Because it's new, I don't know enough about it yet," said Melissa Timmins, Three Square's marketing director. "I'm a little nervous about implanting something into my body."[10]

Is it acceptable for employers to implant microchips into their employees if it is voluntary? What if it is a mandatory condition for employment? How will this technology be used? A Carnegie Mellon University professor commented, "Companies often claim that these chips are secure and encrypted, but encrypted is a pretty vague term which could include anything from a truly secure product to something that is easily hackable." Other critics were concerned that this technology, while designed for one thing—such as entrance to a building or payment at the cafeteria—might be used for another. They warned, for example, that the company could begin tracking the length of employee bathroom or lunch breaks without their consent or even knowledge. The Three Square CEO assured critics that "All it is is an RFID chip reader. It's not a GPS tracking device. It's a passive device and can only give data when data's requested."[11]

Consumers' shopping habits are also a rich source of data for businesses. While individuals may believe they are just an anonymous or nameless shopper among a pool of millions of shoppers, companies tracking big data, sometimes called metadata, can pick out specific details about an individual's shopping habits, preferences, or tendencies. Researchers at MIT analyzed credit-card transactions by 1.1 million shoppers and claimed they needed only four bits of secondary information, such as location or time, to identify the unique

[9] "How Companies Are Using Big Data and Analytics," *McKinsey & Company Interview,* April 2016, *www.mckinsey.com*.

[10] "Microchip Implants for Employees? One Company Says Yes," *The New York Times,* July 25, 2017, *www.nytimes.com*.

[11] Ibid., *The New York Times,* July 25, 2017, *www.nytimes.com*.

individual purchasing patterns of 90 percent of the people involved in their study. Even when the data was cleaned of names, account numbers, and other obvious identifiers, the shoppers' identity could be found.[12]

> Cybersecurity experts warned Verizon in 2015 that the company was putting the privacy of its customers at risk by using computer codes, called unique ID headers, to tag and follow its mobile subscribers around the web. These codes created databases that could make the consumers more vulnerable to covert tracking and profiling. Johnathan Mayer, a lawyer and computer science graduate student at Standard University, warned that the cybersecurity experts' fears were valid. He used computer code to track individuals even after they tried to delete their digital footprints. "Verizon is not in a position to control how others use its [ID] headers," said Mayer. "There is no doubt that this particular approach does introduce new privacy problems."[13]

The collection of consumer information raises important ethical issues of privacy and security. (These issues are further explored in Chapter 14.)

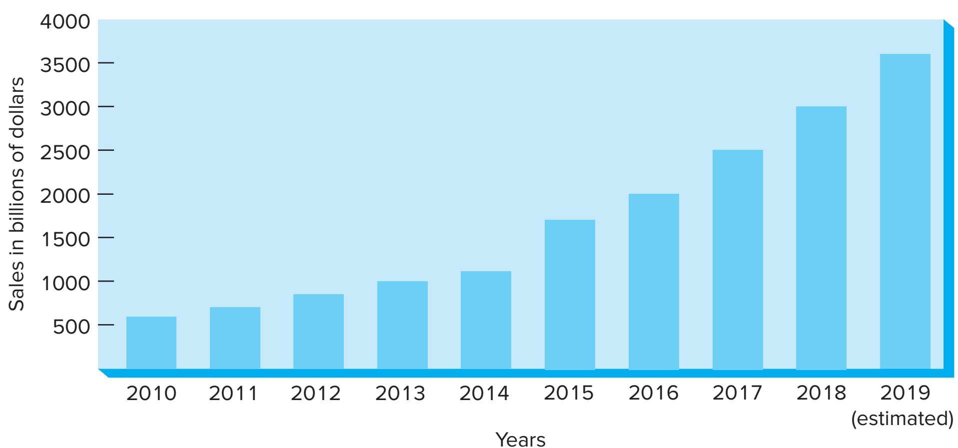
The question of how much information companies should collect about their stakeholders and whether the collection of stakeholders' information benefits these stakeholders or not remain controversial. Whether businesses have adequately built protections against unwanted invasions of stakeholder privacy and breaches of information security remain to be seen.

E-Business

During the most recent phases of technological development, shown in Figure 11.1 in the prior chapter, electronic business exchanges between businesses and between businesses and their customers emerged. These electronic exchanges, generally referred to as **e-business**, consist of buying and selling goods and services between businesses, organizations, and individuals electronically, that is, via Internet-based systems. During the past decade, global e-business revenue increased at a fast pace, as shown in Figure 12.1, and more than that of traditional, or nonelectronic, business. E-business revenues were predicted to continue to rise significantly through 2020 and into the next decade, fueled by consumers in emerging markets.

FIGURE 12.1
Global E-business Sales Growing

Source: "Top E-commerce Trends to Inform your 2017 Marketing Strategy," *Smart Insights,* June 7, 2017, *www.smartinsights.com*.



[12] "Metadata Can Expose Person's Identity Even without Name," *The Wall Street Journal,* January 2, 2015, *www.wsj.com*.

[13] "Verizon's Mobile 'Supercookies' Seen as Threat to Privacy," *The New York Times,* January 25, 2015, *www.nytimes.com*.

In the United States, online sales have consistently been around $300 to $400 billion annually since 2014. E-business sales in China, however, have risen dramatically since 2014, from around $400 billion annually to an estimated $2 trillion by 2019.

Businesses, especially small-sized companies, discovered that adopting new technology and embracing e-business opportunities could save them money in the long run and give them a competitive edge over rivals by enabling them to add new services and operate more efficiently. One United Kingdom website explains these advantages:

> *Worldwide Presence:* The major advantage of engaging business online is to have presence nationwide or worldwide. IBM used e-business to provide services to the customer and was one of the first companies to use this approach. Other firms, such as Dell and Amazon, quickly followed, becoming global leaders in their markets.
>
> *Cost Effective Marketing and Promotions:* Using the Internet to market products required a very simple strategy but generally guaranteed a worldwide reach. Pay per click advertising, for example, is an effective technique that ensures that a business only pays for advertisements that were actually viewed.
>
> *Better Customer Service:* Many customers can visit a firm's website at same time. Some websites have an online chat feature to help the customer to find out more about the product they are interested in. Moreover, orders can be placed online by processing payments securely over the Internet and products can be shipped directly to the customer. Online customers do not have to leave the house or workplace to shop.

The U.K. website also warns of the disadvantages of e-business or online transactions. Some consumers prefer to see or touch products physically before buying; maintaining the website can be costly; and consumers may have security concerns regarding their privacy. Yet, it appears that both businesses and consumers have embraced online sales, and e-business's growth is likely to continue.

These new trends toward greater e-business gave rise to the notion of **omnichannel**, the idea that every distribution channel must work together to deliver a unified and consistent customer experience. Businesses are adjusting and attempting to serve the multiple needs of their customers.

> Amazon is building dozens of "fulfillment centers," brick-and-mortar stores located in major cities to have high-demand products close enough to consumers for same-day or next-day delivery. Brick-and-mortar stores, such as those operated by Apple or Verizon, understand that customers can find out about inventory on their phones before coming to the store. Retailers are focusing more on providing technical assistance for their customers in the stores, equipping employees with tablets or mobile technology to check inventory at other stores, locate complimentary accessories, or enable faster payment of items ordered.[14]

As technology changes the shopping experiences for customers, businesses, too, must understand how they need to change to accommodate and better serve their customers.

The Use of Robots and Artificial Intelligence at Work

Another area where technology has made a significant impact on business is the development of robotic engineering and the increased availability of robots. Initially, robots were

[14] "Retail in Crisis: These Are the Changes Brick-and-Mortar Stores Must Make," *Forbes,* February 12, 2014, *www.forbes.com*

used in high-risk situations, such as bomb detection or handling toxic chemicals, but as they have become more affordable and smarter, they have generated new opportunities for businesses. McKinsey and Company, a global management-consulting firm, recognized that robotic technology and its next-generation extension, **artificial intelligence (AI)**, the ability of a digital computer or computer-controlled robot to perform tasks commonly associated with intelligent beings, will become pervasive throughout business practice.

> "Senior executives need to understand the tactical as well as strategic opportunities, redesign their organizations, and commit to helping shape the debate about the future of work. We are on the cusp of a new age of automation. . . . Robots have long been familiar on the factory floor . . . but rapid strides being made in artificial intelligence and robotics mean machines are now encroaching on activities previously assumed to require human judgment and experience."[15]

A new breed of machines, called collaborative machines, were designed to work alongside people in close settings. Many manufacturers, such as toy makers, used these machines—which were priced as low as $20,000—to increase overall productivity and lower labor costs.

> Panek Precision, founded in 1945 as a small, precision machine shop in Northbrook, Illinois, uses robots to place metal pieces into cutting machines and remove the parts after the cutting is completed. A job difficult for a human employee because of its tediousness, robots can accomplish the tasks quickly, effectively, and less expensively than machine operators paid $16.50 per hour. The robot doubled the output of a human worker "because robots work overnight and don't take a lunch break and they just keep going," said Panek Precision's president.[16]

Robots have found their way into other type of work. They can replace workers that could be injured from doing the work previously assigned to humans. "It's gotten easier to substitute machines for many kinds of labor. We should be able to have a lot more wealth with less labor," explained economist Erik Brynjolfsson.[17]

However, the spread of robots in the workplace posed a clear threat to workers' employment. Within two decades, economists at Oxford University forecast, nearly half of the current jobs would be performed by machine technology. In the U.K., economists predicted that 10 million jobs would be taken over by computers and robots over the next 20 years. They said that people earning less than £30,000, or about $46,000, a year, were most likely to see their jobs eliminated. The International Labor Organization estimated that millions of lower-paying jobs in southeast Asia could be displaced by automation during the next two decades.

In the crosshairs are middle-class workers such as clerks and bookkeepers. Today's computers can conduct legal research, write stock reports and news stories, and translate conversations. At banks, machines can produce government-required documents to flag potential money laundering—all work done by humans a short time ago. Banks using automated teller machines (ATMs) spread quickly throughout the United States from the 1980s to today. In 1985, the United States employed 484,000 bank tellers; by 2014 this number had fallen to 361,000, a drop of more than 25 percent.

Despite these "gloom-and-doom" predictions, some jobs appear to be safe from robotic takeover. McKinsey and Company predicted that jobs that involve managing and developing

[15] "A CEO Action Plan for Workplace Automation," *McKinsey Quarterly,* July 2017, *www.mckinsey.com*.

[16] "Robots Work their Way into Small Factories," *The Wall Street Journal,* September 17, 2014, *online.wsj.com*.

[17] "What Clever Robots Mean for Jobs," *The Wall Street Journal,* February 24, 2015, *www.wsj.com*.

people have an only 9 percent automation potential, and work that applies expertise to decision making, planning or creative work has an 18 percent automation potential. Some experts claim, "robots aren't destroying enough jobs. Too many sectors, such as health care or personal services, are so resistant to automation that they are holding back the entire country's standard of living." Others argue that robots and advanced technology might actually increase labor demand, especially for low-skilled laborers. The presence of technology might allow low-skilled workers to perform tasks previously assigned only to high-skilled employees.

So, what role will robots play in the workplace of the future? The 2017 changes to the U.S. tax code provided incentives for businesses to invest in robotics technology, as they could deduct the entire cost of this investment over five years. Yet, no one fully understands how robots will influence business in the future. Will robots create more jobs than they replace? Will businesses wholly embrace the use of robots in the workplace, or not? What most experts in these fields seem to agree upon is that the potential impact of technology through robotics will be undeniably profound.

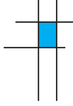
Artificial intelligence is also making its mark in the workplace. According to a study conducted by IBM in 2017, more than 73 percent of 6,000 CEOs surveyed predicted that cognitive computing, or artificial intelligence, technologies would play a "key role" in their business's future. And, 15 percent of the CEOs expected a return on their AI investments.

> For example, Royal Dutch Shell, the energy company, had used AI to create algorithms enabling their managers to determine the most efficient allocation of work among employees and to coordinate with many self-employed and part-time workers. Shell applied AI technology to evaluate their digital business models in the car-maintenance sector to locate Shell staffers with the right expertise and assigned the job with a click. Using machine-learning software, Shell could match workers and projects, track performance, and evaluate this activity so it could refine the next round of matches.[18]

BlackRock, the world's largest asset manager, used automated computer-driven systems, to make stock buy-or-sell decisions, relying more on artificial intelligence decision systems than human decision systems. Before the company had turned to artificial intelligence decision making, BlackRock customers had complained that the human stockbrokers' decisions often lagged behind their competitors and had begun to withdraw their money.[19]

Artificial intelligence has also been applied in the development of **autonomous vehicles**. Also known as driverless or self-driving cars, these vehicles are capable of sensing the surrounding environment and navigating without human input or control. The discussion case at the end of the chapter discusses the costs and benefits of autonomous vehicles.

How will these many technological breakthroughs be successfully managed? Many companies have created and empowered a new executive: the chief information officer, discussed next.



The Chief Information, Security, Technology Officer

Businesses often entrust the responsibility for managing information technology and its many privacy and security issues to the **chief information officer (CIO)** or individuals with other similar titles such as *chief security officer* or *chief technology officer*. Many firms have elevated the role of their data processing managers by giving them the title of chief

[18] "IBM: 73% of CEOs Predict AI, Cognitive Computing to Play 'Key Role' in Future of Business," *TechRepublic,* July 6, 2017, *www.techrepublic.com*; and "Meet Your New Boss: An Algorithm," *The Wall Street Journal,* December 10, 2017, *www.wsj.com*.

[19] "BlackRock Bets on Robots to Improve Its Stock Picking," *The Wall Street Journal,* March 28, 2017, *www.wsj.com*.

information officer. With the emergence of robotics and artificial intelligence in the workplace, the role of the CIO to manage this digital transformation has become even more critical. In a 2018 study of CIOs by Korn/Ferry International, 83 percent said their role was more strategic than it was three years ago. Another 67 percent said they were on their company's executive committee (a committee made up of the firm's CEO and other senor executives), up from 55 percent in a similar survey from 2017.[20] Recently this role has expanded even more to include broader responsibilities and greater influences on corporate policies and practices. Given the increase in costly cyberattacks, as discussed next in this chapter, the CIO plays an even more critical role for the business organization.

> According to Steven Fox, a security expert, "The CIO is a 'General.' Generals are not concerned with how the weapons function or how the rank-and-file are performing. This is the job of the lieutenants. The General focuses on the strategic application of resources on the battlefield. It is his/her duty to bring the plans of the sovereign (e.g. the CEO, the Board of Directors) to fruition."[21]

In recent years, the CIO's role has changed dramatically, becoming more integrated into the overall strategic direction of the firm. "CIOs themselves are in the midst of a make-or-break personal change-management project: CIOs who can only take orders, who can't speak the language of the business, who can't step out of the proverbial back-office and into the front lines of customer service, social media or supply chain management will soon go the way of the ancient tech gear," warned Thomas Wailgum of *CIO Magazine*. Wayne Shurts, CIO of the grocery chain SuperValu concurred, "You're part of the strategic leadership team; you're on the inside of all the issues to help the company win today, tomorrow, and the next decade."[22] As shown in Figure 12.2, the duties assigned to a CIO are quite diverse.

FIGURE 12.2
The Roles and Responsibilities of the Chief Information Officer (CIO)

Sources: The Meta Group study of the role of the CIO can be found at "New Roles, New Responsibilities: Today's CIO," n.d., *www.cioupdate.com*. Additional information for this exhibit is from "What Are the Duties of a CIO?" *eHow,* n.d., *www.ehow.com*; and "The Duties of a CIO," *Ezine Articles,* n.d., *ezinearticles.com*.

In a study conducted by the Meta Group entitled *The CIO as Enterprise Change Agent,* almost half (47 percent) of the CIOs surveyed reported that they have broadened their responsibilities beyond the traditional CIO-only role. Some of these emerging responsibilities include:

- Establishing an innovative language to enable everyone throughout the organization to be clear of the objectives, processes, and timetables for any project that involves technology or information.
- Providing structure to welcome inventive thinking and creating protocols for testing and reviewing these novel ideas.
- Educating others in the organization to help open the eyes of organizational members to what is possible or what is not regarding technological initiatives or information.
- Applying marketing knowledge to ensure that innovative ideas reach the proper stakeholders inside and outside of the organization and have a meaningful impact.
- Acting as the lead security officer to protect information and data integrity by overseeing all functions of information technology in the organization.
- Participating in organizationwide committees and projects to maintain a clear emphasis on the value of information, as well as protect against threats to information.

In the past decade since the creation of the CIO position within most business organizations, the CIO role has evolved from primarily being focused only on the collection and protection of information to a senior executive role essential to all business functions and operations.

[20] "Tech Chief Role Grows More Strategic, Korn Ferry Survey Finds," *CIO Journal,* June 19, 2018, *blogs.wsj.com*.

[21] Steven Fox, "The Art of CIO Success," *CSO Security and Risk,* June 29, 2009, *blogs.csoonline.com*.

[22] "The New CIO Role: Big Changes Ahead," *CIO.com*, August 20, 2010, *www.cio.com*.

IT issues have become more prominent in the national agenda, with implications for employment, privacy, and more. This emphasis was very evident in 2017, when the CEOs and CIOs of Apple, Amazon, and other technology companies met with President Trump at the White House. It was apparent from this gathering how critical the role of CIOs, with their expertise in many different fields of digital transformation and technology, had become not only for businesses but also for the country. CIOs clearly were ascending to greater leadership roles within the companies and for our society.[23]

Cybercrime: A Threat to Organizations and the Public

One of the most profound challenges for CIOs worldwide is to protect their organization's information from unauthorized access or cybercrime. **Cybercrime** is criminal activity done using computers and the Internet. This includes anything from downloading illegal music files to stealing millions of dollars from online bank accounts. Cybercrime also includes nonmonetary offenses, such as creating and distributing viruses on other computers or posting confidential business information on the Internet. One of the largest cybercrimes in the United States occurred at Equifax, discussed in the case at the end of Chapter 6.

Cybercrime is often committed by individuals or groups gaining unauthorized access to a business organization through its computer system. They are called hackers. **Hackers** are individuals, acting alone or in groups often with advanced technology training, who, for thrill or profit, breach a business's information security system. Hackers may be individuals employed by the business organization, or formerly employed, or are strangers and completely unknown to the business. Some violations are simply careless actions, while others are intentional. Some of the hackers' motivations for taking these actions are explored in the next section.

Exploring Why Hackers Hack

Hacking into businesses and other organizations is undoubtedly a powerful and destructive force. Why do hackers do it? The many reasons seem to be to make money, to retaliate against a company or government, or to gain media attention for an issue or the hackers themselves, as shown in Figure 12.3. This section explores these selected motivations for hacking.

A website, called Hacker's List, seeks to match hackers, who are seeking financial reward, with people looking to gain access to e-mail accounts, take down unflattering photos from a website, or gain access to a company's database often out of

FIGURE 12.3
Why Do Hackers Hack?

While hackers may have any number of reasons underlying the motivations for their actions, three of the more common motivations appear to be

- Hackers hack to profit from their actions—*the financial-incentive motive,*
- Hackers hack in retaliation against action or inaction by a company or government—*the retaliation motive,*
- Hackers hack to gain media attention for their political or social viewpoint or to boost their own ego—*the seeking media attention motive.*

[23] "The Morning Download: CIOs Expand Leadership Role as Digital Business Rises on National Agenda," *The Wall Street Journal,* June 19, 2017, *www.wsj.com*.

> retaliation for a prior action. In its first three months of operation, over 800 hacking jobs were posted for bid asking hackers—obviously using anonymous names—to bid on performing the task. A man in Sweden posted that he would pay $2,000 to anyone who could break into his landlord's website. A California woman agreed to pay $500 for someone to hack into her boyfriend's Facebook and Gmail accounts to see if he is cheating on her. And the list continues and grows each day.[24]

At the core of this business arrangement is the hacker's motivation to profit from her or his computer skills and willingness to break the law for payment. The Hacker's List website received a favorable review on *hackerforhirereview.com,* which specializes in assessing the legitimacy of such services. The owner of the site gave his top rating to Hacker's List because "it's a really cool concept" that limits the ability of customers and hackers to take advantage of one another.[25]

Other hackers are more politically motivated. In 2018, U.S. federal prosecutors accused nine Iranians of orchestrating years of cyberattacks on behalf of the Iranian government to steal data from hundreds of universities and businesses in the United States and abroad. Many of the hackers worked on behalf of the Islamic Revolutionary Guard Corps, an Iranian government group responsible for gathering intelligence. The group has been labeled a terrorist organization by the United States.[26]

Some hackers are just trying to prove a point—your system is vulnerable and subject to attack. Some of these efforts are welcomed by businesses; others are not. White hatters are individuals employed by businesses or governments to hack their systems deliberately to discover possible vulnerabilities of their own systems; typically, the discovered weaknesses are used to strengthen these systems' defenses. Grey hatters are hackers working on their own, often seeking media attention, but inclined to share their hacking exploits with the businesses they hacked in the expectation that the firm will pay them for the information. The grey hatters are less welcomed by businesses since they might expose the company's security weaknesses publicly to bring greater attention to the need for more aggressive security measures.[27]

Whether the motivation is for personal profit, retaliation against a company or government, or to gain public attention, the instances of hacking are numerous and the potential for damage profound. The following section discusses the costs of cybercrime.

Costs of Cybercrime

Stephen Schmidt, chief information security officer at Amazon Web Services explained in a 2017 interview,

> "The biggest threat that most organizations are facing right now is a combination of excessive access for their employees and an increased focus by nation-state actors on access to sensitive information. . . . So we have to focus on how to reduce that access, how to prevent people from getting unnecessary access to information, whether it be sales data, intellectual property, material about the next thing you're building, etc."[28]

[24] "Owner of Anonymous Hackers-for-Hire Site Steps Froward," *The New York Times,* May 12, 2015, *www.nytimes.com*.

[25] "Need Some Espionage Done? Hackers Are for Hire Online," *The New York Times,* January 15, 2015, *dealbook.nytimes.com*.

[26] "U.S. Charges Nine Iranians with Cyberattack Campaign," *The Wall Street Journal,* March 23, 2018, *www.wsj.com*.

[27] "Hacking—A New Classification System," *Truth Lies Deception and Coverups, www.truthliesdeceptioncoverups.info*, accessed June 10, 2015.

[28] "Where the Cybersecurity Threats Are," *The Wall Street Journal,* December 18, 2017, *www.wsj.com*.

Moreover, artificial intelligence has made it easier for hackers to invade corporate security systems. Darktrace, a global IT security company, discovered a cyberattack on a client company in India that used basic machine learning, AI, to observe and learn patterns of normal user behavior inside the firm's network. The machine began to mimic that normal behavior, effectively blending into the background and becoming harder for security tools to spot the intruder. Nicole Eagan, CEO of Darktrace, said, "We do imagine that there will be a time when attackers use machine learning and artificial intelligence as part of the attack. We have seen early signs of that."[29]

What are the costs of these increasing hacks? In 2016, Steve Langan, chief executive at Hiscox Insurance, reported, "cybercrime cost the global economy over $450 billion, over 2 billion personal records were stolen, and in the U.S. alone over 100 million Americans had their medical records stolen." The financial impact of cyberthreats has risen in the United States, with the average cost of a data breach now over $7 million, according to research by the Ponemon Institute. In the United Kingdom, the average cost of the most severe online breaches for large companies was valued at $2.24 million in 2015, up from under $1 million a year earlier.[30]

What accounted for these rising costs? A Poneman Institute study noted that most costs were incurred when detecting the intrusion and attempting to recover. It took an average of 46 days, at an average cost of $21,155 per day, for a business to resolve or recover from a cyberattack. Nevertheless, it was imperative that companies do so: seventy-six percent of U.S. adults surveyed said they would stop doing business with companies with a high number of data breaches.

In addition, the Poneman Institute study found that firms encountered significant costs due to disruption of the business organization's computer systems. Business disruption accounted for 39 percent of total external costs, including business process failures and lost employee productivity. Breaches can also result in regulatory fines, legal costs, and an increase in the average cost for each lost or stolen record containing sensitive and confidential information—increasing from $217 in 2015 to $221 in 2016. A report from the U.S. Consumer Bankers Association indicated that re-issuing cards affected by the Target data breach cost the firm over $172 million.[31]

Globally a new type of cyberattack emerged—**ransomware attacks**. A ransomware attack is a kind of cyberattack in which malware (short for malicious software) locks the data on a victim's computer and demands payment to decrypt the data. This type of attack was responsible for 51 percent of all cyberattack incidents reported in 2017. Symantec, a global security company, found that the average amount paid by victims of ransomware had risen to $1,077. It estimated that one out of every 131 e-mail messages worldwide harbored some type of cyberthreat.[32]

Research conducted by McKinsey & Company in partnership with the World Economic Forum suggested that companies were struggling to keep up with criminals when it came to cyber–risk management. As more and more highly visible breaches occurred with growing regularity, most technology executives believed that they were losing ground to cyberattackers. Current strategies were ineffective, and many managers admitted that they had

[29] "Era of AI-Powered Cyberattacks Has Started," *The Wall Street Journal,* November 15, 2017, *www.wsj.com*.

[30] "Understanding the Costs of Cyber Crime: A Report of Key Findings from the Costs of Cyber Crime Working Group," *Home Office Science Advisory Council,* January 2018, *assets.publishing.service.gov.uk*.

[31] "Data Breaches Cost US Businesses an Average of $7 Million—Here's the Breakdown," *Business Insider,* April 27, 2017, *www.businessinsider.com*.

[32] Cybercrime Costs the Global Economy $450 billion: CEO," *CNBC,* February 7, 2017, *www.cnbc.com*; and "Ransomware Attacks around the World Grow by 50%," *BBC,* April 27, 2017, *www.bbc.com*.

difficulty quantifying the true impact of risks and mitigation plans. Moreover, much of the economic harm incurred by business organizations came from an inadequate response to the breach rather than the breach itself.[33] What businesses have done to minimize these costs is explained next.

Business Responses to Invasions of Information Security

Faced with the serious and costly threat of cybercrime, many businesses have gone to great lengths to build strong defenses to protect information and ensure stakeholder privacy. These defenses must be comprehensive, cut across all organizational functions and receive the support of the organization's executive leadership.

Cybersecurity experts point out that most business organizations only protect their digital perimeters with intrusion detection devices. Yet, any strong-minded hacktivist or organized criminal syndicate can find a way to penetrate a business's information system. Experts encourage companies to develop an *incident-response plan for cyberattacks.* These plans compliment the effort to prevent access to information but also focuses on what to do when a breach occurs.

McKinsey & Company partnered with the World Economic Forum to explore how companies were combating the increasing number of cyberattacks. They conclude that businesses around the world were losing this battle. As more and more highly publicized breaches occurred more frequently, most executives entrusted with their company's technology security admitted that they were unsuccessful in addressing the increasing cyberattackers. Past strategies were no longer effective, and many managers admitted that they were no longer able to quantifying the mounting risks. Moreover, much of the economic harm incurred by business organizations came from their lack of an adequate response to the breach, even greater damage than coming from the breach itself.[34] What businesses have done to minimize these costs is explained next.

Most businesses have recognized the likelihood and damaging impact of a cyberattack. After its own bank's cybersecurity was breached, JPMorgan Chase CEO Jamie Dimon announced that his firm would double its spending on cybersecurity over the next five years, totaling more than $500 million annually. Other U.S. banks have followed this lead and quietly launched a doomsday project they hope will prevent a debilitating attack on the country's financial system. Called the *Sheltered Harbor,* banks and credit unions controlling about 400 million consumer and business accounts require members to individually back up data so it can be available to other firms to serve the customers of a disabled bank.[35]

Technology-based firms are also addressing the issue of preventing cyberattacks or more quickly responding when the attacks occur. Facebook offered a privacy checkup to every one of its 1.28 billion users. Facebook CEO Mark Zuckerberg said the company is more sensitive to privacy and it also is good for business to be more vigilant. According to Pam Dixon, executive director of the World Privacy Forum, "They [tech companies] have gotten enough black eyes at this point that I tend to believe that the realized they have

[33] "The Rising Strategic Risks of Cyberattacks," *McKinsey & Company,* May 2014, *www.mckinsey.com*.

[34] For a more thorough description see "How Good Is Your Cyberincident-Response Plan?" *McKinsey & Company*, December 2013, *www.mckinsey.com*.

[35] "Banks Build Line of Defense for Doomsday Cyberattack," *The Wall Street Journal,* December 3, 2017, *www.wsj.com*.

to take care of consumers a lot better." Some firms are taking an even more aggressive, proactive approach.

> Texas Hospital Association president and chief executive, Fernando Martinez, realized that the number or ransomware attacks were on the rise and were gaining media attention. It had become a critical issue for his organization. He wanted to test his employees about their cybersecurity awareness and sent a phishing e-mail to the association's employees. Robert Valdez, manager of risk advisory services at Kaufman Rossin, a professional services firm, explained, "You don't want to tell employees at the beginning. You want true insight into what is your actual exposure, how many people are clicking and what happens to the organization."
> When association employees fell prey to the phishing e-mail, the employee was re-directed at that moment to receive additional cybersecurity training. Shortly thereafter, they were sent a second phishing e-mail to measure the effectiveness of the training they received. After assessing the program, Martinez reported that the association had seen 60 percent improvement in the reduction of click rates to the phishing e-mails. "This shows the training is extremely effective."[36]

Another method some businesses use is to reduce criminal intrusion of their sites by paying hackers, often called white hatters and discussed earlier in this chapter. Businesses use the white hatters' computer skills to identify weaknesses in the company's information systems.

> An ethical hacking contest was held at a Swiss security conference in Geneva. So-called bug bounty programs became popular in Silicon Valley's high-tech sector. PayPal paid about 1,000 hackers for confidentially reporting on big security holes found in their systems. "If you care about the product [and] care about your customers, you care about your customers' security—this is what you have to do," said the director of security intelligence at PayPal. As Yahoo's chief security officer also explained, "There are thousands of people out there with the skill sets that could help us find these bugs and get them fixed faster. And there's nothing lost by bringing them into the fold and giving them the opportunity to participate."[37]

Many companies have institutionalized their attention toward protecting information by hiring managers trained in this field, creating new programs to train employees to spot potential hacking activity, or other strong safeguards within the company and its system.

Government Efforts to Combat Cybercrime

What steps have governments taken to protect sensitive information from cybercrime? Targets can range from individual information that should remain private, such as financial or medical records, to commercial or government information, such as data used to run critical infrastructure like oil pipelines, railroads, water treatment facilities, and the power grid. Leon Panetta, former U.S. Secretary of Defense, predicted that it would take a "cyber-Pearl Harbor," referring to the devastating attack on the U.S. military base in Hawaii that catapulted the United States into World War II against the Japanese, to wake up the nation to the vulnerabilities in its computer systems. While no such attack has occurred—yet—the question remains: What have governments done to slow down, if not stop, the wave of cyberattacks?

[36] "Firms Go Phishing to Bolster Company Cybersecurity," *The Wall Street Journal,* December 11, 2017, *www.wsj.com*.

[37] "Banks Reluctant to Use 'White Hat' Hackers to Spot Security Flaws," *National Public Radio,* November 5, 2014, *www.npr.org*.

Given the global nature of the problem, some believe international government coordination is necessary. Since 2007, representatives from the United States and dozens of European countries have gathered annually for what is known as Data Privacy Day, held annually on January 28th. This event, which brings together privacy professionals, government leaders, academics, students, and business executives, was designed to raise awareness and empower people to protect their privacy, control their digital footprint, and escalate the protection of privacy and data as everyone's priority. Led by the National Cyber Security Alliance, a non-profit, public–private partnership, people can sign-up for free security checks, check their privacy settings, and access various resources for parents, educators and businesses.

More dramatic and legal measures were taken at the multinational level in 2014 when leaders of the North Atlantic Treaty Organization (NATO) ratified a change in the organization's mission of collective defense. For the first time, a cyberattack on any of the 28 NATO nations could be declared an attack on all of them, much like a ground invasion or an airborne bombing. The most obvious target of the new policy was Russia, which was believed to be behind computer attacks that disrupted financial and telecommunication systems in Estonia in 2007 and Georgia in 2008. NATO officials also pointed to increased cyberactivity by China and Iran—calling them "patriotic hackers"—and the need for the organization to keep up with increasingly sophisticated modern warfare.

The Equifax data breach in 2017, discussed in Chapter 6, highlighted the fact that there are 48 different state disclosure laws within the United States and none appears to be strong enough to induce a company to share information with the affected individuals or the government during a cyberattack. Some advocated the passage of federal legislation that mandates the sharing of information, something firms are often hesitant to do under the protection of trade secrets and competitive information.

> As discussed earlier in this chapter, the European Union passed the General Data Protection Regulation in 2018, which forced companies that did business in the 28 countries that comprised the European Union and the United Kingdom to disclose promptly when personal data had been breached. Initially, firms that did not comply would be warned, but if they persisted they could be fined as much as €20 million (more than $23 million U.S.) or 4 percent of a company's total global revenue, whichever was larger.[38]

Additional coordinated efforts by international governmental agencies are needed to better ensure that the threat of cyberattacks on the infrastructure of a country or the invasion of citizens' information are thwarted. These efforts must be in harmony with businesses' anti-cybercrime efforts.

Summary

- In some countries, governments have taken steps to protect their citizens' personal data from terrorism and other threats. These governments have also attempted to better ensure protection of intellectual property.
- Two major market stakeholders targeted by business organizations for the collection of information are employees and consumers, raising numerous ethical issues. The access to big data can be at odds with the protection of individuals' rights to their own information.

[38] "What Is General Data Protection Regulation?" *Forbes,* February 14, 2018, *www.forbes.com*; and General Data Protection Regulation—European Commission, *ec.europa.eu/info/law/law-topic/data-protection_en*.

- Businesses increasingly use electronic exchanges, or e-business, for the buying and selling of goods and services between businesses, organizations, and individuals via Internet-based systems.
- Robotic technology, artificial intelligence, collaborative machines, autonomous automobiles, and other technological advances increasingly assume a greater role in business operations. This transformation of business practices also raises important ethical concerns, such as the loss of jobs for humans and whether artificial intelligence systems can make ethical decisions.
- Many businesses are relying on technology to enhance their operations and increasingly entrusted the management of technology to their chief information officer. These managers often report to the company's CEO and are being entrusted with greater strategic responsibilities within the company.
- Cybercrime is criminal activity committed by individuals or groups, called hackers, which gain unauthorized access to a business organization through its computer system. It imposes substantial costs on businesses that are hacked. Hackers appear motivated by financial incentives, government or business retaliation, or media attention for an issue or the hackers themselves. Hackers are commonly motivated by financial reward, retaliation, or political beliefs.
- Given the serious and costly threats of cybercrime, businesses have created comprehensive defenses, cutting across all organizational functions and supported by the organization's executive leadership. Experts encourage companies to develop incident-responses plans against cyberattacks. International and national government groups have attacked cybercrime through regulatory and voluntary efforts. Additional coordinated efforts are needed and must be in harmony with businesses' anti-cybercrime efforts.

Key Terms

artificial intelligence (AI), *268*
autonomous vehicles, *269*
big data, *264*
chief information officer (CIO), *269*
cybercrime, *271*
Digital Millennium Copyright Act, *263*
e-business, *266*
General Data Protection Regulation (GDPR), *263*
hackers, *271*
intellectual property, *263*
net neutrality, *264*
omnichannel, *267*
ransomware attacks, *273*
right to be forgotten, *262*
software piracy, *263*

Internet Resources

www.ama-assn.org	American Medical Association
www.ftc.gov/datasecurity	Bureau of Consumer Protection, Data Security
www.bsa.org	Business Software Alliance
www.cio.com	Chief Information Officer professional Website
www.ecommercetimes.com	E-Commerce Times
hackercombat.com	Hacker Combat Community
www.foresight.org	Foresight Institute
www.issa.org	Information Systems Security Association
www.dhs.gov	U.S. Department of Homeland Security
www.robotics.org	Robotics Industries Association

Discussion Case: *The Arrival of Autonomous Cars—Bright Future or Looming Threat?*

As Elaine Herzberg walked her bicycle across a six-lane road in Tempe, Arizona, around 10 o'clock at night, she was fatally struck by a Volvo SUV, a prototype autonomous vehicle that Uber had modified to test its self-driving technology. A series of safety failures had combined to cause this fatal accident. First, the sensors mounted on the car failed to spot Herzberg in sufficient time to slow the vehicle down from its 38 miles-per-hour speed. Second, according to police video cameras, the safety driver, a human sitting in the vehicle charged with monitoring the driving, did not have his hands on the steering wheel and was apparently distracted. Third, the car's brakes were never applied by the safety driver or the car's system.

In another incident, a Tesla Model X SUV traveling on Highway 101 in Mountain View, California, slammed into a concrete highway lane divider and burst into flames, killing the driver, Wei Huang. Tesla reported that the autopilot system was engaged and provided warnings to Huang of a potential collision, but Huang failed to take control of the vehicle. According to the company's press release, Huang, "had received several visual and one audible hands-on warnings earlier in the drive and the driver's hands were not detected on the wheel for six seconds prior to the collision. The driver had about five seconds and 150 meters of unobstructed view of the concrete divider . . . but the vehicle logs show that no action was taken."

While the self-driving technology was state-of-the-art in both vehicles at the time of the fatal accidents, it had not been sufficient in either case to prevent tragedy. Some thought that the problem was that the humans in the cars had simply been too slow to react to an unexpected event when they thought the car was in charge. According to Constantine Samaras, a university engineering professor, "When humans are the backup systems, we're pretty bad at doing [what is necessary to prevent crashes]. This is a challenge for this transition to automation, where there's this muddled mixture of human responsibility and robot responsibility."

Many saw autonomous vehicles as a way to improve—not degrade—road safety. In 2017, more than 37,000 people died in car crashes in the United States. Clearly, humans were not perfect drivers. Self-driving cars, by contrast, did not get tired, frustrated, distracted, or drunk, as humans often did when behind the wheel. A study by the Virginia Tech Transportation Institute analyzed more than 50 self-driving vehicles commissioned by Google, which had travelled about 1.3 million miles on roads in California and Texas. The Google fleet was involved in just 17 crashes over six years, with none of the incidents being the fault of the self-driving vehicles. Another study by McKinsey estimated that autonomous vehicles could reduce U.S. auto accidents by 90 percent.

However, others saw negative consequences in a world of autonomous driving. Driverless vehicles could cost truckers, taxi drivers, and other driving professionals their jobs. Already, driverless trucks were being used to move iron ore at mines in Australia, and Canadian-based Suncor Energy had automated its truck fleet, eliminating the jobs of 800 drivers. Companies engaged in other forms of transportation, such as busses, trains and airplanes, could see fewer customers, as people might choose to travel by car when if they were not burdened with the driving. If the number of accidents declined, auto repair shops and mechanics would likely have less business, and layoffs could occur.

Another issue raised by critics of autonomous automobiles was the possibility that the vehicle's computer systems might be hacked. As part of a planned experiment, hackers Charlie Miller and Chris Valasek were able to access the controls of a self-driving Jeep

Cherokee remotely, instructing it to roll out of a parking lot and into a grassy ditch. The person in the driver's seat at the time, a journalist from *Wired* magazine, was not controlling the steering wheel or the pedals. Effectively safeguarding against such hacking can be challenging, since self-driving cars have far higher levels of connectivity than human-driven vehicles currently on the road.

Will autonomous vehicles be widely adopted in our society? The answer to this question is unclear. In a survey reported in *The Washington Post,* most Americans said they thought autonomous cars would be quite common within 15 years. Seventy-four percent, however, said they did not expect to own one, and more than 60 percent said they would not want to walk or ride a bicycle anywhere near one. A study conducted by the American Automobile Association (AAA) shortly after the Uber and Tesla accidents reported that 73 percent of Americans said they would not ride in an autonomous vehicle. Greg Bannon, director of engineering at the AAA said, "Any incident involving an autonomous vehicle is likely to shake consumer trust, which is a critical component to the widespread acceptance of autonomous vehicles."

Yet, as autonomous vehicle technology gained momentum, governments stepped in to regulate. In 2017, the National Highway and Transportation Safety Administration (NHTSA) released new federal guidelines for Automated Driving Systems (ADS). By 2017, 29 states had enacted legislation governing autonomous vehicles. Some states, such as Florida and Arizona, encouraged the safe development, testing, and operation of self-driving vehicles on their public roads, seeing this as an opportunity to encourage business development. Delaware established the Advisory Council on Connected and Autonomous Vehicles, tasked with developing recommendations for innovative tools and strategies that could be used to prepare Delaware's transportation network for these vehicles—an action also taken by numerous other states.

While most people expect that fatal crashes involving autonomous vehicles will occur again in the future, the question of whether self-driving cars impose an acceptable level of risk relative to their benefits to society is a matter of ongoing debate.

Sources: "Study Says Self-Driving Cars Are Safer Than Human-Driven Vehicles: Should You Believe It?" *Tech Times,* January 12, 2016, *www.techtimes.com*; "Hackers Have Self-Driving Cars in their Headlights," *Financial Times,* March 15, 2018, *www.ft.com*; "Autonomous Car Crashes: Who—or What—Is to Blame?" *Knowledge@Wharton,* April 6, 2018, *knowledge.wharton.upenn.edu*; "Are Autonomous Cars Really Safer than Human Drivers?" *The Conversation,* February 2, 2018, *theconversation.com*; "Autonomous Vehicles/Self-Driving Vehicles Enacted Legislation," *National Conference of State Legislatures,* May 21, 2018, *www.ncsl.org/research/transportation*; "33 Industries other than Auto that Driverless Cars Could Turn Upside Down," *CB Insights,* May 24, 2018, *www.cbinsights.com*; and "Most People Expect Driverless Cars to Become Common, and They Worry," *The Washington Post,* June 4, 2018, *www.washington.post*.

Discussion Questions

1. What are the benefits and costs, or advantages and disadvantages, of autonomous driving technology to various corporate stakeholders and society?
2. Are the threats of harm from autonomous vehicles simply an acceptable risk, especially when compared to fatalities caused by human-driven vehicles?
3. What steps could business, government, or individual drivers take to reduce the risk of hacking in autonomous vehicles?
4. Do you think federal or state governments should regulate the emergence of autonomous driving technology, and if so how?
5. If you were the chief technology officer of a company that was developing autonomously driven vehicles, what steps would you take to manage this technology appropriately?

PART SIX

Business and Its Stakeholders

CHAPTER THIRTEEN

Shareholder Rights and Corporate Governance

Shareholders occupy a position of central importance in the corporation because they own shares of the company's stock. As owners, they pursue both financial and nonfinancial goals. How can shareholders' rights best be protected? What are the appropriate roles of top managers and boards of directors in the governance of the corporation? How can their incentives be aligned with the purposes of the firm, including the interests of the company's shareholders? And how can government regulators best protect the rights of investors and promote good corporate governance?

This Chapter Focuses on These Key Learning Objectives:

LO 13-1 Identifying different kinds of shareholders and understanding their objectives and legal rights.

LO 13-2 Knowing how corporations are governed and explaining the role of the board of directors in protecting the interests of investors and other stakeholders.

LO 13-3 Analyzing the function of executive compensation and debating if top managers are paid too much.

LO 13-4 Evaluating various ways shareholders can promote their economic and social objectives.

LO 13-5 Understanding how the government protects against stock market abuses, such as fraudulent accounting and insider trading.

Twenty-first Century Fox, the media company, settled a massive shareholder lawsuit in 2017. Shareholders had sued top executives and the board of directors, saying they had allowed a “toxic culture” of sexual and racial harassment to infect the company, damaging its reputation and stock value. The settlement called for the defendants to pay $90 million to the company, for the benefit of shareholders, and to set up a Workplace Professionalism and Inclusion Council to prevent similar situations from arising in the future. Said the investors who brought the suit, “Corporate boards can no longer pretend that such conduct is isolated, nor can corporate boards pretend that their conduct does not and will not pose a grave risk to companies and their shareholders.”[1]

In early 2018, two large institutional investors, Jana Partners and the California State Teachers’ Retirement System (CalSTRS), wrote an open letter to the board of directors of Apple Inc. Together, the two organizations—one a hedge fund and the other a public pension fund—owned around $2 billion worth of the tech company’s stock. The letter cited evidence that children who were heavy users of Apple products such as iPhones and iPads were distracted in class, at risk for depression, less empathetic than their peers, and often sleep-deprived. It called on the company to make it easier for parents to control their children’s use of technology. “We believe that addressing this issue now will enhance long-term value for all shareholders,” the letter concluded.[2]

In 2017, the chairman of the board of SeaWorld Parks, an operator of theme parks and water parks based in Florida, resigned after failing to win the support of the company’s shareholders. Although he ran uncontested, the chairman did not receive the votes of a majority. Shareholders were apparently angered by high executive compensation, even when attendance and revenues were falling in the wake of the critical documentary *Blackfish*. The day the election results were announced, the company’s stock rose by 7 percent. Said an industry analyst, “The message they’re sending is they’re going to keep management and the board of directors on a relatively short leash to do the right thing for shareholders.”[3]

As these three examples illustrate, the relationships among shareholders, top executives, and boards of directors in today’s companies are multiple and complex. In these cases, shareholders used a variety of techniques to assert their rights—a lawsuit, public persuasion, and voting for the board of directors. This chapter will address the important legal rights of shareholders and how corporate boards, government regulators, managers, and activist investors can protect them. It will also discuss changes in corporate practice and government oversight designed to better guard shareholder interests, in both the United States and other nations.

Shareholders Around the World

Shareholders (or investors or stockholders, as they also are called) are an important market stakeholder of the firm, as explained in Chapter 1. By purchasing shares of a company’s stock, they become owners. For this reason, they have a stake in how well the company performs.[4]

[1] “Massive Derivative Suit Settlement for Alleged Management Failure to Prevent Sexual Misconduct,” *The D&O Diary,* November 21, 2017.

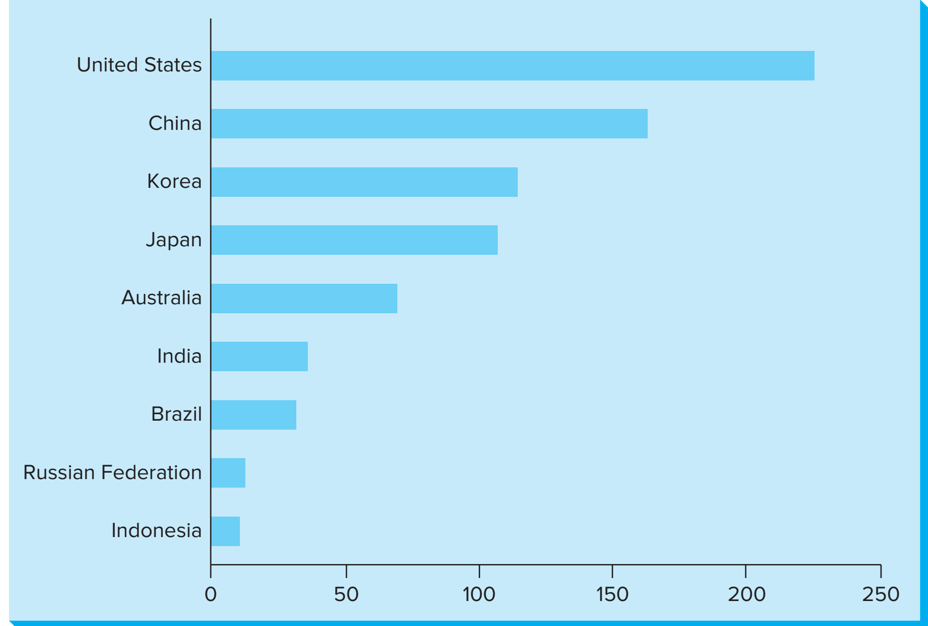
[2] “Open Letter from Jana Partners and CalSTRS to Apple Inc.,” January 6, 2018.

[3] “SeaWorld Stockholders Vote Off Board Chairman, *Orlando Sentinel,* June 14, 2017, and “SeaWorld Calls Time on Chairman after Shareholder Revolt,” *Financial Times,* September 13, 2018.

[4] The following discussion refers to publicly held corporations; that is, ones whose shares of stock are owned by the public and traded on the various stock exchanges. U.S. laws permit a number of other ownership forms, including sole proprietorships, partnerships, and mutual companies. (A *privately held* company, by contrast, is one whose shares are not publicly traded.)

FIGURE 13.1
Stock Market Capitalization as a Percentage of Gross Domestic Product, for Selected Countries, 2016

Source: "Stocks Traded, Total Value (% of GDP), 2016," at *http://data.worldbank.org*.



Stock ownership today is increasingly global. In 2015, the total value of stocks in the world was $62 trillion, slightly down from $64 trillion before the stock market collapse of 2008–09. The market capitalization (total value) of stocks in the United States is by far larger than that of any other country, but stock ownership has grown in many other parts of the world.[5] One way to compare the extent of stock ownership among countries is to examine their market capitalization as a percentage of their GDP (gross domestic product, a measure of the size of their economies). By this yardstick, the United States leads, but many other countries are not far behind, as shown in Figure 13.1.

Who Are Shareholders?

Whether in the United States or other countries, two main types of investors own shares of stock in corporations: individual and institutional.

- *Individual shareholders* are people who directly own shares of stock issued by companies. These shares are usually purchased through a stockbroker and are held in brokerage accounts. For example, a person might buy 100 shares of Apple or Sony Corporation for his or her portfolio and hold these in an account at a firm such as Edward Jones, Fidelity, or Charles Schwab. Such shareholders are sometimes called "Main Street" investors, because they come from all walks of life.
- *Institutions,* such as pensions, mutual funds, insurance companies, and university endowments, also own stock. For example, mutual funds such as Vanguard Wellington and pensions such as the California Public Employees Retirement System (CalPERS) buy stock on behalf of their investors or members. These institutions are sometimes called "Wall Street" investors. For obvious reasons, institutions usually have more money to invest and buy more shares than individual investors.

[5] Comprehensive data on stock market capitalization by countries is available in "Market Capitalization of Listed Companies," at *http://data.worldbank.org*.

Since the 1960s, growth in the numbers of such **institutional investors** has been phenomenal. In 2016, institutions accounted for about 60 percent of the value of all equities (stocks) owned in the United States, worth a total of about $23 *trillion.* In 2017, slightly over half of all U.S. households (54 percent) owned stocks, either directly or indirectly through holdings in mutual funds or retirement accounts, according to a Gallup survey. This proportion had fallen significantly since just before the stock market collapse of 2008 (when 65 percent owned stocks), possibly reflecting investors' lower confidence. Although people of every age, race, and socioeconomic status owned stocks, ownership tended to be higher among some groups than others. For example, whites (60 percent) were more likely to own stocks than African Americans (36 percent), and the college educated (78 percent) were more likely than those with less education (43 percent). The affluent (with household incomes of $100,000 or more) (89 percent) owned stocks as a higher rate than lower income people (with household incomes of less than $30,000) (21 percent). Age also made a difference: 62 percent of people between 50 and 64 years old owned stocks, compared with just 31 percent of young adults under 30.[6]

Figure 13.2 shows the relative stock holdings of individual and institutional investors from the 1960s through 2016 in the United States. It shows the growing influence of the institutional sector of the market over the past five decades, although the relative share of the institutional sector has leveled off since the financial crisis.

Objectives of Stock Ownership

Individuals and institutions own corporate stock for several reasons. Foremost among them is to make money. People buy stocks because they believe stocks will produce a return greater than they could receive from alternative investments. Shareholders make money when the price of the stock rises (this is called *capital appreciation*) and when they receive

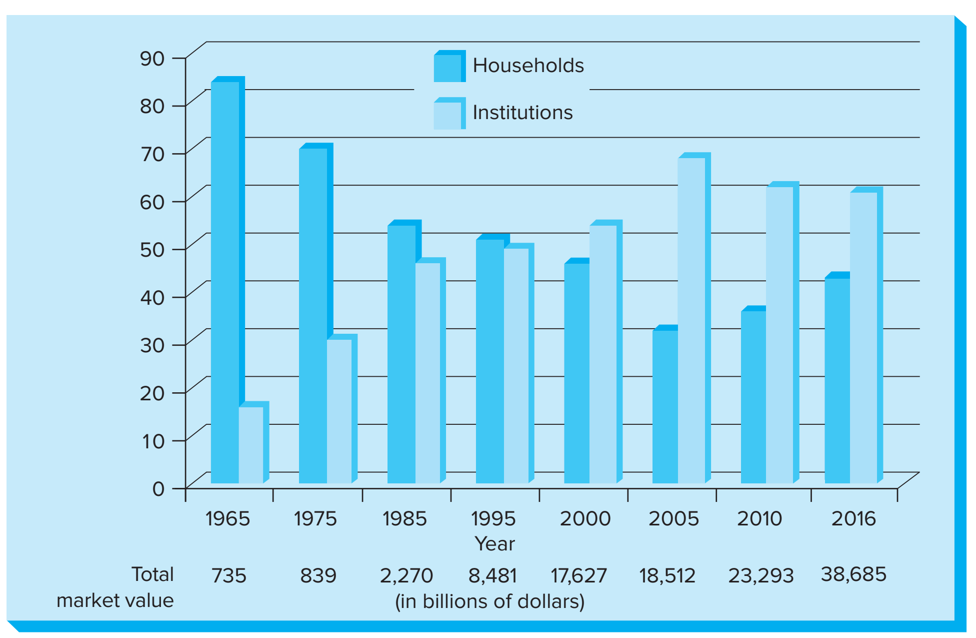


FIGURE 13.2
Household versus Institutional Ownership in the United States, 1965–2016, by Market Value

Source: Securities Industry and Financial Markets Association, *2017 Fact Book* (New York, SIFMA, 2017); U.S. Census Bureau, *Statistical Abstract of the United States, 2012,* Table 1201; and Securities Industry Association, *Securities Industry Fact Book* (New York: Securities Industry Association, 2008). Household sector includes nonprofit organizations. Based on Federal Reserve Flow of Funds Accounts (revised).

[6] "U.S. Stock Ownership Down Among All but Older, Higher-Income," May 24, 2017, *http://news.gallp.com*. Data are based on Gallup's annual economics and personal finance survey.

their share of the company's earnings (called *dividends*). Most companies pay dividends, but some—particularly new companies with good prospects for rapid growth—do not. In this case, investors buy the stock with the goal of capital appreciation only.

Stock prices rise and fall over time, affected by both the performance of the company and by the overall movement of the stock market. For example, in 2008 and early 2009 share values declined sharply—for example, the Dow Jones Industrial Average, a widely tracked index, lost almost half its value in just a year and a half—as the global economy fell into a severe recession. This is called a *bear market.* This was followed by a period in which markets rose again in a *bull market,* which produced gains for many investors. Typically, bull and bear markets alternate, driven by the health of the economy, interest rates, world events, and other factors that are often difficult to predict. Although stock prices are sometimes volatile, stocks historically have produced a higher return over the long run than investments in bonds, bank certificates of deposit, or money markets.

Shareholders are not a uniform group. Some seek long-term appreciation, while others seek short-term returns. Some are looking for capital gains, while others are looking for dividend income. Although the primary motivation of most shareholders is to make money from their investments, some have other motivations as well. Some investors use stock ownership to achieve social or ethical objectives, a trend that is discussed later in this chapter. Investors may also buy stock to take control of a company in a hostile takeover bid. Some investors have mixed objectives; for example, they wish to make a reasonable return on their investment but also to advance social or ethical goals.

Shareholders' Legal Rights and Safeguards

As explained in Chapter 1, managers have a duty to all stakeholders, not just to those who own shares in their company. Nevertheless, in the United States and most other countries, shareholders have extensive legal rights, as shown in Figure 13.3. They have the right to share in the profits of the enterprise if directors declare dividends. They have the right to receive annual reports of company earnings and company activities and to inspect the corporate books, provided they have a legitimate business purpose for doing so and that it will not be disruptive of business operations. They have the right to elect members of the board of directors, usually on a "one share equals one vote" basis. They have the right to hold the directors and officers of the corporation responsible for their actions, by lawsuit if they want to go that far. For example, in 2017 the home health care giant Amedisys paid $44 million to settle a lawsuit brought by its shareholders, whose share values had dropped by half after the company was found to have committed Medicare fraud.[7] Furthermore,

FIGURE 13.3
Major Legal Rights of Shareholders

- To receive dividends, if declared
- To vote on
  - Members of board of directors
  - Major mergers and acquisitions
  - Charter and bylaw changes
  - Proposals by stockholders
- To receive annual reports on the company's financial condition
- To bring shareholder suits against the company and officers
- To sell their own shares of stock to others

[7] "Amedisys Will Pay $43.8 Million to Settle Class-Action Lawsuit," *Modern Healthcare,* June 16, 2017.

shareholders usually have the right to vote on mergers, some acquisitions, and changes in the charter and bylaws, and to bring other business-related proposals. And finally, they have the right to sell their stock.

Many of these rights are exercised at the annual shareholders' meeting, where directors and managers present an annual report and shareholders have an opportunity to approve or disapprove management's plans. Typically, however, only a small portion of shareholders vote in person. Those not attending are given an opportunity to vote by absentee ballot, called a **proxy**. Evidence shows that institutional investors are more likely to vote their proxies; 91 percent of institutions vote, compared with only 29 percent of individual shareholders.[8] The use of proxy elections by activists to influence corporate policy is discussed later in this chapter.

Who protects these rights? Within a publicly held company, the board of directors bears a major share of the responsibility for making sure that the firm is run with the interests of shareholders, as well as those of other stakeholders, in mind. We turn next, therefore, to a consideration of the role of the board in the system of corporate governance.

Corporate Governance

The term **corporate governance** refers to the process by which a company is controlled or governed. Just as nations have governments that respond to the needs of citizens and establish policy, so do corporations have systems of internal governance that determine overall strategic direction and balance sometimes divergent interests.

The Board of Directors

The **board of directors** plays a central role in corporate governance. The board of directors is an elected group of individuals who have a legal duty to establish corporate objectives, develop broad policies, and select top-level personnel to carry out these objectives and policies. The board also reviews management's performance to be sure the company is well run, and all stakeholders' interests are protected, including those of shareholders. In recent years, the role of the board has expanded, with greater emphasis given to strategy development, talent management, and investor relations. Like any group, it also has its own interests, which it seeks to protect. Boards typically meet in full session around six times a year, with about a third of boards now also scheduling strategy retreats and other off-site work.[9]

Corporate boards vary in size, composition, and structure to best serve the interests of the corporation and its shareholders. Some patterns are evident, however. According to a survey of its members by the Society for Corporate Governance, corporate boards typically have between 9 and 11 members. Most of them are *outside* directors (not managers of the company, who are known as *inside* directors when they serve on the board). (The New York Stock Exchange requires the boards of listed companies to have a majority of outsiders.) Board members may include chief executives of other companies, major shareholders, bankers, former government officials, academics, representatives of the community, or retired executives from other firms. Women now make up 20 percent of the boards of Fortune 500 companies; African Americans, 8 percent; Latinos, 3 percent; and Asian Americans, 2 percent. (The representation of women on boards of directors and laws

[8] "Small Investors Support the Boards. But Few of Them Vote," *The New York Times,* October 6, 2017.

[9] "How Boards of Directors Are Reshaping to Meet New Challenges," *Forbes,* May 26, 2017.

mandating quotas for women on boards in some European countries are further discussed in Chapter 16.) The average tenure of a director is eight to ten years.[10]

Board structure in Europe is quite different from its counterpart in the United States. Many European boards use what is called a *two-tier system.* This means that instead of one board, as is common in the United States, these companies have two boards. One, which is called the *executive board,* is made up of the CEO and other insiders. The other, which is called the *supervisory board,* is made up of outsiders—sometimes including labor representatives—and has an independent chairperson. These boards operate autonomously, but of course also coordinate their work. This system is used in all firms in Germany and Austria and in many firms in Denmark, Finland, the Netherlands, Norway, Poland, and Switzerland. Other European nations often use a hybrid system, which has elements of both the unitary and two-tiered systems.[11]

Corporate directors are typically well paid. Compensation for board members is composed of a complex mix of retainer fees, meeting fees, grants of stock and stock options, pensions, and various perks. In 2017, median compensation for non-management directors at the largest U.S. corporations was $300,000. This amount had risen steadily over time (it had been $225,000 a decade earlier). Of this compensation, 40 percent was paid in cash and 60 percent in stock or stock options.[12] Some critics believe that board compensation is excessive, and that high pay contributes to complacency by some directors who do not want to jeopardize their positions by challenging the policies of management. (Compensation of executives is discussed later in this chapter.)

Most corporate boards perform their work through committees as well as in general sessions. The compensation committee (required by U.S. law and staffed exclusively by outside directors) administers and approves salaries and other benefits of high-level managers in the company. The nominating committee is responsible for finding and recommending candidates for officers and directors. The executive committee works closely with top managers on important business matters. A significant minority of corporations now has a special committee devoted to issues of corporate responsibility. Often, this committee works closely with the firm's department of corporate citizenship, as discussed in Chapter 3.

One of the most important committees of the board is the audit committee. Present in virtually all boards, the audit committee is required by U.S. law to be composed entirely of outside directors and to be "financially literate." It reviews the company's financial reports, recommends the appointment of outside auditors (accountants), and oversees the integrity of internal financial controls. Their role is often critical; at Enron, for example, lax oversight by the audit committee was a major contributor to the firm's collapse in 2001. Directors who fail to detect and stop accounting fraud, as occurred at Enron, may be liable for damages.

How are directors selected? Board members are elected by shareholders at the annual meeting, where absent owners may vote by proxy, as explained earlier. Thus, the system is formally democratic. However, as a practical matter, shareholders often have little choice. Typically, the nominating committee, working with the CEO and chairman, develops a list of possible candidates and presents these to the board for consideration. When a final

[10] Deloitte and Society for Corporate Governance, *2016 Board Practices Report, 10th ed.* (2017), and Deloitte and Alliance for Board Diversity, *Missing Pieces Report: The 2016 Board Diversity Census of Women and Minorities on Fortune 500 Boards* (2017).

[11] Information about corporate governance in Europe is available in Heidrick & Struggles, "Towards Dynamic Governance 2014: European Corporate Governance Report," at *www.heidrick.com*.

[12] "Pay for Big Company Directors Tops $300,000," *The Wall Street Journal,* June 28, 2018.

selection is made, the names of these individuals are placed on the proxy ballot. Shareholders may vote to approve or disapprove the nominees, but because alternative candidates are rarely presented, the vote has little significance. The selection process therefore tends to produce a kind of self-perpetuating system. This has begun to change, however, as shareholders have increasingly demanded the right to nominate their own candidates, in a move for greater **proxy access**. Sixty percent of U.S. companies now have rules permitting shareholders to nominate directors under some circumstances.[13] And, as shown in one of the opening examples, board members will sometimes step down when they fail to win the support of a majority of shareholder votes, even if they are running unopposed. Because boards typically meet behind closed doors, scholars know less about the kinds of *processes* that lead to effective decision making by directors than they do about board composition and structure.

> In their book *Back to the Drawing Board,* Colin Carter and Jay Lorsch observe, based on their extensive consulting experience, that boards develop their own norms that define what is—and is not—appropriate behavior. For example, *pilot boards* see their role as actively guiding the company's strategic direction. *Watchdog* boards, by contrast, see their role as assuring compliance with the law—and intervening in management decisions only if something is clearly wrong. These norms are often powerfully influenced by the chairman. Boards that share a consensus on behavioral norms tend to function more effectively as a group than those that do not.[14]

Principles of Good Governance

In the wake of the corporate scandals of the early 2000s and the financial crisis later in the decade, many sought to define the core principles of good corporate governance. What kinds of boards were most effective? By the late 2010s, a broad consensus had emerged among public agencies, investor groups, and stock exchanges about some key features of effective boards. These included the following:

- *Select outside directors to fill most positions.* (Outside directors are also called *independent directors.)* Normally no more than two or three members of the board should be current managers. Moreover, the outside members should be truly independent; that is, should have no current connection to the corporation other than serving as a director. This would exclude, for example, directors who had served as employees of the company within the past three years, who provided consulting services for the company, who were officers of other firms that had a business relationship with the company, or who had a close personal relationship with the CEO. The audit, compensation, and nominating committees should be comprised *solely* of outsiders. By the late 2010s, virtually all major companies were following these practices.
- *Hold open elections for members of the board.* In recent years, dissident shareholders have organized to put their own candidates for the board on the proxy ballot, creating elections with genuine choice. For example, in 2017 investor Nelson Peltz ran for a seat on the board of Procter & Gamble, in a move opposed by management—an example further discussed later in this chapter. Contested board elections are rare, however; more often, dissidents simply vote against candidates nominated by management. Some have argued that candidates should have to get at least 50 percent of votes to be elected (most

[13] EY Center for Board Matters, "2017 Proxy Season Review," Ernst & Young, June 2017.

[14] Colin B. Carter and Jay W. Lorsch, *Back to the Drawing Boards: Designing Corporate Boards for a Complex World* (Boston: Harvard Business School Press, 2003).

companies required only a plurality; that is, more votes than other candidates, but not necessarily a majority of votes cast).

- *Hold elections for all directors annually.* Some boards are *classified;* this means that board elections are staggered; only some directors ("a class") stand for election each year, and then serve for a multi-year term. Proponents of *declassification* believe that all directors should stand for election every year, allowing more opportunities to unseat underperforming directors. This can increase accountability and responsiveness to shareholders. In the past five years, many boards have switched to annual elections; in fact, in 2017, 90 percent of large U.S. companies had declassified boards, up from two-thirds in 2011. Declassified boards are also more likely to be diverse.[15]
- *Appoint an independent lead director (also called a nonexecutive chairman of the board.)* Many experts in corporate governance believed that boards should separate the duties of the chief executive and the board chairman, rather than combining the two in one person as done in some corporations, especially in the United States. The independent lead director can hold meetings without management present, improving the board's chances of having completely candid discussions about a company's affairs. For example, after John Stumpf resigned as Wells Fargo's CEO and chairman, the board decided to split the roles of CEO and chairperson. (The unauthorized customer accounts scandal that led to Stumpf's departure is further described in a case at the end of this book.) One study found that separating the positions of CEO and chairman was most likely in companies that had experienced shareholder activism and had recently appointed a new chief executive. In 2016, 50 percent of S&P 500 companies separated the roles of CEO and chairperson.[16]
- *Diversify board membership.* Many good governance experts have argued that boards should include many different kinds of people. Diversity on the basis of gender, ethnicity, age, nationality, and other dimensions widens the range of experiences, perspectives, and values brought to the boardroom. Such "cognitive variety," in this view, expands options and enriches discussions—potentially improving leadership. A survey of nearly 900 directors conducted by PwC in 2017 found that 73 percent thought that board diversity was beneficial. Of those, 82 percent thought it enhanced board performance.[17] The academic literature on the impacts of board diversity is further discussed in Chapter 16.

The movement to improve corporate governance has been active in other nations and regions, as well as the United States, as some of these examples show. The Organization for Economic Cooperation and Development (OECD), representing 34 nations, has issued a set of principles for corporate governance to serve as a benchmark for companies and policymakers worldwide. For its part, the European Union has worked hard to modernize corporate governance practices and harmonize them across its member states.[18] Corporate governance reforms have also taken hold in South Africa, India, and many other nations.

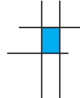
[15] "Declassified Boards Are More Likely to Be Diverse," August 15, 2017, *Harvard Law School Forum on Corporate Governance and Financial Regulation*.

[16] Korn Ferry Institute (in partnership with the National Association of Corporate Directors), *Annual Survey of Board Leadership, 2017 Edition, www.kornferryinstitute.com*. Data based on boards of directors at the 500 U.S.-based firms that made up the S&P Large Cap Index, as of December 31, 2016; and "Results of Public Company Governance Survey," op. cit.

[17] "16 & of Corporate Board Members Say Racial and Gender Diversity Has No Benefit at All," *Fortune,* October 17, 2017.

[18] The OECD's corporate governance principles are available at *www.oecd.org/corporate*. Information about recent changes in corporate governance practices in Europe is available at the website of the European Corporate Governance Institute, *www.ecgi.org*.

In short, by the late 2010s the movement to make boards more responsive to shareholders was an international one.



Special Issue: Executive Compensation

Setting **executive compensation** is one of the most important functions of the board of directors. The emergence of the modern, publicly held corporation in the late 1800s effectively separated ownership and control. That is, owners of the firm no longer managed it on a day-to-day basis; this task fell to hired professionals. This development gave rise to what theorists call the *agency problem*. If managers are merely hired agents, what will guarantee that they act in the interests of shareholders rather than simply helping themselves? The problem is a serious one, because shareholders are often geographically dispersed, and government rules make it difficult for them to contact each other and to organize on behalf of their collective interests. Boards meet just a few times a year. Who, then, is watching the managers?

An important mechanism for aligning the interests of the corporation and its shareholders with those of its top managers is executive compensation. But, as this section will show, the system does not always work the way it is supposed to.

Executive compensation in the United States, by international standards, is very high. In 2017, the median total compensation of the 200 highest paid chief executives in the United States was $17.5 million, including salaries, bonuses, and the present value of retirement benefits, incentive plans, and stock options, according to the compensation firm Equilar. The highest paid executive in 2017 was Hock E. Tan, CEO of Broadcom (a semiconductor company based in San Jose, California), who took home an eye-popping $103 million. A spokesperson for Broadcom said that the CEO's compensation was justified because the company's share value had increased more than 680 percent in five years under Tan's leadership.[19] Because the Equilar survey included only public companies, it did not capture the often-outsized pay of hedge fund and private equity firm executives. In many cases, these individuals earned much more than their public company counterparts. Raymond Dalio, founder of Bridgewater, one of the world's largest hedge funds, for example, earned an astonishing $1.4 *billion* in 2016.[20] (Hedge funds and private equity firms are further discussed later in this chapter.)

Many companies, like Broadcom, compensate their senior executives in part with grants of stock or **stock options**. The latter represent the right (but not obligation) to buy a company's stock at a set price (called the strike price) for a certain period. The option becomes valuable when, and if, the stock price rises above this amount. Grants of stock and stock options are often used to align executives' interests with those of shareholders. The idea behind such *pay-for-performance* approaches is that executives will work hard to improve the company's results, because this will increase the stock price and therefore the value of their compensation. In 2017, more than half (54 percent) of executive pay was performance-based.[21] But critics have highlighted a danger of equity-based compensation: that unscrupulous executives may become so fixated on their performance pay that they will do anything to increase the stock price, even if this involves unethical accounting practices or actions that would hurt employees, customers, or other stakeholders. The classic

[19] Equilar compensation data for 2017 are available at *www.equilar.com/reports/56-equilar-new-york-times-highest-paid-ceos-2018*. See also "Media CEO Pay for the 100 Largest Companies Reached a Record $15.7 Million in 2017," *The Washington Post,* April 11, 2018.

[20] "Highest Earning Hedge Fund Managers 2017," at *www.forbes.com*.

[21] "CEOs Awarded More Cash Pay," *The Wall Street Journal,* April 20, 2015.

example of this was Enron, where fraudulent financial reports made the company seem more successful than it really was—temporarily increasing its stock price and benefiting its top executives (whose compensation was mostly performance-based). Enron later collapsed, devastating its employees, customers, and shareholders. Evidence on the relationship between company performance and equity-based compensation is discussed later in this chapter.

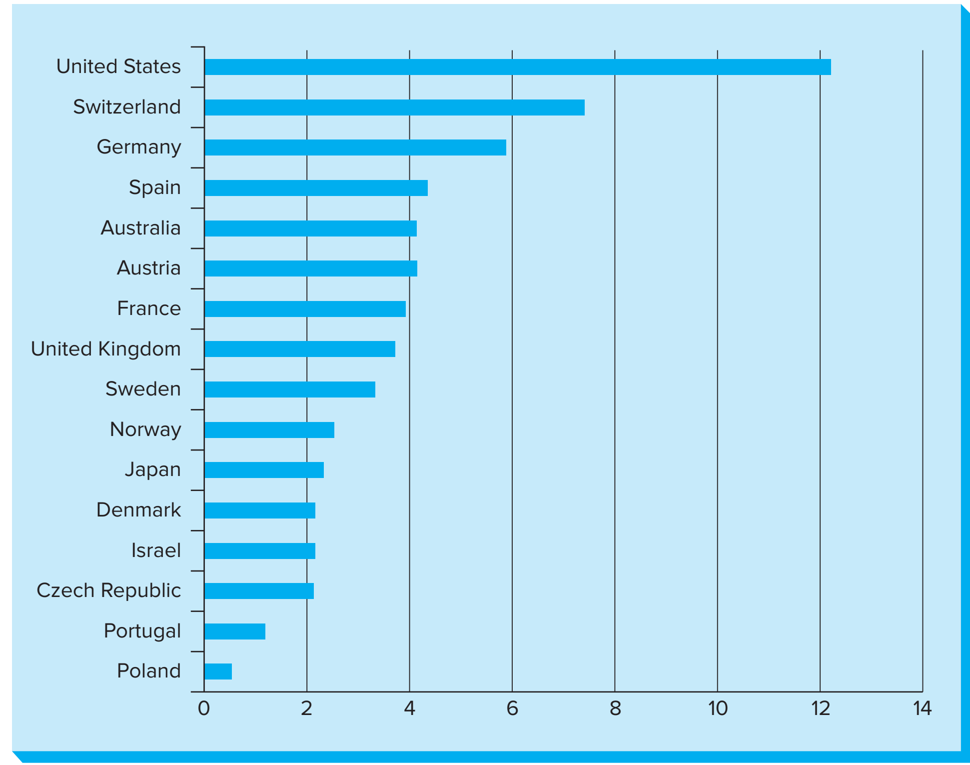
By contrast to the United States, top managers in other countries earn much less. Although the pay of chief executives elsewhere is catching up, it is still generally well below what comparable managers in the United States earn. Figure 13.4 represents graphically the large gap between executive pay in the United States and that of other developed nations.

These disparities have caused friction in some global firms.

> A case in point is Carlos Ghosn, the Brazilian-born chief executive of the Renault-Nissan-Mitsubishi Alliance, a strategic partnership of automakers that ranks second after Volkswagen and sells more than one in ten cars worldwide. In 2017, Ghosn received $7.9 million for his services as CEO of the French partner Renault. Although his compensation was above average for CEO pay in France, it did not seem excessive for a leader that *Forbes* magazine called an "exceptional manager and visionary." But in Japan, where he earned a separate $9.8 million as CEO of Nissan, his compensation seemed out of line to many. "I understand the sensitivity of the issue," said Ghosn, who regularly commuted between homes in Paris and Tokyo. "[But] being in Japan should not be a handicap to attract talent."[22]

FIGURE 13.4
Relative Average Annual CEO Compensation in the United States and Selected Developed Nations, in Millions of Dollars, 2014

Sources: Harvard Business School; *Washington Post*. Statista 2018.



[22] "Nissan Says CEO Ghosn's Salary Rose 2.5 Percent Last Year," *Reuters,* June 26, 2017.

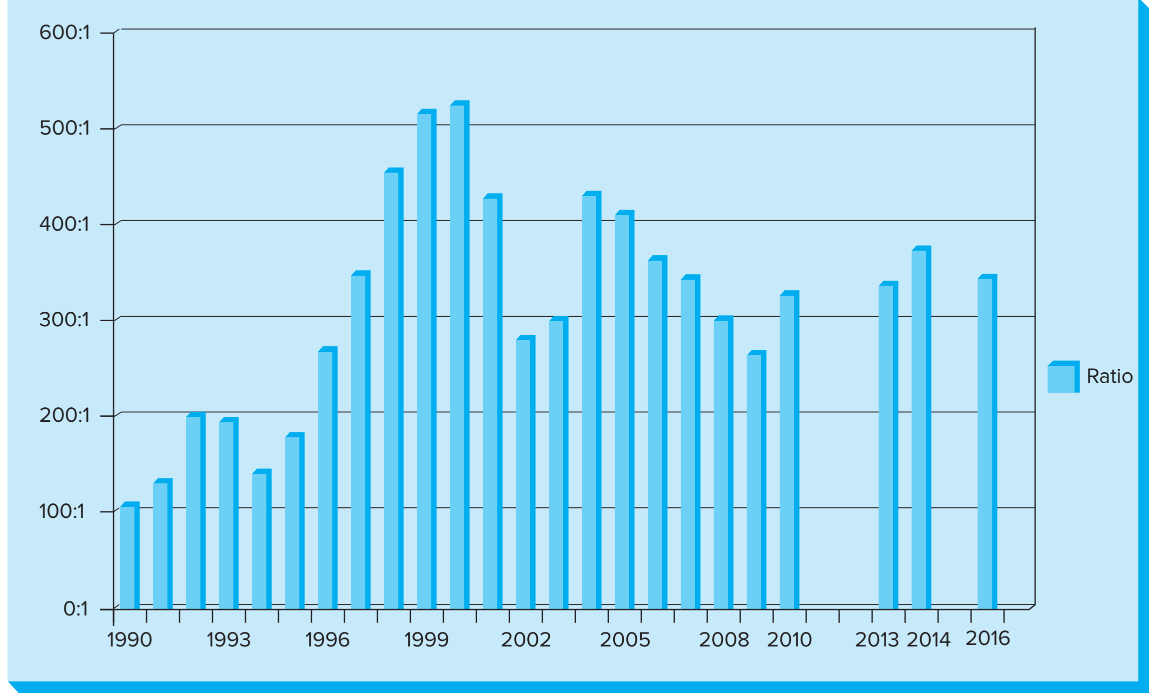
Another way to look at executive compensation is to compare the pay of top managers with that of average employees. In the United States, CEOs in 2016 made 347 times what the average worker did. Figure 13.5 shows that since 1990 the ratio of average executive to average worker pay has increased markedly during periods of economic expansion, such as the "dot com" boom of the late 1990s, but fallen back during periods of economic contraction, such as the Great Recession of 2008–09. The ratio, which has started to rise again, is now more than three times greater than it was in 1990. Research published in the *Harvard Business Review* found that the U.S. public thought the "ideal" pay ratio would be much, much smaller: 6.7 to one. The average ideal in the 16 countries surveyed was 4.6 to one.[23]

A provision of the 2010 Dodd-Frank Act (introduced in Chapter 7) required major U.S. firms for the first time to disclose the ratio of their CEO's compensation to the median compensation of all their employees. This rule went into effect in 2018, revealing information that some employees might find startling. For example, at Live Nation Entertainment, an employee earning the median wage of $24,406 would have to work for 2,893 years to earn as much as the CEO. Companies that operated their own supplier factories in low-wage countries like China—such as the toy maker Mattel—had unusually high pay ratios. But those that outsourced their production to others had relatively low pay ratios.[24]

FIGURE 13.5

Ratio of Average CEO Pay to Average Production Worker Pay, 1990–2016

Sources: Data for 2013, 2014, and 2016 are from the AFL-CIO Corporate Watch website at *www.aflcio/corporate watch*. Data for earlier years are drawn from the Institute for Policy Studies' Executive Excess annual surveys conducted by the Institute for Policy Studies and United for a Fair Economy, available at *www.ips-dc.org* and *www.faireconomy.org*.



[23] "CEOs Get Paid Too Much, According to Pretty Much Everyone in the World," *Harvard Business Review,* September 23, 2014.

[24] "Want to Make Money Like a CEO? Work for 275 Years," *The New York Times,* May 25, 2018, and "SEC Adopts Interpretive Guidance on Pay Ratio Rule," *press release,* September 21, 2017, at *www.sec.gov*.

Why are American executives paid so much? Corporate politics play an important role. In their book, *Pay without Performance: The Unfulfilled Promise of Executive Compensation,* Lucian A. Bebchuk and Jesse M. Fried argue that one reason salaries are so high is that top managers have so much influence over the pay-setting process. Compensation committees are made up of individuals who are selected for board membership in part by the CEO, and they are often linked by ties of friendship and personal loyalty. Many are CEOs themselves and sensitive to the indirect impact of their decisions on their own salaries. Moreover, compensation committees rely on surveys of similar firms and usually want to pay their own executives above the industry average, over time ratcheting up pay for all.[25]

Some observers say that the comparatively high compensation of top executives is justified. In this view, well-paid managers are simply being rewarded for outstanding performance. For example, Amazon CEO Jeff Bezos earned just $1.7 million, while his shareholders enjoyed a return of 56 percent; few shareholders would complain that he was overpaid as leader of the astonishingly successful company. Supporters also argue that high salaries provide an incentive for innovation and risk taking. In an era of intense global competition, restructuring, and financial instability, the job of CEO of large corporations has never been more challenging, and the tenure in the top job has become shorter. Another argument for high compensation is a shortage of labor. In this view, not many individuals are capable of running today's large, complex organizations, so the few that have the necessary skills and experience can command a premium. Today's high salaries are necessary for companies to attract or retain top talent. Why shouldn't the most successful business executives make as much as top athletes and entertainers?

On the other hand, critics argue that inflated executive pay hurts the ability of U.S. firms to compete with foreign rivals. High executive compensation diverts financial resources that could be used to invest in the business, increase shareholder dividends, or pay average workers more. Multimillion-dollar salaries cause resentment and sap the commitment—and sometimes lead to the exodus of—hard-working lower and mid-level employees who feel they are not receiving their fair share. As for the performance issue, most empirical evidence finds little relationship overall between executive pay and company success. A study of 500 large U.S. companies by the nonprofit organization As You Sow, published in 2018, found no statistically significant relationship between total shareholder return (capital gains and dividends) and top executive compensation averaged over the preceding five-year period. In other words, higher paid executives did not necessarily produce higher returns for shareholders. For example, Thomas Rutledge, the CEO of Charter Communications, was paid nearly six times as much as might have been expected, based on shareholder returns.[26]

Executive compensation has also been the subject of government regulations. Under U.S. government rules, companies must clearly disclose what their five top executives are paid and lay out a rationale for their compensation. Companies must also report the value of various perks, from the personal use of corporate aircraft to free tickets to sporting events, which had previously escaped investor scrutiny. Under the so-called **say-on-pay** provisions of the Dodd-Frank Act, which went into effect in 2011, public companies must hold shareholder votes on executive compensation at least once every three years.

[25] Lucian A. Bebchuk and Jesse M. Fried, *Pay without Performance: The Unfulfilled Promise of Executive Compensation* (Cambridge, MA: Harvard University Press, 2004).

[26] As You Sow, "The 100 Most Overpaid CEOs 2018: Are Fund Managers Asleep at the Wheel?" February 2015, and private correspondence. Calculations were contributed by HIP Investor, a partner of As You Sow. The organization's work on executive compensation is available at *www.asyousow.org/our-work/ceo-pay*.

Many voluntarily now do so annually. For example, in 2018 a majority of shareholders voted against the proposed pay package of CEO Robert Iger, which they apparently thought was excessive.[27] Although such say-on-pay referendums are not binding on management, they provide a mechanism for shareholders to voice displeasure over excessive compensation—and boards often take notice. The governments of the United Kingdom, Norway, and Australia require such votes. A study found that in Australia, executive compensation had fallen relative to average workers' pay after these rules went into effect—a "testament to investor vigilance," the study concluded.[28]

The SEC has also proposed, but not finalized, a rule that would require companies to take back incentive-based compensation after a restatement of financial disclosures, a process known as *clawback*. In other words, if executives lied to pump up their compensation, they would have to pay it back. Even in the absence of SEC requirements, some boards of directors had acted. At Wells Fargo, for example, the board clawed back $75 million in compensation from two senior executives under whose watch the bank fraudulently opened customer accounts without their knowledge.[29]

Some unusual companies have voluntarily set caps on executive pay or pay differentials, and some executives have taken pay cuts. In 2015, the CEO of Gravity Payments, a Seattle credit card processor, slashed his own pay and set the minimum salary of workers at $70,000, saying that he thought that "CEO pay is way out of whack." (This story is the subject of the discussion case in Chapter 3.) Whole Foods Market set a rule that no executive's salary could be more than 19 times what the average worker made, but this rule was likely to be revoked after the grocer was acquired by Amazon in 2017.[30]

Legal scholar Michael Dorff recommended in his book *Indispensable and Other Myths* that performance pay be eliminated, or at least restructured. Citing evidence that performance pay does not actually improve company performance—and, in fact, may simply "focus executives on their chances of winning the pay lottery rather than on running the company"—Dorff proposed that executives be paid mostly in cash. Base pay could be supplemented by carefully constructed bonuses based on meeting performance targets that are easy to measure, hard to manipulate, and within the executives' control.[31]

How to structure executive compensation to best align managers' interests with those of shareholders and other stakeholders will remain a core challenge of corporate governance.

Shareholder Activism

Shareholders do not have to rely exclusively on the board of directors. Some owners, both individual and institutional, have also acted directly to protect their own interests, as they define them. This section will describe the increased activism of three shareholder groups: large institutions (including hedge funds and private equity firms), social investors, and owners seeking redress through the courts.

[27] "Disney Shareholders Reject CEO Iger's Pay Package," *Market Watch,* March 8, 2018.

[28] Australian Council of Superannuation Investors, "Boards Respond to Investors on CEO Pay," *press release,* September 19, 2013.

[29] "Wells Fargo to Claw Back $75 Million from 2 Former Executives," *The New York Times,* April 10, 2017.

[30] "Whole Foods' CEO Pay Discount Expires," June 21, 2017, *www.bloomberg.com*.

[31] Michael B. Dorff, *Indispensable and Other Myths: Why the CEO Experiment Failed and How to Fix It* (Berkeley: University of California Press, 2014).

The Rise of Institutional Investors

As shown earlier, institutional investors—pensions, mutual funds, endowment funds, and the like—have enlarged their stockholdings significantly over the past two decades and have become more assertive in promoting the interests of their members.

One reason institutions have become more active is that it is more difficult for them to sell their holdings if they become dissatisfied with management performance. Large institutions have less flexibility than individual shareholders, because selling a large block of stock could seriously depress its price, and therefore the value of the institution's holdings. Accordingly, institutional investors have a strong incentive to hold their shares and organize to change management policy.

The Council of Institutional Investors (CII) is an organization that represents pension funds, endowments, and foundations with combined assets of $3.5 trillion. The council has developed a Shareholder Bill of Rights and has urged its members to view their proxies as assets, voting them on behalf of shareholders rather than automatically with management. Two organizations, ISS (formerly Institutional Shareholder Services) and Glass Lewis, analyze shareholder resolutions and advise institutions how to vote. The activism of institutional shareholders has often improved company performance. One study showed that in the five years before and after a major pension fund became actively involved in the governance of companies whose shares it owned, stock performance improved dramatically, relative to the overall market.[32]

The activism of institutional investors has begun to spread to other countries. In many cases, U.S.–based pension and mutual funds that have acquired large stakes in foreign companies have spearheaded these efforts. As of 2017, U.S. investors had allocated about a fifth of their portfolios to foreign securities. To protect their globalized investments, fund managers have become active in proxy battles in Japan, Britain, Hong Kong, and many other countries. In addition, sovereign wealth funds operated by the governments of Singapore, Abu Dhabi, and China have recently become more active as institutional investors.

Another important group of activist investors is made up of private equity and hedge funds. **Private equity firms** are managed pools of money invested by very wealthy individuals and institutions (they are not usually open to ordinary individuals). **Hedge funds** are also pools of private capital; they are so-called because of the aggressive strategies they use to earn high returns for their investors. Their net asset values in 2017 were $2.9 trillion and $3.7 trillion, respectively.[33] Both types of funds often invest in public companies with the intention of intervening to dramatically improve their shareholder returns.

> For example, in 2017 an activist hedge fund called Trian Partners, headed by Nelson Peltz, waged an aggressive campaign for a seat on the board of Procter & Gamble, the giant consumer staples conglomerate. Trian, which owned a 1.5 percent stake, argued that P&G had not delivered for shareholders and called for the company to be split into three independent global business units. During the three-month campaign, P&G's stock rose 8 percent, as shareholders anticipated that Peltz would improve the company's value. After the shareholder vote yielded a virtual tie, the board offered a seat to the activist investor. "Peltz's experience in the consumer product space will add value to P&G's board," said the director of corporate governance at the California teachers' retirement system.[34]

[32] "The 'CalPERS Effect' on Targeted Company Share Price," July 31, 2009, at *www.calpers-governance.org*.

[33] "Private Fund Statistics," January 17, 2018, Securities and Exchange Commission Division of Investment Management Analytics Office.

[34] "Procter & Gamble Bets on Electoral Math to Keep Nelson Peltz Away," *The New York Times,* October 6, 2017, and "P&G Concedes Proxy Fight, Adds Nelson Peltz to Board," *The Wall Street Journal,* December 15, 2017.

Although some individual investors no doubt welcomed the intervention of activist shareholders like Trian, others sounded an alarm. Commented Jeffrey Sonnenfeld, a professor at the Yale School of Management, "Too often activists pressure companies to cut costs, add debt, sell divisions and increase share repurchases, rather than invest in jobs, R&D, and growth. They do all this in the name of creating shareholder value. But that value is often short-lived."[35]

Social Investment

Another movement of growing importance among a very different kind of activist shareholder is **social investment**, sometimes also called *socially responsible investment* or *sustainable, responsible, and impact investment* (all these terms use the acronym SRI). Social investment refers to the use of stock ownership as a strategy for promoting social, environmental, and governance (ESG) objectives. This can be done in two ways: through selecting stocks according to various social criteria, and by using the corporate governance process to raise issues of concern.

Stock Screening

Shareholders wishing to choose stocks based on social, environmental, or governance criteria often turn to screened funds. A growing number of mutual funds and pension funds use *social screens* to select companies in which to invest, weeding out ones that pollute the environment, overpay their executives, discriminate against employees, make dangerous products like tobacco or weapons, or do business in countries with poor human rights records. In 2016, according to the Global Sustainable Investment Alliance, $23 trillion of assets were managed using responsible investment strategies, making up more than a quarter of all managed assets globally. $8.7 trillion in the United States was invested in mutual funds or pensions using social responsibility as an investment criterion, accounting for more than one in every five investment dollars. In recent years, socially responsible investing has also grown rapidly in Europe, Latin America, and Asia.[36] Growth has been driven, in part, by government rules requiring pension funds to disclose the extent to which they use social, environmental, or governance criteria in selecting investments. It has also been influenced by growing demand by investors who want to align their investment choices with their values. Most evidence shows that ESG–screened portfolios provide returns that are competitive with or superior to the broad market. For example, a study by Morgan Stanley found that sustainable investment (investment in companies focused on creating social and environmental as well as economic benefits) "had usually met, and often exceeded, the performance of comparable traditional investments" on both an absolute and risk-adjusted basis.[37]

Social criteria may also be used when selling stocks. For example, some have at various times called for *divestment* (sale of stock) from companies that had operations in China, where some products were made by forced labor, and in Nigeria, Myanmar (Burma), and Sudan, where repressive regimes had been accused of human rights abuses. More recently, activists have called for divestment from companies that mine, extract, and market fossil fuels, because of their impact on climate change.

[35] "Activist Shareholders, Sluggish Performance," *The Wall Street Journal* [commentary], April 1, 2015.

[36] Global Sustainable Investment Alliance, "2016 Global Sustainable Investment Review," at *www.gsi-alliance.org*. Data are as of early 2016.

[37] Morgan Stanley Institute for Sustainable Investing, "Sustainable Reality: Understanding the Performance of Sustainable Investment Strategies," March 2015.

Social Responsibility Shareholder Resolutions

Another important way in which shareholders have been active is by sponsoring **social responsibility shareholder resolutions**. This is a resolution on an issue of corporate social responsibility placed before shareholders for a vote at the company's annual meeting.

The Securities and Exchange Commission (SEC), a government regulatory agency that is further described later in this chapter, allows shareholders to place resolutions concerning appropriate social issues, such as environmental responsibility or alcohol and tobacco advertising, in proxy statements sent out by companies. The SEC has tried to minimize harassment by requiring a resolution to receive minimum support to be resubmitted—3 percent of votes cast the first time, 6 percent the second time, and 10 percent the third time it is submitted within a five-year period. Resolutions cannot deal with a company's ordinary business, such as employee wages or the content of advertising, since that would constitute unjustified interference with management's decisions.[38]

In 2018, shareholder activists sponsored more than 400 resolutions dealing with major social issues. Backers included faith-based institutions, individual shareholders, unions, environmental groups, socially responsible asset managers, universities, and public pension funds. In the 2018 proxy season, some of the issues most commonly raised in these resolutions included corporate political activity, sustainability and climate change, workplace diversity, and governance practices such as board composition.[39]

When a social responsibility shareholder resolution is filed, several outcomes are possible. In some cases, managers enter into a dialogue with shareholder activists and resolve an issue before the election. For example, activists withdrew a shareholder proposal at ExxonMobil after the company met their key request to issue a report on its forecasts of energy demand and how it was positioning itself for a "lower-carbon future."[40] Many companies now engage with shareholder activists, and in 2017 about a quarter of shareholder proposals resulted in some company action, as it did at ExxonMobil. If no resolution is reached, the proposal will generally be submitted for a vote by shareholders. In 2017, proposals on climate-related risks and proxy access were supported by more than a third of voters, a threshold at which many boards pay serious attention.[41]

Shareholder Lawsuits

Another way in which shareholders can seek to advance their interests is by suing the company. If owners think that they or their company have been damaged by actions of company officers or directors, they have the right to bring lawsuits in the courts, either on behalf of themselves or on behalf of the company (the latter is called a *derivative* lawsuit). **Shareholder lawsuits** may be initiated to check many abuses, including insider trading, an inadequate price obtained for the company's stock in a buyout (or a good price rejected), or failure to disclose material information in a timely manner. The outcome can be very expensive for companies, as illustrated by the following example.

> Multiple groups of shareholders sued LendingClub, a company that runs a digital platform connecting consumers who need loans with lenders, banks, and credit partners. After revelations that some loan information had been falsified—and the

[38] Current SEC rules on shareholder proposals may be found at *www.sec.gov/rules/final*.

[39] As You Sow, *"Proxy Preview 2018: Helping Shareholders Vote Their Values,"* Oakland, Calif.: 2018.

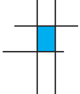
[40] "ExxonMobil Gives in to Shareholders on Climate Risk Disclosure," *Fortune,* December 17, 2017.

[41] EY Center for Board Matters, *"2017 Proxy Season Review,"* Ernst & Young, June 2017. This and additional information about shareholder resolutions are available at *www.ey.com/gl/en/issues/governance-and-reporting/center-for-board-matters*.

company's internal controls had failed to flag these irregularities—the stock fell by 35 percent, destroying $950 million in market value. In 2018, LendingClub settled its shareholder lawsuits for $125 million.[42]

Lawsuits brought by shareholders against the board of Wynn Resorts after a sexual harassment scandal hurt the firm's share price are described in the discussion case at the end of this chapter.

In many ways—whether through their collective organization, the selection of stocks, the shareholder resolution process, or the courts—shareholder activists can and do protect their economic and social rights.



Government Protection of Shareholder Interests

The government also plays an important role in protecting shareholder interests. This role expanded as legislators responded to the corporate scandals of the early 2000s and the financial crisis later in the decade.

Securities and Exchange Commission

The major government agency protecting shareholders' interests is the **Securities and Exchange Commission (SEC)**. Established in 1934 in the wake of the stock market crash and the Great Depression, its mission is to protect shareholders' rights by making sure that stock markets are run fairly, and that investment information is fully disclosed. The agency, unlike most in government, generates revenue to pay for its own operations. (The revenue comes from fees paid by companies listed on the major stock exchanges.)

Government regulation is needed because shareholders can be damaged by abusive practices. Two areas calling for regulatory attention are protecting shareholders from fraudulent financial accounting and from unfair trading by insiders.

Information Transparency and Disclosure

Giving shareholders more and better company information is one of the best ways to safeguard their interests, and this is a primary mission of the SEC. By law, shareholders have a right to know about the affairs of the corporations in which they hold ownership shares. Those who attend annual meetings learn about past performance and future goals through speeches made by corporate officers and documents such as the company's annual report. Those who do not attend meetings must depend primarily on annual reports issued by the company and the opinions of independent financial analysts.

In recent years, management has tended to disclose more information than ever before to shareholders and other interested people. Prompted by the SEC, professional accounting groups, and individual investors, companies now disclose a great deal about their financial affairs, with much information readily available on investor relations sections of company web pages. Shareholders can learn about sales and earnings, assets, capital expenditures and depreciation by line of business, details of foreign operations, and many other financial matters. Corporations also are required to disclose detailed information about directors and top executives and their compensation. In addition, many companies have begun reporting detailed information about social and environmental, as well as financial, performance, as discussed in Chapters 3, 10, and 17.

[42] "LendingClub Agrees to Settle Shareholder Litigation for $125 Million," *American Banker,* February 20, 2018, and "LendingClub CEO Fired Over Faulty Loans," *The Wall Street Journal,* May 9, 2016.

Insider Trading

Another area the SEC regulates is stock trading by insiders. **Insider trading** occurs when a person gains access to confidential information about a company's financial condition and then uses that information, before it becomes public knowledge, to buy or sell the company's stock. Since others do not know what an inside trader does, the insider has an unfair advantage.

In 2011, Raj Rajaratnam, founder and former manager of the prominent hedge fund Galleon Group, was sentenced to 11 years in prison for 14 counts of illegal insider trading, the longest-ever sentence for this crime at that time. He was also ordered to pay $157 million in fines and forfeitures. Federal prosecutors built their case from wiretap evidence. Over several months, they listened as Rajaratnam—as *The New York Times* put it—"brazenly and matter-of-factly swapped inside stock tips with corporate insiders and fellow traders." In one particularly shocking example, a member of the board of directors of Goldman Sachs called Rajaratnam seconds after a board meeting to share earnings information. The government said that Galleon Group had made $63 million in all from illegal trades. "The defendant knew the rules, but he did not care," said one of the government prosecutors. "Cheating became part of his business model."[43]

Insider trading is illegal under the Securities and Exchange Act of 1934, which outlaws "any manipulative or deceptive device." The courts have generally interpreted this to mean that it is against the law to trade stock (or stock options) based on material, nonpublic information. This includes company officials, of course, who may have inside information based on their work. But it also includes also other individuals who obtain such information through a "breach of trust," that is, a tip from someone who has an obligation to keep the information confidential. The tipper can also be guilty, if he or she benefits from the exchange. It is not, however, illegal to trade based on information developed from publicly available sources. Unfortunately, drawing these distinctions in practice has been challenging, and the courts and Congress and the courts have gone back and forth trying to pin down exactly what constitutes a consequential benefit to the tipper, and what information can be said to come from inside versus public sources. Insider trading is also illegal in most other countries.

Insider traders are not necessarily high-placed executives, wealthy individuals, or household names. In 2017, the SEC brought insider trading charges against Daniel Rivas, who worked for the Bank of America, saying he had passed nonpublic information about upcoming mergers and acquisitions to his girlfriend's father, James Moodhe. Moodhe generated $2 million in profits by trading on the tips. Several of the two men's friends and associates were also charged. Rivas and Moodhe both pleaded guilty.[44]

The best-known kind of insider trading—as in this case—occurs when people improperly acquire confidential information about forthcoming mergers and acquisitions before these are announced to the public. A startling study conducted by professors at New York University and McGill University, which examined stock trades between 1996 and 2012,

[43] "Hedge Fund Billionaire is Guilty of Insider Trading" and "A Circle of Tipsters Who Shared Illegal Secrets," *The New York Times,* May 11, 2011; and "Rajaratnam Ordered to Pay $92.8 Million Penalty," *The New York Times,* November 8, 2011.

[44] "Seven Charged in Insider Trading Ring Linked to Bank of America Leaks," *Fortune,* August 17, 2017, and "Insider Trading Case to Be a Test of the Role of Friendship," *The New York Times,* August 21, 2017.

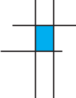
found that insider trading had probably occurred in no less than a quarter of all such deals.[45] In another kind of insider trading, called *front-running,* traders place buy and sell orders for stock in advance of the moves of big institutional investors. They also track big trades in real time and act on them quickly; with today's high-speed trading, even a few milliseconds of advance notice of news about to hit the market can be enough to execute valuable insider trades.

Insider trading is contrary to the logic underlying the stock markets: All stock buyers and sellers ought to have access to the same information. In the Galleon Group case described above, Rajaratnam had insider information that ordinary investors did not—information that he used to give his fund and its investors an unfair advantage over others. If ordinary investors think that insiders can use what they know for personal gain, the system of stock trading could break down from lack of trust. Insider trading laws are important for investors to have full confidence in the fundamental fairness of the markets.

Another responsibility of the SEC is to protect investors against fraud. One situation where they apparently failed to guard against a massive scheme to cheat investors was the fraud perpetrated by Bernard Madoff.

> The victims of Madoff's fraud—including prominent universities, charities, and cultural institutions, as well as individual investors—lost as much as $65 *billion.* Where were the government regulators in all of this? In congressional hearings, SEC chairman Christopher Cox admitted that his agency had missed repeated warnings, dating back to 1999, that things might be amiss at Madoff's firm. "I am gravely concerned by the apparent multiple failures over at least a decade to thoroughly investigate these allegations or at any point to seek formal authority to pursue them," said Cox. *The New York Times* wrote in a harsh editorial that the agency's failure to uncover the Madoff fraud "exemplifies its lackadaisical approach to enforcing the law on Wall Street."[46]

Some evidence suggested that the SEC had become less aggressive in pursuing financial crimes since President Trump's appointee as SEC chair, a Wall Street attorney, took over in 2017.[47]



Shareholders and the Corporation

Shareholders have become an increasingly powerful and vocal stakeholder group in corporations. Boards of directors, under intense scrutiny after the recent wave of corporate scandals and business failures, are giving close attention to their duty to protect owners' interests. Reforms in the corporate governance process are under way that will make it easier for them to do so. Owners themselves, especially institutional investors, are pressing directors and management more forcefully to serve shareholder interests. The government, through the Securities and Exchange Commission, has taken important new steps to protect investors and promote fairness and transparency in the financial marketplace.

Clearly, shareholders are a critically important stakeholder group. By providing capital, monitoring corporate performance, assuring the effective operation of stock markets, and

[45] "Study Asserts Startling Numbers of Insider Trading Rogues," *The Wall Street Journal,* June 16, 2014.

[46] "Standing Accused: A Pillar of Finance and Charity," *The New York Times,* December 13, 2008; "SEC Issues Mea Culpa on Madoff," *The New York Times,* December 17, 2008; "SEC Knew Him as a Friend and Foe," *The New York Times,* December 18, 2008; and "You Mean That Bernie Madoff?" *The New York Times* [editorial], December 19, 2008.

[47] "Wall Street Penalties Have Fallen in Trump's First Year, Study Says," November 14, 2017, *www.bloomberg.com*.

bringing new issues to the attention of management, shareholders play a very important role in making the business system work. A major theme of this book is that the relationship between the modern corporation and *all* stakeholders is changing. Corporate leaders have an obligation to manage their companies in ways that attempt to align investors' interests with those of employees, customers, communities, and others. Balancing these various interests is a prime requirement of modern management. While shareholders are no longer considered the only important stakeholder group, their interests and needs remain central to the successful operation of corporate business.

Summary

- Individuals and institutions own shares of corporations primarily to earn dividends and receive capital gains, although some have social objectives as well. Shareholders are entitled to vote, receive information, select directors, and attempt to shape corporate policies and action.
- In the modern system of corporate governance, boards of directors are responsible for setting overall objectives, selecting and supervising top management, and assuring the integrity of financial accounting. The job of corporate boards has become increasingly difficult and challenging, as directors seek to balance the interests of shareholders, managers, and other stakeholders. Reforms have been proposed to make boards more responsive to shareholders and more independent of management.
- Some observers argue that the compensation of top U.S. executives is justified by performance, and that high salaries provide a necessary incentive for innovation and risk taking in a demanding position. Critics, however, believe that it is too high. In this view, high pay hurts firm competitiveness and undermines employee commitment.
- Shareholders have influenced corporate actions by forming organizations to promote their interests, intervening in board elections, and by filing lawsuits when they feel they have been wronged. They have also organized under the banner of social investment. These efforts have included screening stocks according to social and ethical criteria, and using the voting process to promote shareholder proposals focused on issues of social responsibility.
- Recent enforcement efforts by the Securities and Exchange Commission have focused on improving the accuracy and transparency of financial information provided to investors. They have also focused on curbing insider trading, which undermines fairness in the marketplace by benefiting those with illicitly acquired information at the expense of those who do not have it.

Key Terms

board of directors, *287*
corporate governance, *287*
executive compensation, *291*
hedge fund, *296*
insider trading, *300*
institutional investors, *285*
private equity firm, *296*
proxy, *287*
proxy access, *289*
say-on-pay, *294*
Securities and Exchange Commission (SEC), *299*
shareholders, *283*
shareholder lawsuits, *298*
social investment, *297*
social responsibility shareholder resolutions, *298*
stock option, *291*

Internet Resources

www.nyse.com	New York Stock Exchange
www.cii.org	Council of Institutional Investors
www.ussif.org	Forum for Sustainable and Responsible Investment
www.socialfunds.com	Site for socially responsible individual investors
www.ecgi.org	European Corporate Governance Institute
www.issgovernance.com	ISS (formerly Institutional Shareholder Services)
www.calpers.ca.gov	California Public Employees Retirement System
www.sec.gov	U.S. Securities and Exchange Commission

Discussion Case: *Corporate Governance and Executive Misconduct at Wynn Resorts*

On January 26, 2018, *The Wall Street Journal* published an explosive story about Steve Wynn, the chief executive and chairman of the board of Wynn Resorts, a leading operator of luxury hotels and casinos. The *Journal* reported that dozens of people had recounted "a decades-long pattern of sexual misconduct" involving Wynn's unwanted advances on massage therapists, cocktail waitresses, and other women who worked at his properties. One of the most serious allegations was that in 2005 the CEO had forced a manicurist to remove her clothes and have sex with him. After the woman filed a detailed complaint about the episode, Wynn had settled privately with her for $7.5 million. The executive immediately challenged the *Journal* story, saying, "The idea that I ever assaulted any woman is preposterous."

The day the article came out, the share price of Wynn Resorts dropped by 10 percent, wiping out $2 billion in shareholder value.

Steve Wynn, 76, had begun his career as a young man by taking over his father's bingo parlors in Maryland. He moved on to Las Vegas, Nevada, where he renovated the Golden Nugget, and later developed (and sold) the Mirage, Bellagio, and Treasure Island properties. Over his long career, Wynn was widely credited with driving the transformation of Las Vegas from a seedy strip into a world-class destination for entertainment and gaming. A larger-than-life character, Wynn was said to be inspiration for the casino owner played by Andy Garcia in the "Ocean's" films.

In 2018, Wynn Resorts owned the Wynn Las Vegas and two hotel casinos in Macau, an autonomous zone in southeast China that permitted gambling, and was in the process of building a new property in Massachusetts, expected to open in 2019. The firm had more than 24,000 employees and earned revenues in 2016 of $4.5 billion, about three-quarters of which came from its Macau operations. Wynn's signature was the company's logo.

In 2016, Steve Wynn's total compensation was $28.2 million, placing him tenth on the list of top-paid U.S. CEOs. The research organization As You Sow ranked Wynn sixth on its list of "most overpaid" CEOs, based on a comparison of his compensation with total return to shareholders over the prior five years. But the company defended Wynn's compensation package, pointing out in its proxy statement that between the initial public offering in 2002 and 2017, shareholders had averaged a total return of 19 percent per year, well above the 9 percent return of the S&P 500 during that period. "Mr. Wynn is the founder, creator and name behind our brand," the company said. "We believe he brings extraordinary talent . . . that is unrivaled in our industry."

Wynn Resorts' board of directors was comprised of ten people. Wynn served as chairman, a role he had held continuously since the company went public. The other nine

directors, although nominally independent, had close personal ties with the chief executive. They included D. Boone Wayson, whose father had been Steve Wynn's father's partner in the bingo business; Edward Virtue, who had managed the Wynn family money; and Robert Miller, a former Nevada governor, who had known the CEO for more than 40 years. Patricia Mulroy, the sole woman on the board, was a former member of the Nevada gaming commission. The nine outside directors served staggered terms, with three standing for election or re-election to three-year terms each year. Their annual compensation ranged from $362,406 to $517,973.

Wynn Resorts' board was widely viewed as compliant with the CEO's wishes. The board had voted against Wynn only three times since 2002. The sole board member who was ever opposed for re-election was Elaine Wynn, Steve's ex-wife, who lost the support of the other directors after the couple's divorce. Glass Lewis, a proxy advisory firm, had given the company's corporate governance practices an "F" grade in both 2016 and 2017. In the latter year, 41 percent of shareholders—including the big institutional investors Vanguard Group and BlackRock Inc.—had opposed the company's compensation policies in a "say-on-pay" vote.

On the day the *Journal* article broke, the board issued a statement affirming the company's commitment to maintaining a respectful culture and announced it had formed a committee, headed by Mulroy, to investigate the allegations. But these actions failed to stem a tide of negative press. On February 6, Wynn resigned as CEO and chairman, saying he could no longer be effective. The board accepted his resignation "with a collective heavy heart," calling Wynn a "beloved leader and visionary." A week later, it hired Gibson Dunn, a law firm that had represented the board in earlier litigation, to conduct an inquiry.

Less than four weeks after the publication of the allegations against Steve Wynn, New York state's public pension fund filed a lawsuit against the Wynn Resorts board of directors, saying the board had done nothing to prevent the CEO's sexual abuse and harassment and had allowed him to resign without being held accountable. The pension fund called for the defendants to "disgorge" (give back) all compensation obtained from wrongful conduct. Other states, union pensions, and individual shareholders also filed suit, and gambling regulators in Massachusetts, Nevada, and Macau opened investigations.

"The story of Steve Wynn is a cliché: a powerful man preying on the powerless," said the state of Oregon in its shareholder lawsuit. "But the directors of Wynn Resorts were not powerless. They were the only people with the knowledge and ability—and duty to the company—to investigate and stop Steve Wynn's conduct."

Sources: "Dozens of People Recount Pattern of Sexual Misconduct by Las Vegas Mogul Steve Wynn," *The Wall Street Journal,* January 26, 2018; "Wynn Board Faces Scrutiny Following Allegations Against Steve Wynn," *The Wall Street Journal,* January 30, 2018; "Wynn Steps Down as Wynn Resorts CEO," and "The Board of Wynn Resorts Needs to Go, Too," *The Wall Street Journal,* February 7, 2018; "Who's Going to Fix Wynn Resorts? Not Its Board," February 14, 2018, *www.bloomberg.com*; "Stockholders File Class Action Lawsuit Against Wynn Resorts," *The Real Deal,* February 23, 2018; "Oregon Sues Steve Wynn, Board of Directors for Failing to Stop Sexual Misconduct," March 7, 2018; *www.hollywoodreporter.com*; "Steve Wynn Remade Vegas, But China is Where He Makes Real Money," January 29, 2018, *http://money.cnn.com*; "Steve Wynn's Tarnished Name and Now a Tainted Brand," *The New York Times,* February 11, 2018; and John L. Smith, *Running Scared: The Life and Treacherous Times of Las Vegas Casino King Steve Wynn* (Cambridge, MA: Da Capo Books, 2001).

Discussion Questions

1. Do you think Steve Wynn's executive compensation was justified, and why or why not?
2. Did the board of directors of Wynn Resorts operate according to the principles of good corporate governance, as described in this chapter? Why or why not?
3. Do you think Wynn Resorts' institutional and individual shareholders used the rights described in this chapter effectively to protect their interests? Why or why not?
4. What do you recommend senior executives and the board of Wynn Resorts do now?

CHAPTER FOURTEEN

Consumer Protection

Safeguarding consumers while continuing to supply them with the goods and services they want, at the prices they want, is a prime social responsibility of business. Many companies recognize that providing customers with excellent service and product quality is an effective, as well as ethical, business strategy. Consumers, through their organizations, have advocated for their rights to safety, to be informed, to choose, to be heard, and to privacy. Government agencies serve as watchdogs for consumers, supplementing the actions taken by consumers to protect themselves through self-advocacy and use of the courts and by the actions of socially responsible corporations.

This Chapter Focuses on These Key Learning Objectives:

LO 14-1 Knowing the five major rights of consumers.

LO 14-2 Analyzing the reasons for consumer advocacy and the methods consumer organizations use to advance their interests.

LO 14-3 Assessing the ways in which government regulatory agencies protect consumers and what kinds of products are most likely to be regulated.

LO 14-4 Determining how consumer privacy online can best be protected.

LO 14-5 Examining how the courts protect consumers and efforts by businesses to change product liability laws.

LO 14-6 Evaluating how socially responsible corporations can proactively respond to consumer needs.

On late-night television infomercials, celebrity hairstylist Chaz Dean promoted a line of hair care products under the brand name WEN ("new" spelled backwards in a vaguely new-age script). The pitch was appealing: a single product could take the place of shampoo, conditioner, and detangler. The line was a hit with consumers, bringing in $100 million in just its first year of sales. But there was a problem: the products' ingredients apparently caused itching, rash, hair loss, and even total baldness. Twenty-one thousand complaints poured into WEN Hair Care from extremely upset users, and others expressed their frustrations in online forums. "I was a professional model with beautiful long natural hair," said one angry customer. "After using this product, my scalp and face broke out in boils and my hair fell out in chunks. This shampoo destroyed my life." Many sued WEN and its marketing partner Guthy-Renker in a class-action lawsuit. Eventually, the company settled, agreeing to pay customers $26 million, although it insisted its products were safe and denied any link between WEN and hair loss. WEN began mailing out checks to its aggrieved customers in 2018—but continued to sell the product line.

One reason so many consumers were exposed to a potentially harmful product is that the government has limited authority to regulate beauty and personal care products. Pharmaceutical drugs and medical devices must be tested and shown to be safe and effective before they can be sold to the public. But in 2018 that was not true for most cosmetics and personal care products such as shampoo, lipstick, and deodorant. Companies like WEN Hair Care were not required to report adverse reactions to the government, even if a customer was seriously injured or died. In response to the WEN case and others like it, a bipartisan group of senators proposed legislation called the Personal Care Products Safety Act. Backed by environmentalists, public health organizations, and some big companies like Estée Lauder and Procter & Gamble, this proposed law would require companies to report problems with personal care products to the government and give regulators the power to recall dangerous ones. It would also require that ingredients be tested for safety. But many smaller companies, represented by a trade group called Independent Cosmetic Manufacturers and Distributors, opposed the bill, saying the regulations would be too onerous. A few firms in the industry backed a competing bill that had weaker consumer protections.[1]

The story of WEN's hair care products illustrates some of the complex relationships among consumers, business firms, government regulators, and the courts. Who should bear responsibility for protecting consumers' rights and making sure they are not harmed, as many of WEN's users were? Consumers expect businesses to ensure their products' safety, promote their services honestly, and be transparent in their advertising. But the relationship is not a one-way street: consumers must themselves use care in selecting and using products and services, organize to protect themselves in the marketplace, and even bring a lawsuit as a last resort. Government regulators and the courts must ultimately back up consumers' rights. Today, companies face challenging—and often conflicting—demands to produce a safe and high-quality product or service, keep prices down, protect privacy, prevent fraud and manipulation, and meet the changing expectations of diverse customers around the world. This chapter examines various ways that consumers and their advocates, government regulators, the courts, and proactive business firms have dealt with these issues.

[1] "200 Women Sue WEN Hair Care," *The Daily Beast,* December 10, 2015; "Their Hair Fell Out. Should the F.D.A. Have the Power to Act?" *The New York Times,* August 15, 2106; "Is Your Lipstick Bad for You?" *The New York Times,* August 17, 2016; and "Competing Cosmetic Safety Bills Would Each Expand FDA Regulatory Authority," November 28, 2017, at *www.bdlaw.com*. The website for the class action settlement is at *www.wenclasssettlement.com*.

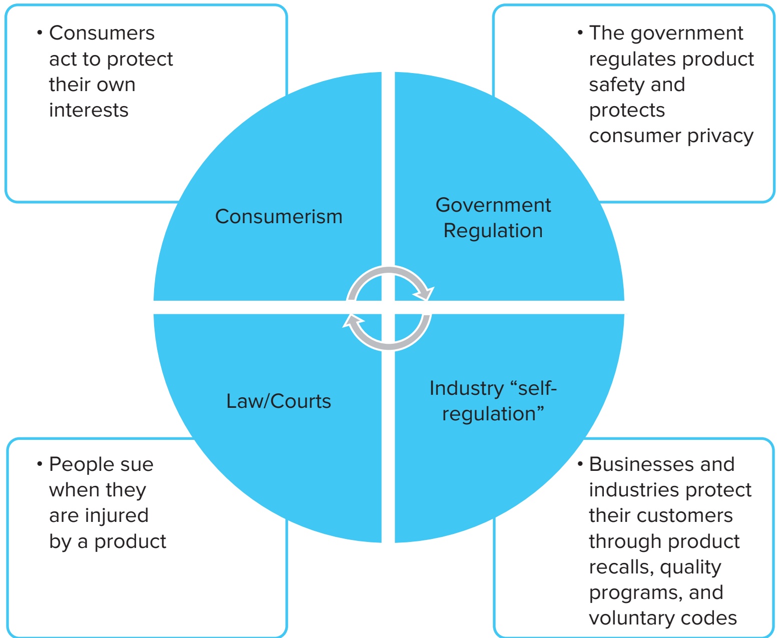
The Rights of Consumers

Over time, consumers and their advocates have defined five core rights to which they are entitled in their relationships with business. (Consumer advocacy is further described in the following section.) These five rights are:

1. *The right to be informed:* to be protected against fraudulent, deceitful, or grossly misleading information, advertising, and labeling, and to be given the facts to make an informed purchasing decision.
2. *The right to safety:* to be protected against the marketing of goods that are hazardous to health or life.
3. *The right to choose:* to be assured, wherever possible, access to a variety of products and services at competitive prices; and in those industries in which competition is not workable and government regulation is substituted, to be assured satisfactory quality and service at fair prices.
4. *The right to be heard:* to be assured that consumer interests will receive full and sympathetic consideration in the formulation of government policy and fair and expeditious treatment in the courts.
5. *The right to privacy:* to be assured that information disclosed during a commercial transaction or while using social media or searching online—such as health conditions, financial status, or identity—is not shared with others unless authorized.

Figure 14.1 shows the four main ways that these core rights of consumers can be protected. Consumers and their advocates can act to protect their own interests in their interactions with business. The government can protect consumers through the regulation of product safety, quality, data privacy, and fair dealing. People can use the courts to seek compensation when they have been injured by unsafe products or unfair practices and to compel businesses to pay greater attention to consumer rights. And finally, companies can

FIGURE 14.1
Four Methods of Protecting Consumers



proactively protect their own customers through careful attention to safety and quality and by taking swift action when something goes wrong. This chapter will take up each of these methods in turn, beginning with consumer self-organization and advocacy.

Self-Advocacy for Consumer Interests

As long as business has existed—since the ancient beginnings of commerce and trade—consumers have tried to protect their interests when they buy goods and services. They have haggled over prices, taken a careful look at the goods they were buying, compared the quality and prices of products offered by other sellers, and complained loudly when they felt cheated by shoddy products. So, consumer self-reliance—best summed up by the Latin phrase *caveat emptor,* meaning "let the buyer beware"—has always been one form of consumer protection and is still practiced today.

However, the increasing complexity of economic life has led to organized, collective efforts by consumers to safeguard their own rights in many nations. These organized activities are usually called *consumerism* or the **consumer movement**. Today, many organized groups actively promote and speak for the interests of millions of consumers.

Consumers International (CI) is an international nongovernmental organization that represents more than 200 consumer groups in more than 100 nations. Headquartered in London, it has offices in Asia, Latin America, and Africa. Its growth since 1960 has paralleled the expansion of global trade and the integration of many developing nations into the world economy, as discussed in Chapter 4. CI's approach is to partner with member organizations to deliver coordinated, multi-national campaigns to address common problems faced by consumers in the global marketplace. For example, in 2017 CI hosted a Consumer Summit in Berlin, Germany, focused on "building a digital world consumers can trust." "As tech increasingly integrates into people's lives, it is no longer sufficient to tell consumers it will bring convenience and speed or save them money," the consumer group said on its website. "[Companies] have to offer more than just a tick box, privacy notice or adjustable settings as an answer to people's growing privacy and security concerns."

In the United States, one organization alone, the Consumer Federation of America, brings together nearly 300 nonprofit groups to espouse the consumer viewpoint. Other active U.S. consumer advocacy organizations include Public Citizen, the National Consumers League, the Public Interest Research Group (PIRG), and the consumer protection unit of the American Association for Retired People (AARP). Consumer Reports (CR, formerly called Consumers Union) conducts extensive tests on selected consumer products and services and publishes the results of its tests, with ratings on a brand-name basis, online at *www.consumerreports.org*. Consumers also self-organize online, for example by creating groups of people injured by a specific product on social media platforms or using review tools to express approval or disapproval of products and services. For example, Trustpilot is a Danish website where consumers can post and share reviews of online businesses; the site garners half a million new reviews each month. Like other such sites, Trustpilot has to work constantly to identify and remove fake reviews.

Through both formal and information organization, consumers band together to promote and protect their interests.[2]

[2] See *www.consumersunion.org* and *http://hearusnow.org*.

How Government Protects Consumers

The role of government in protecting consumers is extensive in many nations. This section will describe legal protections afforded consumers in the United States and offer some comparisons with other countries.

Goals of Consumer Laws

Figure 14.2 lists some of the safeguards provided by U.S. **consumer protection laws**. Taken together, these safeguards reflect the goals of government policymakers and regulators in the context of the five rights of consumers outlined above. Many of these safeguards are also embedded in the laws of other nations.

First, some laws are intended to provide consumers with better information when making purchases. Consumers can make more rational choices when they have accurate information about the product. For example, the laws requiring health warnings on cigarettes and alcoholic beverages broaden the information consumers have about these items. Manufacturers, retailers, and importers must spell out warranties (a guarantee or assurance by the seller) in clear language and give consumers the right to sue if they are not honored. The Truth in Lending Act requires lenders to inform borrowers of the annual rate of interest to be charged, plus related fees and service charges. For example, Countrywide—the largest mortgage lender in the United States until its collapse in 2008—later paid over

FIGURE 14.2
Major Consumer Protections Specified by Consumer Laws

Information protections
Hazardous home appliances must carry a warning label.
Home products must carry a label detailing contents.
Automobiles must carry a label showing detailed breakdown of price and all related costs.
Lenders must provide timely and understandable information about mortgages and other consumer loans.
Tobacco advertisements and products must carry a health warning label.
Alcoholic beverages must carry a health warning label.
All costs related to real estate transactions must be disclosed.
Warranties must specify the terms of the guarantee and the buyer's rights.
False and deceptive advertising are prohibited.
Food and beverage labels must show complete nutritional information.
Food advertising must not make false claims about nutrition.
Direct hazard protections
Hazardous toys and games for children are banned from sale.
Safety standards for motor vehicles are required.
National and state speed limits are specified.
Hazardous, defective, and ineffective products can be recalled under pressure from the EPA, CPSC, NHTSA, and FDA.
Pesticide residue in food is allowed only if it poses a negligible risk.
Pricing protections
Unfair pricing, monopolistic practices, and noncompetitive acts are regulated by the FTC and Justice Department and by states.
Liability protections
When injured by a product, consumers can seek legal redress.
Privacy protections
Limited collection of information online from and about children is allowed.
Other protections
No discrimination in the extension of credit is allowed.

$8 billion to settle charges that it had used unfair, deceptive, or fraudulent practices in dealing with its customers.

U.S. law also requires food manufacturers to adopt a uniform nutrition label, specifying the amounts of calories, fat, salt, and other nutrients contained in packaged, canned, and bottled foods. Labels must list the amount of trans fat—partially hydrogenated vegetable oils believed to contribute to heart disease—in cakes, cookies, and snack foods. Nutritional information about fresh fruits and vegetables, as well as fish, must be posted in supermarkets. Strict rules also define what can properly be labeled "organic."

Deceptive advertising is illegal in most countries. Manufacturers may not make false or misleading claims about their own product or a competitor's product, withhold relevant information, or create unreasonable expectations. In the United States, the Federal Trade Commission (FTC) enforces the laws prohibiting deceptive advertising, and the U.S. Justice Department enforces related laws prohibiting false claims.

> For example, in 2016 DeVry University, a for-profit chain of colleges, agreed to pay $100 million to settle charges brought by the Federal Trade Commission. The government said that DeVry had misled prospective students with deceptive ads that exaggerated its graduates' job prospects and earnings. The university had falsely claimed, for instance, that its alums earned 15 percent more a year after graduation than those from other colleges. Under the settlement, DeVry was required to pay $49 million to qualifying students who were harmed by the ads and to forgive $51 million worth of loans it had issued to them for tuition, books, and fees. "When people are making important decisions about their education and their future, they should not be misled," said the chairperson of the FTC.[3]

The discussion case at the end of this chapter describes deceptive advertising used by Volkswagen to promote its diesel vehicles in the United States.

A second aim of consumer legislation is to protect consumers against possible hazards. As the opening example about WEN hair care products showed, consumers can be injured by dangerous products. U.S. laws seek to safeguard consumers in many ways, such as requiring warnings about possible side effects of pharmaceutical drugs, placing limits on flammable fabrics, restricting pesticide residues in fresh and processed foods, banning lead-based paints, and requiring regular inspections to eliminate contaminated meats. In 2008, following a major recall of toys contaminated with lead paint, Congress passed the Consumer Product Safety Improvement Act, which required that toys and infant products be tested before sale and gave regulators more resources to work with. For example, under this legislation a new rule went into effect in 2018 banning certain phthalates—dangerous chemicals used to make plastic more pliable—from children's toys and child care articles.

The third and fourth goals of consumer laws are to promote competitive pricing and consumer choice. When competitors secretly agree to divide up markets among themselves, or when a single company dominates a market, this artificially raises prices and limits consumer choice. Antitrust laws in the U.S. and Europe forbid these practices, as discussed in Chapter 7. For example, in 2017 the Federal Trade Commission opened an antitrust investigation of Mylan Pharmaceuticals for keeping the price of EpiPen artificially high. EpiPen was a potentially lifesaving device that automatically injected a dose of epinephrine when a person experienced a dangerous allergy attack.[4]

[3] "DeVry University Agrees to $100 Million Settlement with FTC," press release, December 15, 2016, at *www.ftc.gov*.

[4] "FTC Opens Antitrust Investigation of Mylan over EpiPen's Market Dominance," *Consumer Reports,* January 31, 2017.

A fifth and final goal of consumer laws is to protect privacy. This issue has recently received heightened regulatory attention, as discussed later in this chapter. The Children's Online Privacy Protection Act limits the collection of information online from and about children under the age of 13. The Federal Trade Commission has established a "do not call" list to protect individuals from unwanted telemarketing calls at home, and some have called for similar "do not track" rules to protect Internet users. Unwanted calls to a person's mobile phone are also illegal. Other threats to privacy caused by the widespread use of digital technologies are discussed later in this chapter and in Chapters 11 and 12.

Major Consumer Protection Agencies

Figure 14.3 depicts the principal consumer protection agencies that operate at the federal level of the U.S. government, along with their major areas of responsibility.

In addition to the eight agencies listed in Figure 14.3, several others are also involved in consumer protection. The Civil Rights Division of the Department of Justice enforces the provisions of the Civil Rights Act that prohibit discrimination against consumers. For example, in 2018, the department settled a case with a sports bar and lounge in Houston called 360 Midtown, charging that the venue had illegally turned away African American, Asian, and Hispanic patrons, by selectively imposing a cover charge and enforcing a dress code. "No individuals should be denied admission to any place of public accommodation because of the color of their skin," said a representative of the Civil Rights Division.[5]

The National Highway Traffic Safety Administration (NHTSA), which is part of the Department of Transportation, affects many consumers directly through its authority over automobile safety. For example, the agency develops regulations for car air bags, devices that inflate rapidly during a collision, preventing the occupant from striking the steering wheel, dashboard, or side window. Another issue the NHTSA is involved in is distracted driving, any activity that diverts the driver's attention from the road. The NHTSA has issued guidelines for carmakers to encourage them to design vehicles that allow drivers to interact safely with communications, navigation, entertainment, and other tools.[6]

One consumer protection agency with particularly significant impact on the business community is the Food and Drug Administration (FDA). The FDA's mission is to assure the safety and effectiveness of a wide range of consumer products, including pharmaceutical drugs, medical devices, foods, and cosmetics. The agency has authority over *$1 trillion* of products, about a quarter of all consumer dollars spent each year.

One of the FDA's main jobs is to review many new products prior to their introduction. This job requires regulators to walk a thin line as they attempt to protect consumers. On one hand, the agency must not approve products that are ineffective or harmful. On the other hand, the agency must also not delay beneficial new products unnecessarily. The FDA can also pull existing products off the market or put restrictions on their use, if they are found to harm consumers. Historically, the FDA has had a reputation as a cautious agency that has advocated tough and thorough review before approval. This policy has stood in contrast to those of its counterparts in Europe and some other nations, which have tended to favor quick approval followed by careful field monitoring to spot problems.

One group of products that is *not* fully regulated by the FDA is dietary supplements, such as the vitamins, minerals, and herbal remedies often sold at health food stores. In 1994, the supplement industry successfully lobbied Congress for a law that exempted their

[5] "DOJ Settles Discrimination Lawsuit Against Houston Bar 360 Midtown," February 26, 2018, *www.newsfix.com;* and "Midtown Sports Bar Settles Suit for Racial Discrimination," *Houston Chronicle,* February 1, 2018.

[6] The most recent rules concerning air bags are available at *www.nhtsa.dot.gov*.

FIGURE 14.3
Major Federal Consumer Protection Agencies and Their Main Responsibilities

Agency	Main Responsibilities
Federal Trade Commission	Competitive pricing Deceptive trade practices Packaging and labeling Consumer credit disclosure and reporting Online privacy
Food and Drug Administration	Safety, effectiveness, and labeling of drugs, foods, food additives, cosmetics, and medical devices Standards for radiation exposure Toxic chemicals research
Consumer Product Safety Commission	Safety standards for consumer products Flammable fabrics, hazardous substances, poison prevention packaging
National Highway Traffic Safety Administration (Transportation Department)	Motor vehicle safety standards Automobile fuel economy standards National uniform speed limit Consumer safeguards for altered odometers
Department of Justice	Fair competition Consumer civil rights
National Transportation Safety Board	Airline safety
Consumer Financial Protection Bureau	Fairness and transparency in consumer financial products and services
Department of Agriculture	Safety of meat and poultry

Exhibit 14.A The Consumer Financial Protection Bureau

In 2010, as part of the Dodd-Frank Act, Congress created a new agency called the Consumer Financial Protection Bureau (CFPB). Its purpose was "to make markets for consumer financial products and services work in a fair, transparent, and competitive manner." The CFPB consolidated under one roof various consumer financial protection activities, which had previously been spread across seven different federal agencies. Among its mandates were to ensure that consumers had timely and understandable information about loans, to protect them from unfair and deceptive practices and discrimination, and to promote healthy innovation in the financial services industry. It also had oversight of previously unregulated financial institutions, such as payday lenders, which regularly provided short-term, emergency loans at high interest rates to the working poor.

One of the bureau's initiatives was "Know Before You Owe," a campaign to help consumers clearly understand the costs and risks of various financial products, such as student loans. In 2018, the amount owed on student loans—estimated at $1.5 trillion—was second only to mortgages as a portion of household debt. But students and their families had difficulty comparing aid packages, because colleges often failed to distinguish clearly between loans and scholarships or to disclose the total debt a student would accumulate during their education. The bureau worked with the Department of Education to develop a standardized disclosure form that would allow students to make side-by-side comparisons of financial aid offers from several colleges; for example, by seeing how much their monthly payments would be after graduation. The CFPB also acted against unscrupulous student loan debt collectors, ordering them to stop hounding people for money they did not owe and compensate consumers they had harmed.

In 2017, the Department of Education, headed by Trump appointee Betsy DeVos, stopped collaborating with the CFPB, in part by no longer sharing information about federal student loans. This weakened the bureau's efforts to protect student borrowers.

Sources: "A Look at Shocking Student Loan Debt Statistics for 2018," at *https://studentloanhero.com*; "The Department of Education Cuts Off a Student Loan Watchdog," September 20, 2017, at *www,npr.org*; and "DeVos Tells CFPB to Back Off on Student Loans," September 8, 2017, at *www.bloomberg.com*. The CFPB's website is at *www.consumerfinance.gov*.

products from most government regulation. As a result, unlike pharmaceutical drugs, supplements do not have to be approved by the FDA before being sold, although the manufacturer itself is supposed to ensure that that the product is safe—and the government can act after a supplement is on the market.

> For example, the FDA banned ephedra, an herbal stimulant, after several users, including a professional athlete, died. But some supplement makers continued to sell body-building and weight-loss products containing a similar substance called DMAA and other stimulants that had not been proven safe. "Most supplement manufacturers are committed to ensuring quality and safety. But there are a few irresponsible and unscrupulous companies out there, and their actions are putting consumers at risk," said a research scientist.[7]

In the absence of full government regulation, a private standards-setting organization called NSF International has worked to provide certification of dietary supplements, to give consumers greater confidence in their safety.

In 2010, Congress established, as part of the Dodd-Frank Act (also discussed in Chapters 7 and 13), a new consumer regulatory body, called the Consumer Financial Protection Bureau. The purposes and actions of this agency are described in Exhibit 14.A. The debate over whether government should become involved in protecting consumer privacy is discussed in the next section of this chapter.

[7] "Potentially Harmful Stimulants Found in Six Weight-Loss and Pre-Workout Supplements," November 8, 2017, at *www.nsf.org*. Information on the FDA's policies on dietary supplements is at *www.fda.gov/food/dietarysupplements*.

All eight government regulatory agencies shown in Figure 14.3 are authorized by law to intervene directly into the very center of free market activities, if that is considered necessary to protect consumers. In other words, consumer protection laws and agencies substitute government-mandated standards and the decisions of government officials for decision making by private buyers and sellers.

Consumer Privacy in the Digital Age

Rapidly evolving information technologies have given new urgency to the broad issue of **consumer privacy**. Shoppers have always been concerned that information they reveal during a sales transaction—for example, their credit card or driver's license numbers—might be misused. But in recent years, digital technologies have increasingly enabled businesses to collect, buy, sell, and use vast amounts of personal data about their customers and potential customers. The danger is not only that this information might rarely be used fraudulently, but also that its collection represents a violation of privacy and might lead to unanticipated harms.

Individuals are often unaware of how much information about themselves they reveal to others as they shop, interact with friends, play games, use their mobile phones, or look for information online. A variety of technologies make this possible. Many websites place *cookies*—or more powerful *Flash cookies*—on a computer hard drive or mobile device, to identify the user during each subsequent visit and to build profiles of their behavior over time. *Web beacons* embedded in e-mails and websites retrieve information about the viewer. In *deep packet inspection,* third parties access and analyze digital packets of information sent over the Internet, such as pieces of e-mails or Skype calls, to infer characteristics of the sender. *GPS technology* on smartphones and other mobile devices enables service providers to track their customers' location in real time. The *Internet of things*—smart thermostats and home alarm systems, for example—give service providers a transparent window into very personal aspects of their customers' lives.

Many companies track their customers. Retailers know what they shop for and buy, search engine operators know what they are interested in, and mapping service providers know where they are. So-called *data aggregators* such as Acxiom Corporation purchase and combine data about individuals collected from various sources and compile them into highly detailed portraits to be sold to retailers, service providers, and advertisers.[8]

> Today, a major aggregator of personal information for use in marketing is social media. The leading social media company in the world is now Facebook, which has 2.1 billion users worldwide. The company collects and analyzes vast amounts of information about its users, which they must agree to when they sign up for the service; the company explicitly tells its users that its data collection "includes information about the websites and apps you visit, your use of our services on those websites and apps, as well as information the developer or publisher of the app or website provides to you or us." Although Facebook does not sell this information to others, it uses it to recruit advertisers, who are able to target with high accuracy the exact people they wish to reach on Facebook's platform. This business model has proven astonishingly successful: in 2017, the company had $40 billion in annual revenue and a market value greater than $500 billion.[9]

[8] This discussion of the use of technology to collect information about customers draws on Dipayan Ghosh and Ben Scott, "#Digital Deceit: The Technologies Behind Precision Propaganda on the Internet," New America Public Interest Technology, January 2018.

[9] "What You Don't Know about How Facebook Uses Your Data," *The New York Times,* April 11, 2018.

The main reason for all this tracking, as the Facebook example illustrates, is to tailor commercial messages to individuals. The term **behavioral advertising** refers to advertising that is specifically targeted to individuals, based on their observed online behavior. For example, a shopper might view a dress while browsing online for an outfit for an upcoming event, and then later when checking a news site might see an advertisement for the same dress pop up on her screen. In 2017, revenue from digital advertising was around $85 billion, surpassing revenue from TV advertising.[10]

Advertisements tailored to a user's interests and preferences have many advantages for both buyer and seller. The buyer is more likely to receive messages that are relevant, and the seller is more likely to reach prospective customers. For example, Amazon tracks its customers' preferences, so on subsequent visits to the website it can recommend books, electronics, and other products that a person might like—a potential benefit to shoppers. But the vast collection of information that makes behavioral advertising possible also carries risks. For example, in a practice called *weblining,* individuals may be denied opportunities, such as credit, based on their online profiles. After reports spread that Russia had used data harvested from Facebook (and later sold to a company called Cambridge Analytica) to interfere in the 2016 U.S. election, many expressed concerns that data aggregation could facilitate not only targeted advertising, but also the spread of misinformation to those that were vulnerable to it. These events are the topic of the discussion case at the end of Chapter 7.

What do Americans feel about all this? Recent research suggests that most U.S. technology users are willing to share personal information if they feel they receive benefits—such as free services, useful information, or discounts—in exchange, but they are also increasingly concerned about the safety and security of their data. Consumers' trust is fairly low; another study found that only a quarter (26 percent) of adults were "very" or "somewhat" confident that the companies and retailers they did business with would keep their information "private and secure." Consumers expressed particular concern about social media; 80 percent of users said that were concerned about advertisers and businesses accessing data they shared on these platforms.[11]

The dilemma of how best to protect consumer privacy in the digital age, while still fostering legitimate commerce, has generated a wide-ranging debate. Three major solutions have been proposed: consumer self-help, industry self-regulation, and privacy legislation.

- *Consumer self-help.* In this view, the best solution is for users to employ technologies that enable them to protect their own privacy. For example, specialized software can manage cookies and Flash content, encrypt e-mail and text messages, anonymize searches, erase programs, and set default "opt out" preferences. Individuals can learn about and use privacy settings on websites they access. "We have to develop mechanisms that allow consumers to control information about themselves," commented a representative of the Center for Democracy and Technology, a civil liberties group.[12] Critics of this approach argue that many unsophisticated users may be unaware of these mechanisms, or even of the need for them.

[10] Digital Ad Revenue on Pace for $85 Billion in Another Record-Breaking Year," December 20, 2017, at *http://adage.com*.

[11] "Americans' Complicated Feelings about Social Media in an Era of Privacy Concerns," March 27, 2018, "Privacy and Information Sharing," January 14, 2016, and "Americans' Attitudes about Privacy, Security, and Surveillance," May 20, 2015, at *www.pewinternet.org*.

[12] More information about privacy protection for consumers is available at *www.cdt.org* (Center for Democracy and Technology), *www.epic.org* (Electronic Privacy Information Center), and *www.privacyrights.org* (Privacy Rights Clearinghouse).

- *Industry self-regulation.* Many Internet-related businesses have argued that they should be allowed to regulate themselves. In their view, the best approach would be for companies to adopt voluntary policies for protecting individual privacy. For example, the Digital Advertising Alliance, a marketing trade group, has developed an icon—a turquoise triangle placed in the upper right-hand corner of some online ads—that users can click to shield their behavior from tracking; and has introduced other features that allow consumers to set preferences for data collection and advertising on their mobile phones.[13] One advantage of this approach is that companies, presumably sophisticated about their own technology, might do the best job of defining technical standards. Critics, however, feel that self-regulation would inevitably be too weak. After all, companies often made money from selling personal information to advertisers or allowing advertisers to target their messages, giving them a disincentive to protect it.
- *Privacy legislation.* Some favor new government regulations protecting consumer privacy online. Consumer privacy protections are generally stronger in the European Union than in the United States. Under the EU's General Data Protection Regulation, which took effect in 2018, consumers in European nations gained extensive privacy protections. (These regulations also applied to companies based elsewhere that provided services to European customers.) Under these rules, individuals must affirmatively consent to the collection of information about them, and they have the right to carry their data from one service provider to another ("portability") and to remove it under some circumstances ("erasure"). Companies must protect consumers' information against loss or exposure and notify them quickly of any data breach, and they are required to appoint data protection officers to assure compliance.[14] In 2018, after data breaches at Equifax (described in the discussion case at the end of Chapter 6) and other companies, some considered whether the United States should follow the EU's lead in strengthening consumer privacy protections.

A European court recently ruled on the right of individuals to remove information about themselves from Google searches; this development is explored in a case at the end this book, "Google and the Right to be Forgotten," as well as in Chapter 12.

Any approach to online privacy would face the challenge of how best to balance the legitimate interests of consumers—to protect their privacy—and of business—to deliver increasingly customized products and services in the digital age.

Using the Courts and Product Liability Laws

Who is at fault when a consumer is harmed by a product or service? This is a complex legal and ethical issue. The term **product liability** refers to the legal responsibility of a firm for injuries caused by something it made or sold. Under laws in the United States and some other countries, consumers have the right to sue and to collect damages if harmed by an unsafe product. Consumer advocates and trial attorneys have generally supported these legal protections, saying they are necessary both to compensate injured victims and to deter irresponsible behavior by companies in the first place. Some in the business community, by contrast, have argued that courts and juries have unfairly favored plaintiffs, and they have called for reforms of product liability laws. This section describes how consumers can use product liability laws and the courts to protect their rights.

[13] The website of the Digital Advertising Alliance is at *https://digitaladvertisingalliance.org*.

[14] The website of the European General Data Protection Regulation is *www.eugdpr.org*.

Strict Liability

In the United States, the legal system has generally looked favorably on consumer claims. Under the doctrine of **strict liability**, courts have held that manufacturers are responsible for injuries resulting from use of their products, even if they were not negligent. That is, they may be found to be liable, whether they knowingly did anything wrong or not. Consumers can also prevail in court even if they were partly at fault for their injuries.

Some product liability cases have led to large settlements, as the following example illustrates.

> In 2018, a jury in Missouri ordered Johnson & Johnson, the health care and consumer products company, to pay $4.7 *billion* to 22 women and their families. In their product liability lawsuit, the plaintiffs had argued that J&J had failed to warn them that talcum powder made by the company raised their risk of ovarian cancer. The cause, they said, was asbestos fibers mixed with talc, an ingredient in the product. Johnson & Johnson challenged the science behind the argument. Saying that the trial had been "fundamentally unfair," it vowed to appeal. But the cases of 9,000 other women were still pending, threatening potentially huge liability for the company.[15]

Huge product liability settlements, like the Johnson & Johnson case, are often well publicized, but they remain the exception. According to the U.S. Department of Justice, one in five noncriminal cases was a tort (liability) case, and plaintiffs (the people suing companies) won 34 percent of product liability cases filed. The average settlement in all tort cases was $201,000, although a few settlements were much higher.[16]

The product liability systems of other nations differ significantly from that of the United States. In Europe, for example, judges, not juries, hear cases. Awards are usually smaller, partly because the medical expenses of victims are already covered under national health insurance, and partly because punitive damages are not allowed.

> Historically, product liability cases have been exceedingly rare in China. But that began to change in 2009, in the wake of China's tainted-milk scandal. The previous year, almost 300,000 children became ill—and at least six died—after drinking baby formula contaminated by the industrial chemical melamine. Milk producers had apparently knowingly added the hazardous chemical to boost the formula's protein content. More than 200 families sued the formula companies, even though the government sought to keep the case out of the courts. Eventually, two people were executed for their roles in the scandal, and the company most responsible was fined and declared bankruptcy.[17]

The controversial issue of food industry liability for obesity is explored in Exhibit 14.B.

Product Liability Reform and Alternative Dispute Resolution

Many businesses have argued that the evolution of strict liability has unfairly burdened them with excess costs. Liability insurance rates have gone up significantly, especially for

[15] "J&J Hit with $4.7 Billion Jury Verdict in Baby Powder Suit," *The Wall Street Journal,* July 12, 2018.

[16] The most recent data may be found at the website of the U.S. Department of Justice, Office of Justice Programs, Bureau of Justice Statistics, at *www.ojp.gov/bjs*.

[17] "China Milk Scandal: First Court Agrees to Hear Case," May 25, 2011, *www.huffingtonpost.com*; "Two Executed in China over Tainted Milk," *CNN World, http://articles.cnn.com*; "Tainted-Milk Victims File Lawsuit in China's Highest Court," *The Wall Street Journal,* January 20, 2009; and "Chinese Parents File Milk Lawsuit," *The Wall Street Journal,* October 1, 2008.

Big Fat Liability

Should the food industry—such as fast-food restaurants and snack-makers—be held liable for their customers' obesity?

Although some evidence shows that rates of obesity are stabilizing, they remain remarkably high: 71 percent of adults and 33 percent of children in the United States are either obese or overweight, by the most recent measures. Obesity is a major cause of breathing problems, type 2 diabetes, heart disease, arthritis, infertility, and some kinds of cancer. According to the Institute of Medicine, an independent group that advises the government, the annual cost of treating obesity-related chronic disease and disability is now around $190 billion annually. "Left unchecked," the institute concluded, "obesity's effects on health, health care costs, and our productivity as a nation could become catastrophic."

Some observers felt that the food industry was at least partly at fault—and possibly even legally liable for the epidemic of obesity. Fast food had become a big part of Americans' diets. In 1970, they spent $6 billion a year on it; by 2014, they spent nearly $200 billion. This trend seemed to parallel the rise in obesity rates. The problem was not just the relatively high fat and sugar content of fast foods, but the super-sizing of portions. When fast-food restaurants increasingly began to compete based on value—more for less—customers simply ate more.

For their part, food companies had concentrated on developing processed products, such as candy, gum, snacks, and bakery goods, which carried high profit margins along with excessive calories. They had introduced many more new products in these categories than entrées, fruits, and vegetables since the early 1980s, data showed. Moreover, both restaurants and food processors, in their critics' view, had failed to communicate adequately the health risks of some foods and had inappropriately marketed their products to children.

By contrast, others felt that individuals should be held responsible for their own weight—or in the case of children, the parents should be held responsible. Americans consume, on average, more than 2,500 calories a day, well above the healthy amount for most people. Only 3 percent of Americans meet the government's dietary recommendations, and less than one-fifth exercise enough. Unlike cigarettes, food products are not normally addictive. Moreover, obesity has many causes, and the exact role of specific companies is unclear. How could one know whether a person's obesity was caused by eating specific foods, overeating generally, a sedentary lifestyle, or genetic predisposition?

Sources: The Institute of Medicine, "Accelerating Progress in Obesity Prevention: Solving the Weight of the Nation," (2012) at *www.iom.edu*. Overweight and obesity statistics are available from the Center for Disease Control's National Center for Health Statistics (*www.cdc.gov/nchs*) and the office of the U.S. Surgeon General (*www.surgeongeneral.gov*). Data on fast-food industry revenues are from *www.statista.com*.

small businesses, as have the costs of defending against liability lawsuits and paying large settlements to injured parties. Moreover, businesses argue that it is unfair to hold them financially responsible in situations where they were not negligent.

Businesses have also argued that concerns about liability exposure sometimes slow research and innovation. For example, many pharmaceutical companies halted work on new contraceptive methods because of the risk of being sued. Despite the need for new contraceptives that would be more effective and provide protection against viral diseases, such as herpes and AIDS, research had virtually come to a halt by the late 1990s, according to some public health groups.

In 2005, Congress passed the Class Action Fairness Act, the first significant reform of product liability laws in many years. The two key elements of this legislation were:

- *Most large class-action lawsuits were moved from state to federal courts.* This provision applied to cases involving $5 million or more and that included plaintiffs from more than one state. Supporters of the law said this would prevent lawyers from shopping for friendly local venues in which to try interstate cases.
- *Attorneys in some kinds of cases were paid based on how much plaintiffs actually received, or on how much time the attorney spent on the case.* Under the old system,

attorneys were often paid a percentage of the settlement amount. This sometimes led to excessive compensation for the lawyers.

Although most businesses welcomed these changes, some called for further reforms, such as shifting the burden of proof to consumers and limiting punitive damages.

Product liability reforms such as those included in the Class Action Fairness Act have faced vigorous opposition from consumers' organizations and from the American Trial Lawyers Association, representing plaintiffs' attorneys. These groups have defended the existing product liability system, saying it puts needed pressure on companies to make and keep products safe.

Plaintiffs scored a legal victory in 2009 when the U.S. Supreme Court decided an important case called *Wyeth v. Levine.* Diana Levine, a musician, was injected with an antinausea drug made by Wyeth after complaining of migraines. The drug's label said that "extreme care" should be used to avoid hitting an artery, which could lead to "gangrene requiring amputation." Unfortunately, this happened to the musician, whose right arm had to be amputated. In the ensuing lawsuit, Wyeth defended itself on the ground that because the FDA had approved the warning label, the company was shielded from the lawsuit. The Supreme Court disagreed and said the suit could go forward—federal regulatory approval had not preempted the company's liability under state laws.[18]

One approach to settling disagreements between companies and consumers, other than going to court, is **alternative dispute resolution** (ADR). ADR can take the form of *mediation,* a voluntary process to settle disputes using a neutral third party, or *arbitration,* the use of an impartial individual to hear and decide a case outside of the judicial system. The American Arbitration Association (AAA), for example, offers mediation of mortgage foreclosure claims and disputes over insurance claims arising from natural disasters. AAA also offers due process guidelines for companies that want to utilize arbitration to resolve disputes over products or services. Proponents of ADR argue that it is a faster and less expensive way to resolve company–consumer disputes and does not tie up the judicial system with minor issues.

A controversial aspect of consumer ADR is the use of mandatory arbitration clauses. These are clauses in a purchase agreement—for example, for cell phone service, a credit card, or moving services—that require customers to agree to take any future disputes to arbitration rather than to court. A study by the Consumer Financial Protection Bureau found that mandatory arbitration clauses were in place in 44 percent of checking accounts, 53 percent of credit cards, 99 percent of payday loans, and almost 100 percent of mobile wireless service contracts. Companies often favor such clauses, because they enable them to avoid sometimes-expensive lawsuits and, they contend, charge customers less. Consumer rights organizations, on the other hand, have tried to restrict the use of mandatory arbitration because it limits consumers' rights to file suit when they have been harmed. In 2017, the CFPB issued a rule allowing consumers to bypass mandatory arbitration clauses to file individual or class-action lawsuits. But this change never went into effect, because Congress and the president blocked it, in a victory for banks and other service providers.[19]

[18] "High Court Eases Way to Liability Lawsuits," *The Wall Street Journal,* March 5, 2009.

[19] Consumer Financial Protection Bureau, "CFPB Issues Rule to Ban Companies from Using Arbitration Clauses to Deny Groups of People Their Day in Court," July 10, 2017, at *www.consumerfinance.gov*; "Congressional Republicans Use Special Maneuver to Kill Arbitration Rule," *The Washington Post,* October 25, 2017; and Consumer Financial Protection Bureau, *Arbitration Study: Report to Congress Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act,* March 2015. The percentage figure refers to the percentage of the relevant market, not the percentage of contracts.

Positive Business Responses to Consumerism

The consumer movement has demonstrated that business is expected to perform at high levels of efficiency, reliability, and fairness to satisfy the consuming public. Because business has not always responded quickly or fully enough, consumer advocates have turned to government for protection. On the other hand, much effort has been devoted by individual business firms and by entire industries to encourage voluntary responses to consumer demands. Some of the more prominent positive responses are discussed next.

Managing for Quality

One way that many businesses address consumer interests is to manage quality in a highly proactive way. Quality has been defined by the International Organization for Standardization (ISO) as "a composite of all the characteristics, including performance, of an item, product, or service that bear on its ability to satisfy stated or implied needs." **Quality management**, by extension, refers to "all the measures an organization takes to assure quality." These might include, for example, defining the customer's needs, monitoring whether a product or service consistently meets these needs, analyzing the quality of finished products to assure they are free of defects, and continually improving processes to eliminate quality problems. Taking steps at all stages of the production process to ensure consistently high quality has many benefits. Responsible businesses know that building products right the first time reduces the risk of liability lawsuits and builds brand loyalty.

Chrysler Corporation, the U.S. car company, worked hard to boost its products' quality as it emerged from bankruptcy in the early 2010s. Understanding the crucial role of mechanical reliability and consistent fit-and-finish, the company invested $20 million in upgrading the Illinois factory where it planned to build its Dart, Jeep Compass, and Jeep Patriot models, and trained workers to audit vehicles randomly for problems. Chrysler's CEO empowered its quality chief to shut down production or delay a model launch if he needed to—as he did when inspectors found that the rear taillight on the new Chrysler 300 was not completely flush with the body. "Chrysler has made good strides in the products that are in the showrooms now, but it will take time," said the director of *Consumer Reports'* automotive test center.

Managing for product and service quality is an attempt by business to address its customers' needs. It is an example of the interactive strategy discussed in Chapter 2, where companies try to anticipate and respond to emerging stakeholder expectations.

The Malcolm Baldrige National Quality Award, named for a former U.S. Secretary of Commerce, is given annually to organizations that demonstrate quality and performance excellence. A 2017 recipient was the Southcentral Foundation, a nonprofit health care organization owned and managed by Alaskan Natives, who lived in a widely dispersed area including 55 villages reachable only by plane. The foundation was cited for its high rankings on many outcome and quality measures, such as 90th percentile rankings for diabetes, heart health, and cancer screenings, even though its customers were spread out over a vast area. Said CEO Kathleen Gottlieb, "This award reflects the collaborative effort of our Tribal leadership, customer-owners, and employees."[20]

[20] "Best of the Best Win U.S. National Excellence Honor," November 16, 2017, *www.commerce.gov,* and "Southcentral Foundation Accepts Second Malcolm Baldridge Award," press release, April 12, 2018.

Exhibit 14C

General Electric and the Use of Ultrasound Technology in Asia

What should a company do when customers use a legitimate product for an illegal or unethical purpose? This problem confronted General Electric (GE), the diversified global technology firm, in Asia. Among GE's many health care products was a line of lightweight, portable ultrasound scanners used for diagnostic imaging. These devices were less expensive and easier to transport than earlier models, making their use in developing nations and rural areas more practical—and popular. For example, by the mid-2000s, sales of ultrasound devices in India, where GE was the market leader, had reached $77 million annually.

But GE's portable ultrasound machines were, in some settings, used in a shocking and unexpected way: to identify the gender of female fetuses, which were then aborted. In some cultures, including parts of India and China, many families had a strong preference for sons over daughters. Sometimes, this preference reflected a belief that sons were responsible for caring for their parents in old age, or for carrying on the family name or traditions. At other times, poor families felt they could not afford the high cost of a dowry when a daughter married. Whatever the reason, some unscrupulous medical practitioners used GE's ultrasound devices to facilitate the selective abortion of female fetuses. In 2011, the ratio of boys to girls in India was 112 to 100; in China it was 121 to 100. (In nature, the ratio is 105 to 100). Millions of girls were simply never born.

As it became aware of the scope of the problem, General Electric moved proactively to prevent the unethical use of its products. In both India and China, laws prohibited the use of ultrasound for sex selection. GE worked closely with regulators responsible for enforcing these laws to assure that its products were only sold to (and serviced for) properly licensed practitioners, and it trained its sales representatives not to deal with anyone suspected of participating in selective abortions. It followed up with audits. The company also promoted positive images of women, for example, by sponsoring female athletes. GE wrote in a blog posted to its website that its experience had shown that "a manufacturer can take [steps] to reduce the risk that its products will be misused in ways that violate human rights."

Sources: Mara Mvistendahl, *Unnatural Selection: Choosing Boys over Girls and the Consequences of a World Full of Men* (New York: PublicAffairs, 2011); "The War Against Girls," *The Wall Street Journal,* June 24, 2011; and "Medical Quandary: India's Skewed Sex Ratio Puts GE Sales in Spotlight," *The Wall Street Journal,* April 18, 2007.

The challenging issue of business's responsibility for products that are safe and of high quality—but used by others in illegal or dangerous ways—is profiled in Exhibit 14.C.

Voluntary Industry Codes of Conduct

In another positive response, businesses in some industries have banded together to agree on voluntary codes of conduct, spelling out how they will treat their customers. This action may be taken to forestall even stricter regulation by the government. One such voluntary code is described in the following example.

> The Western Growers Association, a trade association of farmers, adopted voluntary guidelines for growers and handlers of leafy green vegetables. The move followed an outbreak of *E. coli* poisoning, in which three people died and hundreds were sickened. Public health investigators traced the rash of illnesses to spinach grown on a California farm that had become contaminated with infected wild pig feces. Over 100 farm companies subsequently signed on to the new standards to alleviate customer concerns—and to reduce pressure for mandatory government rules. Voluntary standards have also been developed to assure the safety of other kinds of fresh produce, including melons and tomatoes.[21]

[21] "Current Issues in Product Safety: The Packinghouse," *Food Safety News,* February 25, 2015.

Consumer Affairs Departments

Many large corporations operate consumer affairs departments, often placing a vice president in charge. The **consumer affairs officer** typically manages a complex network of contacts with customers. The contact infrastructure usually includes a website with a self-service component; many sites are interactive, allowing customers to post comments or questions that are answered electronically by customer relations staff. Most companies also host a call center, using an interactive voice response system that leads callers to an appropriately trained customer service representative.

Increasingly, companies and their consumer relations professionals use sophisticated software to analyze large amounts of customer data from multiple channels, including interactions on a wide range of online platforms. In the past, such data was used mainly to understand what had already happened; that is, what an individual had looked at, purchased, or reviewed. But increasingly, companies are using such "big data" *to predict* what an individual might do or wish for in the future and *to prescribe* the best way to meet these needs. They often use machine learning to do this. Said one expert, the "continuous collection of data . . . provides the ability to prescribe products or offers that are custom-designed for an individual."[22]

> An example of a company that has made extensive use of big data analytics to improve customer service and satisfaction is Netflix. The media services provider began by sending movie DVDs to customers in the mail, but soon expanded into online streaming and film and television production. The company, which in 2018 had 125 million subscribers, has succeeded in large part because of its sophisticated data algorithms. Netflix knows what its customers watch, in what order, for how long—and what shows or movies they quit in the middle of viewing. It uses this information to suggest new titles to each customer, and to predict which films and series they are considering are most likely to be hits.[23]

Successful companies are learning to use data analytics to improve customer satisfaction and anticipate concerns.

Product Recalls

One way companies deal with consumer dissatisfaction is by recalling faulty products. A **product recall** occurs when a company, either voluntarily or under an agreement with a government agency, takes back all items found to be dangerously defective. Sometimes these products are in the hands of consumers; at other times they may be in the factory, in wholesale warehouses, or on the shelves of retail stores. Wherever they are in the chain of distribution or use, the manufacturer tries to notify consumers or potential users about the defect. For example, in 2018 Anheuser-Busch voluntarily recalled some packages of Stella Artois beer, because a flaw in some bottles could cause small pieces of glass to break off and fall into the beer. After announcing which lots were affected, the company and its suppliers fixed the production problem, worked with retailers to get affected units off the shelves, and offered to reimburse customers.[24] The case "General Motors and the Ignition Switch Recalls," which appears at the end of this book, describes a series of recalls carried out by General Motors to correct defects in the ignition switches of some of its models, which caused the cars to stall while moving.

One problem with recalls is that the public may not be aware of them, so dangerous products continue to be used. For example, several babies were killed when Playskool Travel-Lite

[22] "Leveraging the Three Stages of Analytics," *Customer Relationship Management,* March 2017.

[23] "How Netflix Uses Big Data to Drive Success," January 20, 2018, at *https://insidebigdata.com*.

[24] "Voluntary Partial Recall of 11.2-Ounce Bottles of Stella Artois," April 2, 2018, press release, *www.anheuser-busch.com*.

portable cribs unexpectedly collapsed, strangling them. Although the Consumer Product Safety Commission (CPSC) ordered an immediate recall, not all parents and child care providers heard about it, and additional deaths occurred.[25] Some consumer organizations advocated a system that would require manufacturers of certain products—such as cribs—to include purchaser identification cards so users could be quickly traced in the event of a recall.[26]

The four major government agencies responsible for most mandatory recalls are the Food and Drug Administration, the National Highway Traffic Safety Administration, the Environmental Protection Agency (which can recall polluting motor vehicles), and the Consumer Product Safety Commission.

Consumerism's Achievements

The leaders of the consumer movement can point to important gains in both the United States and other nations. Consumers today are better informed about the goods and services they purchase, are more aware of their rights when something goes wrong, and are better protected against inflated advertising claims, hazardous or ineffective products, and unfair pricing. Several consumer organizations serve as watchdogs of buyers' interests, and a network of government regulatory agencies act for the consuming public.

Some businesses, too, have heard the consumer message and have reacted positively. They have learned to assign high priority to the things consumers expect: high-quality goods and services, reliable and effective products, safety in the items they buy, fair prices, and marketing practices that do not threaten important human and social values.

All these achievements, despite negative episodes that occasionally occur, bring the consuming public closer to realizing the key consumer rights: to be safe, to be informed, to have choices, and to be heard—as well as the newer right to privacy.

Summary

- The five key consumer rights are the rights to safety, to be informed, to choose, to be heard, and to privacy.
- The consumer movement represents an attempt to promote the interests of consumers by balancing the amount of market power held by sellers and buyers.
- Consumer protection laws and regulatory agencies attempt to assure that consumers are treated fairly, receive adequate information, are protected against potential hazards, have free choices in the market, and have legal recourse when problems develop.
- The widespread use of digital technologies has given new urgency to the issue of consumer privacy. Three approaches to safeguarding online privacy are consumer self-help, industry self-regulation, and protective legislation.
- Business has complained about the number of product liability lawsuits and the high cost of insuring against them. Although consumer groups and trial attorneys have opposed efforts to change product liability laws, modest tort reforms have been legislated.
- Socially responsible companies have responded to the consumer movement by giving serious consideration to consumer problems, increasing channels of communication with customers, instituting arbitration procedures to resolve complaints, and recalling defective products. They have also pursued voluntary codes of conduct and quality management to meet, and even anticipate, consumers' needs.

[25] David Zivan, "The Playskool Travel-Lite Crib (A), (B), and (C)," Center for Decision Research, University of Chicago, November 5, 2002.

[26] For information on initiatives to protect children from dangerous products, see *www.kidsindanger.org*.

Key Terms

alternative dispute resolution, *319*
behavioral advertising, *315*
consumer affairs officer, *322*
consumer movement, *308*
consumer privacy, *314*
consumer protection laws, *309*
deceptive advertising, *310*
product liability, *316*
product recalls, *322*
quality management, *320*
strict liability, *317*

Internet Resources

www.consumersinternational.org	Consumers International
www.cpsc.gov	U.S. Consumer Product Safety Commission
www.ftc.gov	U.S. Federal Trade Commission
www.bbb.org	Better Business Bureau
www.consumerfed.org	Consumer Federation of America
www.consumeraffairs.com	Consumer news and resource center
www.beuc.eu	The European Consumer Organization
www.consumerreports.org	Consumer Reports

Discussion Case: *Volkswagen's "Clean Diesel" Campaign*

Owners of Volkswagen, Audi, and Porsche diesel cars were shocked to learn in September 2015 that their "clean diesel" vehicles were not so clean after all. Under pressure from U.S. regulators, Volkswagen admitted it had fraudulently equipped certain VW, Audi, and Porsche diesel models with so-called "defeat devices," software designed to cheat on government emissions tests. Cars marketed as environmentally friendly were in fact, unknown to their owners or the public, fouling the air with dangerous pollutants.

Said one owner of a diesel Jetta wagon, "I was very interested in fuel economy and low emissions, and power, but I remember thinking when I bought the car that it almost seemed too good to be true. Now it turns out that is really was too good to be true. I feel completely duped."

In 2007, Martin Winterkorn, the newly appointed CEO of Volkswagen, announced an ambitious goal: to become the world's leading carmaker, pulling ahead of both Toyota and General Motors. A key element of the strategy was the rollout of a new generation of diesels in the United States. This would require the development of a new diesel engine that could deliver lively performance and good gas mileage, while also complying with tough U.S. limits on emissions of nitrogen oxides (a toxic pollutant that causes health problems and contributes to smog). The company's engineers struggled to meet this challenge within tight budgetary and time constraints.

Finally, under increasing pressure, the engineers hit on a solution: software that could detect when the vehicle was undergoing emissions testing. When the vehicle was on rollers and its steering wheel immobilized, the emissions control equipment would be switched on, reducing pollution to permitted levels. At other times—that is, during normal driving—the emissions control equipment would be dialed down, allowing the car to achieve better mileage and sportier performance. Such defeat devices were explicitly prohibited under U.S. environmental law.

To promote its new models, Volkswagen launched a major marketing campaign for its "Clean Diesel" TDI (turbocharged direct injection) technology. The campaign's purpose

was to counteract the stigma associated with diesel engines and convince car buyers that VW diesels were fun to drive, economical, and environmentally responsible. One ad proclaimed:

> This ain't your daddy's diesel. Stinky, smoky, and sluggish. Those old diesel realities no longer apply. Enter TDI "clean" diesel. Ultra-low sulfur fuel, direct injection technology, and extreme efficiency. We've ushered in a new era of diesel.

Other print ad tag lines included: "Diesel is no longer a dirty word," "Diesel has really cleaned up its act," and "Protect the environment and look good doing it."

A series of humorous TV spots, dubbed "Old Wives' Tales," depicted three older women in a diesel VW Passat, arguing about its characteristics. In one, "Old Wives Talk Dirty," the passengers agree the car is beautiful, but insist that it's dirty. To prove it's not, the driver gets out and holds her white scarf against the tailpipe. It comes away pristine.

Another ad, aired during the 2010 Super Bowl, featured the "Green Police" arresting citizens for various environmental transgressions, such as drinking from plastic water bottles, failing to compost orange peels, and using incandescent light bulbs. Then, at a road block set up to catch polluting vehicles, the Green Police allow a diesel-powered Audi A3 to skip the line, saying, "You're good to go, sir." The pleased driver zips off, under the tag line "green car of the year."

The marketing campaign was a great success. From 2009 to 2015, VW sold around 580,000 vehicles with the defeat device in the United States, including VW, Audi, and Porsche-branded TDI (diesel) models. Consumers paid a premium for these cars: a VW diesel cost on average $5,755 more than a comparably equipped gasoline version. (Some operating costs were lower, however, since diesels got better gas mileage.)

Volkswagen's deception began to unravel in 2013, when researchers from West Virginia University set out to study how much various cars polluted on the road, rather than in the lab. They were startled to discover that a VW Jetta and a VW Passat, both with diesel engines, emitted as much as 40 times the nitrogen oxides allowed under federal rules. California air regulators, alerted to these findings, began an investigation that led eventually to Volkswagen's admission of fraud.

Owners of the tainted vehicles suddenly faced difficult choices. They could continue driving their cars, knowing they were emitting dangerous pollutants way over the legal limit. They could attempt to sell their vehicles, but their value had dropped precipitously. Drivers with leases found themselves suddenly "upside down," owing more on their contracts than their cars were worth.

Hundreds of owners chose to sue Volkswagen. In 2016, these cases were consolidated in a single class action in federal court, representing all owners of the affected vehicles. Separately, the U.S. Justice Department and the Federal Trade Commission also sued Volkswagen. In a series of negotiated settlements, Volkswagen agreed to buy back the tainted vehicles (for what the cars were worth before the scandal broke) or to terminate their leases without penalty. If the customer preferred, the company would repair the vehicle's emissions controls (although experts predicted that doing so would reduce performance and fuel economy). In the either case, customers would receive additional restitution of five to ten thousand dollars. The total cost to Volkswagen was estimated at more than $15 billion.

Sources: "Volkswagen Expected to Pay Another $1 Billion in Emissions Scandal," *The New York Times,* December 20, 2016; "Federal Judge Approves $14.7 Billion Settlement in Volkswagen Emissions Class Actions," *Legal News Line,* October 27, 2016; "How VW's Scandal Unfolded," *The New York Times,* October 23, 2015; "VW's Pitch to Americans Relied on Fun and Fantasy," *The New York Times,* September 27, 2015; "Behind Volkswagen's Settlement, Speed and Compromise," *The New York Times,* July 15, 2016; Jack Ewing, *Faster, Higher, Farther: The Volkswagen Scandal* (New York: W.W. Norton, 2017), especially Chapter 10, "The Cheat;" "In Re: Volkswagen 'Clean Diesel' Marketing Sales Practices, and the Products Liability Litigation," amended consolidated consumer class action complaint, United States District Court, Northern District of California, San Francisco Division.

Discussion Questions

1. In what ways were consumers (car owners) harmed by Volkswagen's actions?
2. Did Volkswagen violate any U.S. consumer protection laws, and if so, which ones?
3. What were the potential benefits and risks to Volkswagen of its decision to defraud consumers and regulators?
4. If you were an owner of a VW, Audi, or Porsche vehicle equipped with a defeat device, what would be your options? What would you choose to do, and why?
5. What are the advantages and disadvantages to consumers of a class action lawsuit of the kind described here?
6. Was the settlement fair to consumers, or not?

CHAPTER FIFTEEN

Employees and the Corporation

Employees and employers are engaged in a critical relationship affecting the corporation's performance. There is a basic economic aspect to their association: Employees provide labor for the firm, and employers compensate workers for their contributions of skill and productivity. Yet, also present in the employee–employer exchange are numerous social, ethical, legal, and public policy issues. Attention to the rights and duties of both parties in this relationship can benefit the firm, its workers, and society.

This Chapter Focuses on These Key Learning Objectives:

- LO 15-1 Understanding workers' rights to organize unions and bargain collectively.
- LO 15-2 Knowing how government regulations assure occupational safety and health and what business must do to protect workers.
- LO 15-3 Evaluating the limits of employers' duty to provide job security to their workers.
- LO 15-4 Analyzing employer obligations to pay workers fairly and how pay policies can contribute to income inequality.
- LO 15-5 Appraising the extent of employees' right to privacy, when businesses monitor employee communications, police romance in the office, test for drugs or alcohol, or subject employees to honesty tests.
- LO 15-6 Debating if employees have a duty to blow the whistle on corporate misconduct, or if employees should always be loyal to their employer.

During the first days of a new position, workers are often asked to sign papers verifying their identity, work status, and benefits. So, Krishna Regmi, a personal care aid for a Pittsburgh home health agency, did not think twice about signing a stack of forms during his first days on the job. Little did he realize that when he later left his position for a better paying one at a rival agency, he would be sued under the terms of a non-compete agreement he had unsuspectingly signed. In some cases, franchisees are also bound by non-compete clauses. For example, franchise owners of Burger King, Carl's Jr., and Pizza Hut are not allowed to hire workers away from another franchise under their contract with the parent corporation. This no-hire rule is estimated to affect fast-food employees in more than 70,000 restaurants in the United States. Non-compete clauses were originally restricted to executives or professionals who had access to a company's trade secrets or client lists and were meant to protect a company's intellectual property. But more recently, employees holding low-skilled, low-wage jobs are increasingly being required to sign such clauses. One of every six employees with a college degree in an entry-level position is now being asked to sign a non-compete agreement. Critics claim that non-compete clauses are being used not to protect trade secrets, but rather to keep wages low by making it difficult if not impossible for employees to seek higher-paying jobs.[1]

What is a fair pay level for workers? Who or what should determine wages—the free market, the employer acting unilaterally, collective bargaining negotiations between employers and unions, or government mandates such as minimum wage laws? Should employers be permitted to require employees—even in low-level jobs—to sign non-compete clauses?

Applying for a position as a correctional officer, a man was startled when the interviewer asked him for his Facebook login information, saying it was needed to check for possible gang affiliations. The man did as he was asked but later complained, calling the demand "invasive" and a "violation of [my] personal privacy." Increasingly, employers are conducting background checks on prospective hires by reviewing their social media history, and some use specialized services that "scrape" the web for anything applicants might have done or said online. By 2015, legislation prohibiting employers from asking for access to applicants' social media accounts had been adopted in 21 states and was under consideration in several others.[2]

Should employers, like the correctional services department in this example, have a right to review job applicants' social media pages? What if the job was not in the correction services field but in some other line of work, would the employer have the right to review an applicant's Facebook page then? Who should be responsible for protecting applicant and employee privacy?

In 2014, Starbucks announced it would make changes to its scheduling practices to provide more "stability and consistency" for its 130,000 baristas. According to the new rules, the company said it would post hours at least a week in advance, end the practice of "clopening" (requiring a worker to close a store and then reopen it the next morning, just a few hours later), and allow local managers more say in overriding scheduling software. Fast-forward two years to 2016, and inconsistent, variable scheduling was still a common practice at Starbucks. Barista Darrion Sjoquist led a letter-writing campaign asking management to provide stable scheduling and confronted CEO Harold Schultz at a

[1] "How Noncompete Clauses Keep Workers Locked In," *The New York Times,* May 13, 2017; "These Days, Even Janitors Are Being Required to Sign Non-compete Clauses," *USA Today,* May 27, 2017; and "Why Aren't Paychecks Growing? A Burger-Joint Clause Offers a Clue" *The New York Times,* September 27, 2017.

[2] "Will Employers Still Ask for Facebook Passwords in 2014?" *USA Today,* January 10, 2014; and "Some U.S. Employers Asking for Applicants' Facebook Login Info," *Associated Press,* March 21, 2012. The current status of state legislation may be found on the website of the National Conference of State Legislatures, at *www.ncsl.org*.

Exhibit 15.A

Fair Scheduling: An Emerging Issue

The director of the Fair Workweek Initiative at the Center for Popular Democracy calls predictable schedules the "working class issue of our time." Unstable work schedules negatively impact health, family life, and economic well-being. Inconsistent schedules can make it difficult for workers to budget, save, or set aside money for emergencies.

The negative impact of unpredictable work schedules extends beyond financial consequences. Employees with inconsistent schedules are less happy and experience more psychological distress than employees with stable work hours. Parents are particularly hard-pressed to secure child care on evenings and weekends. Many are forced to rely on family and friends for child care while they are working. Often the employee must ask for help on short notice, upsetting the plans of family and friends and damaging important relationships. Parents working jobs with unstable schedules spend less time on developmental activities with young children.

In 2017, Oregon became the first state to pass a "fair scheduling law." Starting in 2018, companies in Oregon were required to provide work schedules at least seven days in advance. This legislation also said that large retail, hospitality, and food service companies would have to provide schedules at least 14 days in advance. The same year, New York City passed an ordinance requiring that employers provide schedules 14 days in advance, with two hours extra pay for last minute assignments. The ordinance also required that employers pay employees for four hours for scheduled shifts that were cancelled within 72 hours of the start time. Some employers pushed back, saying that legislators did not fully appreciate the negative impact the legislation would have on business.

Sources: "Why a Fair Workweek is the Working Class Issue of Our Time," October 31, 2017, at *www.slate.com/blogs/better_life_lab/2017/10/why_predictable_schedules_are_the_working_class_issue_of_our_time.html;* and Daniel Schneider and Kristin Harknett, "Schedule Instability and Unpredictability and Worker and Family Health and Wellbeing," Washington Center for Equitable Growth, 2016.

shareholders' meeting about support for stable work hours. The worker's campaign led to Starbucks' adoption of two weeks advance notice and a guarantee of eight hours rest between shifts. In 2016, the Seattle city council passed a policy requiring companies like Starbucks to provide stable schedules.[3] The issue of fair scheduling is discussed in more detail in Exhibit 15.A.

What is the best way to balance the employer's need for flexibility and efficiency in scheduling part-time workers' hours with the employee's need for predictability in organizing his or her life and finances? Should scheduling be subject to government regulation, or be left to employers and employees to work out?

All these difficult questions will be addressed later in this chapter. As the situations giving rise to them suggest, the rights and duties of employers and employees in the modern workplace are incredibly complex.

The Employment Relationship

As noted in Chapter 1, employees are a market stakeholder of business—and a critically important one. Businesses cannot operate without employees to make products, provide services, market to customers, run the organization internally, and plan for the future. At the same time, employees are dependent on their employers for their livelihood—and often much more, including friendship networks, recreational opportunities, health care, retirement savings, even their very sense of self. Because of the importance of the relationship

[3] "Starbucks to Revise Policies to End Irregular Schedules for Its 130,000 Baristas," *The New York Times,* August 14, 2014; and "A Push to Give Steadier Shifts to Part-Timers," *The New York Times,* July 15, 2014.

FIGURE 15.1
Major Rights of Employees

to both parties, it must be carefully managed, with consideration for both legal and ethical obligations.

As further explained in Chapter 5, a *right* means someone is entitled to be treated a certain way. Some of these responsibilities are legal or contractual; others are social or ethical in nature. Employees have several major rights, as shown in Figure 15.1.

But employees also have a duty to behave in acceptable ways. (*Duties* are obligations to act responsibly toward others.) For example, most would agree that employees should not abuse drugs or alcohol in a way that impairs their work performance, use company e-mail to send offensive messages, or take the employer's property for their own personal use. Employees should deal with customers and coworkers in an honest, fair, and nondiscriminatory way. They should not reveal proprietary information to others outside the company, unless there is compelling reason to do so—such as an imminent threat to the public's safety. This chapter considers the rights and duties of employees. The following chapter explores the related issue of workforce diversity and discusses the specific legal and ethical obligations of employers with respect to equal employment opportunity.

Workplace Rights

Employees in the United States enjoy several important legal guarantees. They have the right to *organize and bargain collectively* and to have a *safe and healthy workplace.* Some workers have a right to *due process* if they are fired, providing them some measure of job security. This section will explore these three rights, emphasizing U.S. laws and regulation, but with comparative references to policies in other nations. Later sections of this chapter will explore the other three rights listed in Figure 15.1: fair wages, privacy, and free speech.

The Right to Organize and Bargain Collectively

In the United States, and in most other nations, employees have a fundamental legal right to organize **labor unions** and to bargain collectively with their employers. The exceptions

are some communist countries (such as China, Vietnam, Cuba, and the People's Democratic Republic of Korea) and some military dictatorships (such as Eritrea), where workers are not permitted to form independent unions. Labor unions are organizations, such as the Service Employees International Union or the Teamsters, which represent workers on the job. Under U.S. laws, most private and public workers have the right to hold an election to choose what union they want to represent them, if any. Unions negotiate with employers over wages, working conditions, and other terms of employment. Employers are not required by law to agree to the union's demands, but they are required to bargain in good faith. Sometimes, if the two sides cannot reach agreement, a strike occurs, or employees apply pressure in other ways, such as appealing to politicians or refusing to work overtime.

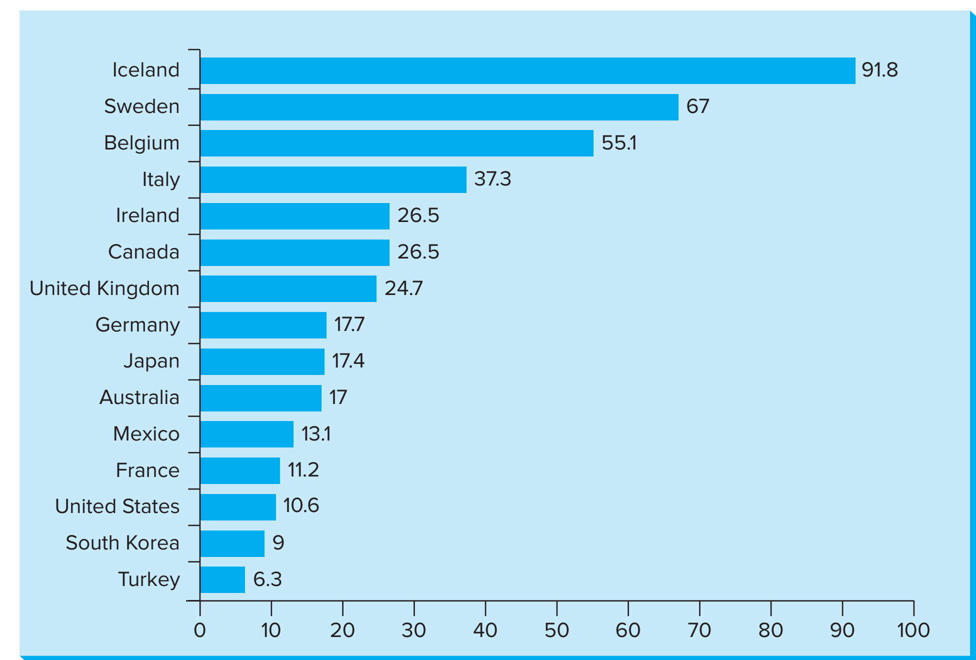
Workers are more highly unionized in some countries than in others. Figure 15.2 shows the percentage of employees who are represented by unions in selected industrialized nations. It shows that unionization rates are very high in the Scandinavian countries; of all countries shown, the unionization rate is the lowest in the United States, South Korea, and Turkey.

The influence of labor unions in the United States has waxed and waned over the years. During the New Deal period in the 1930s, many workers, particularly in manufacturing industries such as automobiles and steel, joined unions, and the ranks of organized labor grew rapidly. Unions negotiated with employers for better wages, benefits such as pensions and health insurance, and improved job safety—significantly improving the lot of many workers. In 2017, the median weekly pay of full-time workers who were members of unions ($1,041) was 20 percent higher than that of nonunion workers ($829). (All workers, whether they are members of unions or not, are protected by wage and hour laws that require employers to pay at least a **minimum wage** and extra pay for certain kinds of overtime work.) Since the mid-1950s, the proportion of American workers represented by unions has declined. In 2017, only about 11 percent of all employees were union members.

FIGURE 15.2

Unionization Rates in Selected Industrialized Countries

Source: Organization for Economic Cooperation and Development, at *https://www.statista.com/chart/99199/the-state-of-the-unions/*. Figures have been rounded to the nearest integer. All data are for 2015.



The percentage was higher—34 percent—in government employment than in the private sector, where just 7 percent were unionized.[4]

In the wake of the Great Recession, elected officials in several states sought to weaken unions by limiting the rights of public sector workers. For example, the Wisconsin legislature passed a law that took away the right of public sector unions (except those representing public safety officers) to bargain over pensions and health care benefits. In 2017, Missouri joined 27 other states in adopting a so-called *right-to-work* law, which barred unions from requiring all workers they represented to pay dues or fees.[5] In 2018, the Supreme Court ruled in an important case, known as the Janus decision, that public sector unions (such as those representing public school teachers, city and state employees, and public safety officers) could not negotiate contracts that required workers to pay dues or fees. Many observers believed that this ruling would weaken unions in the government sector, as some workers would elect not to pay fees.[6] Although unions overall remained weak, some groups of workers continued to organize.

> Dissatisfied with representation from an independent union, in 2016 Cleveland water workers voted to join the Utility Workers Union of America (UWUA), an affiliate of the AFL-CIO. "When they contacted us, we showed them all the water locals we have in our union," says Local 270 President Frank Meznarich. "These guys work in the water distribution plant and they fit in with us very well. . . . So they decided to become part of something bigger that could represent them." The workers overwhelmingly approved joining the union by a vote of 43-to-4 with one vote for no representation. "They decided to go with the UWUA—an honest, straight talking, straight shooting union with a lot of power," asserted Larry Kelly, the national organizer who led the effort to unionize the Cleveland workers. In a climate that had been hostile to union organizing, with efforts by Ohio legislators to limit union influence, the AFL-CIO called this a "major victory for organizing efforts in Ohio."[7]

Other significant recent union organizing wins occurred at IKEA's furniture factory in Virginia; Smithfield Pork in North Carolina, the world's largest pork slaughterhouse; and Delta Pride, a catfish processor in Mississippi.[8] In 2018, a wave of teacher strikes in West Virginia, Oklahoma, Arizona, and other states led in some instances to significant pay raises.[9]

In addition to traditional approaches to organizing workers by occupation and sector, unions such as the Service Employees International Union (SEIU) attempted to broaden their influence through funding advocacy groups that supported low-wage workers in occupations that had historically been difficult to unionize. For example, the SEIU supported *Justice for Janitors* and *Fast Food Forward* to organize walkouts of custodial and fast-food employees.[10] Labor unions sought to exercise influence in other ways, as well. Unions organized in the political arena, using political action committees (PACs) and other

[4] U.S. Bureau of Labor Statistics, "Union Members 2017," January 19, 2018, *www.bls.gov/news.release/pdf/union2.pdf*.

[5] "Right to Work States," National Right To Work Legal Defense Foundation, at *www.nrtw.org/right-to-work-states*.

[6] "Supreme Court Deals Blow to Public-Sector Unions," *The Wall Street Journal,* June 27, 2018; and "Janus Decision Reins in Unions' Political Power," *The New York Times,* June 27, 2018.

[7] "Cleveland Water Workers Join the UWUA: A Major Organizing Victory for Utility Workers," *The Utility Worker Magazine,* Winter 2017, April 18, 2017.

[8] "Gawker Media Employees Vote to Form a Union, and the Bosses Approve," *The New York Times,* June 4, 2015.

[9] "Teacher Walkouts: A State-by-State Guide," April 25, 2018, at *www.npr.org*.

[10] "The Fast-Food Strikes Have Been a Stunning Success for Organized Labor," *Slate,* September 2, 2014; "Fast-Food Workers Seeking $15 Wage Are Planning Civil Disobedience," *The New York Times,* September 1, 2014.

methods (discussed in Chapter 8), and voted shares of stock in which their pension funds were invested (discussed in Chapter 13) to pursue their institutional objectives.

One issue that unions and others have been concerned with is job safety and health. It is discussed next.

The Right to a Safe and Healthy Workplace

Many jobs are potentially hazardous and a threat to worker health and safety. In some industries, the use of high-speed and noisy machinery, high-voltage electricity, extreme temperatures, or hazardous gases or chemicals poses risks. Careful precautions, extensive training, strict regulations, and tough enforcement are necessary to avoid accidents, injuries, illnesses, and even deaths on the job. According to the Bureau of Labor Statistics, most workplace fatalities are the result of transportation accidents, falls, and being struck by an object.

> Wanda Holbrook was a journeyman maintenance technician at Ventra Ionia, a company that performed stamping, molding, and related services in the production of bumpers and trailer hitches. Holbrook was killed when a malfunctioning robot crushed her skull between two parts of a hitch assembly as Holbrook was performing routine maintenance. The robot was not supposed to have access to the area where Holbrook was conducting inspections. Holbrook's husband filed a lawsuit against five companies for the accidental death of his wife, saying the automation system in the work area violated numerous safety regulations.[11]

Over the past few decades, new categories of accidents or illnesses emerged, including the fast-growing job safety problem of musculoskeletal disorders (MSDs). MSDs, which are caused by repetitive motion, often result in chronic pain, such as the wrist pain sometimes experienced by supermarket checkers, meat cutters, or keyboard operators. Other occupations suffered muscle strains affecting the neck, upper back, lower back, and shoulders. Poor working conditions have also caused hearing and vision impairment. In response, many businesses have given greater attention to **ergonomics**, adapting the job to the worker, rather than forcing the worker to adapt to the job. For example, ergonomically designed office chairs that conform to the shape of the worker's spine may help prevent low productivity and lost time due to back injuries.

Annually, slightly more than three million workers in private industry are injured or become ill while on the job, according to the U.S. Department of Labor. This amounts to more than three hurt or sick workers out of every hundred. Some of the most dangerous jobs are in protective services (police, fire fighters, and prison guards); transportation and material moving; farming; and buildings and grounds maintenance and cleaning. In general, manufacturing and construction jobs are riskier than service jobs—although workers in nursing homes and hospitals suffer relatively high rates of injury. In 2016, 5,190 workers died from occupational injuries, the highest rate of occupational injuries since 2008.[12] The reasons range from vehicle accidents, to contact with dangerous equipment, to explosion or fire. For example, a massive explosion at the Upper Big Branch coal mine in West Virginia in 2010 killed 29 workers in the worst coal mining disaster in the United States in 40 years. The causes of this disaster are explored in a case study at the end of this book.

In the United States, the Occupational Safety and Health Act, passed in 1970 during the great wave of social legislation discussed in Chapter 7, gives workers the right to a job

[11] "Work Robot Blamed for Michigan Woman's Death," *Courthouse News Service,* March 8, 2017; and. "Husband Sues after Rogue Robot Kills Wife at Work," WCVB, Boston Massachusetts, March 15, 2017.

[12] U.S. Bureau of Labor Statistics data, "Fatal Occupational Injuries in 2016 (Charts)" *www.bls.gov/iif/oshwc/cfoi/cfcu0015.pdf.*

"free from recognized hazards that are causing or likely to cause death or serious physical harm." This law is administered by the **Occupational Safety and Health Administration (OSHA)**. Congress gave OSHA important powers to set and enforce safety and health standards. Employers found in violation can be fined and, in the case of willful violation causing the death of an employee, jailed as well. In 2009, for example, OSHA fined BP $87 million—on top of $21 million the company had already paid—for safety violations linked to an explosion of a refinery in Texas that killed 15 workers and injured 170, the largest fine ever levied by the agency.[13]

OSHA has had considerable success in improving worker safety and health. Although workers—such as the victims of the Upper Big Branch coal mine and BP refinery explosions—continue to die on the job, since OSHA's creation in 1970 the number of workplace deaths has fallen by more than two-thirds, even as the workforce has almost doubled. Very serious occupational illnesses, such as brown lung (caused when textile workers inhale cotton dust) and black lung (caused when coal miners inhale coal dust), have been significantly reduced. The rate of lead poisoning suffered by workers in smelters and battery plants, among other workplaces, has also fallen dramatically.

Although many businesses have credited OSHA with helping reduce lost workdays and worker compensation costs, others have criticized the agency's rules as being too costly to implement and administer. For example, OSHA withdrew a proposed noise exposure standard, intended to prevent hearing loss, after employers complained it would be too expensive.[14] Some studies showed that the burdens of complying with regulations fell hardest on small businesses.[15] In part in response to employer criticisms, OSHA has entered into cooperative partnerships with employers, aimed at improving occupational safety and health for the benefit of both companies and their workers.

Although problems remain, four decades of occupational safety and health regulation in the United States and efforts by businesses and unions have significantly lowered deaths and injuries on the job. In many developing nations, however, conditions remain brutally dangerous. In Bangladesh, for example, a fast-growing garment and textile industry—mostly sourcing apparel to Western companies—has been the site of numerous tragedies, including a terrible building collapse at the Rana Plaza garment factory complex in 2013 that killed more than 1,100 workers. This incident—and the involvement of Western retailers whose products were manufactured there—is profiled in a case at the end of this book.

Job Security and the Right to Due Process

What obligations do employers have to their employee stakeholders, with respect to job security? Job security is generally not considered a right. However, once someone is hired, under what circumstances is it legal—or fair—to let him or her go? That is, to what extent do employees have due process rights? In recent years, the expectations underlying this most basic aspect of the employment relationship have changed, both in the United States and in other countries around the globe.

In the United States, since the late 1800s, the legal basis for the employment relationship has been **employment-at-will**. Employment-at-will is a legal doctrine that means

[13] "U.S. Department of Labor's OSHA Issues Record Breaking Fines to BP," press release, October 30, 2009, at *www.osha.gov*.

[14] "OSHA Withdraws Proposed Interpretation Involving Occupational Noise Exposure Standard," *Washington DC Employment Law Update,* January 19, 2011, at *www.dcemploymentlawupdate.com*.

[15] "U.S. House of Representatives Committee on Oversight and Government Reform," *Assessing Regulatory Impediments to Job Creation,* February 9, 2011, at *http://oversight.house.gov*.

that if employees are hired without a written employment contract, they can be fired for a good cause, a bad cause, or no cause at all. This doctrine assumed that employees and employers had equal power: employees could leave jobs they no longer wanted, and employers could fire employees for any reason. However, over time, the public and legislators became aware that employers had economic, political, and social advantages that made the relationship unequal. As a result, laws and court decisions have dramatically curtailed the ability of employers to terminate employees at will. Some of the restrictions include the following:

- An employer may not fire a worker because of race, gender, religion, national origin, age, or disability. The equal employment and other laws that prevent such discriminatory terminations are further described in Chapter 16.
- An employer may not fire a worker if this would constitute a violation of public policy, as determined by the courts. For example, if a company fired an employee just because he or she cooperated with authorities in the investigation of a crime, this would be illegal.
- An employer may not fire a worker if, in doing so, it would violate the Worker Adjustment Retraining Notification Act (WARN). This law, passed in 1988, requires most big employers to provide 60 days' advance notice whenever they lay off a third or more (or 500 or more, whichever is less) of their workers at a work site. If they do not, they must pay workers for any days of advance notice that were missed.
- An employer may not fire a worker simply because the individual was involved in a union organizing drive or other union activity.
- An employer may not fire a worker if this would violate an implied contract, such as a verbal promise, or basic rules of "fair dealing." For example, an employer could not legally fire a salesperson just because he or she had earned a bigger bonus under an incentive program than the employer wanted to pay.

Of course, if workers are covered by a collective bargaining agreement, it may impose additional restrictions on an employer's right to terminate. Many union contracts say employees can be fired only "for just cause," and workers have a legal right to appeal the employer's decision through the union grievance procedure. Some states also recognize three exemptions to the at-will doctrine: public policy, implied contract, and just cause. Fourteen states recognize all three of these exemptions. Conversely, three states do not recognize any exceptions to the at-will doctrine: Florida, Georgia, and Rhode Island.[16] Many European countries and Japan have laws that extend just-cause protections to all workers, whether they are covered by a union contract or not.

The commitments that employers and employees make to each other go beyond mere legal obligations, however. Cultural values, traditions, and norms of behavior also play important roles. Some have used the term **social contract** to refer to the *implied understanding* (not a legal contract, but rather a set of shared expectations) between an organization and its stakeholders. This concept includes, perhaps most significantly, the understanding between businesses and their employees.

Research suggests that the social contract governing the employment relationship has varied across cultures, and also across time. For example, in Europe, employers have historically given workers and their unions a greater role in determining company policy

[16] Charles Muhler, "The employment-at-will doctrine: three major exceptions" *Monthly Labor Review,* U.S. Bureau of Labor Statistics January 2001: pp. 3–11. "Employment at Will Exceptions by State" *National Conference of State Legislatures, at http://www.ncsl.org/research/labor-and-employment/at-will-employment-exceptions-by-state.aspx*.

than do most U.S. employers. Employee representatives are often included on boards of directors, in a practice sometimes called *codetermination.* For many years, big Japanese companies offered a core group of senior workers lifelong employment; in exchange, these workers felt great loyalty to the company. This practice has declined in recent years, however.

Fierce global competition and greater attention to improving the bottom line have resulted in significant corporate restructuring and downsizing (termination) of employees in many countries. This trend has led some researchers to describe a *new social contract.* Increasingly, bonds between employers and employees have weakened. Companies aim to attract and retain employees not by offering long-term job security, but rather by emphasizing interesting and challenging work, performance-based compensation, and ongoing professional training. For their part, employees are expected to contribute by making a strong commitment to the job task and work team and to assume a share of responsibility for the company's success. But they cannot count on a guaranteed job.[17]

> An important aspect of the weakening of the social contract between employers and workers has been the elimination of defined benefit pensions (which provide a fixed payout based on age at retirement, years of service, and average pay). In the 1980s, about 60 percent of private sector employers in the United States offered such a pension. But by 2017, only 8 percent of private sector employers offered a defined benefit plan, compared with 48 percent that offered a defined contribution plan such as a 401(k). Such plans gave workers more control over their investments and enabled them to carry their retirement savings with them when they changed jobs but were also much less secure. "People just have to deal with a lot more risk in their lives, because all of these things that used to be more or less assured—a job, health care, a pension—are now variable," said one expert.[18]

Should companies have strong or weak bonds with their employees? When businesses invest in their employees by providing a well-structured career, job security, and benefits including pensions, they reap the rewards of enhanced loyalty, productivity, and commitment. But such investments are expensive, and long-term commitments make it hard for companies to adjust to the ups and downs of the business cycle. Some firms resolve this dilemma by employing two classes of employees: permanent workers, who enjoy stable employment and full benefits, and temporary workers and independent contractors, who do not. This temporary work sector is sometimes referred to as the "gig economy." The rise of the gig economy has allowed companies to become more cost-efficient, but it has also shifted risk to workers, sowed anxiety, and in many cases driven down incomes. And although some workers preferred the flexibility of jobs in the gig economy, many ended up there simply because they could not find stable, permanent employment.[19]

Some of the challenges facing workers in the so-called sharing economy, in which they function as independent contractors rather than employees, are further explored in Exhibit 15.B.

[17] James E. Post, "The New Social Contract," in Oliver Williams and John Houck, eds., *The Global Challenge to Corporate Social Responsibility* (New York: Oxford University Press, 1995).

[18] U.S. Bureau of Labor Statistics, "Employee Benefits Survey," from National Compensation Survey 2017, at *www.bls.gov/ncs/ebs/benefits/2017/ownership/private/table01a.htm*.

[19] "Growth in the 'Gig Economy' Fuels Work Force Anxieties," *The New York Times,* July 12, 2015.

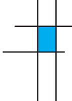
Exhibit 15.B Workers in the Sharing Economy

A study conducted by *Time Magazine* and the consulting firm Penn Schoen Berland estimated that in 2016, about 45 million U.S. "gig workers" offered a product or provided services requested by a "peer" via online "platforms." Why are the words "peer," "platforms," and "gig workers" in quotation marks? It turns out that how actors involved in these transactions are labeled has significant economic and legal consequences.

Postmates, for example, describes itself as an on-demand platform that connects peers wanting products from businesses that do not deliver with peers who are willing to deliver them. Recently, gig workers filed a suit claiming that Postmates deliberately misclassified them as *independent contractors* rather than employees to escape traditional employer obligations. Postmates defended itself, saying that "While we do not comment on the specifics of pending litigation, we believe the flexibility Postmates exercise over how, if, and when they use the platform reflects their independent contractor status."

Policymakers are increasingly concerned about the unintentional consequences of the sharing economy. According to *Time,* about a third of gig workers use this type of work for 40 percent or more of their income—making this a major part of their work identity. Some legislators have expressed concern that this type of employment arrangement can burden welfare and unemployment services if the gig does not pay enough to live on. As one senator observed, "Without a social contract, the social safety net will be stressed much more later on. For some of these workers, the gig economy is good until it's not."

Sources: "See How Big the Gig Economy Really Is," *Time Magazine,* January 6, 2016; and "Why the Sharing Economy Keeps Getting Sued," *Vanity Fair,* November 9, 2017.



Fair Wages and Income Inequality

An important right of employees, as noted in Figure 15.1, is to receive a fair and decent wage. Yet, how wages should be determined, and what exactly is fair or decent, remains contentious. This issue has taken on greater prominence in recent years, as public attention has turned to growing income inequality in the United States and other developed nations. What is the relationship between inequality and wages, and what responsibility if any does business bear for the sharp differences in life circumstances between those at the top and bottom of society?

Figure 15.3 shows changes in the level of income inequality in the United States over the past century, as measured by the share of all income going to the top 10 percent of households. (As explained in Chapter 4, inequality can be expressed for both wealth and income; this figure shows inequality of income.) The figure shows that income inequality fell dramatically during World War II and stayed low during the postwar years until around 1980, and since then has increased dramatically.

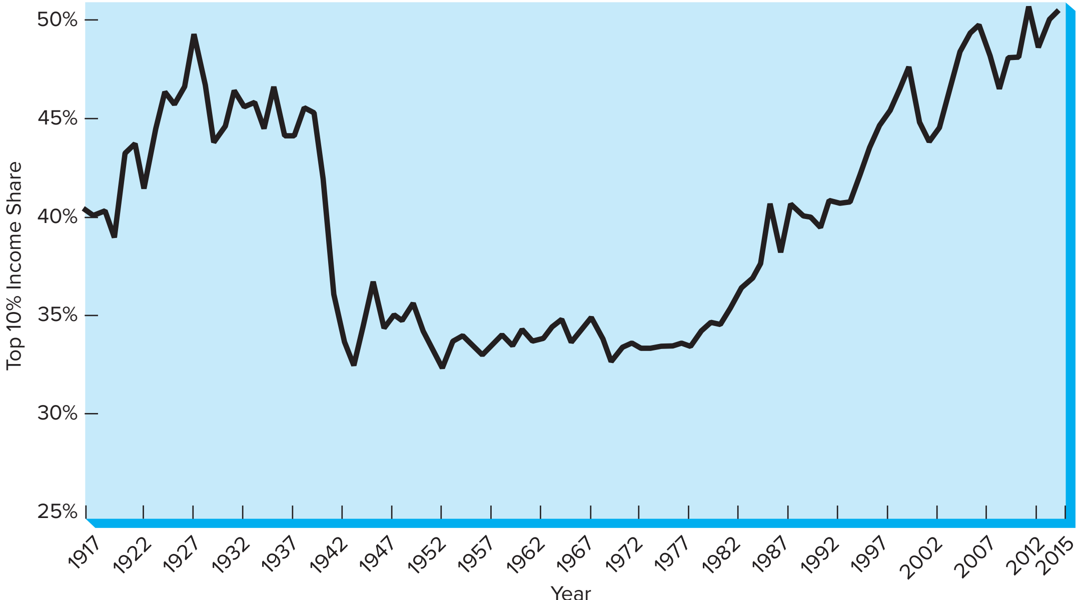
The rise in income inequality, as illustrated by Figure 15.3, has many causes, and some have little directly to do with business practices. These include federal and state minimum wage laws, taxation policy, economic growth, unionization rates, and other factors. But corporate policy plays an important role. When businesses decide to pay very high executive compensation (as discussed in Chapter 13) and to keep wages as low as possible for ordinary employees, they are contributing to inequality in the broader society.[20]

What can companies do to address income inequality? The simple answer is to increase wages—and to reduce pay differentials within their organizations. In 2018, Walmart, identified by the National Employment Law Project as one of the lowest-paying employers, announced it would raise its minimum wage to $11 per hour and would give

[20] Brookings Institute, "Thirteen Facts About Wage Growth," September 25, 2017; and Economic Policy Institute, "Wage Stagnation in Nine Charts," January 6, 2015.

FIGURE 15.3 **Income Inequality in the United States, 1917–2015**

Source: Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States, 1913–1998," *Quarterly Journal of Economics,* 118(1), 2003, updated at *http://emlab.berkeley.edu/users/saez.*



employees bonuses of up to $1,000. In 2017, Wells Fargo announced plans to raise the company's minimum wage to $15 an hour. A few companies—such as Gravity Payments, discussed in Chapter 3—have taken even more dramatic actions to improve compensation for their employees.

One approach, taken by a small minority of companies, has been to commit to paying all employees what is called a **living wage**. This has been defined by the Ethical Trading Initiative as a wage "that enables workers, for their labour during a standard work week, to support half the basic needs of an average-sized family, based on local prices near the workplace."[21] A living wage is generally well above the legally mandated minimum wage. (Minimum wages are set at both the federal and state levels; state minimum wages can be equal to or more than, but not less than, the federal minimum.)

Figure 15.4 shows how well legal minimum wages enable a family of two working adults with two children to sustain themselves in different states. The deeper shades of color indicate that the state minimum wage covered a higher percentage of a living wage for two working adults with two children. None of the 50 states had a minimum wage that resulted in a living wage for such a family. At the top is the District of Columbia, where the minimum wage covered 69 percent of a living wage; at the bottom, Tennessee, South Carolina, Alabama, Mississippi, and Louisiana had no minimum wage.[22]

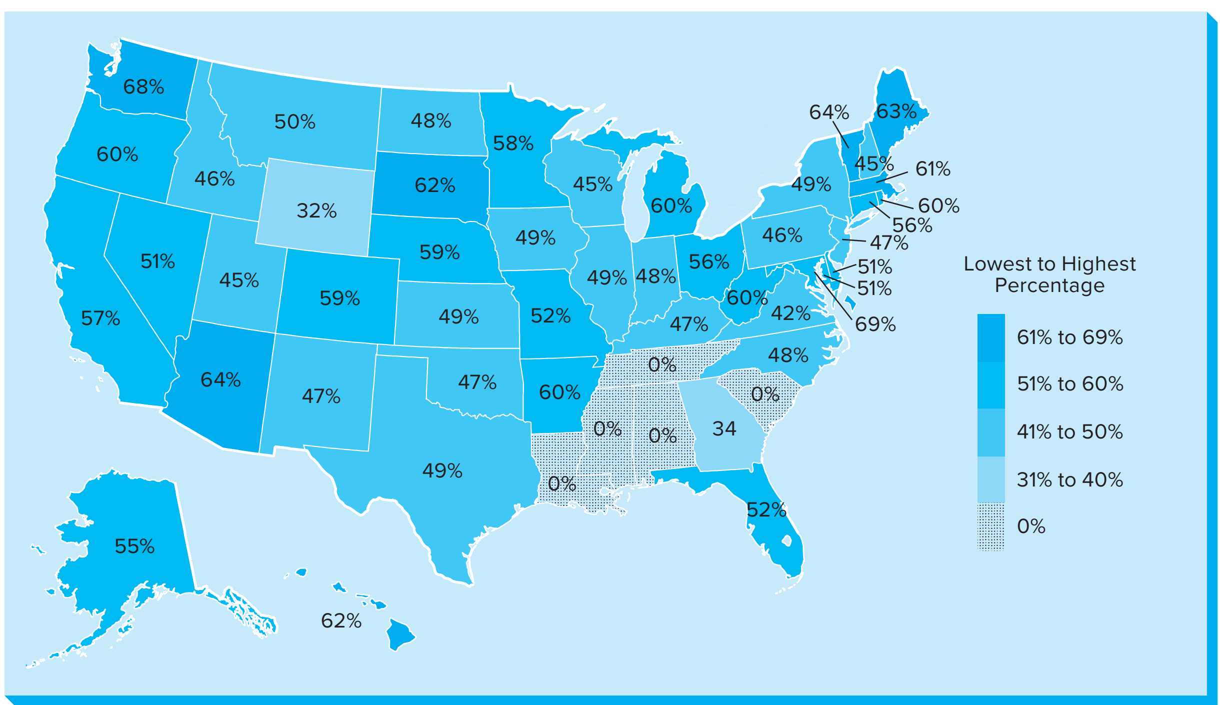
Some companies have taken steps to pay their workers living wages. For example, Novartis, a major multinational pharmaceutical firm, has committed to paying a living wage to all

[21] Ethical Trading Initiative, at *www.ethicaltrade.org/in-action/issues/living-wage/standards.*

[22] Amy K. Glasmeier "Living Wage Calculator," at *www.livingwage.mit.edu*, and U.S. Department of Labor, "*Consolidated Minimum Wage Table,"* January 1, 2018, at *www.dol.gov/whd/minwage/mw-consolidated.htm*.

FIGURE 15.4 **Percentage of Living Wage Covered by Minimum Wage**

Sources: Developed by the authors based on data from "Living Wage Calculator," Amy K. Glasmeier, Department of Urban Studies and Planning, MIT, at *http://livingwage.mit.edu*, and "Consolidated Minimum Wage Table," January 1, 2018 Department of Labor, at *www.dol.gov/whd/minwage/mw-consolidated.htm*.



its employees around the world.[23] U.S. companies that pay well above minimum wage for entry-level work (although they have not necessarily committed to the living wage concept) include Costco, Trader Joe's, In-N-Out Burger, Gap, Shake Shack, CVS Health, and Whole Foods.[24] Evidence suggests that companies that adopt such a "good jobs" strategy reap benefits from doing so. Of course, paying workers well costs more, and in that way can detract from the bottom line. But a study of four retail chains that paid above-average wages by MIT professor Zeynep Ton found that these firms had achieved healthy growth and excellent shareholder returns. They had done so because they had "invest[ed] in their employees with the expectation that they [would] get even more back in terms of labor productivity, customer service, cost-cutting, innovation, and flexibility during difficult times," the researcher concluded.[25] In short, a high-road strategy had paid off for these socially responsible companies.

The Right to Privacy in the Workplace

An important right in the workplace, as elsewhere, is privacy. In the business context, **employee privacy** refers primarily to protecting an individual employee's personal life from

[23] "Implementing a Living Wage Globally—The Novartis Approach," at *www.novartis.com/downloads/corporate-responsibility/responsible-business-practices/living-wage.pdf*.

[24] "20 Chains That Pay More than Minimum Wage," *The Motley Fool,* March 20, 2018.

[25] Zeynep Ton, *The Good Jobs Strategy* (Boston: Houghton Mifflin, 2014). See also the Good Jobs Institute, at *http://goodjobsinstitute.org*.

unwarranted intrusion by the employer. Many people believe, for example, that their religious and political views, their health conditions, their credit history, and what they do and say off the job are private matters and should be safe from snooping by the boss. Exceptions are permissible only when the employer's interests are clearly affected. For example, it may be appropriate for the boss to know that an employee is discussing with a competitor, through e-mail messages, the specifications of a newly developed product not yet on the market.

But other areas are not so clear-cut. For example, should a job applicant who is experiencing severe financial problems be denied employment out of fear that he may be more inclined to steal from the company? Should an employee be terminated after the firm discovers that she has a serious medical problem, although it does not affect her job performance, since the company's health insurance premiums may dramatically increase? At what point do company interests weigh more heavily than an employee's right to privacy? This section will address several key workplace issues where these privacy dilemmas often emerge: electronic monitoring, office romance, drug and alcohol abuse (including medical marijuana), and honesty testing.

Electronic Monitoring

As discussed in Chapters 11 and 12, changing technologies have brought many ethical issues to the forefront. One such issue is employee **electronic monitoring**. A wide range of technologies—e-mail and messaging, social media sites, cell phones, location tracking, Internet browsing, and digitally stored video—enable companies to gather, monitor, and analyze information about employees' activities. For example, a company called Sociometric Solutions makes sensor-rich badges that can be worn by employees. They are equipped with microphones, a location sensor, and an accelerometer (similar to those used in fitness trackers). The company uses "big data" technology to analyze the resulting information and provides a summary in aggregated form to the employer. The use of such monitoring techniques has become increasingly pervasive. One report found that 78 percent of major companies monitored employees' e-mail, Internet use, or phone; the companies surveyed employed over 25 percent of the U.S. workforce. Such data analytics can help companies make more productive use of their employees' time and can also inform discipline or termination decisions.[26]

A company's need for information, particularly about its workers, may be at odds with an employee's right to privacy, however. The European Court of Human Rights affirmed these privacy rights in an important 2017 decision.

> Bogdan Barbulescu, an employee in Romania, created a Yahoo Messenger account to communicate with clients. On a few occasions he also used this account to communicate with his brother and fiancée. His company discovered these texts and fired Mr. Barbulescu. When the matter was originally heard in Romanian courts, the court ruled in favor of the employer, stating that it was appropriate for the employer to monitor employee actions during work hours. However, the high court overturned this ruling, stating that Mr. Barbulescu "had not been informed in advance of the extent and nature of his employer's monitoring, or the possibility that the employer might have access to the actual contents of his messages."[27]

[26] "Active Employee Monitoring of Employees Rises to 78%," ABC News, April 18, 2017; "The Office is Watching You," May 22, 2015, at *www.fastcompany.com*; and "Unblinking Eyes Track Employees," *The New York Times,* June 21, 2014.

[27] "European Court Limits Employers' Right to Monitor Workers' Email," *The New York Times,* September 5, 2017.

Management justifies the increase in employee monitoring for a number of reasons. Employers have an interest in efficiency. When employees log on to the Internet at work or use a company-issued phone to trade stocks, plan their vacations, and message friends and family, this is not a productive use of their time or company resources. Employers also fear lawsuits if employees act in inappropriate ways. An employee who views pornographic pictures on a computer at work, for example, might leave the company open to a charge of sexual harassment—if other workers observed this behavior and were offended by it. (Sexual harassment is further discussed in the following chapter.) The employer also needs to make sure that employees do not disclose confidential information to competitors or make statements that would publicly embarrass the company or its officers. And monitoring is often used for training and quality control purposes.

Is electronic monitoring by employers legal in the United States? For the most part, yes. The Electronic Communications Privacy Act (1986) exempts employers. In general, the courts have found that privacy rights apply to personal, but not business, information, and that employers have a right to monitor job-related communication. The courts have generally ruled that employers may monitor employee e-mail, messages, and texts. However, it is widely recommended that employers inform employees that they are being monitored. An evolving area of the law involves GPS tracking. In 2018, Amazon successfully patented wristband technology that can detect an employee's proximity to the correct bin or shelf for an item. Using this information, the wristband nudges the employee via vibrations if it detects the employee's arm is close to the incorrect bin or shelf, indicating that they may be about to misplace the items. Other companies hand out wearable technology, such as fitness trackers as part of their wellness programs. One vending company offered to implant microchips in employees' hands to make buying snacks easier. Critics complain that while this technology may be helpful, it invades employees' privacy, and data collected could be misused by the employer.[28] (Employee monitoring is further discussed in Chapter 12.)

In seeking to balance their employees' concerns about privacy with their own concerns about productivity, liability, and security, businesses face a difficult challenge. One approach is to monitor employee communication only when there is a specific reason to do so, such as poor productivity or suspicion of theft. For example, the chipmaker Intel Corporation chose not to check its employees' e-mail routinely, feeling this would undermine trust. Most management experts recommend that employers, at the very least, clearly define their monitoring policies, let employees know what behavior is expected, and apply any sanctions in a fair and evenhanded way.

Romance in the Workplace

Another issue that requires careful balancing between legitimate employer concerns and employee privacy is romance in the workplace. People have always dated others at work. In fact, a 2017 survey showed that 57 percent of workers said they had participated in some type of office romance. Twenty-one percent of these romances were reported as "random hook-ups," 16 percent developed into long-term relationships, and 14 percent

[28] "Amazon Wristbands Could Track Workers; New Technology Raises Concerns about Privacy, Discrimination: Workplace Technology," *Dayton Daily News,* March 4, 2018. A summary of the law with respect to employee monitoring may be found in "Fact Sheet 7: Workplace Privacy and Employee Monitoring," at the website of the Privacy Rights Clearinghouse at *www.privacyrights.org*

resulted in on-going casual relationships.[29] In fact, workplace dating has probably become more common, as 10 percent of workers participating in the 2017 study reported meeting their spouse or partner at work. One human resources director commented, "It's a reality that work is where people meet these days. When you don't meet at college, that's a pool of people that's taken away from you."

Yet office romance poses problems for employers. Some relationships are consensual, but others are not. The #MeToo and #TimesUp movements cast a bright light on abuses that can occur when one person in a relationship is in a position of authority over the other and uses that authority coercively. Recent evidence shows that these movements have affected peoples' perception of workplace romance. Forty-three percent of employees surveyed in 2018 thought that relationships between colleagues at different levels was unacceptable, up sharply from 28 percent the previous year.[30]

For many years, most businesses had a strict policy of forbidding relationships in the workplace outright. They assumed that if romance blossomed, one person—usually the subordinate—would have to find another job. Today, however, companies are more likely to draw distinctions, permitting some kinds of office relationships, and not others. A survey by the Society for Human Resource Professionals found that 42 percent of companies had either a written or verbal policy on workplace romance. Almost all these policies (99 percent) banned relationships within a direct chain of command (such as between a supervisor and subordinate.) Forty-five percent banned romances between employees of significantly different rank. But less than a third of companies banned relationships between workers of the same rank who reported to the same supervisor, and only 12 percent banned relationships between workers in different departments. A small proportion of companies (about 5 percent) require their managers to sign a document, sometimes called a *consensual relationship agreement,* stipulating that an office relationship is welcome and voluntary—to protect against possible harassment lawsuits if the people involved later break up.[31]

Employee Drug Use and Testing

Abuse of drugs, both illegal drugs such as heroin and methamphetamine and legal drugs such as OxyContin or Xanax when used inappropriately, can be a serious problem for employers. Only a small fraction of employees abuse illegal or prescription drugs. But those who do can cause serious harm. They are much more likely than others to produce poor-quality work, have accidents that hurt themselves and others, and steal from their employers. Some break the law by selling drugs at work to support their habits. Drug abuse costs U.S. industry and taxpayers an estimated $193 billion a year. This figure includes the cost of lost productivity, medical claims, rehabilitation services, and crime and accidents caused by drugs.[32]

One way that businesses have protected themselves from these risks is through **drug testing**. Significant drug testing first began in the United States following passage of the Drug-Free Workplace Act of 1988, which required federal contractors to establish and maintain a workplace free of drugs. At that time, many companies and public agencies began drug testing to comply with government rules. Today, the landscape for testing for and regulating drug use has gotten more complicated with the increasing abuse of legal

[29] "Work is for Lovers: Vault's 2017 Office Romance Survey Results," February 13, 2017, at *www.vault.com*.

[30] "The 2018 Vault Office Romance Survey Results," February 12, 2018, at *www.vault.com*.

[31] "Forbidden Love: Workplace-Romance Policies Now Stricter," September 24, 2013, at *www.shrm.org*.

[32] "Consequences of Illicit Drug Use in America," April 2014, at *www.whitehouse.gov*.

drugs such as prescription opioids and the legalization of marijuana in some states. Opioid use as been observed to have negative impacts on job performance and increase risk of on the job accidents or injuries. One study estimated that two-thirds of opioid abusers were gainfully employed. While 57 percent of employers surveyed by the National Safety Council reported using drug tests, only about three in five of these screened for opioids.[33]

The legalization of marijuana in some states has also caused confusion among employers about how to address marijuana use in their drug policies. Can an employer discipline or fire an employee for marijuana use in a state where it is legal? It's complicated. Twenty-eight states and the District of Columbia have legalized medical marijuana, and eight states (Alaska, California, Colorado, Maine, Massachusetts, Nevada, Oregon, and Washington) have also legalized recreational use. Since marijuana remains illegal under federal law, employers in all states have the legal right to test for it—*even in states where marijuana use is legal.* As a result, it is left up to the employer's discretion whether to adhere to state or federal law. A few employers in Colorado, the first state to legalize marijuana for recreational use, no longer screen for marijuana in their preemployment and random drug tests. Increasingly, employers report that testing for marijuana in states where recreational use is legal makes it harder to find qualified employees. Furthermore, some states mandate that employers accommodate employees who use the drug for medical reasons. As policymakers continue to debate the use of marijuana, employers are having a difficult time establishing effective policies.[34]

Typically, drug testing is used on three different occasions.

- *Preemployment screening.* Some companies test all job applicants or selected applicants before hiring, usually as part of a physical examination, often informing the applicant ahead of time that there will be a drug screening.
- *Random testing of employees.* This type of screening may occur at various times throughout the year. In many companies, workers in particular job categories (e.g., operators of heavy machinery) or levels (e.g., supervisors) are eligible for screening at any time.
- *Testing for cause.* This test occurs when an employee is believed to be impaired by drugs and unfit for work. It is commonly used after an accident or some observable change in behavior.

Employee drug testing is controversial. Although businesses have an interest in not hiring, or getting rid of, people who abuse drugs, many job applicants and employees who have never used drugs feel that testing is unnecessary and violates their privacy and due process rights. In general, proponents of testing emphasize the need to reduce potential harm to other people and the cost to business and society of drug use on the job. Opponents challenge the benefits of drug testing and emphasize its intrusion on individual privacy.

Alcohol Abuse at Work

Another form of employee substance abuse—which causes twice the problems of all illegal drugs combined—is alcohol use and addiction. About 9 percent of full-time employees

[33] "HireRight Annual Employment Screening Benchmark Report, 2015 Edition" at *http://hireright.com/benchmarking*; "The opioid crisis spills into the workplace," *Chicago Tribune,* September 25, 2017.

[34] "Can my employer fire me for legally using marijuana?" *The Denver Post,* December 4, 2016, and "Should Marijuana be Removed from Pre-Employment Drug Screens?" *Talent Acquisition: Society for Human Resource Management,* April 6, 2017, at *www.shrm.org/resourcesandtools/hr-topics/talent-acquisition/pages/marijuana-removed-preemployment-drug-screens.aspx*.

are heavy drinkers—that is, they had five or more drinks on five or more occasions in the past month. Like drug abusers, they can be dangerous to themselves and others. Studies show that up to 40 percent of all industrial fatalities and 47 percent of industrial injuries are linked to alcohol. The problem is not just hard-core alcoholics, however. Most alcohol-related problems in the workplace, one study found, were caused by people who occasionally drank too much after work and came in the next day with a hangover, or who went out for a drink on their lunch break. U.S. businesses lose an estimated $88 billion per year in reduced productivity directly related to alcohol abuse.[35]

Company programs for drug abusers and alcohol abusers are often combined. Many firms recognize that they have a role to play in helping alcoholic employees. As with drug rehabilitation programs, most alcoholism programs work through **employee assistance programs (EAPs)**. These programs, generally offered as part of a company's benefits package, provide referrals to and paid consultations with outside counselors who can help with substance abuse, as well as other problems employees face. Most U.S. companies employing 1,000 or more workers—and about three-quarters of smaller ones—provide EAPs for alcohol and drug abusers.[36]

Employee Theft and Honesty Testing

Employees can irresponsibly damage themselves, their coworkers, and their employer by stealing from the company. Employee theft has emerged as a significant economic, social, and ethical problem in the workplace. A 2017 survey of large retail stores in the United States showed that almost 30 percent of all inventory losses were due to employee theft (shoplifting, administrative error, and vendor fraud accounted for most of the rest). The retail value of goods stolen by employees was almost $15 billion.[37]

Employee theft is also a problem in other parts of the world, as well. According to the Global Retail Theft Barometer, so-called retail crime costs European, North American, and Asian-Pacific businesses around $124 billion annually, or about 1.2 percent of sales. Of this, 39 percent was due to employee theft (shoplifting, administrative error, and vendor fraud accounted for the rest). The items most commonly stolen were batteries, footwear, mobile device accessories, razor blades, wine, and spirits.[38]

Some companies have used written psychological tests that seek to predict employee honesty on the job by asking questions designed to identify desirable or undesirable qualities. These instruments, sometimes called honesty tests, are controversial. The American Psychological Association noted there is a significant potential for these tests to generate false positives, indicating the employee probably would or did steal from the company even though this is not true. Critics also argue that the tests intrude on a person's privacy and discriminate disproportionately against minorities.

[35] The statistics reported in this paragraph are from the U.S. Substance Abuse and Mental Health Services Administration (SAMHSA) at *www.samhsa.gov*; 10th Annual Report to the U.S. Congress on Alcohol and Health, at *http://pubs.niaaa.nih.gov/publications/10report/intro.pdf*; and the website of the National Drug-Free Workplace Alliance at *www.ndwa.org*.

[36] Kenneth Matos, Ellen Galinsky, and James T. Bond, "2016 National Study of Employers," at *http://familiesandwork.org*.

[37] Richard C. Hollinger and the National Retail Federation, *2017 National Retail Security Survey* (University of Florida and the National Retail Federation, 2017).

[38] These data are for the 12-month period ending December 2015. The Global Retail Theft Barometer is available at *www.globalretailtheftbarometer.com*.

In all these areas—monitoring employees electronically, policing office romance, testing for drugs, and conducting psychological tests—businesses must balance their needs to operate safely, ethically, and efficiently with their employees' right to privacy.

The Right to Blow the Whistle and Free Speech in the Workplace

Free speech in the workplace is a controversial issue. Do employees have the right to openly express their opinions about their company and its actions? If so, under what conditions do they have this right?

The U.S. Constitution protects the right to free speech. This means the government cannot take away this right. For example, the legislature cannot shut down a newspaper that editorializes against its actions or those of its members. However, the Constitution does not explicitly protect freedom of expression in the workplace. Generally, employees are not free to speak out against their employers, since companies have a legitimate interest in operating without harassment from insiders. Company information is generally considered to be proprietary and private. If employees, based on their personal points of view, were freely allowed to expose issues to the public and allege misconduct, a company might be thrown into turmoil and be unable to operate effectively.

On the other hand, there may be situations in which society's interests override those of the company, so an employee may feel an obligation to speak out. When an employee believes his or her employer has done something that is wrong or harmful to the public, and he or she reports alleged organizational misconduct to the media, government, or high-level company officials, **whistle-blowing** has occurred.

A manager at a Wells Fargo branch in Los Angeles alleged that he was unjustly terminated for whistle-blowing fraudulent behavior. The manager observed questionable actions by two bankers under his supervision that he suspected constituted bank, wire, and mail fraud. He reported this behavior to his supervisors and the bank ethics hotline—and then was himself terminated. As part of its whistle-blower protection program, OSHA investigated the manger's claim and found evidence of retaliation and unjust termination. In 2017, regulators ordered Wells Fargo to pay $5.4 million dollars and reinstate the manager to his previous position. This judgment represented the largest individual award for whistle-blowing violations to date.[39]

Some observers speculated that this manager's firing may have been associated with the larger scandal at the bank, in which thousands of employees were found to have set up unauthorized bank and credit card accounts on behalf of customers. This situation is further explored in a case at the end of this book.

While this specific case ended well for the whistle-blower, many do not. Speaking out against an employer can be risky; many whistle-blowers find their charges ignored—or worse, find themselves ostracized, demoted, or even fired for daring to go public with their criticisms. Whistle-blowers in the United States have some legal protection against retaliation by their employers, though, as suggested by the Wells Fargo example. As noted earlier in this chapter, most workers are employed *at will,* meaning they can be fired for any reason. However, most states now recognize a public policy exception to this rule. Employees who are discharged in retaliation for blowing the whistle, in a situation that affects public welfare, may sue for reinstatement and in some cases may even be entitled

[39] "Wells Fargo Whistle-Blower Wins 5.4 Million and His Job Back," *The New York Times,* April 3, 2017.

to punitive damages. The federal Sarbanes-Oxley Act, passed in 2002 (and described more fully in Chapters 5 and 13), makes it illegal for employers to retaliate in any way against whistle-blowers who report information that could have an impact on the value of a company's shares. More recently, the Dodd-Frank Act of 2010 (described more fully in Chapters 7 and 14) requires the government to pay a reward to whistle-blowers who voluntarily provide information that leads to successful prosecutions for violations of federal securities laws. Dodd-Frank also prohibits retaliation against employees who do so.[40]

Moreover, whistleblowing is not restricted to employees reporting ethically questionable behavior to the authorities. The U.S. False Claims Act (also known as the Lincoln Law), as amended in 1986, allows individuals to sue federal contractors for fraud and receive up to 30 percent of any amount recovered by the government. In the past decade, the number of whistle-blower lawsuits—perhaps spurred by this incentive—increased significantly, exposing fraud in the country's defense, health care, municipal bond, and pharmaceutical industries. In 2017, the Justice Department recovered over $900 million dollars in damages as a result of individuals suing companies for fraud on behalf of the government. In many instances, the company in question settled out of court to avoid unfavorable court judgements. For example, Shire Pharmaceuticals paid $350 million to address a whistle-blower's allegations that Shire and its subsidiary, Advanced BioHealing (ABH), had persuaded clinics and physicians to use its bioengineered human skin by offering perks and kickbacks. Shire and ABH had also marketed the skin substitute for non-approved used and made false statements to inflate its price.[41]

Whistle-blowing has both defenders and detractors. Defenders point to the successful detection of fraudulent activities and prosecution of wrongdoers. Under the False Claims Act, $56 billion had been recovered by the federal and state governments that would otherwise have been lost to fraud.[42] Situations dangerous to the public or the environment have been exposed and corrected because insiders have spoken out. Yet opponents cite hundreds of unsubstantiated cases, often involving disgruntled workers seeking to blackmail or discredit their employers.

When is an employee morally justified in blowing the whistle on his or her employer? According to one expert, four main conditions must be satisfied to justify informing the media or government officials about a corporation's actions. These are

- The organization is doing (or will do) something that seriously harms others.
- The employee has tried and failed to resolve the problem internally.
- Reporting the problem publicly will probably stop or prevent the harm.
- The harm is serious enough to justify the probable costs of disclosure to the whistle-blower and others.[43]

Only after each of these conditions has been met should the whistle-blower go public.

[40] "SEC Approves New Rewards for Whistleblowers," *Washington Post,* May 25, 2011; and Securities and Exchange Commission, "Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934," August 12, 2011, at *www.sec.gov*.

[41] "Shire PLC Subsidiaries to Pay $350 Million to Settle False Claims Act Allegations," *press release,* January 11, 2017, at *www.justice.gov*.

[42] "Justice Department Recovers Over 3.7 Billion from False Claims Act Cases in Fiscal Year 2017," U.S. Department of Justice, at *www.justice.gov/opa/pr/justice-department-recovers-over-37-billion-false-claims-act-cases-fiscal-year-2017*.

[43] Manohar Kumar and Daniele Santoro, "A Justification of Whistleblowing," *Philosophy & Social Criticism* 43(7), June 2017. See also Manuel G. Velasquez, *Business Ethics: Concepts and Cases,* 7th ed. (Upper Saddle River, NJ: 2012).

Summary

- U.S. labor laws give most workers the right to organize unions and to bargain collectively with their employers. Although unions have weakened over time, they continue to represent workers in some parts of the economy, particularly in the public sector. Unions are stronger in most other countries.
- Job safety and health concerns have increased as a result of rapidly changing technology in the workplace. U.S. employers must comply with expanding OSHA regulations and respond to the threat of violence at work.
- Employers' right to discharge "at will" has been limited, and employees now have a number of bases for suing for wrongful discharge. The expectations of both sides in the employment relationship have been altered over time by globalization, business cycles, and other factors.
- Corporate wage policies contribute to growing income inequality. Paying living wages and pursuing a "good jobs" strategy can benefit a company through high productivity, strong customer service, and innovation.
- Employees' privacy rights are frequently challenged by employers' needs to have information about their health, their work activities, and even their off-the-job lifestyles. When these issues arise, management has a responsibility to act ethically toward employees while continuing to work for a high level of economic performance.
- Blowing the whistle on one's employer is often a last resort to protest company actions considered harmful to others. In recent years, U.S. legislation has extended new protections to government whistle-blowers.

Key Terms

drug testing, *342*
electronic monitoring, *340*
employee assistance programs (EAPs), *344*
employee privacy 339
employment-at-will, *334*
ergonomics, *333*
labor union, *330*
living wage, *338*
minimum wage, *331*
Occupational Safety and Health Administration (OSHA), *334*
social contract, *335*
whistle-blowing, *345*

Internet Resources

www.workplacefairness.org	Workplace Fairness
www.aclu.org	American Civil Liberties Union
www.fair-wage.com	Fair Wage Network
www.drugfreeworkplace.org	Institute for a Drug-Free Workplace
www.osha.gov	Occupational Safety and Health Administration
www.whistleblowers.org	National Whistleblowers Center
www.aclu.org	American Civil Liberties Union
www.afl-cio.org	American Federation of Labor-Congress of Industrial Organizations
www.workrights.org	National Workrights Institute
www.business.com/human-resources	Business.com (human resources topics)

Discussion Case: *The Ugly Side of Beautiful Nails*

For many people, going to a nail salon for a manicure or pedicure is a small, affordable luxury and a pleasant way to relax. For workers in these salons, however, the story is often less glamorous: low pay, abusive working conditions, and constant exposure to dangerous chemicals that threaten to ruin their health.

Nail care is very popular. In 2017, women (and some men) spent more than $8 billion a year on nail care at around 200,000 nail salons across the nation. The publisher of the magazine *Nails* explained the phenomenon this way: "Nail care isn't just about grooming anymore; it's self-expression. Just as tattoos have become mainstream, nail art has too." Technical innovations such as gel polishes, which last longer and are easier to remove, also drove the trend. For most customers, the price of the service—averaging less than $20 for a manicure—was easy to fit into their budgets.

Who were the manicurists and pedicurists laboring over all these hands and feet? According to *Nails,* 380,000 people worked in nail salons in the United States. Ninety-four percent were women. Over half were Vietnamese, although ethnicity varied by location; in New York City, for example, Koreans dominated the industry. Many workers had limited English proficiency, and a significant proportion were undocumented immigrants.

Wages were very low. According to government data, the median annual wage for a manicurist was $19,620. Only a quarter of the 100 workers interviewed by a reporter for *The New York Times* said they had been paid the equivalent of the state minimum wage. The *Times'* exposé also reported that sometimes workers were not paid at all; many new workers were required to pay a so-called training fee and to work without wages during an apprenticeship period. Overtime pay was "almost unheard-of," the newspaper found, even though long work days and weeks were commonplace. *Nails* magazine reported that more than a fifth of nail salon workers' income came from tips, which relied entirely on the goodwill of customers.

Most salons were small. Barriers to entry were low: an operator could set up business by renting a storefront and investing a few thousand dollars in furnishings, equipment, and supplies. Eighty-one percent of manicurists and pedicurists worked in a shop with three or fewer technicians. The industry was highly competitive, and salons went in and out of business frequently.

Nail technicians worked with polishes, solvents, hardeners, and glues that caused respiratory and skin ailments, reproductive harm, and even cancer. Although occupational health in nail salons had not been fully studied, the three most dangerous chemicals used there were believed to be toluene (which made polish glide on smoothly), dibutyl phthalate (which made it pliable), and formaldehyde (which hardened it). Workers also inhaled acrylic dust; acquired fungal infections from customers' hands and feet; and injured their backs, necks, and shoulders from constant repetitive motion. *Nails* reported that more than half of nail technicians said they suffered from a work-related ailment.

The Occupational Safety and Health Administration set standards for workplace exposure to many of the chemicals used in nail salons and urged workers to wear protective gear like gloves and masks and to properly ventilate their salons. States also set safety and health rules. But as a practical matter these rules were routinely ignored, and inspections were conducted only in response to specific complaints.

In New York, in the wake of the exposé published by *The New York Times,* officials rushed to assemble a task force to address conditions in the industry and said they would post a manicurist's "bill of rights" in 10 languages in every salon, describing minimum wage laws and required safety measures. "We will not stand idly by as workers are deprived of their hard-earned wages and robbed of their most basic rights," said the governor of

New York. But it was unclear how much impact these measures would have. One official observed that manicurists were particularly reluctant to cooperate with investigators, saying, "They are totally running scared in this industry."

Sources: "The Price of Nice Nails," *The New York Times,* May 7, 2015; "Perfect Nails, Poisoned Workers," *The New York Times,* May 8, 2015; "Cuomo Orders Emergency Measures to Protect Workers at Nail Salons," *The New York Times,* May 11, 2015; "New York Salons Now Required to Post Workers' Bill of Rights," *The New York Times,* May 29, 2015; California Health Nail Salon Collaborative, *Overexposed and Underinformed: Dismantling Barriers to Health and Safety in California Nail Salons* (April 2009); and *2014–2015 Nails Big Book,* at *http://files.nailsmag.com/site/NAILS-Magazine-Big-Book-2014.pdf*. Wage data are from the Bureau of Labor Statistics at *www.bls.gov*.

Discussion Questions

1. This section describes several "workplace rights." Which of these rights are violated in the nail salon industry, and what evidence do you have of this?
2. To what degree do you think managers in the nail salon industry would be able to improve conditions voluntarily if they wished to do so, and why do you think so?
3. What factors make it particularly difficult for workers in the nail industry to organize to improve their own conditions, and how could these factors be overcome?
4. What factors make it particularly difficult for government policymakers and regulators to make rules for the nail industry and enforce them? How could these factors be overcome?
5. What do you think is the best way to improve conditions for workers in the nail industry?

CHAPTER SIXTEEN

Managing a Diverse Workforce

The workforce in the United States is more diverse than it has ever been, reflecting the entry of women into the workforce, immigration from other countries, the aging of the population, and shifting patterns of work and retirement. Equal opportunity laws and changing societal expectations have challenged corporations to manage workforce diversity effectively. Full workplace parity for women and persons of color has not yet been reached. However, businesses have made great strides in reforming policies and practices to draw on the skills and contributions of their increasingly varied employees.

This Chapter Focuses on These Key Learning Objectives:

LO 16-1 Knowing in what ways the workforce of the United States is diverse and evaluating how it might change in the future.

LO 16-2 Understanding where women and persons of color work, how much they are paid, and the roles they play as managers and business owners.

LO 16-3 Identifying the role government plays in securing equal employment opportunity for historically disadvantaged groups and debating whether or not affirmative action is an effective strategy for promoting equal opportunity.

LO 16-4 Assessing the ways diversity confers a competitive advantage.

LO 16-5 Formulating how companies can best manage workforce diversity, making the workplace welcoming, fair, and accommodating to all employees.

LO 16-6 Understanding what corporate policies and practices are most effective in helping today's employees manage the complex, multiple demands of work and family obligations.

Ultimate Software is a technology firm providing cloud-based human resource management software. Based in Weston, Florida, the company employs 3,972 people and earned revenues of more than $800 million in 2017. In an industry noted for its lack of diversity, Ultimate Software is different—43 percent of its employees are minorities, and 49 percent are female. The company acknowledges that one size does not fit all when it comes to developing a workplace that works for everyone. Ultimate Software employees—or "UltiPeeps" as they call themselves—enjoy many flexible scheduling options, and half telecommute. Female employees can expect 50 days fully paid maternity leave, and male employees can use 60 days of job-protected paternity leave, with 20 of them fully paid. These policies extend to non-birth parents in same-sex relationships. In addition, Ultimate Software offers child care services, a lactation room, and paid sick leave to care for a sick child or relative. In addition to these family-friendly policies, the company has explicit written policies prohibiting discrimination and formal programs that support professional development for underrepresented racial and ethnic minority groups, women, and LGBTQ employees.

The effectiveness of these diversity initiatives is demonstrated by the presence of minorities and women in leadership positions. Women represent 43 percent of frontline managers and supervisors, 42 percent of mid-level managers, and 37 percent of senior management positions. For their part, minorities represent 33 percent of frontline managers and supervisors, 21 percent of mid-level managers, and 7 percent of senior management positions. This diverse workplace yields dividends for all UltiPeeps, with 98 percent reporting that Ultimate Software is a great place to work, and 99 percent reporting taking great pride in working at the company. Ultimate Software has been ranked #2 of the Best Workplaces for Parents in 2017, #1 Best Workplace for Technology in 2018, and #3 of the Fortune 100 Best Companies to Work for in 2018.[1]

Ultimate Software's success and recognition as an industry leader demonstrates the benefits that result from significant investment of resources required to attract, retain, and develop a diverse workforce. Having many kinds of workers can greatly benefit businesses, giving them a wider pool from which to recruit talent, many points of view and experiences, and an ability to reach out effectively to a diverse, global customer base. Yet, it also poses great challenges, as business must meet the mandates of equal employment laws and help people who differ greatly in their backgrounds, values, and expectations get along—and succeed—in the workplace.

The Changing Face of the Workforce

Human beings differ from each other in many ways. Each person is unique, as is each employee within an organization. Individuals are also similar in many ways, some of which are more readily visible than others. The term **diversity** refers to variation in the important human characteristics that distinguish people from one another. The *primary* dimensions of diversity are age, ethnicity, gender, mental or physical abilities, race, and sexual orientation. The *secondary* dimensions of diversity are many; they include such characteristics as communication style, ways of thinking and interacting, family status, and first language. Individuals' distinguishing characteristics clearly impact their values, opportunities, and perceptions of themselves and others at work. **Workforce diversity**—diversity among employees—thus represents both a challenge and an opportunity for businesses.

[1] "Reviews: Great Place to Work, Ultimate Software," at *http://reviews.greatplacetowork.com/ultimate-software*.

Today, the U.S. workforce is as diverse as it has ever been, and it is becoming even more so. Consider the following major trends:[2]

- *Immigration has profoundly reshaped the workplace.* In 2015, the U.S. immigrant population reached 45 million, representing about 14 percent of the U.S. population. The Pew Research Center projects that by 2065, the immigrant population will reach 78 million, or about 18 percent of the U.S. population. In 2017, 27 million immigrants were working in the United States, comprising almost 17 percent of the workforce. The top five countries of origin were Mexico, China (including Hong Kong and Taiwan), India, the Philippines, and El Salvador. It is estimated that 11 million or one out of every four U.S. immigrants are **undocumented immigrant workers** (noncitizens working without the legally required documents). Some children of undocumented immigrants were brought to the United States as infants or very young children and do not know life in any other country. Many of these "Dreamers," as they are called, have grown up, attended college, and are working for Fortune 500 companies. The discussion case at the end of this chapter explores their status and its implications for their employers.
- *Ethnic and racial diversity is increasing.* In 2016, Hispanics (defined by the Census as persons of Spanish or Latin American ancestry) were about 17 percent of U.S. workers. Asians comprise 6 percent of workers, and African Americans 12 percent. By 2022, the U.S. workforce is projected to be about 39 percent nonwhite (this category includes persons of Hispanic origin).
- *The workforce will continue to get older.* As the baby boom generation matures, birth rates drop, and people live longer and healthier lives, the population will age. Many of these older people will continue to work, whether out of choice or necessity. By 2024 the U.S. Bureau of Labor Statistics projects that 36 percent of 65- to 69-year-olds will continue to work, up from 22 percent in 1994. This trend is not limited to the United States. Globally, almost 20 percent of workers are planning to work beyond age 70. Employers will have to find new ways to accommodate older workers.[3]
- *Millennials are entering the workforce.* Even as many baby boomers extend their working years, so-called *millennials*—young people born in the 1980s and 1990s and reaching adulthood around the turn of the century—have entered the workforce in large numbers, bringing fresh perspectives and practices. In 2015, millennials became the largest generation in the U.S. workforce, and more than a quarter say they are already in management positions. Research conducted by the Pew Research Center found that college-educated millennials had longer track records with their employers than Generation X did in 2000 when they were the same age.[4]

Workforce diversity creates many new employee issues and problems. This chapter will consider the changing face of today's workplace, and its implications for management. Laws

[2] Except as noted, the figures in the following paragraphs are drawn from "Foreign-Born Workers: Labor Force Characteristics—2016" *News Release, Bureau of Labor Statistics,* May 18, 2017; "Key Findings about U.S. Immigrants," *Pew Research Center,* May 3, 2017, at *www.pewresearch.org/fact-tank/2017/05/03/key-findings-about-u-s-immigrants*; and "Household Data, Annual Averages, Table 3: Employment Status of Civilians in Non-institutional Population by Age, Sex, and Race;" *Labor Force Statistics from the Current Population Survey,* Bureau of Labor Statistics, 2017; "The Population Clock" *U.S. Census Bureau,* 2017; "Projections of the Size and Composition of the U.S. Population: 2014–2060: Population Estimates and Projections" *U.S. Census Bureau,* March 2015.

[3] U.S. Bureau of Labor Statistics, *Monthly Labor Review,* "Labor Force Projections to 2022," December 2013. Towers Watson, "Workers Still Uneasy About Financial Security and Retirement," March 2014. "Working past 70: Americans Can't Seem to Retire" *Bloomberg,* July 10, 2017.

[4] "Millennials Aren't Job-Hopping Any Faster than Generation X Did," April 19, 2017, *Fact Tank, Pew Research Center.*

and regulations clearly require that businesses provide equal opportunity and avoid discrimination and harassment. How to meet—and exceed—these mandates presents an ongoing challenge to businesses seeking to reap the benefits of a well-integrated, yet culturally diverse work population. We turn first to two important dimensions of workforce diversity: gender and race.

Gender and Race in the Workplace

Gender and race are both important primary dimensions of workforce diversity. Women and persons of color have always worked, contributing both paid and unpaid labor to the economy. Yet, the nature of their participation in the labor force has changed, posing new challenges to business.

Women and Minorities at Work

One of the most significant changes in the past six decades has been the growing labor force participation of women. The **labor force participation rate** is the proportion of a group of people who are either actively employed or seeking work. The proportion of women working outside the home rose dramatically between 1950 until the late 2000s and has remained between 46 and 47 percent since then. Analysts suggest that the lack of family-friendly policies continue to constitute barriers to women's labor force participation, as women report caring for a family member as an important reason for not participating in the workforce. (These policies will be discussed later in this chapter.) Men's participation rates declined during this period; between 1950 and 2016, the proportion of adult men who worked fell from 70 percent to about 53 percent. Figure 16.1 shows the convergence of the proportion men and women in the labor force over the past six decades.

Why are the rates for men and women converging? Illness, disability, and incarceration have negatively impacted men more than women. Incarceration makes it less likely that someone will be employed even after they have served their time. The increase in women's labor force participation has been attributed to higher levels of educational attainment, delayed child bearing and a decreasing tendency of women staying home to raise children.[5]

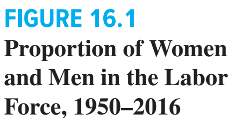
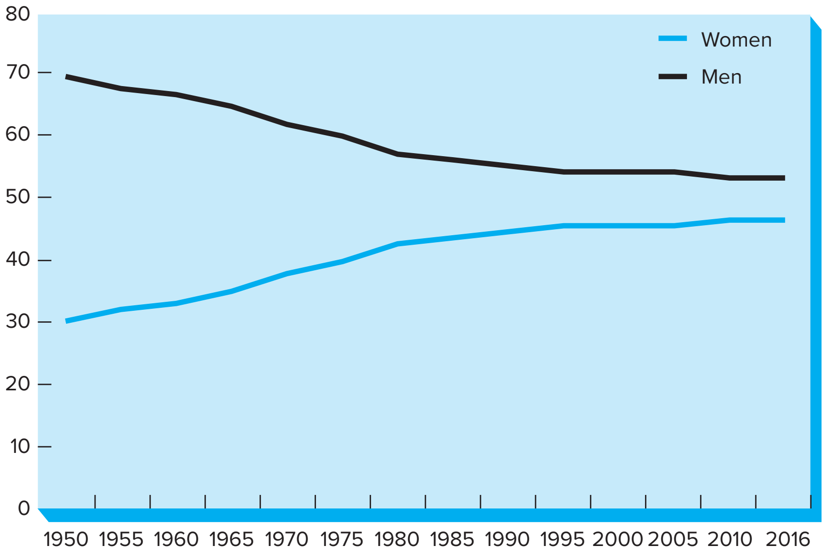


FIGURE 16.1
Proportion of Women and Men in the Labor Force, 1950–2016

Source: U.S. Bureau of Labor Statistics, Current Population Survey, *Civilian Labor Force by Sex, 1948–2016, Annual Averages.*



[5] "Factors Affecting the Labor Force Participation of People 25–54," *Congressional Budget Office,* February 2018.

Labor force participation rates for minorities, unlike those of women, have always been high. In 1970 about 62 percent of all African Americans (men and women combined) participated in the labor force; and currently is just under 60 percent. Participation rates have also been consistently high for most other minority groups; for Asians, it is 63 percent; for Hispanics, 66 percent. While high proportions of these minority groups participate in the labor force, they also experience higher levels of unemployment. (Unemployment rates identify the proportion of individuals who report that they are not employed but are seeking work.) In 2016, national unemployment rate in the United States was 5.8 percent for Hispanics and 8.4 percent for African Americans—both well over the national average of 4.9 percent. Asians experienced the lowest level of unemployment rates at 3.9 percent. While these statistics indicate a move of persons of color into a wider range of jobs and better representation in the ranks of managers, professionals, and the skilled trades, disproportionate rates of unemployment suggest that discrimination and bias remain.[6]

The face of success in the United States is just as diverse as the workforce. Consider Geisha Williams, CEO and president of Pacific Gas & Electric (PG&E), the first Latina CEO of a Fortune 500 Company. Williams emigrated to the United States with her family from Cuba when she was five years old and earned her degree in engineering from the University of Miami. She began her career at Florida Power & Light, where she was encouraged by an older female manager to pursue a series of managerial positions, and later moved to PG&E, the largest utility company in California. In 2016, PG&E's board of directors elected Williams to be CEO. Under her leadership, PG&E has invested in modernizing its electricity infrastructure and moved to become a leader in clean energy. "Geisha transformed us from old grid to grid of the future," said her predecessor as CEO, Tony Early.[7]

The Gender and Racial Pay Gap

One persistent feature of the working world is that women and persons of color on average receive lower pay than white men do. This disparity, called the **pay gap,** has narrowed but not closed over the past quarter century. Figure 16.2 shows the pay disparity among demographic groups in 2017. The bags in the figure show the average weekly earnings of various groups relative to those of white men, expressed as cents to the dollar.

Figure 16.2 does not include Asian Americans. Data show that the one group that tops white men in median weekly earnings is Asian American men; they make about $1.17 for every dollar that a white man earns, on average. (Asian American women make 87 cents for every dollar of what white men earn.) An important reason is education; about half of Asian American adults hold a bachelor's degree or above, far more schooling than any other ethnic or racial group.[8]

Experts disagree about the cause of the pay gap between women and men. Some believe the continuing gender disparity in pay is evidence of sex discrimination by employers; others believe the gap reflects women's choices to pursue lower-paying jobs or slower advancement because of time off for family responsibilities. Many observers agree, however, that the pay gap persists, in part, because of what is called **occupational segregation.** This term refers to the inequitable concentration of a group, such a minorities or women, in

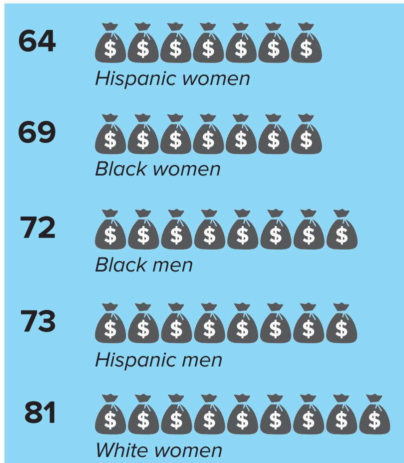
[6] "Labor Force Characteristics by Race and Ethnicity," Bureau of Labor Statistics Reports 1070, October 2017.

[7] "PG&E's Bolt of Energy," *Fortune,* June 15, 2017; "Williams Elected CEO and President of PG&E Corporation as Part of Leadership Succession Plan," PG&E press release, November 14, 2016.

[8] Pew Research Center, "Racial, Gender Wage Gaps Persist in U.S. Despite Some Progress," July 1, 2016.

FIGURE 16.2
The Gender and Race Pay Gap, 2017 (median weekly earnings of full-time workers, as a percentage of those of white men)

Source: U.S. Bureau of Labor Statistics: *Median Usual Weekly Earnings of Full-Time Wage and Salary Workers by Age, Race, Hispanic or Latino Ethnicity, and Sex, Fourth Quarter 2017 Averages, Not Seasonally Adjusted,* Table 3, January 17, 2018.



particular job categories. For example, the large pay gap for Hispanic workers partly reflects their concentration in several low-paid occupations. According to the U.S. Bureau of Labor Statistics, almost two-thirds of drywall installers, half of all agricultural workers and over a third of all grounds maintenance workers and housekeepers are of Hispanic origin—although they make up only 17 percent of the total workforce. Although women, for their part, have made great strides in entering occupations where they were formerly underrepresented, many remain concentrated in a few sex-typed jobs that some have called the "pink-collar ghetto." Women still make up over 90 percent of preschool and kindergarten teachers, hairdressers, and dental hygienists, for example. Eliminating the pay gap will require, therefore, business programs and government policies that create opportunity for women and people of color to move out of more segregated jobs into ones where the pay and chances for upward mobility are greater.[9]

Occupational segregation is common in other societies, as well. According to the European Commission, jobs among member countries of the European Union continue to be split along gender lines. The Commission found that in 2016 women working in the EU were concentrated in the personal care, teaching, and cleaning professions. Women made up 89 percent of workers in the personal care category, 84 percent of cleaners, 80 percent of office clerks, 78 percent of health technicians, and 71 percent of teachers. Men were concentrated in occupations related to construction, transportation, industry, and science. Men comprised 97 percent of builders in the EU, 96 percent of drivers and heavy machine operators, 96 percent of metal workers, and 74 percent science and engineering professionals.[10]

One area of the economy where racial and gender discrimination seems stubbornly persistent is high technology. The challenges faced by minorities and women in the world of high tech is profiled in Exhibit 16.A.

The most prestigious and highest-paying jobs in a corporation are in top management. Because most corporations are organized hierarchically, management jobs—particularly

[9] The data in this paragraph are drawn from two reports by the U.S. Bureau of Labor Statistics, *Labor Force Statistics from the Current Population Survey, Household Data Annual Averages Table 11: Employed persons by detailed occupation, sex, race, and Hispanic or Latino Ethnicity,"* January 2018.

[10] "Jobs Still Split along Gender Lines," March 8, 2018. Data are from the European Labour Force Survey at *http://ec.europa.eu/eurostat/en/web/products-eurostat-news/-/EDN-20180307-1.*

Exhibit 16.A The Dearth of Diversity in High-Tech Firms

Despite a few high-profile exceptions such as Marissa Meyer of Yahoo! and Sheryl Sandberg of Facebook, women and minorities are grossly underrepresented in the fast-moving world of high-tech. At Yahoo! 61 percent of employees were white, 31 percent Asian, 3 percent Hispanic, and 1 percent African American. Men made up 63 percent of all employees. At Facebook, 49 percent of employees were white and 40 percent Asian; only 5 percent were Hispanic and 3 percent African American. Men made up 65 percent of all employees. The story was similar at Google, where 56 percent of employees were white and 35 percent Asian; only 4 percent were Hispanic and 2 percent African American.

Many companies explained these figures by pointing to a lack of diversity in the pipeline of qualified women and minorities in technology-related fields. However, Silicon Valley's well-known "bro" culture may also have been a factor. In 2017, Google software engineer James Damore released an internal memo suggesting that women's underrepresentation was due to "'biological factors' such as women's supposedly greater interest in people and their predisposition to anxiety and stress at work" and that "they are less intrigued by 'things' than men are." Google CEO Sundar Pichai had to determine a response that was consistent both with Google's culture of self-expression and its credo to "Do No Evil." Pichai ultimately fired Damore, stating that parts of the memo violated the company's code of conduct and created a hostile work environment for women. This decision came on the heels of a Department of Labor investigation of Google for wage discrimination against female employees. However, when asked to comment on his decision, Pichai stated that "This isn't a question of legality or policy. This is a question of virtue signaling." The decision to fire Damore, he implied, was less a response to the legal investigation than a demonstration of commitment to the company's values as expressed in its code of conduct.

Sources: "You're Fired; Work Culture in Silicon Valley," *The Economist,* August 12, 2017; "Google's Silent Majority; Did the Tech Giant Just Fire One of Its Most Moderate Employees?" *The Wall Street Journal,* August 11, 2017; "Distribution of Facebook Employees Worldwide from 2014–2017, by Gender," *Statistica,* at *https://www.statista.com/statistics/311776/yahoo-employee-gender-global/* and "Distribution of Facebook Employees Worldwide from 2014 – 2017, by Ethnicity," *Statistica,* at *www.statista.com/statistics/311847/facebook-employee-ethnicity-us*, "Google is Making Slow Progress on Hiring People Who Aren't White Men," *Business Insider,* June 30, 2017, and "The Alarming Downsides to Tech Industry Diversity Reports," *Gizmodo,* at *https://gizmodo.com/the-alarming-downsides-to-tech-industry-diversity-report-1789797486*, December 16, 2016.

those at the top—are few. For that reason, only a small fraction of workers, of whatever gender or race, can hope to reach the upper levels in the business world. White men have traditionally filled most of these desirable spots. Business's mandate now is to broaden these high-level leadership opportunities for women and persons of color, a topic to which we turn next.

Where Women and Persons of Color Manage

Slightly more than 9 million U.S. women were working as managers by the mid-2010s. As Figure 16.3 reveals, in 2018 around half of all managers and professionals were women. Women are more likely to be managers, though, in occupational areas where women are more numerous at lower levels, such as health care and education.

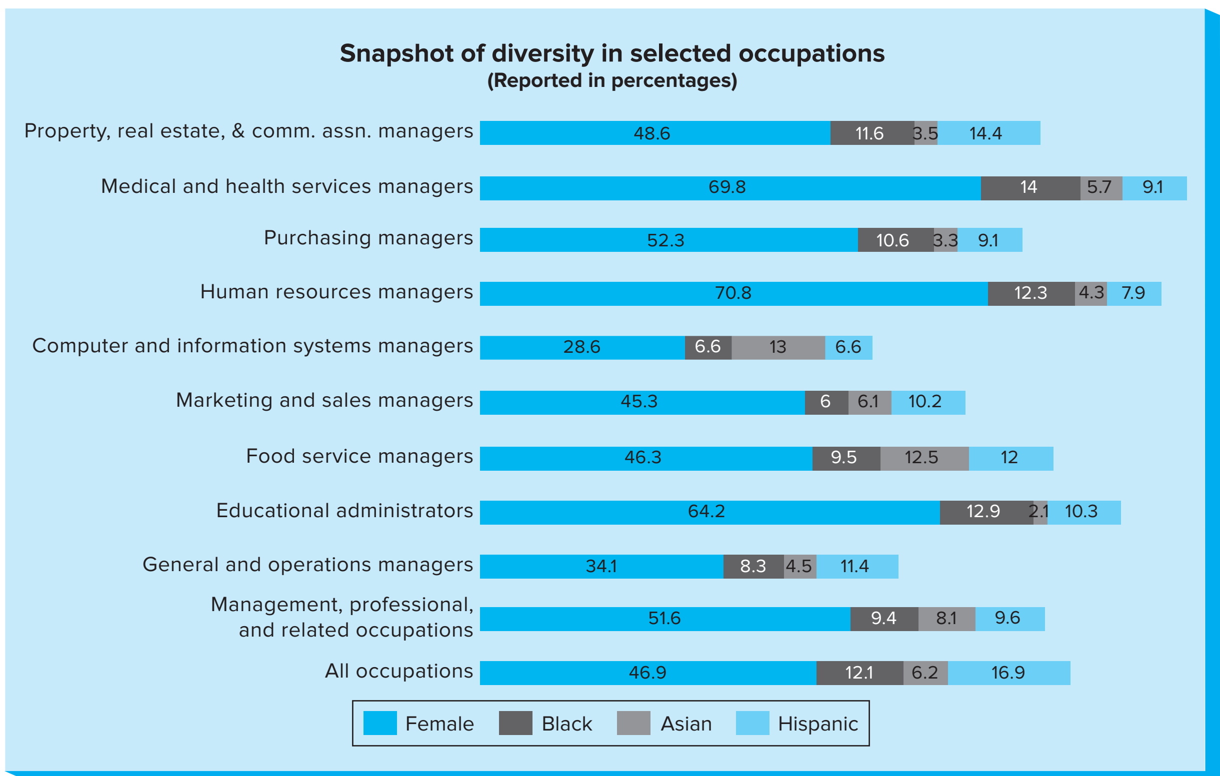
Where do persons of color manage? As Figure 16.3 shows, African Americans and Hispanics are underrepresented in management and professional ranks in the United States, although Asian Americans are overrepresented there. Blacks have made the most progress in educational administration and human resources; Hispanics in property and real estate management; and Asians in information systems.

Breaking the Glass Ceiling

A few exceptional women and persons of color—and some women of color—have reached the pinnacles of power in corporate America.

FIGURE 16.3 Snapshot of Diversity in Selected Occupations

Sources: U.S. Bureau of Labor Statistics, *Labor Force Statistics from the Current Population Survey Table 11: Employed Persons by Detailed Occupation, Sex, Race and Hispanic or Latino Ethnicity,* January 19, 2018.



In 2017, Rosalind Brewer became the first woman and African American to be named chief operating officer of Starbucks. Brewer's path to this role was serendipitous. Brewer was a senior level executive at Walmart, heading the Sam's Club division. After speaking on a panel with Starbucks CEO Howard Schultz at Walmart's Headquarters, Brewer was invited to visit the Starbucks' headquarters in Seattle. The company's leaders were impressed and asked her to serve on the board of directors. Awed by her "insightful questions, ability to connect with people and her operational prowess," Starbucks named Brewer as COO.[11]

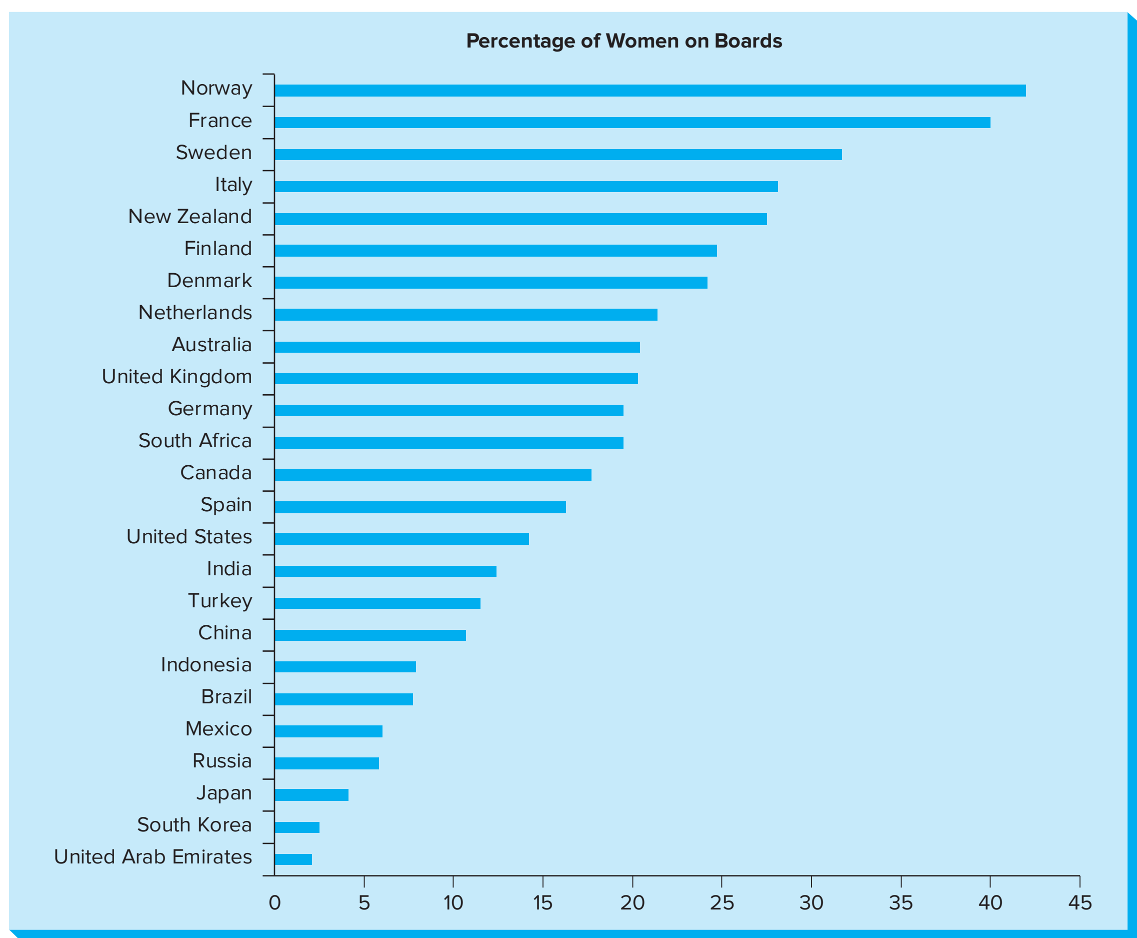
High achievers such as Rosalind Brewer and Geisha Williams remain unusual, however. Although women and minorities are as competent as white men in managing people and organizations, they rarely attain the highest positions in corporations. Their ascent seems to be blocked by an invisible barrier, sometimes called a **glass ceiling.** According to Catalyst, an advocacy organization for female executives, in 2017 women held 26 (about 5.2 percent) of CEO positions at *S&P 500* companies.[12] In 2015, people of color held 25 (5 percent) of CEO positions at *Fortune 500* companies. The latter group included Kenneth Chenault of American Express, George Paz of Express Scripts, and Ajaypal Banga of

[11] "How Rosalind Brewer, Starbucks' First Woman COO, Got the Job" *Fortune Magazine* September 7, 2017.

[12] "Women CEOs of the S&P 500," March 13, 2018, at *www.catalyst.org/knowledge/women-ceos-sp-500*.

FIGURE 16.4 Women as a Percentage of Members of Boards of Directors, Selected Countries, 2016.

Source: *Women in the Boardroom: A Global Perspective* 5th edition, Global Center for Corporate Governance, Deloitte, 2017. Data are as of December 2016.



MasterCard. In 2017, Chenault retired from his post at American Express. Industry observers have expressed concern that as CEOs from underrepresented groups retire, they are being replaced by white men, essentially reversing progress that had been made.[13] (The *S&P 500* and *Fortune 500* are both lists of large companies and have considerable overlap, but the latter includes private as well as public companies.) In Europe, diversity in top executive ranks is also rare.

Another key measure of diversity is the representation of women on corporate boards. Worldwide, women held 15 percent of directorships in 2016.[14] This number, however, obscures significant variations among nations, as shown in Figure 16.4.

What explains the sharp differences in board diversity shown in Figure 16.4? A key factor is that several nations in Europe have passed laws that set quotas for women's representation on boards of directors. Most recently, in 2015 Germany required companies to

[13] "Why Top 50 Companies Beat *Fortune 500* in Diversity Recruiting, Promotions," *DiversityINC,* posted April 23, 2015; and "There are Currently 4 Black CEOs in the Fortune 500," *The Atlantic,* October 26, 2017.

[14] "Women in the Boardroom: A Global Perspective" 5th edition, Global Center for Corporate Governance, Deloitte, 2017.

give 30 percent of board seats to women, joining Norway, Spain, France, Iceland (with 40 percent quotas), Italy (33 percent), and Belgium (30 percent). "The proof is in the pudding: regulatory pressure works," said the European Union's justice commissioner, a leader in the campaign for gender parity.[15] In the United States and the United Kingdom, where similar legislation was unlikely, some institutional investors had started pressuring companies to appoint more women and minorities to directorships.[16]

Does greater diversity on boards make a difference? The evidence is mixed. A 2017 survey of board members found that 73 percent of them thought that diversity was beneficial.[17] A study by MSCI, an investment research firm, found that companies with a higher proportion of women on their boards were less likely to be involved in corruption and earned higher scores for management of carbon emissions, toxic releases, water, labor, and health and safety issues than other firms.[18] Likewise, a study of Australian firms found that board diversity was positively associated with financial performance.[19] But another recent review of academic studies concluded that greater gender diversity on boards did not make much difference, one way or the other. This might have been, the authors concluded, because women directors were quite similar to men serving on boards in all respects other than gender.[20]

Why would adding women to boards improve performance? Gender-diverse boards may be more likely to avoid a rush to consensus and realistically consider alternative courses of action. Women bring different life experiences to the table and are more likely to raise multiple stakeholder concerns.[21] Judith Samuelson, executive director of the Business and Society program at the Aspen Institute, has argued that women simply lead differently, demonstrating traits such as empathy, collaboration, and skill at conflict resolution.[22]

What continues to hold women and minorities back—in the executive suite and on boards of directors? Female and minority managers are often found in staff positions, such as public relations or marketing, rather than in line positions in such core areas as finance, operations, and the law, where they can acquire the broad management skills that are more likely to lead to the executive suite.[23] Another problem is that in filling top positions, recruiters rely on word-of-mouth—the old boys' network from which women and persons of color are often excluded. Sometimes women voluntarily choose to step off the career track to care for children or elderly relatives. Other causes include a company's lack of commitment to diversity and too little accountability at the top management level for equal employment opportunity. However, recent advances by both women and minorities in the executive suite suggest that the glass ceiling may finally be cracking.

Women and Minority Business Ownership

Some women and minorities have evaded the glass ceiling and risen to the top by founding or taking over their own businesses. By the mid-2010s, of the 28 million small businesses

[15] "Germany Sets Gender Quota in Boardrooms," *The New York Times,* March 6, 2015; "Push for Gender Balance on Boards Gains Steam," *The New York Times,* January 24, 2013.

[16] "Women Still Hold Only 19 Percent of U.S. Board Seats. What Could Change That?" *The Washington Post,* January 13, 2015.

[17] "16% of Board Members Say Racial and Gender Diversity Has No Benefit at All," *Fortune,* October 17, 2017.

[18] MSCI, "Governance Issue Report: 2014 Survey of Women on Boards," November 2014.

[19] "Board Diversity and Financial Performance in the Top 500 Australian Firms," *Australian Accounting Review,* 25(4), 413–427.

[20] "Does Gender Diversity on Boards Really Boost Company Performance?" May 18, 2017, at *http://knowledge.wharton.upenn.edu*.

[21] The Conference Board, "Diversity on Corporate Boards: How Much Difference Does Difference Make?" February 2015.

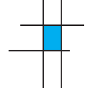
[22] Judith Samuelson, "Do Women Lead Differently? Yes, Thank Goodness," November 8, 2015, at *www.linkedin.com*.

[23] "What's Holding Women Back?" *Harvard Business Review,* June 1, 2003. The reports of the Glass Ceiling Commission of the U.S. Department of Labor may be accessed at *www.dol.gov/oasam/programs/history/reich/reports/ceiling.pdf*.

in the United States, 36 percent were owned by women, and 15 percent were owned by minorities, according to the Small Business Administration.[24]

> Hamdi Ulukaya came to the United States from Turkey 23 years ago on a student visa. In Turkey, his family raised goats and sheep, making cheese and yogurt to sell in their village. After college, Ulukaya worked on a dairy farm and started a feta cheese business. One day, Ulukaya spotted an advertisement for the sale of a fully equipped yogurt plant in upstate New York, then owned by Kraft Foods. Working with a regional bank and the Small Business Administration, Ulukaya was able to buy the facility, saving 200 factory jobs. Today, Chobani Yogurt is the best-selling brand in America. The plant now employs 1,000 employees paying above average wages, and Chobani brings $2 billion annually into the regional economy. In gratitude for his success, Ulukaya gave 10 percent equity in the company to his employees, stating "It's not a gift. . . . It's the right thing to do. It is something that belongs to them that I recognize."[25]

In 2015, there were almost one million minority-owned businesses in the United States, according to the U.S. Census Bureau. More than 50 percent of these firms were owned by Asians. Hispanics owned about 32 percent, and African Americans about 11 percent.[26] Immigrants were responsible for a good share of the entrepreneurial spirit in the minority community. In 2015, immigrants were reported as twice as likely as native born U.S. citizens to start a new business. In 2016, 40 percent of firms in the *Fortune 500* had at least one founder who was either an immigrant or the child of immigrants.[27]



Government's Role in Securing Equal Employment Opportunity

Eliminating workplace discrimination and ensuring equal job opportunity has been a major goal of public policy in the United States for four decades. This section reviews the major laws that govern business practices with respect to equal opportunity, affirmative action, and sexual and racial harassment.

Equal Employment Opportunity

Beginning on a major scale in the 1960s, U.S. presidents issued executive orders and Congress enacted laws intended to promote equal treatment of employees—that is, **equal employment opportunity.** These government rules apply to most businesses in the following ways:

- Discrimination based on race, color, religion, sex, national origin, physical or mental disability, or age is prohibited in all employment practices. This includes hiring, promotion, job classification and assignment, compensation, and other conditions of work. (Discrimination based on sexual orientation and gender identity is not prohibited by federal law, although it is prohibited by some state laws.)
- Government contractors must have written affirmative action plans detailing how they are working positively to overcome past and present effects of discrimination in their workforce. However, affirmative action plans must be temporary and flexible,

[24] U.S. Small Business Administration, "Frequently Asked Questions About Small Businesses," March 2014.

[25] "Chobani's Billionaire Founder on Creating Jobs in America," from "Chief of Chobani," 60 Minutes, CBS News, aired April 9, 2017.

[26] U.S. Census Bureau, "Number of Minority-Owned Employer Firms Increased in 2015," July 13, 2017; and U.S. Census Bureau, "Statistics for U.S. Employer Firms by Sector, Gender, Ethnicity, Race, and Veteran Status for U.S. States and Top 50 MSA: 2015: Company Summary 2015."

[27] New American Economy, "Reason for Reform: Entrepreneurship," October 2016.

designed to correct past discrimination, and cannot result in reverse discrimination against whites or men.

- Women and men must receive equal pay for performing equal work, and employers may not discriminate based on pregnancy.

Figure 16.5 outlines the major laws and one executive order that are intended to promote equal opportunity in the workplace. The major agency charged with enforcing equal employment opportunity laws and executive orders in the United States is the **Equal Employment Opportunity Commission (EEOC).** The EEOC was created in 1964 and given added enforcement powers in 1972 and 1990.

The following section describes three specific areas of government regulation: affirmative action, sexual harassment, and racial harassment.

Affirmative Action

One way to promote equal opportunity and remedy past discrimination is through **affirmative action.** Since the mid-1960s, major government contractors have been required by presidential executive order to adopt written affirmative action plans specifying goals, actions, and timetables for promoting greater on-the-job equality. Their purpose is to reduce job discrimination by encouraging companies to take positive (that is, affirmative) steps to overcome past employment practices and traditions that may have been discriminatory.

Affirmative action has long been controversial. Some states have passed laws banning or limiting affirmative action programs in public hiring and university admissions, and the issue has been debated in Congress and in the courts. Backers of affirmative action argued that these programs provided an important tool for achieving equal opportunity. In this view, women and minorities continued to face discriminatory barriers, and affirmative action was necessary to level the playing field. Some large corporations backed affirmative action programs, finding them helpful in monitoring their progress in providing equal job opportunity. General Electric, AT&T, and IBM, for example, have said that they would continue to use affirmative action goals and timetables even if they were not required by law.

FIGURE 16.5
Major Federal Laws and Executive Orders Prohibiting Job Discrimination

Equal Pay Act (1963)—Mandates equal pay for substantially equal work by men and women.

Civil Rights Act (1964; amended 1972, 1991, 2009)—Prohibits discrimination in employment based on race, color, religion, sex, or national origin.

Executive Order 11246 (1965)—Mandates affirmative action for all federal contractors and subcontractors.

Age Discrimination in Employment Act (1967)—Protects individuals who are 40 years of age or older.

Equal Employment Opportunity Act (1972)—Increases power of the Equal Employment Opportunity Commission to combat discrimination.

Pregnancy Discrimination Act (1978)—Forbids employers to discharge, fail to hire, or otherwise discriminate against pregnant women.

Americans with Disabilities Act (1990)—Prohibits discrimination against individuals with disabilities.

Family and Medical Leave Act (1993)—Requires companies with 50 or more employees to provide up to 12 weeks unpaid leave for illness, care of a sick family member, or the birth or adoption of a child.

Genetic Information Nondiscrimination Act (2008)—prohibits the use of genetic information in employment decisions.

Lilly Ledbetter Fair Pay Act (2009)—Eliminates certain time restrictions for filling pay discrimination lawsuits.

Critics, however, argued that affirmative action was inconsistent with the principles of fairness and equality. In some cases, one group could be unintentionally discriminated against in an effort to help another group. For example, if a more qualified white man were passed over for a job as a police officer in favor of a less qualified African American man to remedy past discrimination in a police department, this might be unfair to the white candidate.

In 2017, the Eleventh Circuit of the U.S. Court of Appeals heard a case brought by Frank Voudy, a white deputy in the Broward County Sheriff's Office in Florida. Voudy claimed that two African American deputies who had scored lower than him on the promotional exam were unjustly promoted over him. In the initial case heard in a lower court, Voudy lost. However, the Court of Appeals decided that "Without any evidence indicating how the identified criteria were weighed or considered in Voudy's case, we can do no more than speculate as to why the other two officers were promoted while Mr. Voudy was not." The higher court ordered the lower court to re-open the case for trial.[28]

Critics of affirmative action also argued that these programs could actually stigmatize or demoralize the very groups they were designed to help. For example, if a company hired a woman for a top management post, other people might think she got the job just because of affirmative action preferences, even if she were truly the best qualified. This might undermine her effectiveness on the job or even cause her to question her own abilities. For this reason, some women and persons of color called for *less* emphasis on affirmative action, preferring to achieve personal success without preferential treatment.[29]

Sexual and Racial Harassment

Government regulations ban both sexual and racial harassment. Of the two kinds, sexual harassment cases are more prevalent, and the law covering them is better defined. But racial harassment cases are a growing concern to employers.

Sexual harassment at work occurs when any employee, woman or man, experiences repeated, unwanted sexual attention or when on-the-job conditions are hostile or threatening in a sexual way. It includes both physical conduct—for example, suggestive touching—as well as verbal harassment, such as sexual innuendoes, jokes, or propositions. Sexual harassment is not limited to overt acts of individual coworkers or supervisors; it can also occur if a company's work climate is blatantly and offensively sexual or intimidating to employees. Women are the targets of most sexual harassment.

In October 2017, *The New York Times* published a story about workplace sexual harassment that would send shock waves through many workplaces and ignite the *MeToo* and *Time's Up* movements. Interviewing actresses and film industry workers, *New York Times* reporters Jodi Kantor and Megan Twohey chronicled about 30 years of unwanted sexual advances, innuendo, and nonconsensual sexual encounters at the hands of the powerful Hollywood mogul Harvey Weinstein. These disclosures empowered other victims of workplace sexual harassment to come forward, accusing dozens of influential men in multiple industries—in some cases, leading

[28] "Frank Voudy v. Sheriff of Broward County, Florida," *United States Court of Appeals, Eleventh Circuit: http://caselaw.findlaw.com/us-11th-circuit/1867787.html*, and "Deputy Sheriff's Reverse Discrimination Case Reinstated," *Business Insurance,* July 14, 2017.

[29] See, for example, Ward Connerly, *Creating Equal: My Fight Against Race Preferences* (San Francisco: Encounter Books, 2000).

to these men's removal from their positions of influence. Put on notice, employers have increased efforts to improve protocols for reporting, investigating, and addressing allegations of sexual harassment.[30]

Sexual harassment is illegal, and the U.S. Equal Employment Opportunity Commission (EEOC) is empowered to sue on behalf of victims.

Women employees regularly report that sexual harassment is common. From 40 to 70 percent of working women (and from 10 to 20 percent of working men) have told researchers they have been sexually harassed on the job. In almost two-thirds of the cases, the individual who was the target did not report the incident.[31] This kind of conduct is most likely to occur where jobs and occupations are (or have been) sex-segregated and where most supervisors and managers are men. It is also common where women workers have low power relative to their supervisors. One study found, for example, that female farmworkers were commonly sexually harassed and assaulted. About 60 percent were illegal immigrants, the study found, and many were afraid of deportation if they complained. "It's easiest for abusers to get away with sexual harassment where there's an imbalance of power, and the imbalance of power is particularly stark on farms," said the study's author.[32]

Although the European Union has recognized sexual harassment as a form of gender discrimination, these behaviors remain all too common. A 2014 study found that 45 to 55 percent of women in the 28 EU nations had experienced sexual harassment. It was most frequent in Denmark, Sweden, the Netherlands, France, and Belgium (where 30 percent or more of survey respondents reported being harassed in the past year). Young women were more likely to be harassed than older women; they also were more likely to experience online victimization, such as unwanted sexually explicit e-mails or text messages. "This is no minor issue. We're talking about mothers, sisters, daughters across the EU," said the director of the European Agency for Fundamental Rights, which had conducted the survey.[33]

Harassment can occur whether the targeted employee cooperates or not. It need not result in the victim's firing or cause severe psychological distress; the presence of a hostile or abusive workplace can itself be the basis for a successful suit. Moreover, a company can be found guilty as a result of actions by a supervisor, even if the incident is never reported to top management.

Racial harassment is also illegal, under Title VII of the Civil Rights Act. Under EEOC guidelines, ethnic slurs, derogatory comments, or other verbal or physical harassment based on race are against the law, if they create an intimidating, hostile, or offensive working environment or interfere with an individual's work performance. Although fewer racial than sexual harassment charges are filed, their numbers have more than doubled since the early 1990s, and employers have been liable for expensive settlements.

For example, in 2017 the EEOC sued Aaron's Inc., a nationwide rent-to-own chain, for racial harassment at one of their warehouses in Jamaica, New York. Supervisors had regularly used racial slurs, using the "n" word and referring to African American employees as "monkeys." African American employees had also been assigned more difficult and unpleasant tasks than other workers. "The law is clear," stated EEOC New York District Director Kevin Berry, "Employers have a responsibility

[30] "Harvey Weinstein Paid Off Sexual Harassment Accusers for Decades," *The New York Times,* October 5, 2017, and "After Weinstein: 71 Men Accused of Sexual Misconduct and Their Fall from Power," *The New York Times,* February 8, 2018.

[31] "Sexual Harassment Statistics in the Workplace," *www.sexualharassmenlawfirms.com*.

[32] "Report: Sexual Abuse of Female Farmworkers Common," *The Washington Post,* May 16, 2012.

[33] European Agency for Fundamental Rights, "Violence Against Women: An EU-Wide Survey," 2014.

to ensure that their workplaces are free from racial harassment and cannot ignore racist behavior by their managers."[34]

What can companies do to combat sexual and racial harassment—and protect themselves from expensive lawsuits? The Supreme Court has ruled that companies can deflect lawsuits by taking two steps. First, they should develop a zero-tolerance policy on harassment and communicate it clearly to employees. Then they should establish a complaint procedure—including ways to report incidents without retaliation—and act quickly to resolve any problems. Companies that take such steps, the court said, would be protected from suits by employees who claim harassment but have failed to use the complaint procedure.

Developing mechanisms for preventing sexual and racial harassment is just one important action companies can take. Others positive steps by business are discussed in the following section.

What Business Can Do: Diversity and Inclusion Policies and Practices

All businesses, of course, are required to obey the laws mandating equal employment opportunity and prohibiting sexual and racial harassment; those that fail to do so risk expensive lawsuits and public disapproval. But it is not enough simply to follow the law. The best-managed companies go beyond compliance; they not only assemble diverse teams but implement a range of policies and practices to include all employees in a workplace that is welcoming, fair, and accommodating. A recent study by Deloitte Consulting explained that "promoting diversity is an expected commitment; it's now a ticket to play." The next essential step, the study concluded, was to "create a work environment that promotes inclusion in all its variations." In this context, **inclusion** means policies and practices that tap into the diverse perspectives, life experiences, and approaches that every individual brings to the workplace. As Deloitte put it, "diversity is the measure; inclusion is the mechanism."[35]

Companies that manage diversity and promote inclusion effectively take several related actions, in addition to obeying all relevant laws. Research shows that these actions include the following.

Articulate clear diversity goals set, quantitative objectives, and hold managers accountable. An important trend in diversity management is metrics—setting specific goals and offering incentives for meeting them.

An example of a company that has done this is the German carmaker BMW. Historically, BMW has had difficulty attracting and retaining female executives, even though women make up a large share of its customers. Believing that "what gets measured is what gets done," the company set numerical goals for the proportion of women at all levels—including doubling the number of women managers by 2020. To assure that the job got done, BMW included specific targets in the annual performance reviews of its top executives. Their success in meeting them would impact their annual bonuses. These targets were cascaded down to lower management levels as well. "You need to hold people accountable," declared the company's human resource and industrial relations director.[36]

[34] "EEOC Sues Aaron's For Race Harassment," *Press Release: U.S. Equal Employment Opportunity Commission,"* December 13, 2017, and "Labor Law: Racial Harassment in the Workplace Still Occurring, But Employers Cannot Tolerate It," *Richmond Times-Dispatch,* February 26, 2018. Information on the latest government policies on racial and sexual harassment may be found at the EEOC website at *www1.eeoc.gov//eeoc/statistics/enforcement/race_harassment*.

[35] Deloitte Consulting LLP, *Global Human Capital Trends 2014: Engaging the 21st Century Workforce.*

[36] "Hard-Wiring Diversity into Your Business," *Boston Consulting Group Perspectives,* June 8, 2011, at *www.bcgperspectives.com*.

Spread a wide net in recruitment, to find the most diverse possible pool of qualified candidates. Those in charge of both hiring and promotion need to seek all workers who may be qualified—both inside and outside the company. This often involves moving beyond word-of-mouth networks, which may produce a pool of applicants who are similar to people already working for the company or in particular jobs. One company's efforts to promote diversity in its hiring using a range of techniques that are described in the following example.

> The accounting firm KPMG works hard to build a diverse workforce. The firm actively recruits at historically black colleges and universities and is a member of INROADS, a program that places minorities in internships with the company. It sponsors the PhD Project, which supports persons of color in doctoral programs that lead to faculty positions in colleges of business—where they can serve as role models for many students. KPMG has embraced the use of technology to cast a wider net in hiring, holding "virtual" recruiting fairs where registrants from around the world can interact with company recruiters online. Its seven national diversity networks engage nearly 40 percent of its employees globally. "All of our people are able to bring their whole self to work," said the company website.[37]

Incorporate selection techniques that diminish the opportunity for bias. Sometimes initial preemployment screening techniques inadvertently eliminate talent from diverse labor pools. When companies focus on a perceived prototype of an ideal candidate instead of on the knowledge, skills, abilities, and other characteristics actually required, qualified candidates from underrepresented groups can inadvertently be overlooked.

> Kedar Iyer, co-founder and CEO of GapJumper, had a hard time getting companies to consider his application for computer science jobs seriously. While Iyer had experience, he did not have a degree, and it took him a long time to convince a company to hire him for a job related to computer science. This experience motivated Iyer to start GapJumper, a company that attempts to lessen bias by eliminating consideration of demographic factors in client companies' hiring processes. Applicants are given a job-related assignment, and then hiring managers assess the completed task without any information that could identify their race, gender, ethnicity, national origin, work experience, or educational background. This technique has worked. GapJumper's clients have seen a 60 percent increase in applications from traditionally underrepresented groups make it beyond the initial screening process to secure an interview. Not only has this resulted in a more diverse workforce, GapJumper's clients have reduced the time it takes to fill positions by 40 percent.[38]

Identify promising women and persons of color and provide them with mentors and other kinds of support. What techniques work to shatter the glass ceiling? Some companies have promoted inclusion by assigning mentors—more senior counselors—to promising women and minority managers and providing them with opportunities for wide-ranging line experience. For example, Chevron Corporation, the energy company, has adopted a wide range of programs to foster inclusion, including employee networks that operate an extensive mentoring program. Adriana Sandoval, as information management supervisor, explained the importance of such mentorship in her career. She recalled that her father had asked her why she has chosen to work for an oil company. "You're a Latina; you're going to get lost," her father had told her. But her first day on the job, "a woman who was a Latina

[37] Information on KPMG's diversity initiatives is available at *https://home.kpmg.com/us/en/home/about/corporate-responsibility/diversity-and-inclusion*.

[38] "Five Leaders Who Are Disrupting Diversity," *HR Magazine,* January 16, 2017.

was there, and she was a representative of SOMOS, the Hispanic employees' network. . . . There's a lot of attention to making sure that folks have the opportunity to grow and learn within the company."[39]

Set up diversity councils to monitor the company's goals and progress toward them. A **diversity council** is a group of managers and employees responsible for developing and implementing specific action plans to meet an organization's diversity goals. Sometimes, a diversity council will be established for a corporation as a whole; sometimes, it will be established within particular business units. A related practice is the formation of special groups of employees to promote professional development for traditionally underrepresented groups.

> An example of a company that has used these practices effectively is Northrop Grumman, which in 2018 ranked #2 on DiversityInc's list of top 50 companies for diversity councils. The company has a diversity and inclusion leadership council, co-chaired by its chairman and CEO. It also operates 12 employee resource groups, including ones supporting African American, Asian Pacific Islander, Hispanic, Native American, women, veteran, and LGBT employees; 19,000 employees participate in them. "While their interests may vary," the company said of these groups, "their goal is one: to offer opportunities to each and every member of [the] Northrop Grumman team."[40]

Businesses that manage diversity and inclusion effectively enjoy a strategic advantage. While fundamental ethical principles, discussed in Chapters 5 and 6, dictate that all employees should be treated fairly and with respect for their basic human rights, there are also bottom-line benefits to doing so.

- Having a widely diverse workforce boosts innovation, many executives believe. Businesses with employees from varied backgrounds can often more effectively serve customers who are themselves diverse and can provide valuable insights into changing tastes and preferences. "Across EY, we recognize that our strength comes from our diversity. We also know that an inclusive culture that values our people's unique perspectives is critical to drive quality and innovation for our clients—and a better working world for all of us." asserted Steve Howe, U.S. Chairman and Americas Managing Partner for the accounting firm EY.[41]
- The global marketplace demands a workforce with language skills, cultural sensitivity, and awareness of national and other differences across markets. For example, Dr. Sally Saba, vice president for operations performance and compliance [and] diversity and inclusion for the Kaiser Foundation Health Plan, was born into a Muslim family in Egypt and later came to the United States, where she successfully ran a small business. Her own experiences as a minority business owner have given her deep insight into the challenges of promoting diversity and inclusion. "All of my life experiences contribute to the complexity of how I view the world and how I view people," Dr. Saba explained.[42]

[39] "The Chevron Way: Engineering Opportunities for Women," [video transcript], March 2015, at *www.chevron.com*; and "Chevron Corporation—The Chevron Way: Engineering Opportunities for Women, 2015 Catalyst Award Winner," at *www.catalyst.org*.

[40] "The 2018 DiversityInc Top 50 for Diversity," at *www.diversityinc.com*. The company's diversity initiatives are described at *www.northropgrumman.com/CorporateResponsibility/Diversity/Pages/DiversityPrograms*.

[41] "EY is #1 for Diversity and Inclusion, according to DiversityInc Top 50 Companies for Diversity," May 3, 2017, at www.ey.com/us/en/newsroom/news-releases/news-ey-is-1-for-diversity-and-inclusion-according-to-diversityinc-top-50-companies-for-diversity-list.

[42] "Diversity Management at Kaiser Permanente: This Female Muslim Entrepreneur Brings Sensitivity to Suppliers," May 25, 2012, at *http://diversity.inc.com*

Finally, companies with effective diversity programs can avoid costly lawsuits and damage to their corporate reputations from charges of discrimination or cultural insensitivity.

Another important step businesses can take to manage diversity effectively is to accommodate the wide range of family and other obligations employees have in their lives outside work. This subject is discussed in the next section.

Balancing Work and Life

The nature of families and family life has changed, both in the United States and in many other countries. The primary groups in which people live are just as diverse as the workforce itself. One of the most prominent of these changes is that dual-income families have become much more common. According to the latest U.S. government data, in 62 percent of married couples with children at home, both parents worked at least part-time. This was up from just a third of such families in 1976. (To round out the picture, in 30 percent of married couples with children, just the father worked; in about 5 percent, just the mother worked. In the remainder, both parents were unemployed.)[43] Families have adopted a wide range of strategies for combining full- and part-time work with the care of children, elderly relatives, and other dependents. How to help employees trying to balance the complex, multiple demands of work and family life has become a major challenge for business.

Child Care and Elder Care

One critical issue for business is supporting workers with responsibilities for children and elderly relatives.

The demand for **child care** is enormous. Millions of children need daily care, especially the more than half of preschool-aged children whose mothers hold jobs. A major source of workplace stress for working parents is concern about their children; and problems with child care are a leading reason why employees fail to show up for work.

Business has found that child care programs, in addition to reducing absenteeism and tardiness, also improve productivity and aid recruiting by improving the company's image and helping to retain talented employees. Most large U.S. companies (1,000 or more employees) provide some type of child care assistance, including dependent care accounts (76 percent) and referral services (61 percent). About one in five large companies subsidizes on-site or near-site child care services. Small businesses are increasingly recognizing the benefit of assisting employees in balancing family obligations with work.[44] An example is S.C. Johnson, a consumer products firm that cares for 500 children in a state-of-the-art center at its Racine, Wisconsin, headquarters. "This isn't a benefit," explained a company spokesperson. "It's a good business decision because we want to attract the best."[45]

In addition to caring for children, many of today's families have responsibilities for **elder care.** Elder caregivers assist with personal needs, household chores, and/or arrange for care outside the home. According to a study conducted by the American Association of Retired Persons (AARP) and the National Alliance for Caregiving, 43.5 million adults in the United States now care for an adult or child of this population, the overwhelming majority of caregivers (34.2 million) provide care for adults 50 years or older. More than half (56 percent) of family caregivers are currently employed. Twenty-two percent of these caregivers are

[43] U.S. Bureau of Labor Statistics, "Families with Own Children: Employment Status of Parents by Age of Youngest Child and Family Type." Data are for 2017.

[44] Families and Work Institute, Society for Human Resource Management & When Work Works, "2016 National Study of Employers," at *www.whenworkworks.org/be-effective/guides-tools/2016-national-study-of-employers*.

[45] Information about S.C. Johnson's child care center is available at *www.scjohnson.com*.

currently or have in the past cared for a person with Alzheimer's or other form of dementia. Caregivers are predominantly female. This is a concern for employers because caregivers often have to go to work late or leave early to attend to these duties or are distracted or stressed at work by their responsibilities.[46] Some have recognized the demand for family caregiving—of both children and elders—as a business opportunity, as the following example illustrates.

> Entrepreneur Sheila Lirio Marcelo, a Filipina American, founded Care.com to use an online platform to connect people looking for caregivers with others looking to provide these services. She got the idea for the company when her father, then 54, had a heart attack and fell down the stairs while carrying her infant son. (Fortunately, the boy was not hurt, but Marcelo realized she needed to hire a caregiver right away—for her son *and* her father.) The company now has 13 million users and is adding thousands more every day. A number of companies, including Facebook and LinkedIn, offer Care.com services as a benefit for their employees. "Caregiving is among the fastest growing job categories in the country, and there's a need there," said a scholar at the Pew Research Center. "It's the most important work families do."[47]

Many firms offer referral services, dependent care accounts, long-term care insurance, and time off to deal with the often-unpredictable crises that occur in families caring for children and elders.

When a mother or father is granted time off when children are born or adopted and during the important early months of a child's development, this is called a **parental leave;** when the care of elderly relatives is involved, this is called a **family leave.** Under the Family and Medical Leave Act (FMLA), companies that employ 50 or more people must grant unpaid, job-protected leaves of up to 12 weeks to employees faced with serious family needs, including the birth or adoption of a baby. Smaller companies, not covered by the FMLA, usually do less for expectant and new parents and for those with ill family members.

Work Flexibility

Companies have also accommodated the changing roles of women and men by offering workers more flexibility through such options as flextime, part-time employment, job sharing, and working from home (sometimes called telecommuting because the employee keeps in touch with coworkers, customers, and others by phone or online). An example of a company that has done so is Bank of America, the second largest bank in the United States. The bank has made the *Working Mother Magazine* list of 100 best companies for 29 consecutive years and has been inducted the into its Hall of Fame for its family-friendly best practices.

> Ten percent of employees at Bank of America care for both a child and an older adult. These employees can depend on 16 weeks of paid parental leave, $8,000 in adoption reimbursements per child, and $240 per month in child care subsidies. Employees caring for an older adult can count on 25 days of in-home assistance for $6 per hour, free elder-care consultations, and discounted legal advice on issues related to managing the affairs of aging relatives. The effectiveness of these programs can be seen in the successful retention and advancement of women. More than 50 percent of the company's global workforce, 40 percent of its global management team, and 30 percent of its independent directors are women. "From benefits that support creating a family to policies that help manage a family, all

[46] "Caregiving in the U.S. 2015," National Alliance for Caregiving & AARP Public Policy Institute, June 2015.

[47] "Who Profits? Care.com Finds Sitters for Baby or Dad," December 8, 2014, at *www.bloomberg.com*.

while supporting women as we strive for professional development and personal growth, working at Bank of America is truly extraordinary as a working mom," asserted Tracy Daniels, business executive for Global Banking and Markets Operations.[48]

Bank of America is not the only corporation using these practices. A 2016 study found that many companies offered some kinds of flexible work schedules, such as allowing some employees to change starting or quitting times periodically (81 percent), work from home at least occasionally (66 percent), or compress workweeks into fewer days (43 percent).[49] These arrangements can benefit employers by attracting and retaining valuable employees, reducing absences, and improving job satisfaction.

However, many observers believe that most careers are still structured for people who are prepared to put in 40 hours a week at the office—or 50 or 60—giving their full and undivided commitment to the organization. Many women and men have been reluctant to take advantage of various flexible work options, fearing that this would put them on a slower track, sometimes disparagingly called the *Mommy track* or *Daddy track*. In this view, businesses will need to undergo a cultural shift, to value the contributions of people who are prepared to make a serious, but less than full-time, commitment to their careers.

What would such a cultural shift look like? Some have used the term **family-friendly workplace** to describe firms that would fully support both men and women in their efforts to balance work and family responsibilities. Job advantages would not be granted or denied on the basis of gender. People would be hired, paid, evaluated, promoted, and extended benefits based on their qualifications and ability to do the tasks assigned. The route to the top, or to satisfaction in any occupational category, would be open to anyone with the talent to take it. The company's stakeholders, regardless of their gender, would be treated in a bias-free manner. All laws forbidding sex discrimination would be fully obeyed. Programs to provide leaves or financial support for child care, elder care, and other family responsibilities would support both men and women employees and help promote an equitable division of domestic work. And persons could seek, and achieve, career advancement without committing to a full-time schedule, year after year.[50] An example of a family-friendly corporation is American Express, long admired for its support of working parents having made the *Working Mother Magazine* top 100 list of best companies for 26 consecutive years. Forty-eight percent of managers and executives are women, and almost half of the company's employees telecommute. The company invests resources in training managers on how to effectively manage employee work-life flexibility concerns.[51]

An important step business can take is to support lesbian, gay, bisexual, and transgender employees. This issue is further explored in Exhibit 16.B.

No other area of business illustrates the basic theme of this book better than the close connection between work and life. Our basic theme is that business and society are closely and unavoidably intertwined, so that what affects one also has an impact on the other. As the workforce has become more diverse, business has been challenged to accommodate their employees' differences and to include their multiple perspectives. When people go to

[48] "Best Companies: Bank of America" *Working Mother Magazine,* March 5, 2018; and "Bank of America Makes Top 10 in Working Mother's 100 Best Companies of 2017," December 5, 2017.

[49] Families and Work Institute, Society for Human Resource Management & When Work Works, "2016 National Study of Employers," at *www.whenworkworks.org/be-effective/guides-tools/2016-national-study-of-employers*.

[50] *Working Mother* magazine publishes an annual list of the "100 Best Companies for Working Mothers." The current year's list may be viewed at *www.workingmother.com*.

[51] "2017 Working Mother 100 Best Companies, American Express," *Working Mother Magazine*.

Exhibit 16.B Corporate Policies on LGBT Equality

For many years civil rights for citizens in the LGBT community lagged protections extended to other groups. At work, many LGBT employees were denied access to benefits enjoyed by heterosexual employees and their families. Significant progress has been made for LGBT workplace rights since the 2015 Supreme Court ruling legalizing gay marriage, however. A 2018 report by the Human Rights Campaign Foundation found that 83 percent of the *Fortune 500* companies included sexual orientation in their nondiscrimination policy, and 97 percent offered explicit prohibitions against gender identity discrimination. Transgender employees are more likely to have access to health care services: fifty-eight percent of *Fortune 500* firms now provide transgender-inclusive health care, up from no firms providing this benefit in 2002. Capital One was among the 609 companies that met all the criteria in the HRC's Corporate Equality Index in 2018. Like many companies, Capital One perceives sexual orientation as another aspect of diversity that is central to its success: "Diversity and inclusion is central to our business strategy and success as a company. Inclusion drives innovation and our success is driven by the power of perspectives at the table. . . . Our inclusive culture represented by seven associate networks (African American, Asian, CapAbilities, Hispanic, LGBT, Military, and Women's) fosters a collaborative environment where all associates know their voice is heard and matters."

Sources: Human Rights Campaign Foundation, *Corporate Equality Index 2018: Rating American Workplaces on Lesbian, Gay, Bisexual, Transgender, and Queer Equality* at *www.hrc.org*; and "Fortune 100 Best Companies to Work For 2018: Capital One," at: http://reviews.greatplacetowork.com/capital-one-financial-corporation.

work, they do not shed their identities at the office or factory door. When employees come from families where there are young children at home, or where elderly parents require care, companies must learn to support these roles. Businesses that help their employees achieve a balance between work and life and meet their obligations to their families and communities often reap rewards in greater productivity, loyalty, and commitment.

Summary

- The U.S. workforce is as diverse as it has ever been and is becoming more so. More women are working than ever before, many immigrants have entered the labor force, ethnic and racial diversity is increasing, the workforce is aging, and millennials are entering the workplace.
- Women and persons of color have made great strides in entering all occupations, but they continue to be underrepresented in many business management roles, especially at top levels. Both groups face a continuing pay gap. The number of women-owned businesses has increased sharply, and many minorities, especially immigrants, also own their own businesses.
- Under U.S. law, businesses are required to provide equal opportunity to all, without regard to race, color, religion, sex, national origin, disability, or age. Sexual and racial harassment are illegal. Affirmative action plans remain legal, but only if they are temporary and flexible, designed to correct past discrimination, and do not result in reverse discrimination.
- Companies that manage diversity effectively have a strategic advantage because they foster innovation, serve a diverse customer base, and avoid expensive lawsuits and public embarrassment.
- Successful diversity and inclusion management includes articulating goals and measuring progress, recruiting widely, mentoring promising women and persons of color, and establishing mechanisms for assessing progress.
- Many businesses have helped employees balance the complex demands of work and family obligations by providing support programs such as child and elder care, flexible work schedules, domestic partner benefits, and telecommuting options.

Key Terms

affirmative action, *361*
child care, *367*
diversity, *351*
diversity council, *366*
elder care, *367*
equal employment opportunity, *360*
Equal Employment Opportunity Commission (EEOC), *361*
family-friendly workplace, *369*
family leave, *368*
glass ceiling, *357*
inclusion, *364*
labor force participation rate, *353*
occupational segregation, *354*
parental leave, *368*
pay gap, *354*
racial harassment, *363*
sexual harassment, *362*
undocumented immigrant worker, *352*
workforce diversity, *351*

Internet Resources

www.eeoc.gov	U.S. Equal Employment Opportunity Commission
www.familiesandwork.org	Families and Work Institute
www.abcdependentcare.com	American Business Collaboration for Quality Dependent Care
www.sba.gov	U.S. Small Business Administration
www.catalyst.org	Catalyst—"expanding opportunities for women and business"
www.diversityinc.com	*Diversity Inc.* magazine and other resources
www.workingmother.com	*Working Mother* magazine and other resources
www.hrc.org	Human Rights Campaign Foundation

Discussion Case: *Apple and the Dreamers*

In the first year of his presidency, Donald Trump announced he would end the *Deferred Action for Childhood Arrivals (DACA)* program—a policy enacted during the Obama administration that protected the foreign-born children of undocumented immigrants from deportation—in six months if Congress did not act to make it permanent. The 800,000 or so immigrants covered by DACA were often called "Dreamers," because many were young people pursuing the American dream of higher education, careers, and public service.

Dreamers came from many global regions. According to a 2017 report by the Pew Foundation, about 94 percent of all DACA-eligible immigrants were born in Mexico, Central or South America. Three percent were born in Asia, and most of the rest hailed from countries in the Caribbean, Europe and Africa. The highest concentration of Dreamers lived in California and Texas. Most DACA recipients were 25 years old or less, and about half were enrolled in high school or college at least part-time. The half a million or so Dreamers in the labor force were concentrated in sales, office, and administrative support positions, and many worked for the top 25 *Fortune 500* firms. If these individuals were deported, the potential loss of talent would be significant.

The corporate community responded swiftly to the threat posed to the DACA program. Among the corporate leaders calling for action was Tim Cook, the CEO of Apple. Cook—along with the CEOs of Microsoft, Amazon, Facebook, Google, Netflix, AirBnB, and Lyft—wrote a letter to the president, the speaker of the House, and leading legislators from both parties expressing support for DACA. "Dreamers are vital to the future of our

companies and our economy," the executives wrote. "With them, we grow and create jobs. They are part of why we will continue to have a global competitive advantage."

For its part, Apple employed around 250 Dreamers. They hailed from many countries, including Mexico, Kenya, Canada and Mongolia, and worked for the company in 28 states in customer support roles, as engineers, and in research and development. At the same time Cook was working with other industry leaders, he expressed his support for Dreamers at Apple in a memo addressed to all employees. "America promises all its people the opportunity to achieve their dreams through hard work and perseverance," he wrote. "At Apple, we've dedicated ourselves to creating products that empower these dreams. And at our best, we aspire to be part of the promise that defines America . . . I am deeply dismayed that [Dreamers working for Apple] may soon find themselves cast out of the only country they've ever called home." He concluded that "despite this setback for our nation, I'm confident that American values will prevail, and we will continue our tradition of welcoming immigrants from all nations. I'll do whatever I can to assure this outcome."

Nationally, the threat to DACA posed difficult challenges for businesses, like Apple, that employed Dreamers. Employers that intentionally continued to employ Dreamers with expired DACA permits would face steep penalties, fines and or even jail time. Businesses that did not lay off Dreamers who were ineligible for employment due to an expired permit would be fined $548 to $4,384 *per unauthorized worker* for the first offense. Additional violations could result in fines and up to ten years in jail.

Although employers could be penalized for hiring or retaining Dreamers with expired permits, they also could not discriminate against individuals who were still legally protected by the DACA program. Legal experts advised employers that if they asked employees about their DACA status, or prematurely fired or denied employment to a DACA permit holder, their company could be sued for damages for illegal job discrimination. The Department of Justice also counselled employers that it would be illegal to take back a job offer because someone's work authorization was set to expire in the future.

While employers were responsible for verifying the immigration status of their employees before they were hired, they could not legally ask for information beyond what was included on the I-9 form, which asked prospective employees to demonstrate that they were eligible to work. Prospective employees could present one of several documents to show eligibility, including a DACA permit; once eligibility had been documented, the employer was not required to investigate further. The government relied on employers to keep track of the expiration of employment authorization documents. However, some employers did not continue to check eligibility documents after the initial hire. According to Daniel Brown, a Washington D.C.-based immigration lawyer and former Homeland Security official, "The odds of any particular employer ever being audited are fairly low. That being said, we don't know what the government might do immediately or in the future in terms of enforcement." With more than seven million businesses in the United States, immigration agents would find it difficult to audit each one.

Employers, including Apple, were faced with managing their talent in the context of an uncertain and shifting legal landscape. The Dreamers comprised a significant source of talent for American businesses. The CATO Institute reported in 2017 that complying with a decision to end DACA would cost employers $6.3 billion dollars because of the expenses associated with recruiting, hiring and training employees to replace displaced Dreamers. More broadly, both the private and public sectors would be negatively impacted by the loss of purchases and taxes contributed by the Dreamers.

Sources: "What Should Employers Do with Their DACA Employees" *SHRM*, September 25, 2017, at *www.shrm.org/resourcesandtools/hr-topics/talent-acquisition/pages/faqs-employers-daca-employees.aspx;* "Amazon, Facebook, Google

and other tech giants urge Trump to continue DACA Program," *TechCruch.com,* posted September 1, 2017: *https://techcrunch.com/2017/09/01/tech-giants-urge-trump-to-continue-daca-program;* "CEO Tim Cook Says He Stands by Apple's 250 DACA-Status Employees," *Washington Post*, September 3, 2017; "Apple CEO Tim Cook Says He is 'Deeply Dismayed' By Trump's DACA Decision," *Fortune*, September 5, 2017; "Do DACA 'Dreamers' Work for your Company? Here's What You'll Need to Know," *Fortune,* September 7, 2017; "The Education and Work Profiles of the DACA Population," *Migration Policy Institute*, August 2017; "Key Facts about Unauthorized Immigrants Enrolled in DACA," *Pew Research Center*, September 25, 2017; "Ending DACA will Impose Billions in Employer Compliance Costs," David Bier, *CATO Institute*, September 1, 2017.

Discussion Questions

1. Do you consider being a Dreamer a form of workplace diversity? How is it similar to and different from other kinds of workplace diversity discussed in this chapter?
2. What are the benefits and risks to employers, such as Apple and others mentioned in this case, of continuing to hire or employ Dreamers?
3. Beyond employers, which stakeholders benefit, and which are harmed when a business hires Dreamers?
4. Do you agree with Apple's response to the public policy threat to DACA? What else should Apple's managers do now, and why?
5. If you a human resources manager at Apple, what steps would you take (or not take) if DACA protections were rescinded by the government?

CHAPTER SEVENTEEN

Business and Its Suppliers

Corporations have complex relationships with their *suppliers,* other firms that provide them with goods and services and in some cases manufacture their products. In today's interconnected world, many firms are embedded in complex, global supply chain networks. Increasingly, managers are responsible for social, ethical, and environmental issues that arise in supplier firms. A failure to manage these issues proactively can lead to reputational and financial losses; conversely, success in doing so can yield benefits. Many companies have adopted supplier codes of conduct, carried out audits, and remediated failures. A growing trend is for lead firms to work collaboratively with their suppliers to build capabilities and create shared value.

This Chapter Focuses on These Key Learning Objectives:

LO 17-1 Understand what suppliers are, the nature of suppliers' interests and power, and the scope of the global supply chain.

LO 17-2 Examine the social, ethical, and environmental issues that arise in global supply chains and how they can affect a company's reputation and bottom line.

LO 17-3 Describe contemporary trends in the private regulation of supply chain practices and analyze the reasons for the emergence of company and industrywide codes of conduct.

LO 17-4 Understand the various methods businesses and nonprofit organizations use to audit global supply chains for compliance with codes of conduct and other standards.

LO 17-5 Analyze the reasons for and benefits of engaging collaboratively with suppliers to build capability and create shared value and the conditions under which such initiatives are likely to succeed.

In 2017, Walmart launched Project Gigaton, a commitment to reduce greenhouse gas emissions by one billion metric tons by 2030—the equivalent of taking more than 200 million passenger vehicles off the road for a year. This effort necessarily involved the company's suppliers, since 90 percent of its carbon footprint came from its supply chain—the vast network of farmers, manufacturers, shippers, and others that filled the retailer's huge stores in 28 countries. The company developed a digital toolkit, organized meetings to share best practices, and engaged with its suppliers. In China, for example, Walmart rolled out the project first with its top 100 suppliers, working with them to reduce emissions in multiple areas, including energy, waste, deforestation, agriculture, packaging, and product use. By the following year, 400 suppliers in 30 countries had joined the effort. "Project Gigaton is an example of the transformative impact that private sector leaders can have on our greatest environmental challenges. Every company can look at their supply chain and see where they can reduce emissions and make a difference," said the World Wide Fund for Nature, which had partnered with Walmart on the initiative.[1]

Monster Beverage makes a range of energy drinks, including Monster Energy, Burn, and Relentless, sold under the slogan "Lifestyle in a Can!" "At Monster," the company declared, "all our guys walk the walk in action sports, punk rock music, partying, hangin' out with the girls, and living life on the edge." But in 2018, activist investors filed a shareholder resolution, calling on Monster to report on slavery and human trafficking in its supply chain—and received 20 percent of shareholder votes. The investors' action had been prompted by a report by Know the Chain, which ranked Monster dead last among food and beverage firms in its commitment to ending forced labor. "[Monster's] careless, rebel mindset is fine for marketing," said the activists, "but . . . dangerous for corporate policies and practices." Although it maintained that risk in its supply chain was low, the company pledged to "further refine our efforts related to training employees and monitoring suppliers."[2]

Patagonia is an outdoor apparel company with a long-standing commitment to the environment. The company committed to purchasing all of its merino wool—a key component of its outerwear and socks—from ranches in Argentina's Patagonia region (after which the company had been named) that practiced rotational sheep grazing and other methods aimed not only at conserving, but actually restoring, environmentally degraded grasslands. It also worked with partners to develop the Patagonia Wool Standard, to establish guidelines for its suppliers, and in 2018 started selling wool products sourced under these rules. The company's actions gave a big boost to conservation efforts. "We have often sought to be sustainable," said Patagonia's director of environmental strategy. "But this is the first time we have actually been able to improve an environment by placing business there."[3]

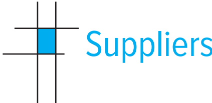
These three examples capture some of the extraordinary complexity of the relationship between businesses and their suppliers. Should a company concern itself with the environmental impact of suppliers of raw materials, or even collaborate with them to promote conservation? To what lengths should a company go to prevent human rights abuses in a multi-tiered supply chain? Do companies have a duty to protect the rights of workers on supplier farms or

[1] "Walmart Launches Project Gigaton to Reduce Emissions in Company's Supply Chain," press release, April 19, 2017; "WWF Works with Walmart to Cut Carbon Emissions and Fight Climate Change," at *www.worldwildlife.org;* "Inside Walmart's Lofty Project Gigaton," May 11, 2018, at *www.triplepundit.com;* "Walmart Commits to Reduce Emissions by 50 Million Metric Tons in China," *The New York Times,* March 29, 2018; "Walmart: Joining Project Gigaton Doesn't Have to Be a Heavy Lift," February 9, 2018, at *www.greenbiz.com*. Project Gigaton is further described at *www.walmartsustainabilityhub.com*.

[2] "Monster Beverage Shareholders Vote to Fix Slavery Problem," press release, June 8, 2018, at *www.asyousow.com;* "Slavery Makes a Monster," blog, May 3, 2018, at *www.asyousow.org;* and Know the Chain, "Food & Beverage Benchmark Findings Report," October 2016.

[3] "Wool Sourcing," at *www.patagonia.com*.

factories halfway around the word? This chapter will explore the social and ethical responsibilities of firms toward their suppliers and people working for them, as well as the impacts of the global supply chain on surrounding communities and the natural environment.



Suppliers

In business, the term **supplier** refers to an organization that provides goods or services to another organization. Suppliers are also known as *vendors* or *contractors.* They are an important market stakeholder of businesses, since they provide critical inputs and often manufacture entire products that companies then sell to customers under their own brand.

Major transnational firms can have an enormous number of suppliers. Intel, for example, has 19,000 suppliers in 100 countries. The exact number of suppliers in the world is uncountable: new ones emerge, and others go out of business, every day. One study by the consultancy CVM Solutions estimated that *Fortune 1000* companies (the thousand largest U.S. companies, ranked by revenue) had 4.9 million unique suppliers (meaning that suppliers that served multiple companies were counted only once). However, the number of widely used suppliers was much smaller: only 6 percent (about 300,000) supplied two or more companies.[4] Some evidence suggests that the number of suppliers dropped in the wake of the global financial crisis. A study by the World Bank found that the crisis had accelerated lead firms' preference for larger, more capable suppliers with whom they had ongoing strategic relationships.[5] (Because a business and its supplier are both companies, this chapter will sometimes use the term *lead firm* to distinguish a company from its supplier.)

Suppliers are a diverse group. They range from tiny—a farmer growing vegetables on a small plot for a local restaurant, for example—to enormous, such as Foxconn, the world's largest electronics manufacturer, which makes iPads and iPhones for Apple, Kindles for Amazon, and PlayStations for Sony, among other products. Foxconn, with 1.3 million employees and $148 billion in revenue in 2017, is itself a major transnational corporation. Lead firms often categorize their suppliers according to *tier,* or level. **Tier-1 suppliers** (sometimes called *contractors*) are hired to manufacture products and provide them directly to the company. These may in turn work with **tier-2 suppliers** (sometimes called *subcontractors*), who may in turn work with even more distant suppliers. In the automobile industry, for example, there may be six to ten levels of suppliers between the automaker and the source of raw materials, and a company may not even be aware of some of the parties that contribute at some point to the finished product. The term **supply chain** refers to the multiple steps involved in the movement of a product or service from the most distant supplier to the customer. Because of the complexity of these systems, firms sometimes refer to their *supply webs* or *networks,* rather than use the term *supply chain,* which implies a simple, linear relationship.

Although several steps removed, distant suppliers can still have a big impact on a company's reputation and bottom line.

> The toy company Mattel learned this the hard way, when it discovered that toxic lead paint had been applied to several of its toys, including Sarge vehicles and Dora the Explorer characters. In its investigation, the company found that a tier-1 supplier, a Chinese firm called Early Light Industrial, had subcontracted painting to another firm, which had violated Mattel's specifications and substituted cheaper lead paint. "Early Light . . . is every [bit as] much the victim as Mattel is," the CEO

[4] "How Many Suppliers are in the Global Supply Chain?" *Industry Market Trends,* August 25, 2010.

[5] Olivier Cattaneo, Gary Geriffi, and Cornelia Staritz, eds., *Global Values Chains in a Postcrisis World* (Herndon, VA: World Bank Publications, 2010), Chapters 1 and 2.

> later commented. Mattel ended up spending $110 million dollars to recall the tainted toys and communicate with the public, all because of unapproved actions by a tier-2 supplier.[6]

As this example illustrates, companies need to understand and monitor actions by all participants throughout their supply networks, not just those with whom they have direct relationships.

Chapter 1 introduced the concepts of stakeholder *interest,* that is, what a stakeholder wants from its relationship with a firm, and *power,* a stakeholder's ability to secure a desired outcome. What are the interests—and sources of power—of suppliers? Despite their tremendous diversity, most suppliers share an interest in obtaining orders that will enable them to make money, use their productive capacity efficiently, and build long-term, stable relationships with business customers.[7] Naturally, suppliers' power, relative to lead firms, varies. Suppliers may have many kinds of power, including economic and informational power. A supplier that is a sole source for a key component or natural resource naturally has more leverage, relative to its lead firms, than one that is not. Similarly, suppliers that control critical worker skills, technical know-how, or relevant manufacturing infrastructure have more leverage than others. When Apple wanted to launch the iPad, for example, only one supplier—Foxconn—had the immediate capability to do the job competently and at scale, giving the Taiwanese company strong bargaining power. Proximity to major markets, long-standing relationships with other contractors, and a reputation for quality, speed, and low cost also enhance supplier power.

As was further discussed in Chapter 4, the world's economy has become increasingly globalized. Although much manufacturing still occurs in the developed economies of the United States, Japan, and Germany, the developing nations of Brazil, India, and Mexico also have significant shares. Particularly striking has been the emergence of what has been called "Factory Asia." In 2010, China passed the United States as the nation with the largest share of global manufacturing, and in 2016 made more than one-quarter—26 percent—of the world's products. Almost half of all manufacturing production now takes place in Asia; and in some industries, such as footwear and apparel, the shift has been almost total.[8] As the world's economy has globalized, so has its supply chain. Richard M. Locke, a scholar who has extensively studied business–supplier relationships, has described the process this way:

> Globalization, with its volatile mix of economic opportunity and social disruption, is redefining the boundaries of the firm; changing dynamics among consumers, global corporations, and their suppliers; and shaping the working conditions of the millions of individuals employed in today's global supply chains. The world of global supply chains links thousands of firms, large and small, across multiple cultural and political boundaries.[9]

In such a network, even seemingly simple products can have a truly worldwide footprint. Consider just one familiar, everyday product: a cotton T-shirt. In her book, *The Travels of a T-Shirt in the Global Economy,* economist Pietra Rivoli described the probable history of

[6] Pricewaterhouse Coopers (PwC) and EcoVadis in collaboration with the INSEAD Social Innovation Centre, "Value of Sustainable Procurement Practices," 2010.

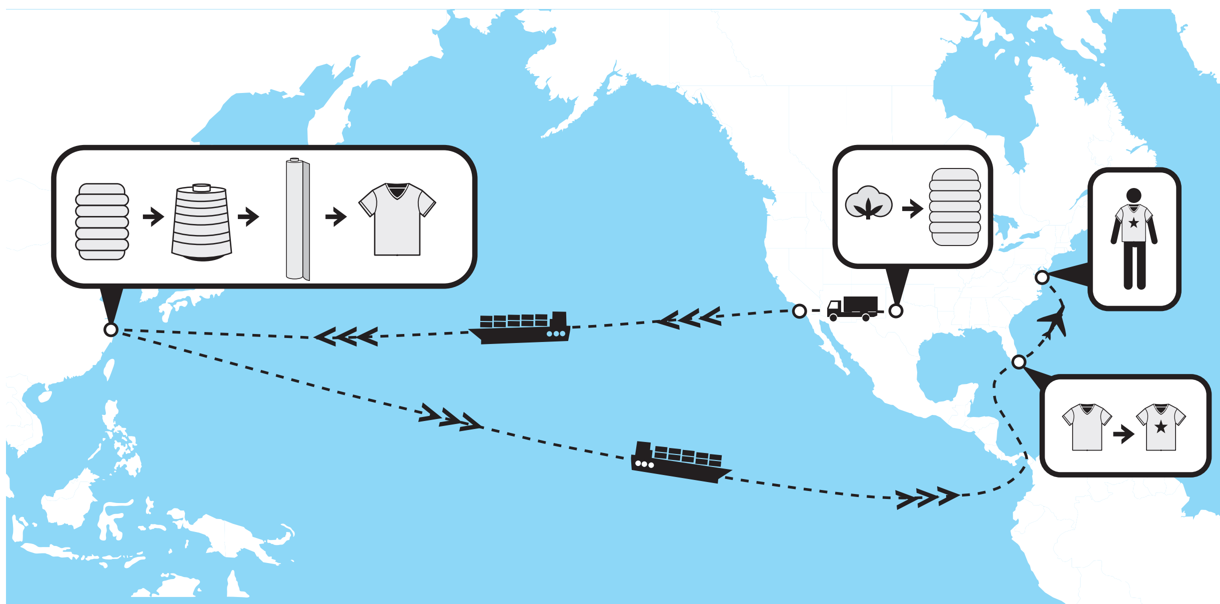
[7] Richard M. Locke, *The Promise and Limits of Private Power: Promoting Labor Standards in a Global Economy* (Cambridge University Press, 2013), p. 13.

[8] Congressional Research Service, "U.S. Manufacturing in International Perspective," February 21, 2018; and "Changing Global Production Landscape and Asia's Flourishing Supply Chain," HKTDC Research, October 3, 2017.

[9] Richard Locke, p. 3.

FIGURE 17.1 A Supply Chain Map for a Cotton T-Shirt

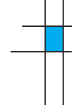
Graphic design by Colorbox Industries. © 2015. All rights reserved. Used by permission.



a cotton T-shirt emblazoned with a colorful design that she had purchased at a Walgreen's drugstore in Fort Lauderdale, Florida. This is what she surmised from her research:

> Cotton for the T-shirt had been grown on a large, mechanized cotton farm near Lubbock, Texas, and processed, graded, and baled at a nearby mill. From there, a truck carried it to the port of Long Beach, California, where it was loaded onto a freighter for shipment across the Pacific. In Shanghai, China, a mill spun the raw cotton into yarn and knitted it into fabric. Nearby, garment workers cut and sewed the fabric into plain, white T-shirts. The T-shirts were returned to the port, put back on another freighter, and shipped through the Panama Canal to Miami. There, they were purchased by a Florida maker of novelty clothing, who screened the shirts with tourist-friendly images and sold them to Walgreen's—where the economist bought her T-shirt and took it back home to Washington D.C.[10]

Figure 17.1 shows a **supply chain map** that graphically depicts the travels of this T-shirt. A supply chain map is a visual representation of the multiple links between a lead firm (in this case, the novelty clothing maker), its suppliers, and eventually its customers. It shows the movement of a particular product from the beginning of the supply chain to the end, superimposed on a geographical map.



Social, Ethical, and Environmental Issues in Global Supply Chains

As supply chains have globalized, their social, ethical, and environmental impacts have become increasingly complex, and their potential risks to corporate reputation heightened. This section will describe these three kinds of issues and provide examples of companies

[10] Pietra Rivoli, *The Travels of a T-Shirt in the Global Economy,* 2nd edition (Hoboken, NJ: John Wiley & Sons, 2015).

that are actively considering social, ethical, and environmental risks in their sourcing decisions. It will also show some of the risks of failing to manage these issues proactively, as well as the benefits associated with doing this well.

Social Issues

Global supply chains have many social impacts. Prominent among them are the wages, working conditions, and health and safety of employees in supplier factories.

Wages in overseas supplier factories are generally much lower than they would be in the United States, Europe, or the developed Asian economies of Japan and Korea. In the garment industry, to cite one example, in 2018 monthly wages were $280 in China, $100 in Bangladesh and India, and just $60 in Kenya—all far below the minimum wage a U.S. employer would be required to pay.[11] Low wages are, of course, one of the main reasons that brands contract with suppliers in developing countries; they reduce overall costs and enable brands to price their products more competitively. Low wages are not necessarily unethical. People in developing countries need jobs and are often willing to work at pay below what would be considered acceptable in developed nations. Employment in export-oriented factories often offer workers—particularly young women—their first point of entry into the wage economy and an alternative to domestic and farm labor. On the other hand, if a company's customers believe that its products are made in **sweatshops** —a derogatory term referring to factories where workers toil long hours, at low wages, and under unsafe conditions—its reputation can be harmed. Workers who believe they are treated unfairly can quit, go on strike, or produce poor quality work.

The challenge for businesses, then, is to assure that their suppliers pay wages that are perceived as fair and that permit workers and their families to achieve a decent standard of living. (The related concept of a *living wage* is discussed in Chapter 15.) Minimum wages established by law may not be sufficient.

> In its 2017 sustainability report, the fashion retailer H&M reported that it had made progress on its commitment to eliminate the gap between the wages its suppliers paid and wages that covered families' basic needs. H&M said that suppliers making 40 percent of its products were now paying "fair" wages—benefiting more than 375,000 workers. The NGO Clean Clothes Campaign (CCC) criticized H&M, however, saying that the company had failed to define what it meant by a "fair" wage or to disclose what its suppliers were actually paying their workers. It also faulted the company for not saying whether it had changed its purchasing practices to enable higher wages. "Measures could include rewarding factories that are willing to raise wages with larger orders, closer cooperation, or price premiums," said a CCC representative.[12]

Just as what constitutes a fair wage varies across cultures and economies, so do other terms and conditions of work. For example, in some countries, unions are legal and the right to organize is protected; in others, unions are illegal or actively discouraged. Excessive overtime (usually defined as more than 60 hours or six days a week) is not permitted in most developed countries. Yet, in some settings, workers are eager to work as many hours as they can, to save for marriage, for example, or to remit earnings to family members. Finding the right balance can be a challenge.

[11] Textile Excellence, "Labour Costs to Rise in 2018," January 1, 2018.

[12] *H&M Group Sustainability Report 2017,* at *https://about.hm.com;* Clean Clothes Campaign, "H&M Is Trying to Cover Up Its Unfulfilled Commitment on Living Wage," April 12, 2018; and "H&M Under Fire Over Living Wage Claims," *Just-Style,* April 13, 2018.

An issue of emerging importance is worker health and safety in supplier factories. Combustible dust can cause explosions and fires. Workers can be exposed to dangerous chemicals in poorly ventilated spaces. Malfunctioning or improperly guarded mechanical equipment or tools can maim and kill. In some developing countries, structurally unsound buildings have been repurposed for use as factories, with horrifying results.

In 2013, an eight-story building in Bangladesh collapsed catastrophically, killing 1,134 workers, most of them young women, who had been working in six separate garment factories on different floors. More than 2,500 others were injured, many severely. It was the worst industrial disaster in the history of the garment industry. The building, known as Rana Plaza, was partially situated on a drained swamp, and additional floors had been illegally added. The structure was carrying almost six times the weight it was designed to bear. Although workers had earlier reported large cracks in the walls, managers dismissed the problem and threatened workers if they did not report for duty. At the time Rana Plaza collapsed, dozens of well-known North American and European brands were sourcing products from factories in the building. Photos of the carnage, which were widely reported around the world, showed scattered garments—some showing their brand labels—lying alongside workers' corpses.

This incident shocked the conscience of many customers and precipitated a reputational crisis for some brands. The collapse of Rana Plaza and the challenge it posed to Western manufacturers sourcing from Bangladesh are further profiled in a case at the end of this book.

Ethical Issues

Human rights, as defined in Chapter 5, refer to basic human entitlements such as the right to life, freedom, and due process. Companies must avoid violations of human rights in their supply chains.

Human trafficking (also called *forced labor*) is modern-day slavery—the illegal recruitment and movement of people against their will, usually to exploit them for economic gain, is an important ethical issue. Of the world's estimated 25 million victims of forced labor, about five million—almost all women and children—are forced into prostitution. Sixteen million people are coerced into domestic labor or work on farms and in factories in many industries, including food processing, construction, textiles, and hospitality, often for low pay or even no pay at all. For example, the government of Uzbekistan—a country in Central Asia that was formerly part of the Soviet Union—has routinely forced millions of its ordinary citizens and to plant, weed, and harvest cotton without compensation.[13] [14]

A related concern is **child labor**. Child labor has been defined by the International Labor Organization (ILO) as "work that deprives children of their childhood, their potential and their dignity, and that is harmful to physical and mental development." As the ILO points out, whether or not work can be considered child labor depends on a number of factors, including the child's age, the type and hours of work performed, and the conditions under which it is performed, and may vary among cultures and countries.[15] In 2017, despite progress, child labor remained a persistent problem; 152 million children continued to work, most of them in agriculture and more than half in hazardous jobs.[16] Many observers trace the modern antisweatshop movement to a famous photograph that appeared in *Life* magazine in

[13] "Uzbekistan's Forced Labor Problem," at *www.cottoncampaign.org*.

[14] International Labour Organization, "Forced Labour, Modern Slavery and Human Trafficking," at *www.ilo.org*.

[15] "What is Child Labor?" International Labor Organization, at *www.ilo.org/ipec/facts*.

[16] International Labour Organization, "The International Partnership on Child Labour in Agriculture on the New ILO Global Estimates of Child Labour," September 19, 2017, at *www.ilo.org*.

1996, showing a 12-year-old Pakistani boy, crouched on a dirt floor hand-stitching the hexagonal pieces of a Nike-branded soccer ball. Within days, activists were standing in front of Nike stores, holding up the photograph and demanding an elimination of child labor in the supply chain. Although virtually all lead companies require their suppliers, at the least, to comply with relevant national laws regarding child labor, the possibility that children continue to be employed somewhere in the supply chain poses a risk.

Few major companies, of course, knowingly tolerate human trafficking or child labor in their organizations or those of their suppliers. But in today's complex supply networks, the presence of such labor practices can pose a serious reputational and legal risk.

> In 2018, activists brought a class action lawsuit against Nestlé, saying the company had engaged in deceptive marketing. The plaintiffs said that the company had failed to disclose that it had sourced cocoa, the main ingredient in chocolate, from farms in the Ivory Coast (in West Africa) that used child and forced labor. Nestlé reacted sharply, saying that it did not tolerate illegal labor practices in its supply chain, and called for the case to be dismissed. Indeed, the company had already adopted a code of conduct, commissioned a study of its cocoa supply chain, trained farmers, and published comprehensive reports. But with most cocoa still grown on small land holdings deep in the tropical forest, child labor had remained stubbornly intractable in the Ivory Coast—and Nestlé vulnerable to charges of exploiting underage workers.[17]

Companies that set up operations in countries with antidemocratic, repressive regimes can be caught up in violations of human rights. Some governments require foreign firms to partner with state-owned companies in order to do business there, adding another level of risk. For example, when the energy companies Unocal and Total undertook to build a gas pipeline across Burma to link a natural gas field in the Andaman Sea to a power plant in Thailand, they were required to partner with the government, a notorious abuser of human rights. Activists later charged that the Burmese government had used brute military force to clear the pipeline area, relocating entire villages and terrorizing the civilian population. Many civilians, including women, children, and the elderly, had been forcibly conscripted to clear land and build roads, barracks, and helipads. Although Unocal and Total had not engaged in these acts directly, the companies' critics felt that as the government's business partners, they shared responsibility.

A specific human rights challenge in global supply chains is sourcing minerals and other valuable commodities from conflict zones. For example, much of the world's *coltan,* a metallic ore used to make tantalum (which regulates electricity in portable consumer electronics) is sourced from mines in the Democratic Republic of the Congo. As further described in the discussion case at the end of Chapter 4, warring groups there have traded coltan to fund horrific civil conflict—and the electronics industry has been accused of indirectly contributing to the murder of civilians, sexual assault, and labor abuses. Other metals and minerals coming from war zones in Africa and elsewhere include tin, tungsten, and gold. Many electronics firms, including Texas Instruments, LG Innotek, and Intel have committed to buying minerals only from certified, "conflict-free" sources.

Transnational companies that depend on resources that are farmed, extracted, or mined—such as the cocoa, natural gas, metals, and minerals mentioned in this section—are particularly at risk for human rights abuses by their suppliers. Often, their choices of where and from whom to source their supplies are limited. For example, Monster Beverages,

[17] "Nestlé Sued Again for Allegedly Using Child and Slave Labor to Make Chocolate," *Confectionery News,* February 13, 2018; and "Nestlé Cocoa Plan: Tackling Child Labour—2017 Report," at *www.nestle.com*.

mentioned in an opening example of this chapter, was at risk of human rights violations mainly because of its use of sugarcane—an agricultural sector where human trafficking had occurred. Under these conditions, these companies must take special precautions to avoid complicity in ethical violations in their supply chains.

Environmental Issues

When a supplier of raw materials, parts, or finished goods contributes to climate change, dumps toxic chemicals, emits air pollution, or reduces biodiversity, it can threaten the reputation of companies at the top of the supply chain.

> Activist stakeholders, including environmentalists and public pension funds, criticized ConAgra for the practices of its suppliers of palm oil, an ingredient in many processed foods. The U.S. food company sourced much of its palm oil from Indonesia and Malaysia, where tropical rainforests had been cleared to make way for commercial plantations. This destroyed the habitat of endangered species like the Sumatran orangutan, released pollutants into waterways, and destroyed peat bogs that sequestered carbon. Facing shareholder resolutions demanding change, ConAgra announced that it would buy only sustainably sourced palm oil. By the end of 2016, it reported it had secured supply chain certification for 98 percent of its production facilities that used palm oil. "The rampant deforestation for palm oil has captured public attention, creating real reputational risks for companies that use the ingredient in their branded products," said a manager of socially responsible mutual funds.[18]

Another issue of concern to supply chain managers is the environmental impact of transporting products long distances from where they are made, grown, or extracted to where they are further processed or sold to consumers. Much of the coffee, fruit, and fish from Latin America; toys, electronics, and garments from Asia; and wine, meat, and wool from Australia, for example, is shipped to Europe and North America on enormous container ships, which now carry more than half of global seaborne trade.[19] These ships, which burn dirty bunker fuel, emit slightly more than 2 percent of all greenhouse gas emissions.[20] Some companies have responded to environmental concerns by adopting a policy of *local sourcing,* seeking to source from nearby suppliers where practical. Retail grocery chains, for example, have increasingly adopted policies of buying fruit and produce from local farmers whenever possible, to prevent waste, save money on shipping, and cater to customers who prefer fresh and seasonal offerings.[21] Others have taken steps to improve efficiency in their supply chains. For example, when Patagonia, the outerwear company, made the simple decision to switch its port of entry for products coming from Asia from Long Beach to Oakland, California, it reduced the distance the goods traveled by truck to its Reno, Nevada, distribution center—reducing its carbon emissions on the route by 31 percent.[22]

[18] Conagra Brands Citizenship Report 2017, "Certified Ingredients: Sustainable Palm Oil," at *www.conagrabrands.com;* "ConAgra's Palm Oil Commitment: Saving Forests and Reducing Greenhouse Gases," *The Guardian Sustainable Business,* August 22, 2014; and "ConAgra Joins Movement to Eliminate Deforestation," *Sustainability Investment News,* August 16, 2014. For more information about efforts to improve the sustainability of the palm oil supply chain, see the Roundtable on Sustainable Palm Oil, at *www.rspo.org*.

[19] Review of Marine Transport 2013, at *www.unctad.org*.

[20] International Maritime Organization, *Third IMO Greenhouse Gas Study 2014* (Suffolk, UK: Micropress, 2015), Table 1.

[21] "What Trends Will Shape Grocery Retail in 2018?" January 10, 2018, at *www.foodnavigator.com*.

[22] "Changing Ports Pays Dividends," at *www.patagonia.com*.

Exhibit 17.A

Supply Chain Transparency

Supply chain transparency means that what happens in a company's supply chain is fully disclosed to stakeholders—as if seen through a clear glass window. Some firms have realized that openly revealing supply chain information can enhance brand loyalty among consumers concerned about social, ethical, and environmental responsibility. Technology increasingly makes this possible at the point of purchase. Products have always been labeled, of course. But today, advances in so-called technology tags, genetic markers, mobile phone apps, and virtually unlimited cloud data storage make it possible for consumers to see how and where a product was made in startling detail. For example, Switcher, a Swiss clothing company that sources from Bangladesh, China, India, Portugal, Romania, Turkey, and Taiwan, provides a unique number on the label of each of its garments. When the customer inputs this number at the website Respect-Code.org, he or she can track every step of the specific garment's journey, from the farm where its cotton fibers were grown to the factory where the garment was sewn. The emergence of blockchain technology holds the potential to make supply chains even more transparent. Each product can be assigned a unique identifier at its point of origin and time-stamped as it moves through multiple transactions, with each stored in the blockchain archive—allowing a buyer at the end of the chain to check if it was responsibly sourced. An advantage of such a distributed database, concluded an article in the *Harvard Business Review,* "is that it resolves problems of disclosure and accountability between individuals and institutions whose interests aren't necessarily aligned." Supply chain transparency, whether supported by blockchain or other technologies, can give consumers confidence in the positive impacts of products they buy.

Sources: Michael J. Casey and Pindar Wong, "Global Supply Chains Are about to Get Better, Thanks to Blockchain," *Harvard Business Review,* March 13, 2017; "How to Make Supply Chains Ethical and Sustainable with Blockchain," June 5, 2018, at *www.supplychaindive.com;* and Steve New, "The Transparent Supply Chain," *Harvard Business Review,* October 2010.

The efforts the home furnishings retailer IKEA made to lessen the adverse environmental impacts of cotton in its supply chain are described in the discussion case at the end of this chapter.

Supply Chain Risk

In short, supply chain managers face a number of significant social, ethical, and environmental issues. Failure to manage these social, ethical, and environmental risks in supply chains can be very costly, managers have learned. One study looked at the impact on stock prices of disruptions in companies' supply chains. Over a three-year period bracketing publicly announced disruptions, these companies' stock underperformed that of their peers by 40 percent. Operating income, return on sales, and return on assets were all adversely impacted, the researchers found, and firms did not recover quickly.[23] A strike by many of the 43,000 workers at Yue Yuen Industrial Holdings, an enormous shoe factory in China, disrupted supplies to Adidas, Asics, and Nike, all of which had contracts with the firm. The workers were upset by their employer's failure to make required payments on their behalf into a government social security program.[24] In an effort to get production back on track, Adidas later worked with labor rights groups in China to seek the release of two strike leaders who had been detained.[25] In the meantime, production was halted and the flow of shoes to customers stalled.

What happens in a company's supply chain can help its reputation—as well as hurt it. Exhibit 17.A profiles the use of technology to promote supply chain transparency and build brand loyalty.

[23] Kevin B. Hendricks and Vinod R. Singhal, "An Empirical Analysis of the Effect of Supply Chain Disruptions on Long-Run Stock Price Performance and Equity Risk of the Firm," *Production and Operations Management,* 14, no. 1 (March 2005), pp. 35–52.

[24] "Strike at Nike, Adidas China Supplier Halts Output," *Bloomberg.com,* April 18, 2014.

[25] "How Adidas Supported Worker Rights in China Factory Strike," *The Guardian,* June 12, 2014.

Private Regulation of the Business–Supplier Relationship

Who establishes the rules for social, ethical, and environmental issues in supply chains? In other words, who regulates businesses' relationships with their suppliers?

This simple question has a complex answer. As the manufacturing supply chain has become increasingly globalized, its regulation has become more fragmented and ineffective. In response, new institutions have arisen to fill the void created by the inability of governments in both developed and developing countries to police the far-flung operations of large transnational corporations and their global supply chains. Mutually agreed-on standards, developed by private firms—often working in collaboration with nongovernmental organizations and United Nations affiliates such as the International Labor Organization—have emerged to complement, and in some cases even substitute for, national-level regulation.

Private regulation, also called *private governance,* refers to nongovernmental institutions that govern—that is, enable and constrain—economic activities. It occurs when private companies or groups of companies voluntarily set rules of behavior for themselves and their business partners.[26] Private regulation often takes the form of company and industrywide codes of conduct that establish standards governing labor, human rights, environmental, and related practices within global supply chains. Since the 1990s and accelerating in the 21st century, private regulation has assumed increasing importance, for several related reasons.

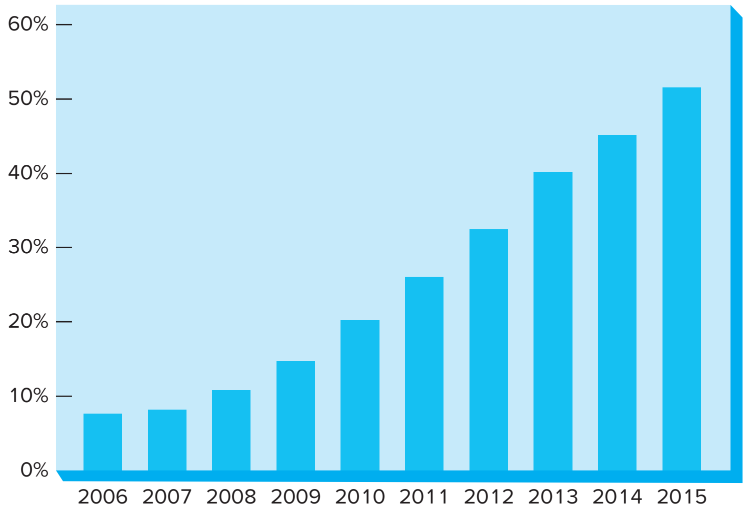
- *Lack of jurisdiction of home country governments.* The authority of governments in the home countries of lead firms normally does not extend to supplier factories in other countries. For example, in the United States, the Department of Labor and the Occupational Safety and Health Administration (OSHA) establish rules governing wages, overtime, child labor, safety conditions, and other workplace matters. The reach of these regulatory agencies normally does not extend beyond their national borders, however. For example, if blocked fire exits threatened worker safety in a factory in Indonesia making clothes for an American retailer, OSHA would have no authority to intervene.
- *Weak regulatory capacity in developing countries.* Nations with growing export-oriented manufacturing sectors often lack the institutional capacity, resources, and staff to regulate their own workplaces adequately. In some cases, business elites are so politically powerful that they can effectively block regulation. In Bangladesh, for example, one in ten members of parliament (or their relatives) are themselves garment factory owners, and members of powerful trade associations in the garment and knitwear industries sit on important government committees. Although regulatory capacity varies greatly by country, of course, in some cases, government agencies simply do not have the clout or independence to constrain the actions of powerful transnational corporations and their local partners.
- *Limited enforcement power of transnational institutions.* The United Nations has several affiliates that are deeply concerned with labor and human rights; among them are the International Labor Organization (ILO), the United Nations Children's Fund (UNICEF), and the Global Compact. All of these have developed important global standards, promoted them globally, and sought to implement them. The ILO, for example, has developed a Better Factories initiative that has improved working conditions in dozens of countries. These institutions have moral authority, but lack enforcement power, and their influence is limited by companies' willingness to cooperate with them.

[26] Frederick Mayer and Gary Gereffi, "Regulation and Economic Globalization: Prospects and Limits of Private Governance," *Business and Politics* 12, no. 3 (October 2010), pp. 1–25; and Richard M. Locke, op cit.

FIGURE 17.2

Percentage of Large and Mid-Sized Firms in Developed Countries with a Supply Chain Code of Conduct, 2006–2015

Source: Anne T. Lawrence, Thomas G. Altura, and Ronald M. Roman, "The Global Diffusion of Supply Chain Codes of Conduct: Brand Value, Stakeholder Scrutiny, and Institutional Effects," paper presented at the annual meeting of the Society for Business Ethics, August 6, 2017. Used by permission.



Data are drawn from Bloomberg ESG. Firms include those that have appeared at least once on the FTSE All-World index from the years 2006 to 2015; that are domiciled and traded within a developed, OECD-member country; and have at least one identified supply chain relationship. N = 2,048 firms.

In the absence of effective public regulation, many companies and industries have written—and undertaken to enforce—their own voluntary **supply chain codes of conduct** (SCCCs). A SCCC can be defined as a public set of rules, adopted by a firm or group of firms, that establishes mandatory standards governing labor, human rights, environmental, and related practices for suppliers. One of the first companies to develop such a code was Levi Strauss, a U.S. apparel maker. After the company was accused of using an unethical contractor in Saipan in 1991, the company reviewed its procedures and adopted a wide-ranging set of guidelines for its overseas manufacturing.[27] Supply chain codes of conduct quickly spread, with the footwear, apparel, and electronics industries leading the way. Since 2006, the proportion of large and mid-sized firms in developed countries that have adopted a supply chain code of conduct has risen dramatically, from less than 10 percent to more than 50 percent, as shown in Figure 17.2.

Scholars have hypothesized that supply chain codes of conduct are most likely to be adopted by firms that:

- Have highly valuable brands and are therefore more vulnerable to reputational damage;
- Are highly scrutinized by the investment community, including activist shareholders;
- Are headquartered in countries with strong unions, social welfare policies, and cooperative relationships among government, business, and labor;
- Are members of industry coalitions or country networks, such as those sponsored the United Nations Global Compact, that promote supply chain responsibility; and
- Are targets of pressure for responsible practices by nongovernmental organizations; for example, through campaigns, boycotts, or shareholder resolutions.[28]

[27] Karl Schoenberger, *Levi's Children: Coming to Terms with Human Rights in the Global Marketplace* (New York: Grove Press, 2000).

[28] Anne T. Lawrence, Thomas G. Altura, and Ronald M. Roman, "The Global Diffusion of Supply Chain Codes of Conduct: Brand Value, Stakeholder Scrutiny, and Institutional Effects," paper presented at the annual meeting of the Society for Business Ethics, August 6, 2017; and Frederick Mayer and Gary Gereffi, "Regulation and Economic Globalization: Prospects and Limits of Private Governance," *Business and Politics* 12, no. 3 (October 2010), pp. 1–25.

Exhibit 17.B

The Responsible Business Alliance Coalition Code of Conduct

Founded in 2004 as the Electronics Industry Citizenship Coalition (EICC) and now known as the Responsible Business Alliance, this group is made up of around 110 companies, mostly in the electronics industry. These include such well-known firms as Hewlett-Packard Enterprise, IBM, Apple, Dell, Intel, Lenovo, Oracle, Samsung, Sony, Microsoft, and Cisco. The coalition collaboratively developed a code of conduct and committed to enforce its terms in their own operations and in their tier-1 suppliers. Over 3.5 million employees are covered by the code, which includes the following provisions, among others:

- *Labor standards:* No forced labor, no child labor, workweek not to exceed 60 hours except under emergency situations, compliance with local wage laws, no harsh or inhumane treatment, no discrimination, freedom of association.
- *Health and safety:* Safe and healthy workplaces, with procedures to control hazards and prevent injury and illness; access to sanitation, clean water, and eating facilities.
- *Environmental standards:* Pollution prevention; waste minimization; proper handling of hazardous substances; proper control and treatment of water and air emissions.
- *Ethics:* Highest standards of integrity; fair business practices; no bribery; protection of intellectual property and privacy.
- *Management:* Systems in place to assure implementation, compliance, and improvement.

Source: The full code is available at *www.responsiblebusiness.org*.

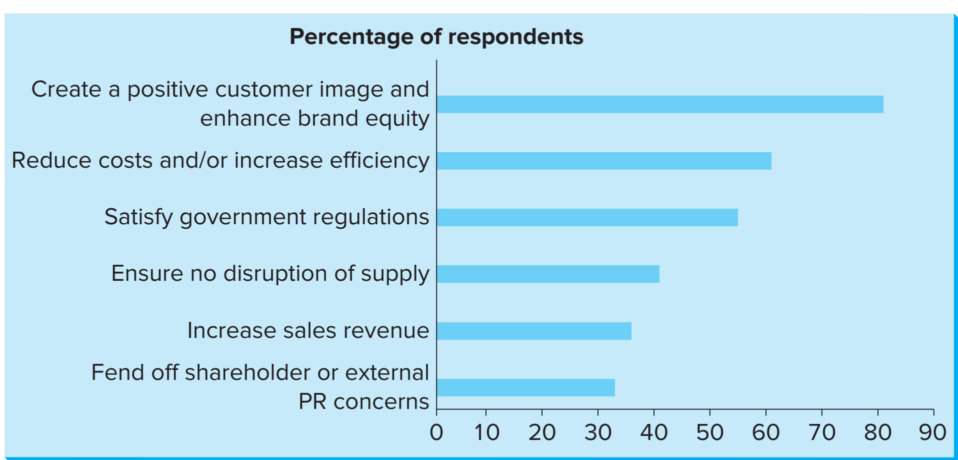
Although early codes of conduct were typically developed by and were specific to individual companies, the current trend is toward adoption of common standards within industries. In part, this reflects the influence of nongovernmental organizations and standard-setting associations that have provided templates. Common standards also reflect the efforts of coalitions of companies—sometimes with participation of government officials, NGOs, and worker and consumer representatives—to define industrywide standards that they can all agree to. For example, many leading high-tech companies joined forces as the Electronic Industry Citizenship Coalition (EICC), now called the Responsible Business Alliance, to establish a code of conduct that provided a uniform set of labor, health and safety, and environmental standards for their global supply chains. This code is further described in Exhibit 17.B. Supporters of this industrywide approach argue that common standards improve compliance, since suppliers are not faced with myriad conflicting demands. It also can reduce the costs of monitoring, since brands can share audit results. (Supply chain auditing is further described in the following section.) Such industry coalitions are now active in many sectors, including telecommunications, toys, jewelry, pharmaceuticals, and automobiles.

A 2016 survey of supply chain management practitioners in more than 1,300 companies around the world found that the leading reason why their firms had invested in supplier social and environmental responsibility was to create a positive customer image and enhance brand equity. Other reasons were to reduce costs, satisfy government regulations, avoid disruptions, increase sales, and allay public criticism. These findings are shown in Figure 17.3.

Does private regulation make a difference? In an important book, *The Promise and Limits of Private Power,* Richard M. Locke argues that the most effective way to assure socially responsible practices in global supply chains is a *combination* of public and private regulation. Either, when used alone, is insufficient; they work best, he believes, when "layered" on top of each other in a kind of hybrid system. For example, private companies

FIGURE 17.3
Drivers of Social and Environmental Responsibility in Supply Chains
"What is your best judgment of your board's motivations for investing in social and environmental responsibility?"

Source: Supply Chain World, *Future of Supply Chain Report,* November 2016, Figure 32. Based on a survey of 1,346 supply chain practitioners. Used by permission.



can rely on local laws to give legitimacy to demands for workplace changes, and government regulators can benefit from detailed workplace record keeping required by private companies' codes of conduct. Public and private regulators can also share the work. In the Caribbean nation of the Dominican Republic, for example, one study found that government inspectors (public regulators) and auditors for major North American brands (private regulators) had developed an informal division of labor, in which the former concentrated on firms producing for the domestic market, and the latter on firms producing for export.[29]

Companies can adopt their own code or agree to one of the NGO or industrywide codes. But who is to say that they, and their suppliers, are actually living up to these rules? Many now conduct independent audits to determine if a code's standards are being met. This is discussed next.

Supply Chain Auditing

Once a company has developed its own code of supplier conduct or agreed to comply with an industrywide or global code, it must undertake to enforce these rules. In a simpler time, when a firm operated its own manufacturing facilities in a limited geographical area, monitoring compliance with an established set of standards was straightforward. But in today's more complex world, obtaining this information can be extraordinarily difficult. A lead firm's supplier code of conduct can require, for example, that all workers making its products are paid at least the minimum wage, but how can it assure that this is actually true? This assurance is usually obtained by conducting a **supply chain audit**. Such an audit monitors a supplier's performance to determine if it complies with the relevant code of conduct. (Auditing is also discussed in Chapter 3.)

Companies have several choices in carrying out an audit. One is to hire and train its own staff of auditors whose job is to inspect factories—either its own or those operated by contractors—to determine whether or not they comply. This is sometimes called an *internal audit.* For example, Gap Inc. hired its own staff of vendor compliance officers, as they were called, who visited thousands of factories where Gap products were made.[30]

[29] Matthew Amengual, "Complementary Labor Regulation: The Uncoordinated Combination of State and Private Regulators in the Dominican Republic," *World Development* 38, no. 3 (2010), pp. 405–414.

[30] Gap's corporate social responsibility reports are available at *www.gapinc.com*.

An advantage of an internal audit is that the company controls and manages the process. It can train its own compliance officers, determine what factories need to be audited, and learn immediately about any problems uncovered. On the other hand, a disadvantage is that stakeholders might view reports based on an internal audit as less credible, because the company would have an interest in casting itself and its suppliers in a favorable light.

A second option is to hire another organization to carry out the audit and report back to the company. This is called an *external audit* or a *third-party audit,* because it is carried out by someone other than the company or the managers of the factories that produce its goods. The three largest publicly traded, for-profit monitoring companies are Bureau Veritas, Intertek, and SGS. Lead firms may also engage nonprofit organizations, such as Verité, the Fair Labor Association, or the Worker Rights Consortium. Several large accounting firms such as PricewaterhouseCoopers have developed specialized services in which they will conduct a social or environmental audit for clients (rather than a financial audit, which is their traditional specialty). The advantage of an external audit is that it is often perceived by stakeholders as more objective and reliable. Companies may find, however, that the information is delayed, and it does not directly control the quality of the audit.

An audit, whether conducted internally or externally, generally consists of a review of documentation (such as payroll and personnel records), a facility inspection, and interviews with workers and managers. Companies normally do not reveal what they spend on supply chain auditing. However, *The New York Times* estimated that the cost of a factory audit could range from $1,000 for a one-day, "check-the-box" audit to as much as $5,000 for a thorough, multi-day inspection.[31] A major firm can require hundreds of audits a year. For example, in 2017 Nike completed full assessments of 406 of its approximately 500 supplier factories.[32]

While audits can provide considerable insight into conditions in supplier factories, they also have drawbacks. On-site inspections are expensive and time-consuming, and therefore cannot be scaled to cover a brand's entire supply chain, which might consist of thousands of factories. Audits are not always unannounced; in many cases, suppliers receive advance notice and are able to stage conditions to pass the inspection. Workers sometimes distrust auditors, not knowing if the inspectors represent the supplier, the brand, or an independent third party, and are therefore reluctant to share their experiences.

An emerging approach to auditing involves bypassing the factory inspection process entirely. Instead, a **crowd-sourced audit** gathers information about factory conditions directly from workers using their mobile phones. In this approach, rather than relying on inspectors—who may be deceived by factory managers who want conditions to appear better than they really are—workers provide information directly by responding to questions generated by a recorded voice on their mobile phones when they are away from work. For example, LaborVoices, a social venture, has piloted such an approach in the garment industry in India and Bangladesh.[33] Workers must trust the process and participate widely for crowd-sourced data to be reliable and useful.

Increasingly, companies are working together to audit major suppliers and to share results on a common digital platform. This avoids *audit fatigue,* in which supplier factories must endure audit after audit conducted by different buyers, and spares companies from duplicating efforts and incurring unnecessary costs.

EcoVadis, a French company founded in 2007, provides a secure, cloud-based digital platform where lead firms, suppliers, industry groups, and auditors can share

[31] "Fast and Flawed Inspections of Factories Abroad," *The New York Times,* September 1, 2013.

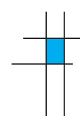
[32] Nike, "FY12/13 Sustainable Business Performance Summary," *www.nikeresponsibility.com*.

[33] Ronald M. Roman, Anne T. Lawrence, and Chirag Amin, "LaborVoices: Bringing Transparency to the Global Supply Chain," *Case Research Journal* 34, no. 4 (Fall 2014). For more information, see *www.laborvoices.com*.

data on environmental, social, and ethical performance in supply chains. In 2017, the platform served 30,000 subscribers in 128 countries. More than 150 major companies used the service, including BASF, Coca-Cola, Johnson & Johnson, and Schneider Electric. Lead firms used the data not only to track their suppliers' compliance, but also to set and maintain corrective action plans and to learn from others' innovations. EcoVadis recently raised $32 million in funding to support its artificial intelligence capabilities, to help automate the analysis of the millions of pages of documents collected annually in more than 20 different languages.[34]

Similar services are also offered by industry groups such as the Responsible Business Alliance and by nonprofits, such as Sedex (Supplier Ethical Data Exchange) Global.

What do companies do when an audit reveals a gap between their social, ethical, and environmental standards and a supplier's practices? Most audits turn up at least some instances in which a company's global operations are not in compliance. For example, inspectors may uncover underage workers, violations of environmental commitments, or discriminatory hiring practices. Sometimes, a company will terminate a supplier, if the supplier is unwilling to change or the deficiencies are egregious. For example, when Gap's auditors found an unauthorized, makeshift factory operated by a subcontractor in India, where children were embroidering a product for GapKids, the company immediately cancelled the order and banned the subcontractor from any future work. Forty-eight percent of companies said in a survey they would terminate a supplier in certain cases, as Gap did, if violations were found.[35] But increasingly, firms try to work in a positive way with suppliers to help them improve their practices. This topic is discussed next.



Supplier Development and Capability Building

A growing trend is for lead firms to work collaboratively with their suppliers to help them improve their social, ethical, and environmental performance. The term **supplier development** refers to activities undertaken by companies to improve the performance of firms in their supply chains.[36] Rather than terminate or punish a supplier, a lead firm may choose instead to invest time and resources to build the supplier's capabilities. Such an approach starts from the premise that many suppliers wish to comply, but simply lack the managerial skill, technical knowledge, or resources to do so.

Why would lead firms decide to engage in **capability building**, rather than simply give their contracts to someone else—or even do the work themselves? One reason is that the cost of switching suppliers may be too high. A supplier may have critical capabilities, such as technical expertise in making a specific product, or other attributes that the lead firm values, such as relationships with other firms farther upstream in the supply chain. The lead firm may feel a moral obligation to the workers and local community not to cause job loss. Or, other suppliers may not be readily available to take over the contract. For many reasons, then, a lead firm may find it preferable to work with a supplier to fix problems and improve its performance.

[34] "EcoVadis Supplier Sustainability Ratings Activity Report 2016," at *www.ecovadis.com,* and "Can Artificial Intelligence Make Supply Chains More Sustainable?" January 23, 2017, at *www.greenbiz.com*.

[35] Barchi Gillai, Angharad H. Porteous, and Sonali V. Rammohan, "The Relationship between Responsible Supply Chain Practices and Performance," Stanford Global Supply Chain Management Forum, November 2013, Appendix 2, p. 9.

[36] Daniel R. Krause, Robert B. Handfield, and Beverly B. Tyler, "The Relationship between Supplier Development, Commitment, Social Capital Accumulation, and Performance Improvement," *Journal of Operations Management* 25 (2007), online at *www.sciencedirect.com*. See also Steven C. Dunn and Richard R. Young, "Supplier Assistance within Supplier Development Initiatives," *Journal of Supply Chain Management* (Summer 2004).

Supplier development may take several forms, including training, joint problem solving, and investing in equipment or infrastructure. For example, the Responsible Business Alliance, mentioned earlier, offers its members and their suppliers an e-learning platform and in-person trainings in multiple languages. An online course in "responsible supply chain management" designed specifically for factory managers, for instance, is offered in English, Chinese, Thai, Japanese, Korean, and Spanish.[37] Following the catastrophic factory collapse in Bangladesh, mentioned earlier in this chapter, dozens of lead firms organized as the Accord on Fire and Building Safety inspected 1,100 supplier factories and found structural deficiencies in more than 100 of them. Under the terms of the accord, member brands committed to providing funds to correct these safety problems, either through loans or favorable contract terms.

Some companies have invested directly in improving the lives and professional skills of their suppliers' workers.

> Gap Inc., the apparel retailer, supports a program called Personal Advancement and Career Enhancement, or P.A.C.E., which has served 68,000 low-skilled women garment workers in 12 countries throughout its global supply chain—with plans to reach more than one million by 2020. Created in collaboration with several NGOs—the International Center for Research on Women, CARE, and the Swasti Health Resource Centre (located in India)—P.A.C.E. provides up to 80 hours of free life skills and technical training. Classes have been held in India, Cambodia, Vietnam, Bangladesh, Sri Lanka, and China. An evaluation of the program showed that women who participated had a greater sense of self-worth and were better able to manage their work and professional lives. The program also decreased worker turnover, and women who completed the program were more likely to be promoted at work.[38]

This initiative went beyond the factory walls to empower women and build communities.

Lead firms can provide a variety of rewards to suppliers that collaborate to build capabilities. For example, PUMA, the German footwear company, has partnered with the International Finance Corporation to offer lower borrowing costs to suppliers that meet strict social and environmental standards.[39] Other companies have offered premium pricing, extended contracts, or other incentives. Research has shown that capability building initiatives work best where interactions between buyer and supplier are frequent and ongoing, and where the two parties have a long-term relationship. If suppliers are unconvinced they will benefit from more orders or higher margins, they are less willing to participate. On the other hand, they are more likely to engage when lead firms are prepared to offer them stable, long-term contracts, so they feel that investing in compliance is worthwhile.[40]

Effective supplier development often involves careful study to determine the underlying cause of repeated violations of particular code requirements or standards. This is known as **root cause analysis**. For example, Nike's supplier audits turned up repeated instances of excessive overtime in apparel manufacturing factories, particularly in China, despite rules prohibiting this practice. When the company studied the problem, it found that the biggest root cause was *style proliferation*—asking factories to make too many different styles and to switch frequently from one style to another. Each change reduced

[37] "Supporting All Learners on their Path to Leadership in Supply Chain Sustainability," at *www.responsiblebusiness.org*.

[38] "P.A.C.E.—Changing One Million Lives," at *www.gapincsustainability.com*.

[39] "PUMA Launches Financing Program to Reward Suppliers for Sustainability Performance," September 8, 2016, at *www.sustainablebrands.com*.

[40] Locke, pp. 101–104.

efficiency and required extra work hours. Nike also found other root causes, such as miscalculations in placing orders, last-minute changes in colors and fabrics, and poor forecasting of customer demand. In response, the company committed to reducing the number of styles contracted to each supplier.[41]

As this example implies, demands placed on suppliers may run at cross-purposes. If an electronics company places a rush, high-volume order for a popular new product, and at the same time prohibits excessive overtime, the supplier may be unable to fulfill both requirements at once. Or, a lead firm may pressure suppliers, on one hand, for ever-lower costs and, on the other hand, for compliance with expensive environmental standards. Suppliers are caught in a bind, not knowing which set of expectations is more important. These contradictory demands sometimes reflect divergent priorities within the lead firm itself. Departments of supply chain management or procurement may be focused on one set of goals, and departments of citizenship, sustainability, or social responsibility on another.

Some forward-thinking companies have directly addressed this problem. They have developed organizational mechanisms to resolve differences in priorities internally, and they have tried to communicate expectations more clearly to suppliers. One trend is the use of **integrated supplier scorecards** that rate suppliers on multiple dimensions, including both traditional measures (such as cost, quality, and timeliness) and newer measures of social, ethical, and environmental performance. For example, Nike has introduced a Manufacturing Index that measures and rewards suppliers on four dimensions—quality, on-time delivery, cost, and sustainability—each of which is weighted 25 percent. (The sustainability factor is broadly defined to include social, environmental, and health and safety issues.) "The [Manufacturing] Index enables us to reward contract factories that score consistently well across all categories," said Nike's vice president of sustainable business and innovation.[42]

Research shows that when companies invest in suppliers and their employees, exchange knowledge, and collaborate on improvements, they create *shared value,* that is, mutual benefit for both the business and its suppliers.

> One of the poorest countries in the world is Madagascar, an island nation off the east coast of the African continent. It is the source of about 80 percent of the global supply of vanilla—the world's most popular flavor. Vanilla comes from an orchid that is cultivated by farmers on small plots, using labor-intensive methods, often in remote villages. Two major companies—Unilever, the Anglo-Dutch multinational consumer goods company, and Symrise, a German supplier of flavors and fragrances—partnered with NGOs and aid organizations to train vanilla farmers in Madagascar to improve yields and diversify their crops. They also invested directly in local primary schools. The result was higher income and expanded opportunities for vanilla farmers and their children, and a more stable and higher-quality supply of vanilla for their business customers. Symrise said that its goal was "to establish a supply chain that created value for everyone involved."[43]

Supplier development, as shown in this example, can benefit both the lead firm and the supplier.

[41] More information about Nike's corporate responsibility and sustainability practices is available at https://sustainability.nike.com.

[42] Angharad H. Porteous and Sonali V. Rammohan, "Integration, Incentives, and Innovation: Nike's Strategy to Improve Social and Environmental Conditions in its Global Supply Chain," *Stanford Initiative for the Study of Supply Chain Responsibility,* November 9, 2013; and Hannah Jones, "Forum: Can Global Brands Create Just Supply Chains," May 21, 2013, at *www.bostonreview.net/forum/can-global-brands-create-just-supply-chains/new-conversation-responsibility*.

[43] "Unilever, Symrise and GIZ Join Forces With Save the Children to Support Vanilla Farming Communities in Madagascar," November 11, 2016, at *www.unilever.com*. Symrise's description of the partnership is available at *https://vanilla.symrise.com/creating-shared-value*.

FIGURE 17.4
Lead Firm Responses to Supply Chain Audits of Social, Ethical, and Environmental Performance

Source: Created by the authors, based on a figure appearing in Gap Inc., 2011/12 Social and Environmental Responsibility Report, p. 35.

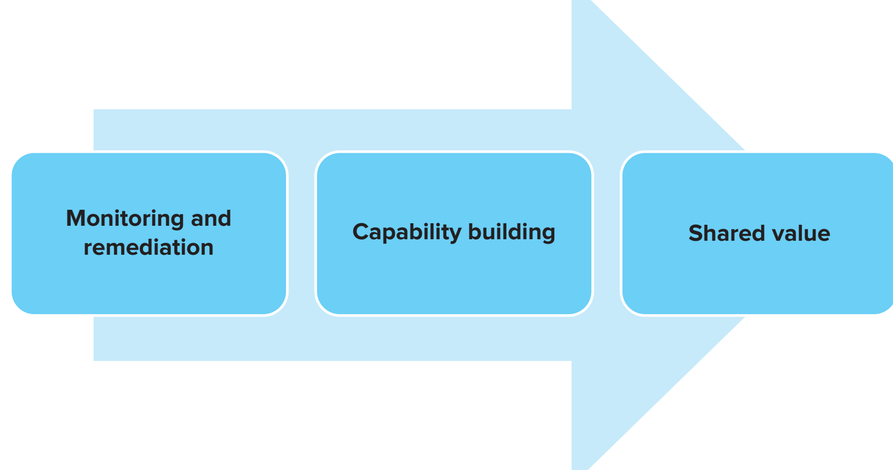


Figure 17.4 portrays interactions between lead firms and suppliers as a sequential process that begins with monitoring and remediation, and then moves upward through capability building, and finally to the creation of shared value. Firms continue activities at the lower levels, even as they progress through the next two, in cumulative steps.

Summary

- A supplier is an organization that provides goods or services to another organization. Suppliers are important market stakeholders, since they provide critical inputs and often manufacture branded products. Although suppliers are diverse, they share a common interest in building long-term, stable relationships with buyers. Suppliers that provide unique skills, resources, or capabilities tend to have more power. As globalization has increased, supply chains have become increasingly complex.
- Many social, ethical, and environmental issues arise in global supply chains. These include low wages, unsafe conditions, child and forced labor, unethical sourcing from conflict areas, and adverse environmental impacts of resource extraction, production, and transportation. Companies that do not manage supply chain risks effectively can suffer financial and reputational damage; conversely, those that manage these risks well can benefit.
- Private regulation refers to nongovernmental institutions that establish rules in global supply chains. It generally takes the form of company and industrywide codes of conduct with which suppliers must comply. Private regulation tends to arise in situations where public regulation is weak, and lead firms carry significant reputational risk because of strong consumer brands.
- Lead firms and groups of firms use several methods to audit compliance with supply chain codes of conduct. These include internal audit, third-party (external) audits, and crowd-sourced audits. Increasingly, companies are working together to audit major suppliers and to share results, often on cloud-based platforms.
- A growing trend is for companies to engage collaboratively with suppliers to build capability. This benefits both the firm and supplier, creating shared value. Suppliers are more likely to engage with lead firms with which they have stable, long-term relationships.

Key Terms

capability building, *389*
child labor, *380*
crowd-sourced audit, *388*
human trafficking, *380*
integrated supplier scorecard, *391*
private regulation, *384*
root cause analysis, *390*
supplier, *376*
supplier development, *389*
supply chain, *376*
supply chain audit, *387*
supply chain codes of conduct, *385*
supply chain map, *378*
supply chain transparency, *383*
sweatshop, *379*
tier-1 and tier-2 suppliers, *376*

Internet Resources

www.weforum.org/	World Economic Forum (reports on supply chain responsibility)
www.sourcingnetwork.org/	Responsible Sourcing Network
https://knowthechain.org/	Forced Labor in Supply Chains
www.greenbiz.com/topics/supply-chain	GreenBiz supply chain topics
www.responsiblebusiness.org/	Responsible Business Alliance
www.gsb.stanford.edu/value-chain-innovation/research/responsible-supply-chains	Stanford University Research on Responsible Supply Chains

Discussion Case: *IKEA's Sustainable Cotton Supply Chain*

In 2017, for the second year in a row, IKEA, the home furnishings retailer, was judged to have the most responsible cotton supply chain in the world, out of 75 consumer-goods companies that used significant amounts of cotton. A group of leading nonprofits scored these companies on three dimensions—having a strong sustainability policy, using a high percentage of sustainable cotton in their products, and tracing the origin of cotton across their entire supply chains. "This ranking shows we are well on our way, even if we all have to do more to transform the cotton and textile industry," said IKEA's sustainability manager.

In 2018, IKEA—founded in 1943 by Swedish entrepreneur Ingvar Kamprad—was the largest furniture retailer in the world, with annual revenues of $36 billion. The privately owned company operated 415 stores in 49 countries, selling ready-to-assemble furniture, housewares, and home décor to mass-market customers. Cotton was the company's second most important raw material after wood. IKEA used nearly 1 percent of the world's entire supply in a range of products, including bedding, bath towels, upholstery, mattresses, and cushions.

First grown by humans in the Indus Valley 7,000 years ago, by the 2010s cotton was grown in more than 80 countries and supported more than 250 million people worldwide, most of them in developing economies. Cotton's supply chain was long and complex. Cotton was grown on a farm, then sent to a ginning mill to remove seeds, stems, and dirt and compress the lint into bales. These were then shipped to a spinning mill to be made into yarn, then to a factory to be woven or knit into fabric, and then to a separate facility to be dyed. Yet another supplier cut, stitched, and made the fabric into products for sale to IKEA or other retailers. IKEA sourced its cotton from all over the world, with the largest shares

coming from India (25 percent), China (23 percent), Pakistan (18 percent), and Turkey (11 percent). Only 5 percent came from the United States.

Conventional cotton farming had many adverse environmental and social effects. Cotton used more water than any other agricultural commodity; about 3,000 gallons were required to grow the fiber used in just one pair of jeans, depleting surface and groundwater supplies. The sector was a major user of synthetic fertilizers, pesticides (insect-killers), and herbicides (weed-killers), many of which were highly toxic—threatening worker health and polluting land and water. Many cotton farmers had poverty-level incomes, and women received on average 25 to 30 percent less pay than men doing the same work. Child labor was used in the cotton industry in 18 countries.

IKEA was an early mover in supply-chain responsibility. In 2000, it adopted a supply chain code of conduct, called the IKEA Way on Purchasing Products, Materials, and Services (IWAY), which established minimum standards for environmental and social practices. The company believed this code to be consistent with its core values, which it described this way: "We want to economize with resources. We do not want to be wasteful, and we always strive to make more from less." It also believed that clear supply-chain standards would reduce risk and appeal to customers.

In its efforts to implement IWAY, the company quickly recognized cotton as a key area of concern. In 2005, IKEA joined with several other companies and NGOs—including the World Wide Fund for Nature (WWF), Oxfam, the Pesticide Action Network, The Gap, H&M, Levi Strauss, and Marks & Spencer—to form the Better Cotton Initiative (BCI), a multi-stakeholder collaboration aimed at making the global cotton industry "better for the people who produce it, better for the environment it grows in, and better for the sector's future." In 2009, the BCI published a set of standards calling for farms to use water efficiently, care for the soil, conserve habitats, maintain fiber quality, and promote decent work. BCI aimed to have 30 percent of the world's cotton produced to its standards by 2020.

For its part, IKEA adopted an ambitious goal of sourcing 100 percent of its cotton from sustainable sources by 2015. It started by mapping its own supply chain to better understand the long journey of cotton fiber from farm to end product. The company held workshops for tier-1 and 2 suppliers to communicate its sustainability commitments and provided them with preferred sourcing lists. It also worked directly with farmers. In Pakistan, for example, IKEA partnered with the WWF to train cotton farmers in more sustainable methods. The pitch to farmers was straightforward: they could save money and increase their incomes by reducing their use of water and chemical inputs. In China, the company worked with ginners to convince them to separate sustainable from conventional cotton; although the ginners would incur extra costs, they would benefit by winning market share. IKEA announced it would no longer source cotton from Uzbekistan, where child and forced labor had been ongoing concerns. It worked with BCI to introduce specialized software that farmers, spinners, and traders could use to track sustainable cotton through the multi-tiered supply chain.

By September 2015, IKEA had met its goal: 82 percent of its cotton supplies were grown to BCI standards, and the remaining 18 percent came from recycled sources.

In a 2017 evaluation, researchers found that the BCI and allied companies like IKEA had in a sense become *too* successful. The proportion of the world's cotton that was grown sustainably had increased rapidly. But demand for "better cotton" had lagged supply—even though the price was comparable—so only 21 percent of it was purchased by buyers looking specifically for sustainable cotton, with the rest entering the conventional cotton market. Several NGOs argued that the movement for sustainable cotton should shift its

focus from improving practices on farms to convincing more retailers and brands to buy their output. "Without demand from buyers, more sustainable cotton will remain a niche product, and the cotton sector's social and environmental problems will persist," said one NGO report.

Sources: Yu Gong et al., "Multiple Multi-Tier Supply Chain Management: A Single-Case Study on IKEA's Sustainable Cotton Initiative in China," presented at the 12th International Conference on Operations and Supply Chain Management, Qingdao, July 12–15, 2018; Francine Laurin and Kamal Fantazy, "Sustainable Supply Chain Management: A Case Study at IKEA," *Transnational Corporations Review,* November 2017; "Sustainable Cotton Ranking 2017: Assessing Company Performance," October 2017, Pesticide Action Network, Solidaridad, and WWF; "IKEA Ranked Number 1 for the Second Year in Sustainable Cotton Report," press release, October 2, 2017, at *https://newsroom.inter.ikea.com;* Better Cotton Initiative, *2016 Annual Report,* July 20, 2017, at *https://2016.bciannualreport.org;* IKEA Group Sustainability Report FY 2016, at *www.ikea.com;* "Mind the Gap: Towards a More Sustainable Cotton Market," Pesticide Action Network, Solidaridad, and WWF, April 2016; "IKEA Says 100% of its Cotton Now Comes from More Sustainable Sources," *Sustainable Brands,* November 2, 2015; "People & Planet Positive: IKEA Group Sustainability Strategy for 2020," June 2014, at *www.ikea.com;* and Kavita Joshi Rai, "Case Study: The IKEA Experience in Moving Towards a Better Cotton Supply Chain," Dutch Sustainable Trade Initiative, 2011.

Discussion Questions

1. Draw a supply chain map of IKEA's cotton supply chain.
2. What social, ethical, and environmental risks were present in IKEA's cotton supply chain?
3. What characteristics of the cotton supply chain made enforcing its code of conduct especially challenging for IKEA?
4. What were the advantages and disadvantages to IKEA of working collaboratively with other companies and NGOs to improve sustainability in its cotton supply chain?
5. What motivated actors throughout the complex cotton supply chain to comply with IKEA's sustainability goals?
6. What more, if anything, could IKEA do now to improve sustainability in the cotton sector?

CHAPTER EIGHTEEN

The Community and the Corporation

A strong relationship benefits both business and its community. Communities look to businesses for civic leadership and for help in coping with local problems, while businesses expect to be treated in fair and supportive ways by the community. As companies expand their operations, they develop a wider set of community relationships. Community relations programs, including corporate giving, are an important way for a business to express its commitment to corporate citizenship.

This Chapter Focuses on These Key Learning Objectives:

LO 18-1 Defining a community, and understanding the interdependencies between companies and the communities in which they operate

LO 18-2 Analyzing why it is in the interest of business to respond to community problems and needs.

LO 18-3 Knowing the major responsibilities of community relations managers.

LO 18-4 Examining how different forms of corporate giving contribute to building strong relationships between businesses and communities.

LO 18-5 Evaluating how companies can direct their giving strategically, to further their own business objectives.

LO 18-6 Analyzing how collaborative partnerships between businesses and communities can address today's pressing social problems.

Vodafone is one of the world's largest telecommunications companies, with networks or partner networks in 66 countries around the world. This means that the U.K.–based firm has complex relationships with multiple communities, ranging from major cities to remote villages. "We have a duty to work within these communities to create better, more equal societies," said its CEO, Vittorio Colao. Vodafone was one of the first companies in the world to report its taxation and economic contributions country-by-country, acknowledging that paying taxes was a critical contribution to community well-being. The Vodafone Foundation, the company's charitable affiliate, donates more than $30 million a year to partner foundations and NGOs throughout the world, with a focus on using mobile technology to promote health, education, and disaster relief. For example, in 2018 the foundation supported a program in Ghana that would anonymously track the movement of mobile phone users, to assist public health authorities prevent the spread of infections like Ebola.[1]

Whole Foods Market is a natural foods retailer with stores in many communities in North America and the United Kingdom. Founded in 1980 in Austin, Texas, and acquired by Amazon in 2017, the company believes that its business "is intimately tied to the neighborhood and larger community that we serve and in which we live." Whole Foods donates 5 percent of its net profit to charitable causes and operates a foundation that supports rural economic development, as well as projects that support animal welfare, organic production, and healthy nutrition. Each of the company's 484 stores hosts a community giving day several times a year, with 5 percent of the day's total sales revenue contributed to a worthy local nonprofit organization. Whole Foods also encourages its employees to volunteer their time and expertise to the community. Employees have been involved in a wide range of service projects, including organizing blood donation drives, raising money for breast cancer research, developing community gardens, renovating housing, and delivering "meals on wheels."[2]

In 2018, the pharmaceutical company Pfizer paid a $24 million fine to settle kickback charges related to its donations to patient-assistance charities. Why should corporate donations to a charity be considered illegal? Pfizer and other drug makers had donated hundreds of millions of dollars to charities that gave grants to Medicare patients who could not afford the out-of-pocket expenses (such as copays and deductibles) for expensive new drugs for prostate cancer and other conditions. Without this assistance, many of these patients would have gone without treatment or turned to less-expensive alternatives. But with it, they were able to fill their prescriptions—and Medicare paid the rest of the cost, which could approach $10,000 a month. The drug companies found that $1 million in tax-deductible donations to these charities could generate $21 million in sales—a great rate of return. "Pfizer knew that the third-party foundation was using [its] money to cover the copays of patients taking Pfizer drugs, thus . . . masking the effect of Pfizer's price increases," said the government prosecutor.[3]

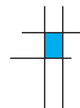
Why do businesses as diverse as Vodafone, Whole Foods, and Pfizer invest in community organizations, projects, and charities? Why do they contribute their money, resources, and time to help others? What benefits do they gain from such activities, and are their motivations always appropriate? This chapter explains why many companies believe that being an involved citizen is part of their basic business mission. The chapter also looks at how companies participate in community life and how they build partnerships with other businesses, government, and community organizations. The core questions that we consider in

[1] "Vodafone Foundation 'Big Data for Good' Programme," *Financial Times,* February 26, 2018. Vodafone's sustainability report and information about its foundation are at *www.vodafone.com*.

[2] See *www.wholefoodsmarket.com/mission-values/caring-community/community-giving*.

[3] "Pfizer Settles Kickback Case Related to Copay Assistance for $24 Million," *The Washington Post,* May 24, 2018; "U.S. Probe Sheds Light on Charities' Role in Boosting Drug Sales," *The Wall Street Journal,* June 11, 2017.

this chapter are: What does it mean to be a good corporate neighbor? What is the business case for doing so? How do charitable activities interact with a firm's strategic objectives?



The Business–Community Relationship

The term **community**, as used in this chapter, refers to a company's area of business influence. Traditionally, the term applied to the city, town, or rural area in which a business's operations, offices, or assets were located. With the rise of large, complex business organizations, the meaning of the term has expanded to include multiple localities. A local merchant's community relationships may involve just the people who live within driving distance of its store. A bank in a large metropolitan area, by contrast, may define its community as the both the central city and the suburbs where it does business. And at the far extreme, a large multinational firm such as Vodafone, ExxonMobil, or H&M has relationships with numerous communities in many countries around the world.

Today the term *community* may also refer not only to a geographical area or areas but to a range of groups that are affected by an organization's actions, whether or not they are in the immediate vicinity. In this broader view, as shown in Figure 18.1, the *geographical* (sometimes called the *site*) community is just one of several different kinds of communities.

Whether a business is small or large, local or global, its relationship with the community or communities with which it interacts is one of mutual interdependence. As shown in Figure 18.2, business and the community each need something from the other. Business depends on the community for education, public services such as police and fire

FIGURE 18.1
The Firm and Its Communities

Source: Adapted from a discussion in Edmund M. Burke, *Corporate Community Relations: The Principle of Neighbor of Choice* (Westport, CT: Praeger, 1999), Ch. 6.

Community	Interest
Site community	Geographical location of a company's operations, offices, or assets
Fence-line community	Immediate neighbors
Virtual communities	People who buy from or follow the company online
Communities of interest	Groups that share a common interest with the company
Employee community	People who work near the company

FIGURE 18.2
What the Community and Business Want from Each Other

Business Participation Desired by Community	Community Services Desired by Business
· Pays taxes	· Schools—a quality educational system
· Provides jobs and training	· Recreational opportunities
· Follows laws	· Libraries, museums, theaters, and other cultural services and organizations
· Supports schools	· Adequate infrastructure, e.g., sewer, water, and electric services
· Supports the arts and cultural activities	· Adequate transportation systems, e.g., roads, rail, airport, harbor
· Supports local health care programs	· Effective public safety services, e.g., police and fire protection
· Supports parks and recreation	· Fair and equitable taxation
· Assists less advantaged people	· Streamlined permitting services
· Contributes to public safety	· Quality health care services
· Participates in economic development	· Cooperative problem-solving approach

Exhibit 18.A

Community Support for Professional Sports Franchises

The professional sports franchise is one kind of business that has historically been particularly dependent on support from the community. Cities often compete vigorously in bidding wars to attract or keep football, basketball, baseball, hockey, and soccer teams. Communities subsidize professional sports in many ways. Government agencies build stadiums and arenas, sell municipal bonds to pay for construction, give tax breaks to owners, and allow teams to keep revenues from parking, luxury boxes, and food concessions. Some say that public support is warranted, because high-profile teams and sports facilities spur local economic development, offer wholesome entertainment, and build civic pride. But critics argue that subsidies simply enrich affluent team owners and players at taxpayer expense and shift spending away from other more deserving areas, such as schools, police and fire protection, social services, and the arts. In this view, this is a case in which the relationship between business and the community is deeply out of balance.

A recent example was the Little Caesars Arena, built in Detroit at a cost of $823 million to house the National Hockey League's Red Wings and National Basketball Association's Pistons. About 62 percent of the funding for the new arena came from private sources, mostly from the Ilitch family, which owned the Little Caesars pizza chain. The remaining 38 percent came from public financing, including the sale of municipal bonds structured to be paid off using local property taxes. A group of citizens sued, saying that tax revenues should go to support public goods like schools and parks, not sports arenas. But the suit failed, and the arena opened in 2017. A 2016 study by the Brookings Institution found that professional sports franchises had surprisingly little impact on local economic development; their facilities did not employ many people, and dollars spent on attending sporting events were typically dollars not spent on other recreational activities.

Sources: "Little Caesars Arena's Funding Mix Not Without Critics," *The Detroit News,* October 4, 2017; "Data Released on Little Caesars Arena Taxing District," *Arena Digest,* December 12, 2016; and "Tax-Exempt Municipal Bonds and the Financing of Professional Sports Stadiums," *Economic Studies at Brookings,* September 2016. A website critical of public subsidies to sports facilities is *www.fieldofschemes.com*.

protection, recreational facilities, and transportation systems, among other things. In some cases, businesses receive financial support from a community to locate a facility there. In 2017, for example, the state of Wisconsin announced $3 billion in tax credits to induce the Taiwanese electronics giant Foxconn to locate a huge flat-panel television plant in the state. The company said the plant would directly create at least 3,000 jobs, and many more indirectly.[4] On the other side, the community depends on business for jobs and economic development. Businesses support the arts, schools, health care, and the disadvantaged, and other urgent civic needs through donations of money, goods, and time. And, a key obligation of companies to the communities (and nations) where they do business and earn revenue is, of course, paying applicable taxes.

Ideally, community support of business and business support of the community are roughly in balance, so that both parties feel that they have benefited in the relationship. Sometimes, however, a business will invest more in the community than the community seems to provide in return. Conversely, a community sometimes provides more support to a business than the firm contributes to the community. Exhibit 18.A discusses subsidies by communities to professional sports franchises, an instance in which the relationship between business and the community is sometimes perceived as out of balance.

The Business Case for Community Involvement

The term **civic engagement** describes the active involvement of businesses and individuals in changing and improving communities. *Civic* means pertaining to cities or communities,

[4] "Wisconsin's Lavish Lure for Foxconn: $3 Billion in Tax Subsidies," *The New York Times,* July 27, 2017.

and *engagement* means being committed to or involved with something. Why should businesses be involved with the community? What is the *business case* for civic engagement?

The ideas of corporate social responsibility and citizenship, introduced in earlier chapters, refer broadly to businesses acting as citizens of society by behaving responsibly toward all their stakeholders. Civic engagement is a major way in which companies carry out their corporate citizenship mission. As explained in Chapter 3, business organizations that act in a socially responsible way reap many benefits. These include an enhanced reputation and ability to respond quickly to changing stakeholder demands. By acting responsibly, companies can also avoid or correct problems caused by their operations—a basic duty that comes with their significant power and influence. They can win the loyalty of employees, customers, and neighbors. And by doing the right thing, businesses can often avoid, or at least correctly anticipate, government regulations. All these reasons for social responsibility operate at the level of the community as well, via civic engagement.

Another specific reason for community involvement is to win local support for business activity. Communities do not have to accept a business. They sometimes object to the presence of companies that will create too much traffic, pollute the air or water, or engage in activities that are viewed as offensive or inappropriate. A company must earn its informal **license to operate**—or right to do business—from society. In communities where democratic principles apply, citizens have the right to exercise their voice in determining whether a company will or will not be welcome, and the result is not always positive for business.

> Walmart has encountered serious local objection to its plans to build superstores and distribution centers in a number of local communities. Although some towns have welcomed Walmart for the shopping opportunities and jobs it brings, others have mounted intense opposition to the company's plans to move in. For example, in 2017 a judge blocked an effort by local activists in Chico, California, to stop the expansion of a Walmart store in the community. The activists, who called themselves Chico Advocates for a Responsible Economy, said they were acting to protect the community's economy, environment, and quality of life. The problem of community opposition seems likely to grow more complex for Walmart as it continues its expansion into international markets.[5]

Through positive interactions with the communities in which its stores are located, Walmart is more likely to avoid this kind of local opposition.

Community involvement by business also helps build social capital. **Social capital** has been defined as the norms and networks that enable collective action. Scholars have also described it as "the goodwill that is engendered by the fabric of social relations."[6] When companies such as Whole Foods Market, described at the beginning of this chapter, work to address community problems such as blood shortages, hunger, and dilapidated housing, their actions help build social capital. The company and groups in the community develop closer relationships, and their people become more committed to each other's welfare. Many experts believe that high levels of social capital enhance a community's quality of life. Dense social networks increase productivity by reducing the costs of doing business, because firms and people are more likely to trust one another. The development of social capital produces a win–win outcome because it enables everyone to be better off.[7]

[5] "Judge Sides with Walmart," December 7, 2017, at www.newsreview.com. For the company's perspective on its community relationships, see *www.walmart.com*.

[6] Paul S. Adler and S. W. Kwon, "Social Capital: Prospects for a New Concept," *Academy of Management Review* 27, no. 1 (January/February 2002), pp. 17–40. For a more general discussion, see Robert D. Putnam, *Bowling Alone: The Collapse and Revival of American Community* (New York: Simon and Schuster, 2000).

[7] Some benefits of social capital are described on the World Bank website at *www.worldbank.org*.

Community Relations

The organized involvement of business with the community is called **community relations**. Some corporations have established specialized community relations or community affairs departments; others house this function in a department of corporate citizenship or corporate responsibility.[8] The job of the **community relations manager** (sometimes called the community involvement manager) is to interact with local citizens, develop community programs, manage donations of goods and services, work with local governments, and encourage employee volunteerism. These actions are, in effect, business investments intended to produce more social capital—to build relationships and networks with important groups in the community. Community relations departments typically work closely with other departments that link the company to the outside world, such as public relations (discussed in Chapter 19), as well as internal departments such as human resources and marketing. Sometimes they serve in concurrent positions in a company's foundation. All these roles form important bridges between the corporation and the community.

An example of an executive with broad responsibility in this field is Marlene Ibsen, vice president of community relations at Travelers Corporation and CEO and president of its affiliated Travelers Foundation. In these roles, she oversees around $20 million in charitable gifts annually. A focus of the company's community engagement has been Traveler's EDGE, a program that supports the education of young people from underrepresented communities who wish to pursue careers in insurance and finance, using metrics to track impacts. Ibsen also manages a program that matches Travelers employees with volunteer service opportunities. "From the funding we provide to nonprofits and community programs to our employees' incredible level of volunteerism, we work to help foster resilience and vitality in local neighborhoods," Ibsen said.[9]

Community relations departments have a wide range of responsibilities. According to a recent survey of professionals, these include managing employee volunteer programs, sustainability reporting, corporate giving, stakeholder engagement, and disaster preparedness and response. Although not exhaustive, this list suggests the range of needs that a corporation's community relations professionals are asked to address. Most of these professionals are part of small teams; three-quarters manage fewer than three people.[10] These community relations managers must leverage their connections both inside and outside their companies to develop creative ways to strengthen the community. Several specific ways in which businesses and their community relations departments have addressed critical concerns facing communities are discussed below.

Economic Development

Business leaders and their companies are frequently involved in local or regional economic development that is intended to bring new businesses into an area or to develop workforce skills.

When the Distinct 89 Nightclub closed in downtown Newark, New Jersey, no one had much hope that the abandoned lounge would provide jobs any time soon. But that changed when a start-up called AeroFarms took over the space to test a

[8] Boston College Center for Corporate Citizenship, "Profile of the Professionals 2018," *at http://ccc.bc.edu*.

[9] "Travelers Publishes Its 2017 Community Report," *The New York Times,* April 18, 2018.

[10] "Profile of the Professionals 2018," op. cit.

technology called aeroponics that used LED lighting, fabric, and nutrient-rich mist to grow vegetables indoors. The experiment worked so well that the company leased a former steel mill in Newark's Ironbound district, where it created the largest vertical farm in the world in growing capacity, shipping 2 million tons of produce annually. The company chose its location because of strong community support, access to consumers, and a desire to support job creation. "We are very much focused on how we can drive economic development and job creation," said the company's cofounder.[11]

Housing

Another community issue in which many firms have become involved is housing. Life and health insurance companies, among others, have taken the lead in programs to revitalize neighborhood housing through organizations such as Neighborhood Housing Services (NHS) of America. NHS, which is locally controlled, locally funded, nonprofit, and tax-exempt, offers housing rehabilitation and financial services to neighborhood residents. In Newark, New Jersey, Prudential took the lead in revitalizing an abandoned downtown department store called Hahne & Company, investing $50 million to create a combination of apartments, retail, and office space with 40 percent of the housing units set aside for low- and moderate-income residents.[12] Corporations also often work with nongovernmental organizations (NGOs) such as Habitat for Humanity to build or repair housing. Globally, businesses have also been active in housing issues, as illustrated by the following example.

CEMEX, a global leader in the building materials industry that is based in Mexico, is a longtime supporter affordable housing in developing countries. Through its Patrimonio Hoy ("heritage today") program, it assists low-income families with the training, materials, and microfinancing needed to construct their own low-cost housing safely and efficiently. It is also a member of Business Call to Action, an alliance of companies and governments supporting the United Nations' Millennium Development Goals. By 2017, Cemex's program was active in Mexico, Costa Rica, Colombia, the Dominican Republic, and Nicaragua, and had helped 2.8 million people. "CEMEX is a company that is constantly striving to innovate so that our products, services, and strengths contribute to improve the quality of life, particularly of vulnerable families," said the company's director of corporate responsibility.[13]

Aid to Minority, Women, and Disabled Veteran-Owned Enterprises

Private enterprise has also extended assistance to minority, women, and disabled veteran-owned small businesses. These businesses often operate at an economic disadvantage. In some cases, they do business in economic locations where high crime rates, poor transportation, low-quality public services, and a low-income clientele combine to produce a high rate of business failure. In others, they face competition from more established suppliers. Many large corporations now have supplier diversity programs that seek out partnerships with such enterprises.

AT&T has operated supplier diversity programs for more than 40 years. In 2017, the company spent $14 billion procuring products and services from certified minority, women, and disabled veteran-owned businesses—more than a fifth of its

[11] A collection of news stories about AeroFarms is available on the company's website at *http://aerofarms.com/farms*.

[12] "Taking Care of Business," *Chronicle of Philanthropy,* October 2017.

[13] Cemex's Patrimonio Hoy and other related initiatives are described in the company's 2017 Integrated Report at *www.cemex.com*.

procurement spending. An example of such a supplier is Group O Direct, an Illinois–based firm that provides fulfillment services for customer promotions. Group O Direct, which is 100 percent Hispanic-owned, has many other high-profile clients in addition to AT&T, including Caterpillar, MillerCoors, and Best Buy, and annual revenues of about $560 million.[14]

Disaster, Terrorism, and War Relief

One common form of corporate involvement in the community is disaster relief. Throughout the world, companies, like individuals, assist local citizens and communities when disaster strikes. When floods, fires, earthquakes, ice storms, hurricanes, or terrorist attacks devastate communities, funds pour into affected communities from companies.

Businesses from all over the world responded with great generosity to the communities impacted by the devastating hurricanes that struck the Gulf Coast and the Caribbean in 2017. After Hurricane Harvey battered Houston, Texas, and the surrounding areas, many companies donated cash through the Red Cross or other aid organizations, or matched employee contributions; 90 firms gave at least $1 million. Airbnb came up with an innovative idea: it allowed hosts in nearby communities to use its platform to offer free housing to those displaced by the storm. Uber donated rides and food and supply deliveries, and WeWork offered free workspace. In the aftermath of Hurricane Maria, Tesla shipped batteries to Puerto Rico and sent employees to attach them to solar panels to provide life-saving electricity while the power grid was off-line. AT&T sent its Flying COW (Cell on Wings)—a specially-equipped drone—to hover over San Juan to provide wireless connectivity and cell phone service. The logistics company DHL sent a disaster response team to help organize relief supplies pouring into the Caribbean islands from all over the world.[15]

International relief efforts are becoming more important, as communications improve and people around the world are able to witness the horrors of natural disasters, terrorism, and war. Corporate involvement in such efforts is an extension of the natural tendency of people to help one another when tragedy strikes. It is also a way for companies to build brand loyalty, as people often develop lasting gratitude to those who helped them in times of great need.

In all these areas of community need—economic development, housing, aid to minority enterprise, and disaster relief—as well as many others, businesses around the world have made and continue to make significant contributions.

Corporate Giving

An important aspect of the business–community relationship is **corporate philanthropy**, or **corporate giving**. Corporate philanthropy has been defined as the voluntary and unconditional transfers of cash or other assets by private firms for public purposes.[16] Every year,

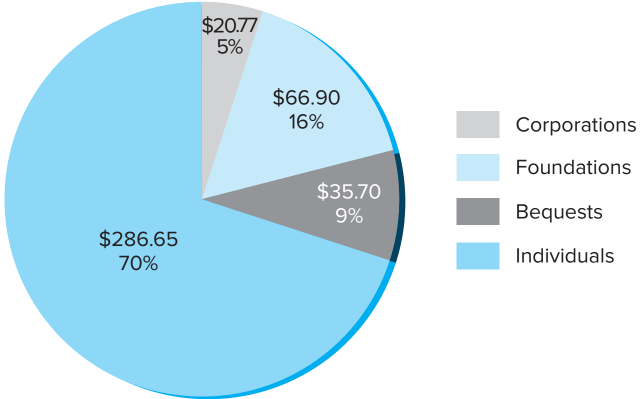
[14] AT&T's supplier diversity programs are described at *www.attsuppliers.com/sd*. The website of Group O is at *www.groupo.com*.

[15] "Tesla is Shipping Hundreds of Powerwall Batteries to Puerto Rico," September 29, 2017, *www.engadget.com;* "These Companies are Donating Millions to Help Victims of Hurricane Harvey," *Fortune,* August 28, 2017; "Airbnb Extends Hurricane Harvey Free Housing Program," August 29, 2017, at *http://money.cnn.com;* "Corporate Donations for Harvey, Irma Disaster Relief Near $225 Million," *Reuters,* September 22, 2017; and "Standing Strong in the Caribbean," October 2017, at *www.delivered.dhl.com*.

[16] This definition is drawn from Arthur Gautier and Anne-Claire Pache, "Research on Corporate Philanthropy: A Review and Assessment," *Journal of Business Ethics,* February 2015, and is based on one developed by the Financial Accounting Standards Board.

FIGURE 18.3
Philanthropy in the United States, by Source of Contributions, 2017 (in $ billions)

Source: *Giving USA 2018: The Annual Report on Philanthropy for the Year 2017,* p. 22. Researched and written by Indiana University Lilly Family School of Philanthropy. Sponsored by *Giving USA Foundation,* a public service initiative of *The Giving Institute.*



Total value of contributions was $410.02 billion.

businesses around the world give generously to their communities through various kinds of philanthropic contributions to nonprofit organizations.

America has historically been a generous society. In 2017, individuals, bequests (individual estates), foundations, and corporations collectively gave more than $410 billion to churches, charities, and other nonprofit organizations, as shown in Figure 18.3. This figure for the first time crossed the $400 billion mark. Businesses were a small, but important, part of this broad cultural tradition of giving. In 2017, corporate contributions totaled $20.8 billion, or about 5 percent of all charitable giving. This amount included in-kind gifts claimed as tax deductions and giving by corporate foundations.

As U.S. firms have become increasingly globalized, as shown in Chapter 4, their international charitable contributions have also grown. A 2017 survey of 258 companies by the Conference Board found that international giving (contributions to recipients outside the country where the firm was headquartered) comprised one-fifth of all donations that were made the prior year. Companies tended to give where they had operations or customers or in response to specific natural disasters. Global energy companies and technology companies were particularly likely to focus their giving internationally. For example, between 2000 and 2018, ExxonMobil has donated $170 million to efforts to eradicate malaria, mostly to programs in Africa and Asia.[17]

In the United States, tax rules have encouraged corporate giving for educational, charitable, scientific, and religious purposes since 1936. Current rules permit corporations to deduct from their taxable income all such gifts that do not exceed 10 percent of the company's before-tax income. In other words, a company with a before-tax income of $1 million might contribute up to $100,000 to nonprofit community organizations devoted to education, charity, science, or religion. The $100,000 in contributions would then reduce the income to be taxed from $1 million to $900,000, thus saving the company money on its tax bill while providing a source of income to community agencies. Of course, nothing prevents a corporation from giving more than 10 percent of its income for philanthropic purposes, but it would not be given a tax break above the 10 percent level. Opinions differed on how the tax changes that went into effect in 2018 in the United States might affect corporate giving. Some thought companies might give less, because the drop in their tax rate from 35 percent to 21 percent would make contributions less valuable as a deduction.

[17] See *http://corporate.exxonmobil.com/en/community/malaria-prevention*.

But others thought they might donate more, because they would retain more of their profits after taxes—and so have more to give.

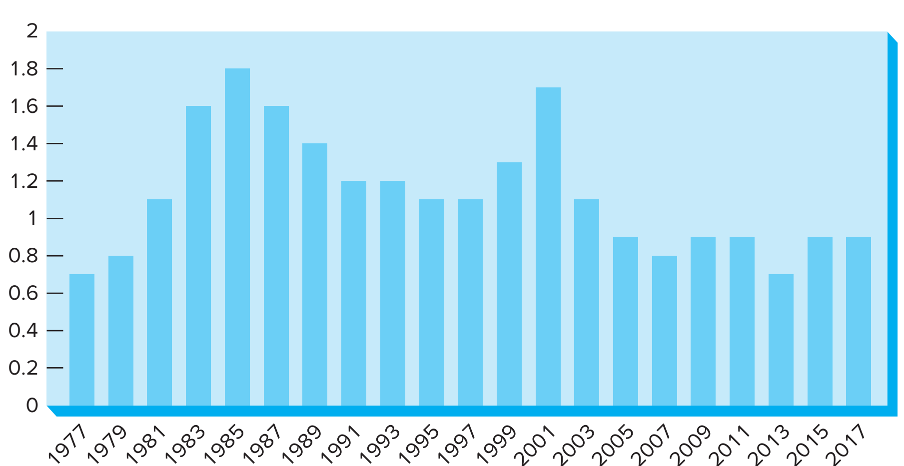
As shown in Figure 18.4, average corporate giving in the United States is far below the 10 percent deduction now permitted. Though it varies from year to year, corporate giving has generally ranged between one-half of 1 percent and 2 percent of pretax profits since the early 1960s. Corporate giving was 0.9 percent of pretax profits in 2017. A few companies, including a cluster in the Minneapolis–St. Paul area that has pledged to donate 5 percent annually, give much more than this. The top cash givers in 2015, relative to pretax profits, included General Mills (6 percent), Chevron (5 percent), and Nationwide and Xerox (4 percent each).[18] One company, Newman's Own, the philanthropic corporation established by the late film star Paul Newman, gives *all* of its earnings to charity.

A recent academic study concluded that corporate giving was sometimes motivated not so much by charitable impulses as by a desire to gain political influence. This study's findings are presented in Exhibit 18.B.

In Europe, corporate philanthropy has lagged behind that in the United States, in part because tax breaks are less generous and differences in the law across countries make cross-border giving difficult. Greater spending on social welfare by governments, civil society organizations, and by the Catholic Church in some regions of Europe has also reduced the incentive for private-sector donations.[19] Europe-based multinational corporations remain active, however. To cite one example, the Shell Foundation, based in the United Kingdom and endowed by the Shell Group, provides grants and technical assistance to entrepreneurs working on access to energy, mobility, and job creation in developing countries. In 2017, the Foundation and a partner bank announced $50 million in financing to connect households that were off-the-grid in Africa and India to modern energy services.[20]

Is the public generally aware of corporate giving? An intriguing 2018 study from the United Kingdom suggested that companies were not doing a good job of

FIGURE 18.4
Corporate Contributions in the United States, as a Percentage of Pretax Corporate Profits, 1977–2017



Source: *Giving USA 2018: The Annual Report on Philanthropy for the Year 2017,* p. 380. Researched and written by Indiana University Lilly Family School of Philanthropy. Sponsored by *Giving USA Foundation,* a public service initiative of *The Giving Institute.*

[18] "Cash Giving from Business Edges Up, Chronicle Survey Shows," *Chronicle of Philanthropy,* June 1, 2016.

[19] "The State of European Philanthropy," *Alliance for Philanthropy of Social Investment Worldwide,* January 24, 2017, at *www.alliancemagazine.org*.

[20] "New $50 Million Energy Access Growth Fund Announced by Shell Foundation, FMO," November 2, 2017, at *https://medium.com*. The website of the Shell Foundation is at *www.shellfoundation.org*.

Exhibit 18.B

Corporate Philanthropy—Charitable Giving or Influence-Peddling?

What motivates companies and their affiliated foundations to support some causes rather than others? A comprehensive recent report by economists affiliated with the National Bureau of Economic Research came to a startling conclusion: at least some corporations' charitable giving is a strategy to gain political influence.

How does this work? The authors cited the example of Exelon Corporation, the energy company, which was seeking approval to build a nuclear power plant. Around the same time, Exelon donated $25,000 to the Barton Family Foundation. Joe Barton, a prominent member of Congress, served on the House Energy and Commerce Committee, which had jurisdiction over the nuclear energy industry. Barton had started his family foundation to support charities in his Texas district, such as the Boys and Girls Club and Meals-on-Wheels. Was Exelon's donation intended to support these worthy programs, or to curry favor with the congressman? "Raising money for a foundation can be done very easily behind the scenes and outside the public's view, and allows the special interest groups to court members of Congress for something they need," said the director of Texans for Public Justice.

The economists tested their hypothesis by examining the tax records of foundations affiliated with large U.S. companies (members of the *S&P 500* or *Fortune 500*) from 1998 to 2015. They found that these corporate foundations were more likely to give to charities in congressional districts when its representative sat on a committee relevant to the company's interests and to charities linked to particular politicians, such as ones on whose boards the congressmembers served. In all, the economists estimated that about 7 percent of total corporate foundation giving was politically motivated. This amount was significant—it exceeded the amount companies spent annually on lobbying. "Corporations wouldn't do this if it didn't pay off," said one of the report's authors.

Sources: "Charitable Giving by Corporations Is Also About Getting, a New Study Finds," *The New York Times,* April 3, 2018; "Barton's Foundation Not So Charitable," *The Washington Times,* April 6, 2009; and Marianne Bertrand, Matilde Bombardini, Raymond Fishman, and Francesco Trebbi, "Tax-Exempt Lobbying: Corporate Philanthropy as a Tool for Political Influence," March 14, 2018, available at *www.nber.org*.

communicating their philanthropic efforts. The research showed that large companies in the United Kingdom had increased their donations of cash, products, and employee time by almost 70 percent since 2009. But when people were asked what they knew about corporate philanthropy, the answer was: very little. Respondents thought that about 35 percent of big companies gave to charity; in fact, almost all did. They thought consumer services and consumer goods companies were the most generous (perhaps because they were most familiar with these brands); but, in fact, these two actually ranked fourth and sixth among the ten industries studied (the leading industry was pharmaceuticals). "A large gap exists between perception and reality," concluded the report's authors.[21]

Although many companies give directly, some large corporations have established nonprofit **corporate foundations** to handle their charitable programs. This permits them to administer contribution programs more uniformly and provides a central group of professionals that handles all grant requests. To give just one example, over the past decade the General Motors Foundation has given more than $261 million to support STEM education, traffic safety, disaster relief, and other causes. Seventy-eight percent of large U.S.–based corporations have such foundations; collectively, corporate foundations gave about $6.09 billion in 2017.[22] Some foreign-owned corporations, such as Panasonic, also use

[21] "Corporate Giving by the FTSE 100: Bigger Impact Through Better Business," January 2018, available at the website of the Charities Aid Foundation at *www.cafonline.org*.

[22] *Giving in Numbers,* 2017 ed., op. cit., p. 30; and *Giving USA 2018,* op. cit., p. 26.

foundations to conduct their charitable activities in the United States. Foundations, with their defined mission to benefit the community, can be a useful mechanism to help companies implement philanthropic programs that meet this corporate social responsibility.

Forms of Corporate Giving

Typically, gifts by corporations and their foundations take one of three forms: charitable donations (gifts of money), in-kind contributions (gifts of products or services), and volunteer employee service (gifts of time). Many companies give in all three categories.

> An example of a particularly generous cash gift was one made by Regeneron, a biotechnology company. In 2016, Regeneron pledged $100 million over a 10-year period to the Society for Science & the Public Interest. The purpose of the gift was to support this organization's Science Talent Search, a prestigious science competition for high school seniors. The gift also included funds for outreach to young people, particularly in underserved areas, and for more prize money. As part of the competition, every year 40 finalists traveled to Washington, DC, to present their research to members of the scientific community. Awards included college scholarships and computers. Many former winners had gone on to distinguished careers in science and entrepreneurship. "This should be the best reality show in the world," said Regeneron's founding scientist. "The world has challenges like cancer, the Zika virus, and global warming. We need to change who are heroes are."[23]

The share of all giving comprising **in-kind contributions** of products or services has been rising steadily for the past decade or so and has now surpassed cash contributions. Of U.S. corporate contributions in 2016, 18 percent were in-kind (noncash), 48 percent were cash, and the balance came in the form of contributions from affiliated foundations.[24] For example, high-technology companies have donated computer hardware and software to schools, universities, and public libraries. Grocery retailers have donated food, and Internet service providers have donated time online. Publishers have given books. The most generous industry, in terms of in-kind contributions, is pharmaceuticals. Gilead Sciences, for instance, gave $1.9 *billion* to charity in 2015, almost all in the form of medicines. In-kind contributions can be creative—and they need not cost a lot. Frito-Lay, for example, donated publicity to Do Something—a nonprofit whose mission is to encourage young people to improve the world—by featuring photos of the organization's work on 500 million bags of Doritos chips. "It drove fabulous recognition for our organization and helped our Web traffic," said the grateful director.[25] The contribution was a low-cost one for Frito-Lay, which would have had to print its bags anyway.

Under U.S. tax laws, if companies donate new goods, they may deduct their fair-market value within the relevant limits. For example, if a computer company donated $10,000 worth of new laptops to a local school, it could take a deduction for this amount on its corporate tax return, provided this amount was less than 10 percent of its pretax income.

Business leaders and employees also regularly donate their own time—another form of corporate giving. **Volunteerism** involves the efforts of people to assist others in the community through unpaid work. According to a report by the Department of Labor, about

[23] "Regeneron Pharmaceuticals to Sponsor Science Talent Search," *The New York Times,* May 26, 2016. The website of the Regeneron Science Talent Search is at *www.societyforscience.org*.

[24] *Giving in Numbers: 2017 Edition,* op. cit., p. 15.

[25] "Philanthropy: A Special Report: Firm Decisions: As Companies Become More Involved in Giving, Charities Are Glad to Get Aid Faster and with Less Red Tape," *The Wall Street Journal,* December 10, 2007.

25 percent of Americans ages 16 and older volunteered during the prior year, donating on average 52 hours of their time.[26] Many companies encourage their employees to volunteer by publicizing opportunities, sponsoring specific projects, and offering recognition for service. Research shows that offering such opportunities can benefit companies by attracting young employees.

> A survey by the consulting firm Achieve found that a company's volunteer policies had a big impact on where Millennials chose to work. One third of Millennials said that the opportunity to volunteer had influenced their decision to apply for a job, two-fifths said it had influenced their decision to interview, and more than half said it had influenced their decision to accept an offer. "Millennials are blending who they are, what they do, what they stand for, and the causes and things they care about into the workplace," said the president of the consulting firm. An example of a company that was acting on this insight was ExactTarget, a cloud marketing firm, which ran a program that matched the interests of employees with the needs of local nonprofits. The company's vice president for community programs reported she regularly received e-mails from employees saying, "It is so fantastic to be part of an organization that is committed to giving back." "That is all the evidence we need that we are doing the right thing," she concluded.[27]

An important trend is what is known as **skills-based volunteerism**, in which employee skills are matched to specialized needs. For example, the financial services firm Fidelity paired its experts with the Capital Good Fund, a nonprofit that provided financial services such as home loans to disadvantaged communities. The project's goal was to improve the interface for the fund's lending portal. Technical specialists from Fidelity modified the system to permit people who did not have computers at home to apply on their mobile phones and to save their work and continue at a later time. The result was a 9 percent increase in application completion rates and greater usability for the fund's low-income clients. And, as a side benefit, the individual who had led the partnership for the Capital Good Fund said that working with the Fidelity experts had "changed [my] career trajectory."[28]

Another approach is for companies to provide employees with *paid* time off for volunteer service in the community. For example, Wells Fargo offers a volunteer leave program, under which employees can apply for a fully paid sabbatical of up to four months to work in a nonprofit organization of their choice. In recent years, Wells Fargo employees on paid leave have trained teachers in Afghanistan; built homes in Oaxaca, Mexico; and helped renovate a facility for the mentally ill. A 2016 survey found that 23 percent of U.S. employers allowed all or most of their employees to volunteer during regular work hours, and 45 percent allowed at least some to do so.[29] One country where this trend is particularly strong is Brazil: in just a two-year period between 2010 and 2012, the proportion of employers allowing volunteering on work time increased from 35 to 60 percent.[30]

[26] "Volunteering in the United States, 2015," U.S. Department of Labor, press release, February 25, 2016.

[27] "Millennials Are Drawn to Companies That Offer Chances to Volunteer," *Chronicle of Philanthropy,* July 17, 2014.

[28] "The Promise of Skills-Based Volunteering," *Stanford Social Innovation Review,* Fall 2017, and "Impact Inspirations: Capital Good Fund," January 29, 2016, at *https://commonimpact.org*.

[29] "2016 National Study of Employers," at *http://familiesandwork.org*.

[30] Silicon Valley Community Foundation, *Global Employee Engagement Report: Brazil, China, India, South Africa, United Kingdom* (2015), at *www.siliconvalleycf.org*.

Exhibit 18.C Using Technology to Encourage and Track Employee Engagement

Many companies have turned to technology to improve the amount and effectiveness of employee volunteerism and giving. Several vendors now offer cloud-based software that enables companies to match volunteer opportunities with interested employees who have appropriate skills and experience, and to track their hours of contribution. The software also tracks employee charitable giving and employer matching programs, and organizes disaster response activities, among other functions. For example, JetBlue used software called VolunteerMatch to expand the range of volunteer opportunities available to employees. "Rather than restrict volunteering to a single cause or organization," the company said, "JetBlue supports the unique, individual passions and causes of *all* JetBlue crewmembers." Other providers of such software include CyberGrants LLC, MicroEdge LLC, Benevity, and JK Group Inc. Some firms—among them, Oracle, IBM, and Salesforce—have developed their own platforms to manage their employees' engagement. Bank of America has developed a custom-designed website to measure and recognize employee volunteerism and giving; in 2017, bank employees volunteered two million hours and donated $30 million, which the company matched. Whether provided by outside vendors or in-house, software enables companies to better monitor and measure the impact of their employees' contributions to the community.

Sources: Boston College Center for Corporate Citizenship, "Community Involvement Technology Vendors 2016: An Overview," at *http://ccc.bc.edu;* and "Get to Know JetBlue, Finalist for 2016 Employee Volunteer Program of the Year," August 30, 2016, at *https://blogs.volunteermatch.com*.

Evidence shows that companies with robust volunteer programs reap benefits, even as communities gain from their workers' contributions of time and skill. For example, Keurig Green Mountain, a purveyor of specialty coffees and single-cup brewing systems based in Vermont, has an active volunteer program called Community Action for Employees (CAFÉ). Keurig Green Mountain employees can spend up to 52 hours per year of paid work time volunteering for nonprofits in their communities. The company's Dollars-for-Doers program provides a $250 grant to any organization to which an employee donates 25 hours or more in a year. More than half of their 6,600 employees participate. An academic study of the company's volunteer program found that employees who valued the program were more likely to be proud of their company and want to continue to work there. Moreover, their supervisors reported separately that these employees ranked higher than their peers in organizational citizenship. The researcher concluded the program had benefited Keurig Green Mountain directly through its impact on employees, quite apart from any impact it may have had on branding and consumer loyalty.[31]

The increasing use of technology to help organize and promote employee engagement in the community is profiled in Exhibit 18.C.

All three forms of giving—cash, in-kind donations, and employee time—are part of the integrated model of corporate philanthropy promoted by the cloud-based software company Salesforce, described in the discussion case at the end of this chapter.

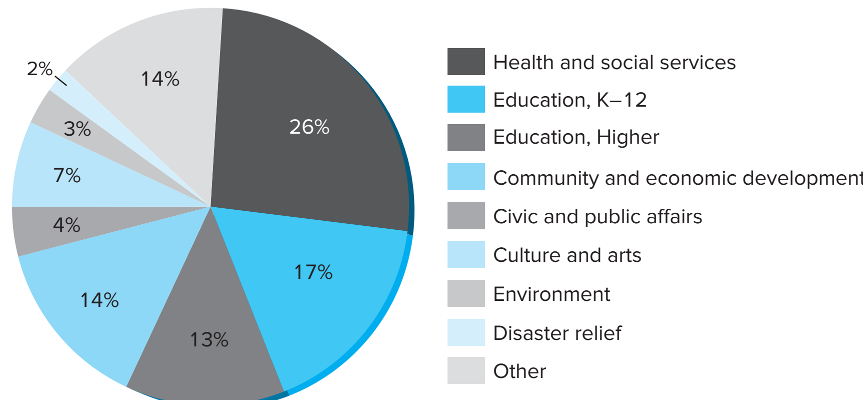
Priorities in Corporate Giving

Overall, what kinds of organizations receive the most corporate philanthropy? The distribution of contributions reflects how businesses view overall community needs, and how

[31]David A. Jones, "Does Serving the Community Also Serve the Company? Using Organizational Identification and Social Exchange Theories to Understand Employee Responses to a Volunteerism Programme," *Journal of Occupational and Organizational Psychology* 83, (2010); and "Engaging Our Employees," at *www.keuriggreenmountain.com*.

FIGURE 18.5
Priorities in Corporate Giving (percentage of corporate cash and in-kind contributions to various sectors)

Source: *Giving in Numbers: 2017 Edition* (New York: The Conference Board, 2017), p. 12. All data are for 2016.



this perception has changed over time. As shown in Figure 18.5, the corporate giving "pie" is divided into several main segments. The largest share of corporate philanthropy goes to health and human services; the next largest share goes to education. Civic and community organizations and culture and the arts also receive large shares of business philanthropy. Of course, these percentages are not identical among different companies and industries; some companies tend to favor support for education, for example, whereas others give relatively greater amounts to cultural organizations or community groups.

Corporate Giving in a Strategic Context

Communities have social needs requiring far more resources than are normally available, and businesses often face more demands than they can realistically meet. This is particularly true in hard economic times, when funds may be less plentiful. Companies must establish priorities to determine which worthy projects will be funded or supported with the company's in-kind or volunteer contributions and which ones will not. What criteria should community relations departments apply in determining who will receive corporate gifts? These are often difficult choices, both because businesses may want to support more charities than they can afford, and because saying no often produces dissatisfaction among those who do not get as much help as they want.

One increasingly popular approach is to target corporate contributions *strategically* to meet the needs of the donor as well as the recipient. **Strategic philanthropy** refers to corporate giving that is linked directly or indirectly to business goals and objectives. In this approach, both the company and society benefit from the gift.

For example, Cisco Systems, a manufacturer of hardware for the Internet, has established a Networking Academy to train computer network administrators. From a modest start in 1997 in a high school near the company's headquarters in San Jose, California, by 2018 the program had expanded to include more than 10,000 sites in 180 countries and had trained almost eight million students. The academy initiative benefits communities throughout the world by providing job training for young people, many of whom go on to successful careers in systems administration. But it also benefits the company, by assuring a supply of information technology professionals who can operate Cisco's complex equipment. Companies and governments are more likely to buy from Cisco if they are confident skilled technicians are available.[32]

[32] More information about the Networking Academy is available at *www.netacad.com*.

A study in the *Harvard Business Review* identified four areas in which corporate contributions were most likely to enhance a company's competitiveness, as well as the welfare of the community.[33] Strategic contributions focus on:

- *Factor conditions,* such as the supply of trained workers, physical infrastructure, and natural resources. Cisco's Networking Academy is an example of philanthropy that helps the donor by providing skilled employees both for Cisco and for its corporate customers.
- *Demand conditions,* those that affect demand for a product or service. When Microsoft provides free software to libraries and universities, new generations of young people learn to use these programs and are more likely later to buy computers equipped with the company's products.
- *Context for strategy and rivalry.* Company donations sometimes can be designed to support policies that create a more productive environment for competition. For example, contributions to an organization such as Transparency International that opposes corruption may help a company gain access to previously unreachable markets.
- *Related and supporting industries.* Finally, charitable contributions that strengthen related sectors of the economy may also help companies. For example, when Starbucks contributes to programs that provide training and assistance to coffee farmers in developing countries, as described in Chapter 3, the company is not only helping farmers, it is helping itself assure a continuing supply of high-quality, ethically sourced coffee beans.

Of course, not all corporate contributions benefit their donors directly, nor should they. But most, if handled correctly, at least build goodwill and help cement the loyalty of employees, customers, and suppliers who value association with a good corporate citizen.

Specialists in corporate philanthropy recommend several other strategies to help companies get the most benefit from their contributions.[34]

- *Draw on the unique assets and competencies of the business.* Companies often have special skills or resources that enable them to contribute in ways that others could not. For example, Google provides free advertising on its search engine to nonprofit organizations in many countries. In 2018, it helped 35,000 NGOs in this manner. Donations to Direct Relief International, just one of many charities supported in this way, increased more than tenfold after it joined Google's program.[35] As mentioned earlier in this chapter, many companies have drawn on their unique competencies in responding to natural disasters—such as Tesla's contributions of batteries, AT&T's of cellular service, and DHL's logistics support in the aftermath of Hurricane Maria.
- *Align priorities with employee interests.* Another successful strategy is to engage employees in directing the company's charitable donations. For example, VMware, a software company, gives all new employees $31.41 (a play on the mathematical π) on their first day at work to give to a nonprofit of their choice. "Our people are very geeky, and we embrace that about our community," said the director of the VMware Foundation. "And it's a memorable amount for the nonprofit recipients—they know it's from

[33] Michael E. Porter and Mark R. Kramer, "The Competitive Advantage of Corporate Philanthropy," *Harvard Business Review,* December 2002.

[34] See, for example, David Hess, Nikolai Rogovsky, and Thomas W. Dunfee, "The Next Wave in Corporate Community Involvement: Corporate Social Initiatives," *California Management Review* 44, no. 2 (Winter 2002).

[35] More information is available at *www.google.com/grants*.

us." When VMware employees reach certain career milestones, they are invited to direct additional amounts to their nonprofit of choice, and engineers who are promoted to Fellow—the company's top technical position—are invited to endow an $800,000 scholarship at a university of their choice. These opportunities and other service learning activities are part of an integrated model the company calls "citizen philanthropy," in which employees are empowered to engage with the community on issues and causes they are passionate about.[36]

- *Align priorities with core values of the firm.* McDonald's Corporation, the fast-food giant, focuses its philanthropic contributions on children's programs. One of the company's major recipients is the Ronald McDonald House Charities, which operates facilities where families can stay together in a homelike setting while their child receives treatment at a nearby hospital. The program operates 365 houses in 64 countries. Each year, McDonald's franchises across the world host McHappy Day events, raising millions of dollars for the RMHC and related charities. McDonald's believes that this initiative is consistent with its mission to improve the lives of children and their families.[37]

In short, businesses today are taking a more strategic approach to all kinds of corporate giving. They want to make sure that gifts are not simply made randomly, but rather are targeted in such a way that they are consistent with the firm's values, core competencies, and strategic goals.

Measuring the Return on Social Investment

A final important trend in corporate philanthropy is assessment of impact. Increasingly, companies are using standard business tools to measure the outcomes of their investments in the community, just as they would any other investment. The benefits that accrue to business and society are sometimes called **return on social investment**. Return on social investment is often more difficult to measure than other kinds of return. For example, return to shareholders may be readily gauged by changes in share price and dividends paid. Return on investment in new machinery may be readily gauged by increases in productivity. By contrast, the results of corporate donations and employee volunteerism may occur over longer periods of time and be less amenable to measurement. Nevertheless, community relations and corporate giving professionals have made significant advances in developing appropriate metrics. Figure 18.6 shows the four elements that are often measured in assessing the return on social investment.

Inputs are the resources companies provide. They may include cash contributions, employee time, products and services, or logistics support. For example, a pharmaceutical company that has committed to help address the HIV-AIDS epidemic in sub-Saharan Africa might measure the value of medicines donated, employee time to administer the program, and cash donated to partner nongovernmental organizations in receiving countries.

Outputs are measures of the activities that took place—usually numerical counts of people and communities served. In the same example, outputs might be the number of persons who received antiretroviral medications and doses provided, the number of clinics provisioned, or the number of medical professionals trained.

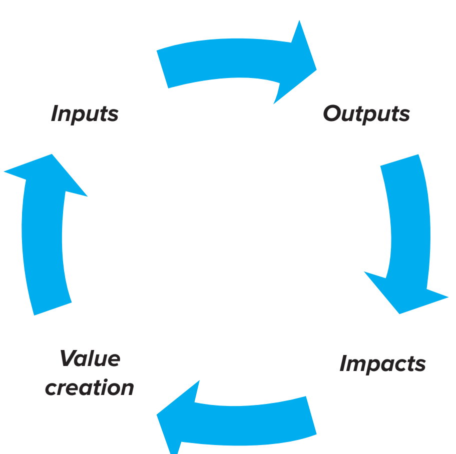
Impacts represent the difference the program made; that is, the actual benefits that accrued to the people and communities served. (Some research has used the term

[36] Personal correspondence with Jessamine Chin, director of the VMware Foundation.

[37] "Worldwide Corporate Social Responsibility 2010 Report" *www.mcdonalds.com;* and "Our History" [Ronald McDonald House Charities] at *http://rmhc.org*.

FIGURE 18.6
Measuring the Return on Social Investment

Sources: "Effective Community Engagement," *BCG Perspectives,* May 22, 2012, at *www.bcgperspectives.com;* and *Measuring the Value of Corporate Philanthropy: Social Impact, Business Benefits, and Investor Returns,* Committee Encouraging Corporate Philanthropy, 2010.



"outcomes" to describe these benefits.) It is similar to outputs, except that it tries to capture the actual results of the gift. How many cases of mother-to-child transmission of infection were prevented? What were the impacts on the ability of HIV-positive individuals to continue to work and contribute to the economic and social health of their communities? Since most firms partner with nonprofit agencies and governments, measuring the impacts of their gifts generally requires close collaboration with these organizations.

An example of a company that has worked hard to measure the impact of its social investments is Intel. The chipmaker's "Intel Teach" program has trained more than 15 million teachers in 70 countries. Its purpose is to help teachers use technology to promote students' problem solving, critical thinking, and collaboration skills. The company does more than simply count the number of teachers trained (outputs); it works with research organizations to measure how they actually use technology in their own classrooms and the impact of these efforts on student learning (impacts). "Intel is rigorously numerical," commented Wendy Hawkins, executive director of the Intel Foundation. "Measurement makes it more likely that our leaders will support and fund the philanthropy."[38]

Value creation represents the benefits to the business of the program. This is similar to the concept of enlightened self-interest, as presented in Chapter 3. Often this is the most difficult element to measure. In the same example used earlier, was the reputation of the pharmaceutical company enhanced? Did the firm develop new relationships and opportunities in developing countries? Did the program help it attract and retain the brightest scientists? Increasingly, companies are moving away from reliance on anecdotal evidence and trying to measure the business benefits quantitatively. As shown in Figure 18.6, when businesses benefit from their gifts (*value creation*), this enhances their ability to make further gifts (*inputs*), thus creating a kind of virtuous circle.

Research shows that about three-quarters of companies now measure the inputs and outputs of at least some of their community involvement efforts, but fewer measure impacts. (This study did not examine the percentage that measured value creation.)[39]

[38] Updates on Intel's Teach Program are available at *www.intel.com*.

[39] "Community Involvement Study 2015," at *http://ccc.bc.edu*.

Building Collaborative Partnerships

The term *partnership,* introduced in Chapter 4, refers to a voluntary collaboration among business, government, and civil society organizations to achieve specific objectives. The need for such **collaborative partnerships** is very apparent when dealing with community problems.

One arena in which collaborative partnerships among business, government, and communities have been particularly effective is education. As mentioned earlier in this chapter, community relations managers count education as the most critical challenge they face. Many school districts and colleges in the United States face an influx of new students from the so-called echo boom generation, increasing class sizes and making it more difficult to give students the individual attention they need. Many schools are challenged to educate new Americans, immigrants from other parts of the world who often do not speak English as their native language. More children are living in poverty, and many come from single-parent homes. A fast-changing economy demands that the technological tools accessible to students be greatly expanded. All these challenges must be met in many states under conditions of extreme fiscal constraint, as tax revenues fall and budget crises loom. The difficulties faced by schools are of immediate concern to many companies, which rely on educational systems to provide them with well-trained employees equipped for today's high-technology workplace.

> An example of a successful collaborative partnership is IBM's work with P-TECH (short for Pathways in Technology Early College High School), specialized public schools designed to track students into technology careers. Once accepted into P-TECH, students—most of whom are minority and low-income—take a sequence of technically focused courses that lead, in six or fewer years, to a high school diploma, an associate degree in applied science—and a job interview with IBM. The company also supported the schools with volunteer mentors, structured workplace visits, and paid summer internships. The company initially partnered with the public school and city university systems in Brooklyn, New York, to create the program in 2011. Since then, three other IBM-affiliated P-TECHs have opened in New York and Connecticut, and in 2018 they graduated 150 students. Said Ginni Rometty, CEO of IBM, of the company's efforts to fill technology jobs: "We will need new kinds of collaboration—involving federal and state governments, public school systems, community colleges and private business, across multiple industries."[40]

The success of P-TECH illustrates the potential of collaborative partnerships that allow business to contribute its unique assets and skills to a broader effort to solve significant community problems.

Communities need jobs, specialized skills, executive talent, and other resources that business can provide. Business needs cooperative attitudes in local government, basic public services, and a feeling that it is a welcome member of the community. Under these circumstances much can be accomplished to upgrade the quality of community life. The range of business–community collaborations is extensive, giving businesses many opportunities to be socially responsible.

Like education, other community challenges are, at their core, people problems, involving hopes, attitudes, sentiments, and expectations for better human conditions. Neither

[40] "We Need to Fill 'New Collar' Jobs That Employers Demand: IBM's Rometty," *USA Today,* December 13, 2016; and "P-TECH: When Ambition Meets Opportunity, Success Happens," at *www.ibm.com/thought-leadership/ptech.*

government nor business can simply impose solutions or be expected to find quick and easy answers to problems so long in the making and so vast in their implications. Moreover, neither government nor business have the financial resources on their own to solve these issues. Grassroots involvement is needed, where people are willing and able to confront their own needs, imagine solutions, and work to fulfill them through cooperative efforts and intelligent planning. In that community-oriented effort, government, nonprofit organizations, and businesses can be partners, contributing aid and assistance where feasible and being socially responsive to legitimately expressed human needs.

Summary

- The *community* refers to an organization's area of local influence, as well as more broadly to other groups that are impacted by its actions. Businesses and their communities are mutually dependent. Business relies on the community for services and infrastructure, and the community relies on business for taxes and support of various civic activities.
- Addressing a community's needs in a positive way helps business by enhancing its reputation, building trust, and winning support for company actions. Like other forms of corporate social responsibility, community involvement helps cement the loyalty of employees, customers, and the public.
- Many corporations have established community relations departments and foundations that respond to local needs and community groups, coordinate corporate giving, and develop strategies for creating win–win approaches to solving civic problems.
- Corporate giving comprises gifts of cash, property, and employee time. Donations currently average about 0.9 percent of pretax profits. Philanthropic contributions both improve a company's reputation and sustain vital community institutions. But, critics have also charged some companies with self-interested motives.
- Many companies have adopted a strategic approach to philanthropy, linking their giving to business goals. Corporate giving is most effective when it draws on the unique competencies of the business and is aligned with the core values of the firm and with employee interests. Increasingly, companies are measuring the return on their social investment for both recipients and themselves.
- The development of collaborative partnerships has proven to be effective in addressing problems in education and other civic concerns. Partnerships offer an effective model of shared responsibility in which businesses and the public and nonprofit sectors can draw on their unique skills to address complex social problems.

Key Terms

civic engagement, *399*
collaborative partnerships, *414*
community, *398*
community relations, *401*
community relations manager, *401*
corporate foundations, *406*
corporate philanthropy (corporate giving), *403*
in-kind contributions, *407*
license to operate, *400*
return on social investment, *412*
skills-based volunteerism, *408*
social capital, *400*
strategic philanthropy, *410*
volunteerism, *407*

Internet Resources

https://ccc.bc.edu	The Center for Corporate Citizenship at Boston College
www.pointsoflight.org	Points of Light Foundation
www.corporatephilanthropy.org	Committee Encouraging Corporate Philanthropy
www.givingusa.org	Giving Institute and Giving USA Foundation
www.onphilanthropy.com	Resources for nonprofit and corporate professionals working in the philanthropic sector
http://foundationcenter.org	Foundation Center
www.businessfightspoverty.org	Business Fights Poverty
www.taprootfoundation.org	Taproot Foundation (skilled-based volunteerism)

Discussion Case: *Salesforce's 1+1+1 Integrated Philanthropy Model*

Just four months after she started work at Salesforce, the cloud computing company, a colleague approached engineer Claire Whitehead with two questions: "Do you know HTML?" and "Can you help us teach some kids later today?" A few hours later, Whitehead found herself in front of a roomful of girls and boys demonstrating how to build a website. "I knew I owed it to my geeky 12-year-old self," Whitefield later said, explaining why she became a regular volunteer at CoderDojo, a global nonprofit that ran free clubs in 69 countries to teach coding to youngsters. Whitefield's efforts were part of a broader partnership between CoderDojo and Salesforce, which had donated $200,000 and close to 2,000 hours of its employees' time to the nonprofit.

Salesforce was a leading provider of customer relationship management software ("CRM" was the company's stock market symbol). Founded in 1999 by Marc Benioff, a former Oracle executive, the company provided cloud-based software designed to help organizations manage relationships with customers and other stakeholders. In 2018, the company had 25,000 employees, a market capitalization of more than $90 billion, and annual revenues of around $10 billion. Benioff had a broad vision of the purpose of the company he had founded. "The business of business," he stated, "is improving the state of the world."

Salesforce was widely recognized as one of the world's most charitable companies. It embraced what it called the 1+1+1 model of integrated philanthropy: the company pledged to give 1 percent of equity, 1 percent of product, and 1 percent of employee time to charity annually. Initially, it set aside 1 percent of its founders' equity for this purpose; later, after this amount was exhausted, it funded grants from general revenue. Suzanne DiBianca, the chief philanthropy officer and executive vice president of corporate relations, explained the company's approach: "Integrated philanthropy means aligning your community support with your core business and competencies. . . . [It recognizes] that your technology, your products, and your time are just as valuable as the dollars you can give away." The company coordinated its philanthropy through its affiliated nonprofit foundation, called Salesforce.org.

Salesforce employees received seven days a year of paid time-off to volunteer in whatever way they chose. Eighty percent took advantage of the opportunity to do so. Many

employees—like Whitehead—tapped into their professional expertise to lend a helping hand. Right after Hurricane Harvey hit the Houston area in 2017, for example, the Red Cross contacted Salesforce with an urgent problem: the website the Red Cross had set up to provide immediate cash assistance to victims had gotten so many hits it had crashed. Within hours, Salesforce had assembled a 40-person team of volunteers, who worked at night and over the weekend to put together a platform that could handle 275,000 aid applications an hour—at no cost to the Red Cross.

Through its Power of Us program, Salesforce.org provided free or deeply discounted software to nonprofits and educational institutions to help support their missions, with a value of as much as $20,000 a year to the recipient. Revenue that flowed back to Salesforce from discounted product sales to nonprofits was reinvested in the foundation. An example of a nonprofit that made good use of its free subscription was Polaris, an organization devoted to ending human trafficking and modern-day slavery. Polaris used the software to capture information from hotline calls, which had previously been recorded on paper documents, and to track cases through the system—enabling them to better serve clients, satisfy funder requirements, and demonstrate their impact.

Salesforce also donated millions of dollars directly to charitable causes. Education—especially in the areas of science, math, engineering, and technology—was a priority. Unlike some companies that donated to charter schools and special academies, Salesforce targeted public education, especially in its home community of San Francisco, where its multimillion-dollar annual gifts enabled the school district to develop the first-in-the-country computer science curriculum at every grade level. In many cases, the company linked monetary gifts to other forms of support. For example, it donated money, time, and resources to Year Up, an organization that placed talented but disadvantaged young adults in internships that could lead to living-wage jobs and stable careers—including ones at Salesforce.

In 2017, the company launched the Salesforce Impact Fund, endowing it initially with $50 million. The social venture fund's goal was to "accelerate the growth of companies using Salesforce technology to address challenges across workforce development, equality, sustainability, and the social sector." Early investments included Viridis Learning, a company that linked community colleges, their students, and local employers. Viridis helped schools to develop appropriate courses, students to track their progress in a "skills passport," and employers to find qualified candidates. "We've reverse-engineered the pathway to competency," said the Viridis CEO.

In 2018, Salesforce.org launched Philanthropy Cloud—which it dubbed a "social giving platform"—in partnership with United Way. Organizations could use the product to empower their employees to select causes to donate to, request employer matches, set personal goals, track their volunteer hours, and assess their impact. "We are living in an age of individuals, not institutions," said the CEO of United Way, which embraced the online platform as a way to modernize its established role as a middleman in workplace giving. An advantage of Philanthropy Cloud was that individuals could carry their profiles with them when they changed jobs.

In its 2018 annual report, Salesforce reported that since its founding, the company—together with Salesforce.org—had donated $200 million to charitable organizations, 2.6 million hours of employee time, and free or discounted services to more than 34,000 nonprofits and educational institutions. And Salesforce's integrated philanthropy model had spread to other companies as well. A nonprofit called Pledge 1% encouraged other companies to follow the Salesforce example and "take the pledge" by donating

1 percent of equity, employee time, profits, sales, products or services—or any combination of these. By 2018, Pledge 1% had reached 5,000 companies in 100 countries.

Sources: "Next Up for a Pioneer in Corporate Philanthropy: Transforming Workplace Giving," *Inside Philanthropy Today,* March 8, 2018; "Why Salesforce Has a Chief Philanthropy Officer," *Fast Company,* February 2, 2017; "Salesforce Chief Philanthropy Officer Suzanne DiBianca Wants All Companies to Drive Social Change," *Forbes,* July 21, 2016; "Suzanne DiBianca, Chief Philanthropy Officer of Salesforce, on Her Movement to Give Away $128 Million," April 27, 2017 [blog] at *http://medium.com;* "Inside the Salesforce Foundation: What's This Leader in Corporate Philanthropy Up to Now?" *Inside Philanthropy,* August 3, 2015. The website of Salesforce's nonprofit arm is at *www.salesforce.org;* the website of Pledge 1% is at *www.pledge1percent.org*. The founder's description of his philanthropic vision appears in Marc Benioff and Carlye Adler, *Behind the Cloud* (San Francisco: Jossey-Bass, 2009), Part 6, "The Corporate Philanthropy Playbook."

Discussion Questions

1. What evidence do you see in this case of the three kinds of corporate philanthropy discussed in this chapter: contributions of cash, in-kind products or services, and employee time?
2. What does integrated philanthropy mean, and how does it compare with the philanthropic initiatives of other companies discussed in this chapter?
3. Do you consider Salesforce's various charitable initiatives to exemplify strategic philanthropy, as defined in this chapter? Why or why not?
4. What are the benefits and risks to Salesforce of its approach to philanthropy?
5. If you were a corporate philanthropy manager for Salesforce, how would you evaluate the impact of the company's giving? What kinds of impacts would you attempt to measure?
6. Would Salesforce's philanthropic programs lead you to consider working for this company, and why or why not?

CHAPTER NINETEEN

Managing the Public and the Corporate Reputation

How the general public perceives a business firm can have a major effect on its performance and its ability to remain in business. Therefore, building a positive public reputation for providing superior products or services is of great importance. Most companies employ many people to help establish and maintain a good reputation. Their job is to formulate a strategy that includes, at a minimum, the careful management of the brand, interaction with the media, managing key issues that may arise, and successfully responding to any unanticipated crises. Ultimately, maintaining a positive public reputation depends on acting in an ethical and socially responsible manner.

This Chapter Focuses on These Key Learning Objectives:

LO 19-1 Recognizing why the general public is an important organizational stakeholder.

LO 19-2 Understanding what constitutes a good corporate reputation and why it is important.

LO 19-3 Knowing the basic elements and activities of a firm's public relations department.

LO 19-4 Assessing how brand management can best manage a firm's reputation.

LO 19-5 Evaluating a firm's crisis management plan as an effective tool for handling an unexpected situation.

LO 19-6 Recognizing tactics that enable businesses to engage with the general public and other stakeholders to enhance the firm's reputation.

In 2017, Pepsi, the 125-year-old beverage company, apologized for a controversial advertisement that borrowed imagery from the Black Lives Matter movement. The ad showed young people smiling, laughing, clapping, hugging, and high-fiving while holding generic signs saying, "Join the conversation." In the ad's climactic scene, a police officer accepts a can of Pepsi from Kendall Jenner, the daughter of television personalities Kris and Caitlyn Jenner and half-sister to Kim, Khloe, and Kourtney Kardashian, setting off loud approval from the young people and an appreciative grin from the police officer. Many people argued that the ad trivialized the widespread protests against the killing of black people by police and minimized the danger protesters encounter and the frustration they feel. Marsha P. Johnson, a former Black Lives Matter organizer, said, the ad "plays down the sacrifices people have historically taken in utilizing protests." A Pepsi spokesperson said, "Pepsi was trying to project a global message of unity, peace and understanding. Clearly, we missed the mark and apologize."[1]

21st Century Fox, the parent company of the conservative news show *Fox News,* encountered multiple sexual harassment scandals. Gretchen Carlson, a former Miss America and anchor of a *Fox News* show, accused long-time *Fox News*'s CEO Roger Ailes of publicly making harassing comments about her. Ailes reportedly made negative comments about Carlson's legs and suggested she wear tight-fitting outfits on camera. She tried to ignore him but finally complained to her supervisor. When Ailes heard of her criticisms, he responded by calling Carlson a man-hater and killer who "needed to get along with the boys." After this conversation, Carlson's role on *Fox News* diminished, as she was demoted to *Fox & Friends,* a lower-rated afternoon show. The incident went public and, according to Vanity Fair magazine, which initially broke this story, Fox agreed to pay Carlson $20 million. A year later, a *New York Times* investigation revealed that Bill O'Reilly, the anchor of Fox's most popular show, *The O'Reilly Factor,* and 21st Century Fox had settled multiple sexual harassment complaints against O'Reilly, resulting in $13 million in payments to five women. In response, BMW, GlaxoSmithKline, and Allstate Corporation joined a long list of other Fox programs' advertisers to withdraw their commercials from *The Bill O'Reilly Factor* show. Shortly thereafter, O'Reilly was fired.[2]

Both the Pepsi and 21st Century Fox examples illustrate the importance of maintaining a good reputation with the public. In an era when information travels at lightning speed through both conventional channels—television, radio, and newspapers—as well as social media outlets—blogs, websites, Twitter, e-mails, and others—reaching thousands, if not millions, of people, reputations can be lost in an instant. While businesses seek publicity and spend millions of dollars annually to improve their image and reputation, company executives must navigate many minefields as they compete for the hearts and minds of the consuming public. This chapter will define the general public as a stakeholder and present a variety of tools that businesses can use to build and protect their reputations and brands.

The General Public

The **general public** is broadly defined as an organizational stakeholder comprised of individuals and groups found in society. As described in Chapter 1, the general public does not deal with business organizations through an economic exchange with the firm, but it does affect the firm through its opinions of the firm's activities or performance. These opinions

[1] "Pepsi Pulls Ad Accused of Trivializing Black Lives Matter," *The New York Times,* April 5, 2017, *www.nytimes.com*.

[2] "The Revenge of Roger's Angels," *New York Magazine,* September 2016, *nymag.com;* "BMW, Glaxo and Allstate Join Wave of Advertisers Withdrawing from Bill O'Reilly's Show," *The Wall Street Journal,* April 4, 2017, *www.wsj.com;* and, "Fox Is Preparing to Cut Ties with Bill O'Reilly," *The Wall Street Journal,* April 18, 2017, *www.wsj.com*.

in turn help shape the firm's public image or reputation, as initially discussed in Chapter 3 and later in this chapter.

The public may utilize its own stakeholder networks—consumer advocacy groups, employee labor unions, or local community action groups—and engage with government agencies, special interest groups, or the media to demand a certain level of performance or to condemn or praise a firm. The public may react strongly against a business firm, even when its intentions are good, as the following story shows.

> Parents, consumer advocates, and health professionals called on the Academy of Nutrition and Dietetics, one of the world's largest groups of health professionals with over 100,000 credentialed practitioners, to address the issue of child obesity and nutrition. They developed the "Kids Eat Right" program to spread the message that children need more calcium and vitamin D in their diets. Kraft Foods, an American producer and marketer of foods products, sponsored the Kids Eat Rights program, and was given permission to print the Kids Eat Right logo on packages of its Kraft American Singles packages. Some supporters of Kids Eat Right were outraged at the Kraft brand associated with the program. They noted that Kraft Singles is a "pasteurized prepared cheese product" and not a "healthy food" for children. Opponents also pointed out that the Academy and Kraft were in a financial partnership, in which Kraft agreed to provide a grant to support research or public education initiative undertaken by the academy.[3]

Companies should be aware of how their actions may be portrayed in the media. The **media** is understood as the collective means of communicating to an audience. It traditionally included television, radio, and newspapers, but has grown to include the influential communication networks found on the Internet and through social media. Through the media, the firm can establish its reputation, repair a tarnished image, manage its public relations, address an organizational crisis, or engage with multiple stakeholders in a variety of ways. These topics will be addressed throughout this chapter.

What Is Reputation?

It may seem obvious that business organizations want to cultivate a good reputation. The term **corporate reputation** refers to desirable or undesirable qualities associated with an organization or its actors that may influence the organization's relationships with its stakeholders. It relies on the collective perceptions of past actions, results, and future prospects.[4]

> The importance of a good reputation is certainly obvious to Warren Buffet, owner of conglomerate Berkshire Hathaway. He reminds his managers each year in a now famous memo that their top priority must be to guard Berkshire's reputation: "As I've said in these memos for more than 25 years," Buffet wrote, "we can afford to lose money—even a lot of money. But we can't afford to lose reputation—even a shred of reputation. It takes 20 years to build a reputation and five minutes to ruin it."[5]

Scholars have noted that reputation is related to corporate identity and corporate image and that these sometimes reinforce each other. **Corporate identity** refers to the way in which

[3] "'Eat Right' Meltdown for Kraft Singles," *The Wall Street Journal,* March 23, 2015, *www.wsj.com*. Also see Eat Right Pro, the website for the Academy of Nutrition and Dietetics, at *www.eatrightpro.org*.

[4] Charles Fombrun and Cees Van Riel, "The Reputational Landscape," *Corporate Reputation Review,* 1 (1997), pp. 5–13.

[5] "Warren Buffet on Ethics: We Can't Afford to Lose Reputation," *The Wall Street Journal,* May 31, 2011, *blogs.wsj.com*.

an organization presents itself to an audience, while **corporate image** refers to the way organizational members believe others see the organization.[6] For example, the way an organization presents itself to it stakeholders (identity) may influence the stakeholders' perceptions of the organization (image). Each of these concepts is important to keep in mind when crafting a reputation-building strategy.

Few companies start with a reputation of distinction, simply because such a reputation must be built over time. Firms may have name recognition—an identity—but that is not the same as having a good reputation. So, firms need a strategy for building a good reputation.

Building a reputation can be thought of as a step-by-step process beginning with the very product(s) or service(s) the firm offers. Therefore, managers must first strive to become a company that is perceived by its stakeholders to offer *significantly* better products and services than its competitors. This perception is largely based on image. For example, the success of Apple products or Lexus automobiles is based in large part on their reputation for superior performance.[7]

Next, managers must aim to create and convey an *identity:* a consistent and compelling story about who the company is and what it stands for. This story needs to grab the attention of the news media, online media, and opinion leaders.

> The L.L. Bean company consistently tells the story that its products, designed for the outdoor enthusiast, are durable. Its policy of allowing consumers to return items, indefinitely, helps it uphold that reputational claim. One consumer has been returning her L.L. Bean backpacks for two decades whenever a zipper breaks. According to Steve Fuller, L.L. Bean's chief marketing officer, "If she believes her zippers should last a longer time, we'll respect that and we'll refund her money or give her a new product until she's happy," he said. Fuller believes that the real value of the policy is in how many times the woman tells people about her backpack returns.[8]
>
> REI, also a maker of outdoor clothing and gear, had the same policy but noticed that the amount of questionable returns was increasing after people talked about it on social media. In contrast to L.L. Bean, REI thought it was getting a reputation as a sucker. Nicknames like "Rental Equipment Inc.," "Rent Every Item," or "Return Every Item" began popping up on Facebook and Twitter. REI decided to change its policy to a one-year limit.[9]

These two different examples illustrate that a company's story must be a message that it can uphold and one that echoes the strong ethical values and beliefs of the company.

Why Does Reputation Matter?

Academic researchers and practitioners share a consensus that organizations with strong positive reputations, such as L.L. Bean, outperform their competitors. Respected organizations are generally more successful because they (1) receive more opportunities to advance their interests, (2) are given the benefit of the doubt in uncertain circumstances, and (3) are generally more immune to the long-term effects of harsh criticism than their less-respected

[6] See Reggy Hooghiemstra, "Corporate Communication and Impression Management: New Perspectives Why Companies Engage in Corporate Social Reporting," *Journal of Business Ethics* 27, (2000), pp. 55–68; Cees van Riel and C.B.M. van Riel, *Principles of Corporate Communication* (Harlow, England: Pearson Education, 1995); and The Reputation Institute at *www.reputationinstitute.com*.

[7] See "Why Is Reputation Important in a Business?" *ThriveHive,* January 23, 2017, *thrivehive.com*.

[8] "10 Retailers That Will Let You Return Anything," *Business Insider,* September 23, 2013, *www.businessinsider.com*.

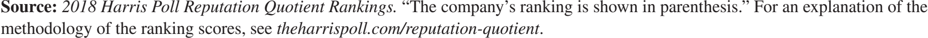
[9] "REI Return Policy Changes: Items Must be Returned within 1 Year," *The Denver Post,* June 4, 2013, *blogs.denverpost.com*.

counterparts. Research also shows that a sound reputation allows firms to charge premium prices; enhance their access to capital markets and investors; and obtain better credit, trust, and social ratings.[10] Likewise, stakeholders want to engage with respected companies.

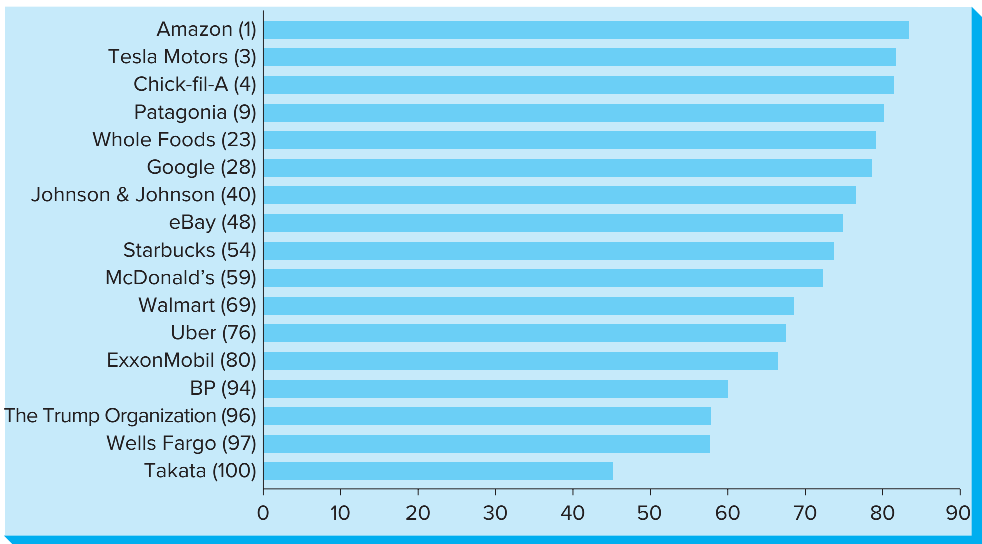
In short, a good reputation can help firms gain a competitive advantage over other companies in the same industry. Unfortunately, numerous opinion polls like those conducted by *Edelman* (Trust Barometer), *Fortune* (World's Most Admired Companies), and the *Reputation Institute* (Rep Trak) indicate that relatively few organizations have a reputation of distinction. Harris Insights and Analytics, the public opinion pollster, annually conducts an evaluation of a company's reputation quotient, that is, how a company is perceived by the public. The 2018 findings are shown in Figure 19.1. Some businesses—such as Amazon, Tesla Motors, Chick-fil-A and Patagonia—earned a high reputation quotient, based on their company's vision and leadership, social responsibility activities, financial performance, consumer support and workplace environment.

In a separate poll, conducted by The Reputation Institute and reported in *Forbes Magazine,* Amazon, the holder of the top position for the past three years, was unseated by the Swiss luxury timepiece producer Rolex. Another top performer in the 2018 list included Lego, which jumped to second place from sixth the previous year. Respondents to the survey, in gauging reputation, were more positive toward some industries than others. Companies that garnered the most respect came from the consumer goods, food and beverage, transport, and automotive industries. Meanwhile, firms that operated in the financial, health care, telecom, and energy sectors were viewed less favorably.[11] The task of building a corporation's reputation, and protecting it against various risks, is often entrusted to the firm's public relations department, as discussed next.

FIGURE 19.1 **Select Companies from the 2018 Harris Poll Reputation Quotient Rankings**



Source: *2018 Harris Poll Reputation Quotient Rankings.* "The company's ranking is shown in parenthesis." For an explanation of the methodology of the ranking scores, see *theharrispoll.com/reputation-quotient*.



[10] Reggy Hoogheimstra (2000) and Charles Fombrun and Cees van Riel (1997), ibid.

[11] "The World's Most Reputable Companies in 2017," *Forbes,* February 28, 2017, *www.forbes.com*.

The Public Relations Department

Given the importance of the general public to business and the potential for business to significantly benefit or harm the public, firms often create public relations departments, appoint public relations officers, and develop public affairs strategies to manage their relationship with the public. Josh Ong, director of marketing and communications at app developer Cheetah Mobile, explained the importance of developing a strong public relations team in today's environment:

> "The public relations [PR] team has become both the teller and the guardian of a brand's story; in order for them to fulfill each of these roles successfully, PR practitioners must be able to insert themselves into each of the touchpoints going out to the public in a healthy way. This requires thinking holistically about public image, what the brand does and what the brand stands for, among other things, and ensuring that these ideas are present in every communiqué that is released."[12]

The role of the **public relations department** is to manage the firm's public image and, more generally, its relationship with the public. This department may also be called *media relations,* since much of its work involves interacting with the media. It does so through direct communications with the public (for example, through its website) and indirect communications with them through various media outlets. Most public relations officers have close links with top managers. According to a study by the Foundation for Public Affairs, nearly half of the public affairs executives surveyed report directly to the CEO, chairman of the board of directors, or company president, and another nearly 30 percent report to the company's general counsel. According to the report, because of this access, public affairs executives have been able to persuade CEOs to become increasingly involved in corporate public affairs activities.[13] The specific major activities carried out by public relations managers include advertising, corporate sponsorship, external and internal communications, and publicity.[14]

Public Relations in the Internet and Social Media Age

Historically, public relations officers worked mostly through contact with traditional media outlets. An organization worked to enhance its public image by seeking positive coverage in news reports and feature stories, or by paid advertisements via television, radio, magazines, newspapers, or billboards. Public relations may still utilize these interactions, but as technologies have evolved, the variety of available channels of communication has grown dramatically. More and more people are finding their news, marketing, or other public relations information through Internet-related vehicles, such as blogs, e-mails, social networks, podcasts, and other technology-based communication sources. A study of about 50,000 people across 26 European counties reported that 18- to 24-year-olds used social media sites as their main news source, compared with 24 percent who used television.[15] As shown in Figure 19.2, most Americans acquired their news from cable, local or network nightly news television, but more and more, especially people under 50 years of age, were turning to online sources, such as social media websites or apps on their laptop, computer, or cellphones.

Coupled with the growing trend by younger generations to access information via social media or other new technology, businesses have turned to **social media influencers** to get

[12] "PR's Role in the Company: Chief Storyteller," *Forbes,* July 6, 2017, *www.forbes.com*.

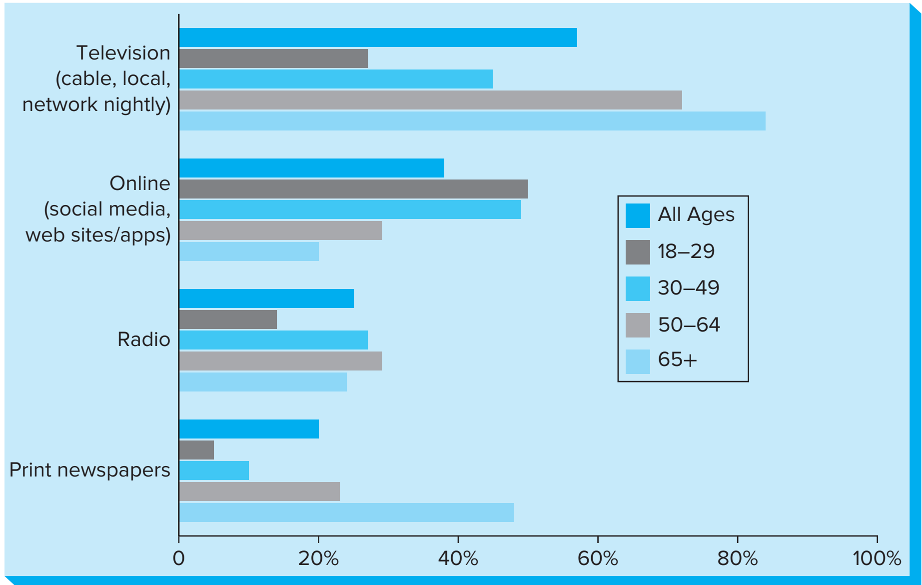
[13] See the Foundation for Public Affairs at *pac.org*.

[14] "Public Relations Activities," *MediaMiser, www.mediamiser.com*.

[15] "Social Media 'Outstrips TV' as News Source for Young People," *BBC News,* June 15, 2016, *www.bbc.com*.

FIGURE 19.2
Public's Access to the News by Platform

Source: "Pathways to News," Pew Research Center, July 7, 2016, www.journalism.org.



their message out to the public. A social media influencer is a user on social media who has established credibility in a specific industry. This individual has access to a large audience and can persuade others by virtue of their authenticity and reach. A company's public relations strategy that relies on social media influencers can identify topics of influence that speak to the company's target stakeholders, vet influencers who are a good contextual fit with the company's message, encourage social media influencers to build mutually beneficial relationships with target stakeholders, and enable the company to measure the impact their social media influencers and decide if they should be retained or select different influencers moving forward.[16]

Many firms, from chocolate makers to pharmaceuticals, are using social networking to connect with their past or potential customers, prospective employees, and others in the communities where they operate as shown in this example.

> The state of Bahia in Brazil had a blood shortage and needed to change consumer attitudes to inspire more people to become blood donors. The Hemoba Foundation (Blood Foundation) in Brazil decided to make a brand connection between giving blood and a passion shared by vast numbers of people—football. The Hemoba Foundation collaborated with the leading football club of the region—Esporte Clube Vitoria—to run a campaign called "My Blood is Red and Black." The club removed the red color from their iconic shirts and only added the red color back as the volume of blood donations increased. The campaign reached 130 million people and recorded a 46 percent increase in blood donations. Fans were encouraged to post on social media when they had donated blood and to post photos as each new stripe of red color was added back to the football team's shirt. The campaign captured the attention of all media channels. There were 935 minutes of television exposure and significant print news coverage.[17]

[16] "Social Media Influencers," *GroupHigh, www.grouphigh.com*.

[17] "Four Integrated PR Campaigns that Really Worked," *WorldCom Public Relations Group,* n.d., *worldcomgroup.com*.

Public relations strategies increasingly assume a global focus, since business interactions with the public through media channels frequently transcend national boundaries. Therefore, many businesses have extended their public relations strategies globally, as shown in the following example.

> P&G (formerly Procter & Gamble), based in Cincinnati, Ohio, is the largest consumer packaged goods company in the world. P&G created a comprehensive, yet unified network of public affairs departments to address the flow of information from the company to and from its stakeholders around the world. At P&G, public affairs is broken down into functions (corporate communications, global marketing and consumer and marketing knowledge, corporate digital communications, and global business services); product lines, with each major product line having its own "brand newsroom" media team (Bounty, Braun, Charmin, Gillette, Old Spice, Pampers, Puffs, and Tide); and geographical regions, with a "corporate" media team in different locations around the world (United States, United Kingdom, France, Germany, Spain, and Switzerland). Each contact point has its own set of contact information directing you to a person, location, office telephone number, mobile telephone number, and e-mail address.[18]

When public relations strategies take on a global perspective, new challenges emerge. For example, public relations managers must be sensitive to cultural disparities, as well as similarities, in crafting press releases and interactions with the media. The impact of the organization's public relations program could vary country to country given the culture, social mores, political system, or history. A public relations manager must be able to communicate with local media and other stakeholder groups in their native language and avoid embarrassing or misleading communication due to poor translations. All basic public relations tasks are more complex in an international business environment.[19] Some businesses decentralize their global public relations programs and establish officers in each of the locations where they have operations. This helps to ensure that the local public relations strategy is in tune with local customs and emerging issues.

Brand Management

Managers are very aware how important and how difficult it is to create a widely recognized brand; typically, the focus of the marketing team. **Brand management** uses techniques to increase the perceived value of a product line or brand over time.

Well-established brands must be managed as part of maintaining the firm's reputation. All brands have to re-establish themselves continually. Even luxury brands have begun to tout the number of their Facebook fans and Twitter followers. The *Brand Directory* publishes the value of the largest worldwide brands. In 2018, the U.S.–based Amazon brand was valued at more than $150 billion, followed by the Apple brand at $146 billion, and the Google brand at nearly $121 billion. Korea's Samsung brand was valued at $92 billion, and Chinese banking institution, ICBC, was estimated to be worth $59 billion.[20]

A recognizable brand is one that can immediately signal to stakeholders how the company is different from its rivals. For example, the company *3M* communicates innovation.

[18] See P&G's website at *news.pg.com/media_contacts* and additional information acquired through private communication.

[19] For a thorough discussion of these issues, see Craig S. Fleisher, "The Development of Competencies in International Public Affairs," *Journal of Public Affairs* 3, no. 3 (March 2003), pp. 76–82, and "8 Reasons Why Companies Don't Succeed at Global RP," *PR Daily,* February 14, 2014, *www.prdaily.com*.

[20] "Global 500 2018—The World's Most Valuable Brands," *Brand Directory, branddirectory.com*.

Exhibit 19.A Unflattering Nicknames

DHL = Documents Hopelessly Lost
Fiat = Fix It Again, Tony
Ford Motor Company = Fix Or Repair Daily
British Petroleum = Burning the Planet; Big Problems; Broken Pipelines; and Bloated Profits
Neiman Marcus = Needless Markup
REI = Rental Equipment Inc.; Rent Every Item; Return Every Item
Starbucks = Four Bucks
Taco Bell = Taco Hell; Toxic Bell
UBS (bank) = Used to Be Smart
Whole Foods = Whole Paycheck

Sources: "10 Best Company Nicknames," *Daily Finance,* August 30, 2010, *www.dailyfinance.com;* and Grahame R. Dowling, "Winning the Corporate Reputation Game" (Cambridge, MA: MIT Press, 2016).

But increasingly, a truly iconic brand fosters an emotional appeal that creates loyalty, even love, of the brand. Brand consultants' say that it is this emotional attachment that gives brands their market power. For example, the Apple brand (and its creator Steve Jobs) instilled such a strong emotional appeal that fans were moved to place hundreds of cards and flowers at numerous Apple stores around the world upon hearing of Jobs's death in 2012. Similarly, Harley-Davidson riders tattoo the brand name on their bodies. It is difficult to think of another brand that people would be willing to tattoo on themselves.

A corporation's reputation is captured in a recognized and trusted name. The company's name and logo act as its signature, a sign that says they can be trusted to deliver exceptional value to customers. Often, brand management involves conveying what the product or service offers—the benefits, solutions to problems, or simply an experience. This can be challenging, because the experience may not be an obvious feature of the product. Charles Revson, the founder of the *Revlon* cosmetics company, commented that "in the factory we make cosmetics; in the drugstore we sell hope."

When a company fails to meet the public's expectations, people can retaliate by ascribing a new meaning to a company's name, with devastating results for its reputation. Some examples of some unflattering corporate nicknames are shown in Exhibit 19.A.

Crisis Management

A critical function for any manager is *crisis management.* **Crisis management** is the process by which an organization deals with a major event that threatens to harm the organization, its stakeholders, or the general public.[21] Every organization is likely at some time to face a crisis that forces management and its employees to act quickly and without perfect information. A **corporate crisis** is a significant business disruption that stimulates extensive news media or social networking coverage. The resulting public scrutiny can affect the organization's normal operations and also can have a political, legal, financial, and governmental impact on its business. A crisis is any event with the potential to negatively affect

[21] Paul Shrivastava, Ian I. Mitroff, Danny Miller, and Anil Miglani, "Understanding Industrial Crises," *Journal of Management Studies,* 25 (1988), pp. 285–304.

the health, reputation, or credibility of the organization.[22] Many corporate crises can be classified into one of these groups:

- "Acts of God"—earthquakes, tornados, violent storms, volcanic eruptions.
- Mechanical problems—breakdowns of or faulty equipment, metal fatigue.
- Human errors—through miscommunication, improper employee behavior.
- Management decision or indecision—often involving a cover-up or lack of urgency.
- Poor financial performance.
- Backlash against stance on controversial social or political issues.
- Terrorism or other acts of violence against the company. [23]

A case at the end of this book, "The Boycott of Stoli Vodka," describes how Stoli Group USA managed a crisis that erupted when gay activists organized a boycott because of the brand's association with Russia, which had restricted LGBT rights.

A corporate crisis can take many different forms and, by definition, are generally unexpected, such as the crisis that confronted Wendy's, described in Exhibit 19.B.

Some businesses or industries are more prone to corporate crises than others and therefore have greater need for a crisis management plan. According to the Institute for Crisis Management, medical and surgical manufacturers, pharmaceutical companies, and software manufacturers (because of the sophisticated technology found in their products and the potential for disruptive impact on consumers' lives) are at the top of a recent list of crisis-prone industries.

Most experts recommend that organizations develop a **crisis plan** ahead of time, to deal with such unexpected events as the one that happened to Wendy's. Since the first 24 hours during a crisis are the most crucial, having a plan ready for implementation when the crisis occurs is imperative, citing the biblical wisdom: Noah built his ark *before* it began to rain. These plans must understand the situation confronting the business and try to get past the initial reaction of this is a catastrophic disaster. Melissa Agnes, a crisis management expert, explained how a crisis is often perceived only as a negative situation when the letters of the word "crisis" are believed to represent the following:

People:

- **C**reate their problems;
- **R**eact by blaming others;
- **I**nfer that all will be okay (but don't believe it)
- **S**ecure themselves behind false claims;
- **I**ndependent . . . instead of working together as a collective; and
- **S**ue to protect the little honor they have left.

Agnes said, "If this [a negative perception of a crisis] is how an organization—any organization—chooses to see and conduct their crisis management, "crisis" would indeed be a bad word."[24] She continues to observe that it would also be the beginning of the end for the organization that chooses to implement this mindset into their crisis management response plan.

[22] For additional information on crisis management strategies, see Melissa Agnes, "Transforming the Word 'CRISIS' from Negative to Positive," March 22, 2016, *melisaaagnes.com;* and "Are You Prepared for a Corporate Crisis?" *McKinsey & Company,* April 2017, *www.mckinsey.com*.

[23] From the Institute for Crisis Management's website, *www.crisisexperts.com;* and "Conquering the Three Most Common Types of Company Crisis," *Fast Company,* August 12, 2016, *www.fastcompany.com*.

[24] Melissa Agnes, *Crisis Ready: Building an Invincible Brand in an Uncertain World,* (Herndon, VA: Mascot Books, 2018).

Exhibit 19.B

Excuse Me, There Is a Finger in My Chili!

Denny Lynch, senior vice president for communications at Wendy's, one of the country's largest fast-food restaurant chains, received a shocking and unexpected call. A customer, Anna Ayala, claimed she had bitten down on a severed finger while eating a cup of chili purchased at a Wendy's restaurant in San Jose, California. Lynch knew that he had to act quickly, since this incident would certainly be the top story in the news within minutes.

Wendy's immediately assembled its crisis management team in its regional headquarters in Sacramento, California. Lynch prepared a statement for the press, instructed the company's website to be frequently updated, and began coordinating with the San Jose police department, which was already involved in the case. According to Lynch, "It went nonstop the next two or three days. Even when the Pope passed away, it still got coverage."

In the wake of the crisis, Wendy's focused on trying to discover what had really happened. Through an internal investigation, Lynch learned that a 10-year veteran and trusted employee had prepared the chili for Ayala; he assured Lynch there was nothing improper in the food preparation.

While Lynch and his team worked furiously around the clock to discover the truth, Ayala, the woman who had made the accusation, was a guest on numerous morning and late night television shows. Yet, it was soon discovered that Ayala had a litigious history that included a settlement for medical expenses for her daughter, who had claimed she became sick at an El Pollo Loco restaurant in Las Vegas.

The break Lynch and Wendy's needed occurred exactly one month after the initial incident, when Anna Ayala was arrested in her Las Vegas home for attempted grand larceny, accused of trying to extort $2.5 million from Wendy's. The finger in her chili was all a hoax. "The true victims are Wendy's owners and operators," said San Jose chief of police Rob Davis. Forensic evidence proved that the finger was not cooked at 170 degrees for three hours—the typical preparation of Wendy's chili. It was later discovered that Ayala acquired the finger through her husband's workplace, where a fellow worker had lost part of his finger in an industrial accident.

Later that year, Ayala and her husband, Jaime Plascencia, pleaded guilty to attempted grand larceny and conspiring to file a false claim. Ayala was sentenced to 9 years in prison and her husband, who supplied the finger, was sentenced to 12 years and 4 months in prison.

Sources: "At CSI: Wendy's, Tracking a Gruesome Discovery," *The New York Times,* April 22, 2005, *www.nytimes.com;* "Finger in Chili Is Called Hoax; Las Vegas Woman Is Charged," *The New York Times,* April 23, 2005, *www.nytimes.com;* and "Stiff Sentences for Wendy's Chili-Finger Couple," *Bay City News,* January 18, 2006, *www.SFGate.com*

According to experts, an effective crisis management plan must include these steps:

- *Get ready before the crisis hits* by creating an internal communication system that can be activated the moment a crisis occurs. Scenario-based press releases, key employees and discussion points, and procedures to activate the organization's website (to use the Internet to announce any news, product recalls, etc.) should be at the ready. Many organizations create a **dark site**, a website that is fully developed and uploaded with critical information, contacts for the media, and other useful details, ready to be activated at the moment it is needed. McDonald's holds "hater" sessions where they ask themselves the following question, "If we said X, how would someone who doesn't like us respond?" That way, when people criticize the company on social media, they're not surprised.[25]
- *Communicate quickly, but accurately.* Firms facing a crisis must communicate with the media and others promptly. Communications must always be honest and disclose fully what the company knows—even if it does not know the full story. Wendy's, for example, effectively communicated with the public even when it did not yet know how the finger got in the chili. The media have excellent resources and will find the truth whether the organization speaks it or not.

[25] Jana Seijts, "When the Twitterverse Turns on You," *Harvard Business Review,* March 2014, pp. 117–21.

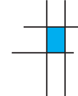
Exhibit 19.C A Dozen Critical Checkpoints for Ethics and Crisis Management

1. Create and document policies and procedures and circulate them widely.
2. Know the policies and procedures and follow them.
3. Be prepared with a continuity plan to provide for continuing operations during the crisis management phase.
4. Work as a team with assigned responsibilities and a clear leader and practice, practice, practice in mock drills.
5. Identify and understand the organization's vulnerabilities; most importantly, correct shortcomings.
6. Let your conscience be your guide, follow good ethical practice, and remember the "front-page test." (Or, better yet, consider: What would Grandma say?)
7. Beware of dangerous and distorted minds and protect coworkers and facilities.
8. Put all phases of the event under a microscope and track and record activities.
9. Handle all records, samples, information, materials, and evidence with care.
10. Know the media and how to handle it. NEVER lie, cover up, or obfuscate.
11. Keep your eyes on the law and contact legal counsel; don't make decisions simply to avoid lawsuits.
12. Provide timely updates to coworkers and provide follow-up meetings and counseling.

Source: FosterHyland & Associates, Inc. Used with permission.

- *Use the Internet* to convey the message to minimize the public's fears and provide assistance. In addition to face-to-face press releases, Wendy's frequently updated its company website to communicate to the public and others what the company was doing about the crisis situation.
- *Do the right thing.* Often the true test of an organization is how it reacts in a time of crisis. Public relations managers should not try to minimize the seriousness of a problem or make excuses. It is possible for the organization to accept responsibility without accepting liability. It also is important that the organization be sympathetic. For example, Wendy's clearly expressed regret over its customers' fears and advised the public that it was doing everything possible to investigate.
- *Follow up* and, where appropriate, make amends to those affected. Seek to restore the organization's reputation. Wendy's relentless pursuit of the truth resulted in vindication for the company and assisted law enforcement in the prosecution of those making the false claims.

A *crisis management guide* describing a series of critical crisis management checkpoints is shown in Exhibit 19.C.



Engaging Key Stakeholders with Specific Tactics

In the past, building the corporate reputation was achieved mostly through contact with traditional media outlets, like newspapers, magazines, and television. While reputation management still involves these tactics, new technologies have emerged creating a much larger variety of available communication options. As the Internet has transformed how organizational stakeholders search for and find information, public relations managers have increasingly embraced social media as a platform for reaching the public.

Using all of these media outlets, companies strive to build a solid reputation by targeting the stakeholders who are important to their commercial success. Employees and customers are very important to the organization's success, as are many other market and nonmarket stakeholders listed in Chapter 1. Different tactics for communicating and enhancing the firm's reputation may be more appropriate for some stakeholders than others. For example, executive visibility and event sponsorship are most often targeted to employees. The other tactics, such as user-generated content, paid content, public service announcements, and image ads, discussed next in this chapter, can be used to target almost any type of stakeholder.

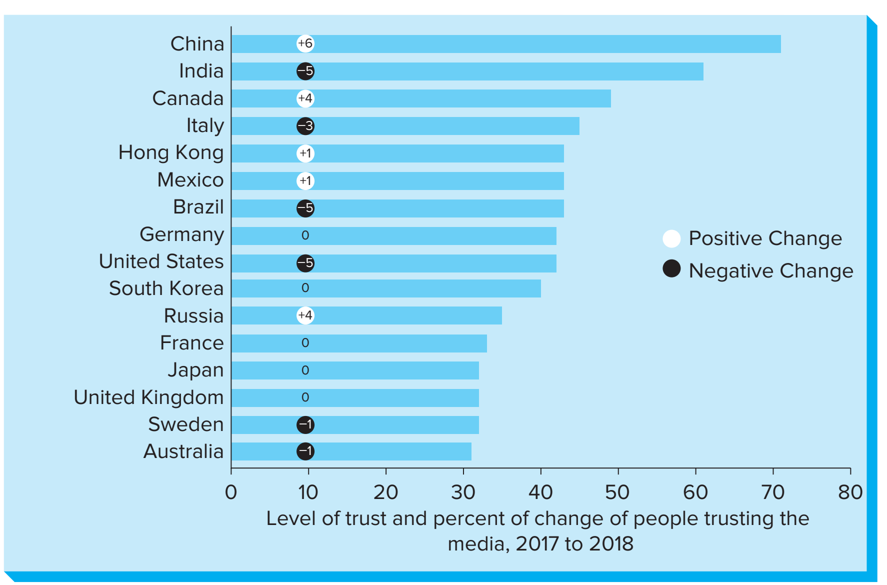
The most important element in establishing the firm's reputation is to win the trust of its key stakeholders. What media outlets are most trusted by the public? The 2018 Edelman Trust Barometer, as shown in Figure 19.3, reported that in a majority of the countries surveyed, trust in the media declined from 2017 and 2018. According to a survey conducted by Gallup and the Knight Foundation, 73 percent of Americans believed that the media spread inaccurate information on the Internet, a growing source for news information among those 50 years old and younger. Sixty-nine percent surveyed said that owners of new outlets were attempting to influence the ways stories were reported, and 65 percent said that there was too much bias in the reporting of news stories that was supposed to be objective. Overall, 45 percent of the Americans surveyed saw greater bias in the news, compared to only 25 percent in 1989.[26]

Executive Visibility

In today's business environment, the firm's overall reputation is clearly on the agenda for the board of directors because of its effect on the firm's products and profits (for more information on the board of directors and its role in the governance of the company see Chapter 13). The growing importance of board-level attention toward a firm's reputation, combined with assuring damage control that a bad or failing reputation can cause, makes executive visibility a necessity. Specifically, executives need media training that focuses

FIGURE 19.3
Declining Percentage of People Trust the Media, 2017–2018

Source: 2018 Edelman Trust Barometer Global Report, *cms. edelman.com*.



[26] "American Views: Trust, Media and Democracy," *NiemanLab,* January 16, 2018, *www.niemanlab*.org.

on helping them to interact with the public and media. This is especially true for those executives who are likely to have contact with the media, such as members of the board of directors, the CEO, CIO, CFO, general counsel, and directors of human resources, investor relations, and marketing. They are the ones who will tell the corporate story, and they must be well versed in all aspects of the story and aware of how their comments might affect the reputation of the company. Executives should make themselves visible and available to both their internal and external stakeholders in good times and in bad. Media training is necessary because communicating with the media is not as simple as talking with friends or coworkers.

Mark Zuckerberg, CEO of Facebook, encountered significant backlash from lawmakers, regulators and social media users over Facebook's mishandling of their customers' data, as presented in the discussion case in Chapter 7. Cambridge Analytica, a British political consulting firm, reportedly acquired a large amount of Facebook users' private information through inappropriate means and allegedly collaborated with Russian agents to use this data to support the 2016 Trump Presidential campaign. Zuckerberg immediately went into crisis management mode and testified before a hearing of the House Energy and Commerce Committee, conducted numerous press conferences with the global media, and held a staff meeting to address questions from the company's 25,000 employees. Zuckerberg assured his employees and other stakeholders that regaining trust was paramount for the company. "I think it's a clear signal that this is a major trust issue for people, and I understand that," Zuckerberg said during an interview with the *New York Times.*[27]

Zuckerberg's response to the Facebook crisis echoes many of the recommendations offered to CEOs facing similar crises. Media communication experts generally give their clients the following advice.

- *Be honest.* Always tell the truth and explain why you cannot discuss a particular subject.
- *Be current.* The media wants to speak with you because of your up-to-date knowledge. If you do not have current information, promise to find out and get back to the media.
- *Be accessible.* A spokesperson is expected to be on-call and promptly respond to demands made by the media, so long as the demands are reasonable.
- *Be helpful.* If you do not know the answer to a question, say so and offer to find out. Try to make the media's job easier; they will print or broadcast anyway, so if you are helping them there is a better chance of your message being heard.
- *Be understanding.* Understand the needs of the media, their pending deadline or the importance of their acquiring background information.
- *Be cool, courteous, and professional.* You are representing your organization in the eyes of the media and the public. Remember, nothing is really ever "off the record."

Employees trained to interact with the media should know the basic message points that the organization wants communicated. These key points need to be reinforced with facts and statistics, whenever possible, and elaborated upon in an interview or press conference. Many times the audience is not aware or knowledgeable of the organization's operations or product or whatever is the focus of the press conference. Therefore, it is important to be clear and avoid jargon or technical language. Finally, the spokesperson should close the interview by reiterating the organization's key message.

[27] "Zuckerberg Takes Steps to Calm Facebook Employees," *The New York Times,* March 23, 2018, *www.nytimes.com*.

Some of the best techniques to assist a spokesperson to stay on point when challenged by a reporter with a tough question follow:

- *Hooking.* Grab the reporter's attention by making a statement that influences the next question. For example, "We are undertaking a program to correct the situation." Typically the reporter will follow up by asking about the organization's new program.
- *Bridging.* Answer the challenging question but quickly move on to the key message. For example, "Yes, but . . ." or "What I can tell you is . . ." or "While that is true, what is important to know is . . . ."
- *Flagging.* Emphasize key points and guide the reporter to them. For example, "Your listeners may not know that . . ." or "This is important news because . . . ."

Managers may also consider using not only the traditional press conference but also other media outlets—namely, user-generated content and well-heeled content distributors—all of which are useful tools to tell the company's story to maintain, or sometimes defend, its reputation.

User-Generated Content

User-generated content refers to sources of information provided by users through social media sites like Facebook, YouTube, Twitter, and Instagram. This information can be supportive or critical of business since the content is created by consumers, employees, investors—indeed, by anyone with access to a computer. Larry Weber, founder of Weber Shandwick Worldwide, a global communications company, suggests the communications world is dramatically moving in a digital direction. Managers who understand the growing importance of user-generated content will communicate much more effectively than those who do not. Weber, and coauthor Lisa Leslie Henderson, argue in their book, *The Digital Marketer,* that managers need to embrace a world where, "the 'digital genie' isn't going back into her bottle and neither is the consumer."[28]

User-generated sites can be used effectively for brand, issue, and crisis management. An increasingly popular technique is to create a hashtag on Twitter, which is simply text placed in the beginning, middle, or end of a tweet by inserting a pound sign in front of a keyword. Hashtags are used to start an online dialogue with employees, consumers, media, and brand lovers, creating buzz around a product or an issue. One effective example is Keurig Green Mountain's #keurig hashtag campaign, which is full of happy thoughts about this coffee maker and its coffee. A recent post on Twitter said it well:

> Say hello to my new bestfriend. #KeurigK45 **#KeurigCoffee** #KeurigKCups #HelloKeurig #Keurig #ImpulseBuy #Kcups
>
> —Annette Williams @LadyGemini71 Oct 15

However, these campaigns can sometimes result in the hashtag becoming what has been called a *bashtag* as McDonald's recently found out.

> When McDonald's promoted the hashtag #McDStories, hoping that customers would tweet about positive experiences with the company, they discovered that after just a few hours, the conversation was turning unexpectedly negative. In response, the company changed the hashtag to #MeettheFarmers, which had been successful earlier that day in soliciting positive posts, and they also stopped

[28] Larry Weber and Lisa Leslie Henderson, *The Digital Marketer: Ten New Skills You Must Learn to Stay Relevant and Customer-Centric* (New York: Wiley, 2014).

promoting the troublesome one. Within 15 minutes, the disparaging tweets were down to zero. So, managers need to be mindful that critics can take over and direct a firm's hashtag campaign.[29]

Paid Content

When firms pay to have online or print publishers create and distribute their content—also referred to as *content distribution*—they are using the tactic of **paid content**. This represents a major shift in the way firms manage their reputation because corporations now deliver directly to multiple stakeholders via the web, whereas traditional marketing and public relations relied on journalists to disseminate it.

Companies are increasingly paying to put information on a newswire or other distribution network. This tactic can reach almost any stakeholder with the same message. Creating high-quality content is very important for a firm's brand and image management, but its distribution is equally vital. There are many companies that provide distribution services for paid content. Perhaps best known are promoted feeds on Facebook, LinkedIn, and Twitter, but other less well-known options, like CSRWire, Outbrain, Taboola, and Disqus, are also available.

For example, CSRwire, perhaps one of the largest of these distributors with over 70,000 readers per month and nearly 60,000 News Alert subscribers, has a membership that includes corporations, NGOs, advertising agencies, and universities. These organizations pay CSRwire to communicate their corporate citizenship, sustainability, philanthropy, and socially responsible initiatives to not only this membership base but to its vast individual subscriber base. CSRwire's CEO Joe Sibilia stated, "All content is paid for now."[30]

Experts warn, however, understanding the nuances of the distribution process can be the difference between getting ignored or standing out.

Event Sponsorship

Another important tactic to reach consumers, the general public, employees, and the media is to sponsor an event with the company's name and logo, as mentioned earlier when Kraft added the Kid Eat Right logo to their cheese packages. The total value of global sponsorships by companies or individuals continues to rise, as shown in Figure 19.4.

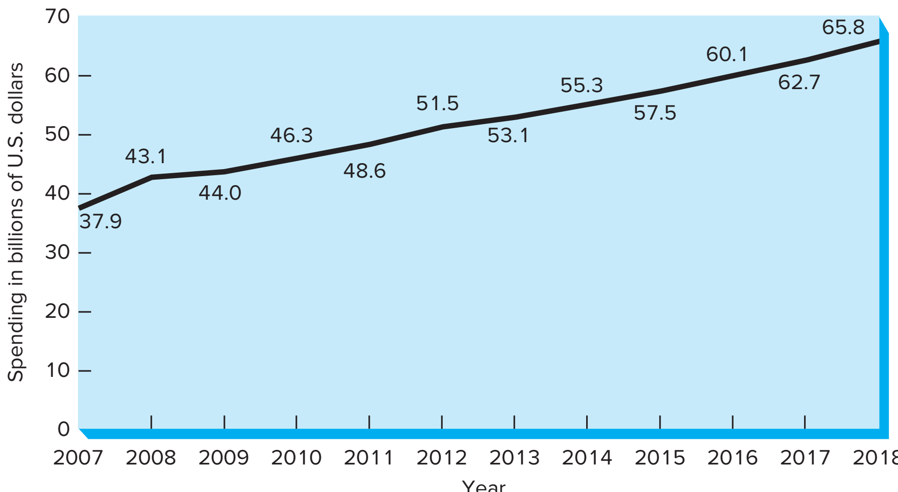
However, sponsorship is not as simple as placing the company name on a colorful banner. According to Jeff Haden at *Inc.com,* "when you sponsor an event your focus should

[29] "How to Use Hashtags on Twitter: A Simple Guide for Marketers," *HubSpot Blogs,* April 24, 2012, *blog.hubspot.com*.

[30] CSRWire information from a speech by CSRWire's CEO Joe Sibilia at the 10th Annual Bentley Global Business Ethics Symposium on Integrated Reporting. May 19, 2014.

FIGURE 19.4
Global Sponsorship Spending, 2007–2018

Source: The Statistics Portal, *www.statista.com*.



always be on the *quality* rather than the *quantity* of brand impressions." Therefore, Haden recommends that much emphasis be placed on choosing the right event. Haden also recommends that businesses ask the following questions:

1. What's in it for me?
2. What is unique about this opportunity over others?
3. How is my company directly engaging the audience at this event?
4. What kind of return could I see from sponsorship? (not necessarily monetary)
5. Do I like this event and does the audience fit my target audience?[31]

While sponsoring an event can be a real benefit for employees, having them volunteer at these events must be done by considering whether it adds value to the firm as would be the case for any comparable monetary donation. (This tactic is similar to strategic philanthropy—where corporate giving is linked directly or indirectly to business goals and objectives—and discussed in Chapter 18.) Many companies understand that their employees not only want to work and pay their bills—they also want to do good for their communities and others. Today's workforce wants to find a sense of purpose at work, and one way to do that is by increasing options to give back to the local community.

Novo Nordisk, a Danish pharmaceutical company, was recognized by *Fortune Magazine* as one of the best companies with an employee volunteering program. Novo Nordisk employees were provided with paid time off to volunteer 80 hours (10 days) per year. Community engagement was integrated into the company, with various programs and resources to help employees give back. For example, most of the company's offsite meetings had a community service component built into them, and there is a Novo Nordisk Social Awareness Team in charge of organizing community service projects. The company also created an intranet portal to track and help employees find volunteering opportunities.[32]

[31] Jeff Haden, "Sponsoring an Event? Tips to Maximize Your Return," *Inc.*, September 25, 2012, *www.inc.com*.

[32] "These 8 Employers Will Pay You to Volunteer," *Fortune Magazine,* March 21, 2016, *fortune.com*.

Public Service Announcements

Since 1942, the Ad Council has been the leading producer of **public service announcements** (PSAs), addressing critical social issues for generations of Americans and global citizens. The Ad Council has created some of the most memorable slogans, such as its inaugural campaign of "Loose Lips Sink Ships," promoting secrecy of military operations during World War II to the more recent "Friends Don't Let Friends Drive Drunk" and "A Mind Is a Terrible Thing To Waste."

More recently, PSA campaigns have ranged from preventing teen bullying and suicide to promoting lung cancer screening and getting volunteers for meals on wheels programs. The longest running PSA in American history, introduced in 1944 and continuing today, features Smokey the Bear and his famous warning: "Only You Can Prevent Forest Fires." The forest fire prevention campaign has reduced the number of acres lost annually from 22 million to less than 10 million.[33]

Modeled after the actions taken by the Ad Council, businesses have discovered that public service announcements are an effective means for promoting various social issues or topics that affect the business work environment, as demonstrated by the campaign by the Ad Council's #ThatsHarassment campaign.

> The Ad Council created the #ThatsHarassment project, a series of six short films that depict cases of sexual harassment in the workplace. The project was intended to spark further awareness of sexual harassment, encourage women to report and speak out, and send a message to all that sexual harassment will not be tolerated in any environment. The Ad Council distributed three of these PSAs to help raise awareness of sexual harassment. The films depicted different scenarios where male co-workers in positions of power took things too far and acted inappropriately toward female co-workers. The PSAs directed viewers to the Rape, Abuse & Incest National Network (RAINN), which is the nation's largest anti-sexual violence organization. RAINN provides support and information to both bystanders and victims of sexual harassment and operates a 24-hour hotline, along with a live chat option.[34]

Image Advertisements

Image advertisements are used by business organizations to enhance their public image, create goodwill, or announce a major change such as a merger, acquisition, or new product line. These ads are different than issue advertisements, as discussed in Chapter 8, that focus on a public policy issue or piece of legislation. Image ads promote the image, or general perception, of a product or service, rather than promoting its functional attributes. They target the public's emotions and seek to influence the consumers' imaginations.

> Brazilian modeling agency Star Model created an anorexia ad campaign to help change the image of the modeling industry. Designers used software graphic techniques to turn real women into life-size versions of fashion illustrations, as shown in Figure 19.5. Showing what women would look like if they had the same measurements as the illustrations. Star Model's "Say No To Anorexia" campaign stated: "You are not a sketch." The fashion industry seemed to hear this challenge and, in 2017, two of the world's largest luxury fashion conglomerates, LVMH Moet

[33] See the Ad Council's website, *www.adcouncil.org*.

[34] See *www.adcouncil.org/Our-Campaigns/Safety/Confronting-Sexual-Harassment*.

FIGURE 19.5
Brazil's Star Model's "Say No To Anorexia" Campaign

Hennessy Louis Vuitton and Kering Company, announced the creation of a code of conduct to protect models from mistreatment. Under the new code, models are required to furnish a medical certificate attesting to their good health and ability to work, or modeling agencies cannot hire them. However, this new effort cannot reverse the tragedy that occurred in the past. Sadly, Isabelle Caro, the model who became the international face of anorexia when she allowed her ravaged body to be photographed nude for an Italian advertising campaign to raise awareness about the disease, as shown in Figure 19.5, died at the age of 28.[35]

The American Association of University Women (AAUW) and Pantene, a well-known maker of hair products, joined forces on a new program called *Shine Strong,* designed to challenge women student leaders on college campuses throughout the country to initiate change and tackle biases and stereotypes that permeate our culture.

The company offered campus action project grants to 11 American universities, including Clemson, Murray State, Pacific Lutheran, Wisconsin–Milwaukee, and West Virginia Wesleyan. "Pantene believes women are stronger when they work together, and we are thrilled to have collaborated with the AAUW and been able to provide these grant recipients with the opportunity to work as a team to fight the stereotypes and biases on their college campuses across the country, said Jodi Allen, P&G vice president.[36]

This chapter illustrates that managers, and particularly public relations managers, are in charge of safeguarding the story of the firm. By using information strategies and tactics that can apply broadly to managing the corporate reputation they may avoid some of that harm that can befall any company.

[35] "Why Brazil's 'Shocking Say No To Anorexia' Campaign May Be Self-Defeating," *Metro,* May 13, 2013, *metro.co.uk;* and "LVMH and Kering Ban Ultrathin Models," *The Wall Street Journal,* September 6, 2017, *www.wsj.com*.

[36] "Pantene Earns Social Capital Sponsoring Grants to College," *Cosmeticsdesign.com,* February 10, 2015, *www.cosmeticsdesign.com*.

Summary

- The general public affects the firm through its opinions of the firm's activities or performance, which in turn help shape the firm's public image or reputation. The public may utilize its own stakeholder networks and engage with government agencies, special interest groups, or the media to demand a certain level of firm performance.
- A good corporate reputation conveys the desirable qualities associated with an organization in order to positively influence the organization's relationships with its stakeholders, on whom it depends to survive and thrive.
- Firms often create public relations (or media relations) departments, appoint public relations officers, and develop public affairs strategies to manage their relationship with the public. As new technologies have emerged, the variety of available channels of communication for the public affairs officer and departments has grown dramatically, including social media platforms and apps.
- Effective brand management helps increase the perceived value of a product line or brand over time and helps companies be more successful because they can charge premium prices, enhance their access to capital markets and funding, obtain better credit, trust, and social ratings.
- An effective crisis management plan is one that is ready to be implemented before the crisis occurs. Such a plan enables the organization to quickly and accurately communicate with the media and to use a wide range of online platforms to reach the public directly, while always remaining focused on the organization's ethical responsibilities to its stakeholders.
- Business organizations can influence or change their reputation through a variety of tactics such as executive visibility, media training, user-generated or paid content, event sponsorship, public service announcements, and image advertisements.

Key Terms

brand management, *426*
corporate crisis, *427*
corporate identity, *421*
corporate image, *422*
corporate reputation, *421*
crisis management, *427*
crisis plan, *428*
dark site, *429*
general public, *420*
image advertisements, *436*
media, *421*
paid content, *434*
public relations department, *424*
public service announcements, *436*
social media influencers, *424*
user-generated content, *433*

Internet Resources

aipmm.com	The Association of International Product Marketing & Management
www.nc-cm.org	National Center for Crisis Management
www.pcma.com	Professional Crisis Management Association
www.prsa.org	Public Relations Society of America
www.adcouncil.org	The Ad Council
socialmediaassoc.com	Social Media Association
americanmediainstitute.com	American Media Institute
www.reputationinstitute.com	The Reputation Institute
www.fcc.gov	U.S. Federal Communications Commission
www.ftc.gov	U.S. Federal Trade Commission (FTC)

Discussion Case: *United Airlines—Navigating a Social Media Storm*

In 2017, a United Airlines gate agent barred two girls from boarding a flight because the teenagers were wearing leggings. Passengers boarding the fight saw the commotion and began tweeting about the incident. Social media exploded, with users calling the incident "horrendous," "outrageous," and "nonsense." Many questioned why United considered this clothing inappropriate, since many women passengers wear leggings, yoga and athletic apparel for comfort while traveling. United responded to the criticisms by quoting their policy: "United shall have the right to refuse passengers who are not properly clothed via our Contract of Carriage." The company statement continued, "This is left to the discretion of the agents." Moreover, the two girls were traveling using a United employee pass and, according to the airline spokesperson, "were not in compliance with our dress code policy for company benefit travel." It was a common industry practice to expect persons using the employee benefit privilege to dress more nicely than paying passengers. United promised to review their dress code policy but indicated that they would likely remain in agreement with the industry practice regarding a dress code for passengers using company benefit travel.

A month later, United customers posted videos across multiple media outlets showing airport police dragging a passenger, Dr. David Dao, off a United Airlines flight. Dao appeared to have a bloodied face. The airline defended its actions, stating that it was customary practice to remove paying passengers on full flights so that off-duty crew members, needed at the flight's destination, could have a seat. United reported that passengers were asked if they would voluntarily give up their seat for compensation, and three passengers agreed. But four seats were needed, so the airline moved to its next action in their protocol—asking passengers to leave the plane. Dao reportedly was asked, and when he refused, the airline instructed airport security to remove him.

Munoz immediately issued an apology, saying that it was unfortunate that sometimes "we have to re-accommodate customers." One woman reacted to this statement by posting on Twitter, "Nice to know that re-accommodate on United now means 'drag you violently out of your seat.'" Some Chinese social media users accused United of racism, believing that Dao was targeted since he appeared Asian. The incident also drew the attention of Congressional leaders. Four members of the Senate commerce committee said in a letter to United Airlines, "The last thing a paying airline passenger should expect is a physical altercation with law enforcement personnel after boarding, especially one that could likely have been avoided." This incident occurred at a time when passengers were increasingly unhappy with higher airfares, as well airlines' practice of adding on extra fees for baggage, seat reservations, and other services that once were included with the basic plane ticket.

A few hours after Munoz's initial apology, the company seemed to go on the offensive when it circulated a letter in which Munoz appeared to blame Dao, saying he defied the officers. Finally, a few days later, the airline changed its position once again, when Munoz stated that "United would take full responsibility for the situation." He also pledged that the company would conduct a full review of its policies in re-accommodating paid passengers to give off-duty crew members their seats and its interaction with law enforcement agencies within a few weeks. "We are going to fix what's broken so this never happens again," he said. The company subsequently issued a report stating that the incident involving Dao "was a failure of epic proportions that's grown to this breach of public trust. We get that. We let our policies and procedures get in the way of doing the right thing."

A few weeks later United announced that it had reached "an amicable" settlement with Dao, although the specific terms were not disclosed. The company also reported that many

of its policies related to this case were revised in the hope these actions will prevent a repeat of the public relations disaster that has engulfed the company after Dao was forcibly removed from a plane. Morning Consult, a brand-tracking company, reported that shortly after Dao was dragged off the airline, United's favorability rating dropped 47 points (on a scale from negative 100 to positive 100). This rating slowly rebounded in the days after the incident, but still lagged behind rivals American, Delta, and Southwest.

As the airline attempted to win back the public's trust and rebound from a major drop in the company's favorability rating, another tragic story hit social media: the news of a dog dying after being placed in an overhead cargo bin without water during a three-hour flight. One passenger said, "I heard the dog barking a little and we didn't know it was barking a cry for help." According to another passenger, the flight attendant who placed the bag in the bin did not know there was a dog inside the bag. Morning Consult reported that United's favorability rating dropped 28 points when this incident became public.

United Airlines tried to reassure the public of its care and compassion. "This was a tragic accident that should have never occurred, as pets should never be placed in the overhead bin," United said in a statement. "We assume full responsibility for this tragedy and express our deepest condolences to the family and are committed to supporting them. We are thoroughly investigating what occurred to prevent this from ever happening again."

Sources: "Two Girls Barred from United Flight for Wearing Leggings," *The Washington Post*, March 26, 2017, *www.washingtonpost.com*; "United Grapples with PR Crisis Over Videos of Man Being Dragged Off Plane," *The New York Times*, April 11, 2017, *www.nytimes.com*; "United CEO Apologizes to Passenger Pulled from Plane," *The Wall Street Journal*, April 11, 2017, *www.wsj.com*; "United Says Litany of Failures Led to Flight Fiasco," *The Wall Street Journal*, April 27, 2017, *www.wsj.com*; "United Settles with Passenger Dragged Off Flight," *CNBC*, April 27, 2017, *www.cnbc.com*; "Dog Dies on United Flight after Being Placed in Overhead Bin, Airline Confirms," *ABCNews*, March 13, 2018, *abcnews.go.com*; and, "United Airlines' Favorability Rating Was Rebounding Until Dog Died in Overhead Bin," *Chicago Tribune*, March 26, 2018, *www.chicagotribune.com*.

Discussion Questions

1. What was the impact of the incidents described in the case on United Airlines' reputation?
2. Did these incidents impact the firm's corporate identity or corporate image, or both, as described in the chapter?
3. Did these incidents constitute a crisis, as defined in the chapter?
4. Did United Airlines engage in effective crisis management, and why or why not? If you were the public relations manager at United Airlines, what steps would you have recommended the company take when these incidents occurred?
5. What should the company do now to regain its customers' trust?

Cases in Business and Society

CASE ONE

Profiting from Pain: Business and the U.S. Opioid Epidemic

In 2017, McKesson Corporation, a leading wholesale drug distributor, agreed to pay $150 million in fines to the U.S. Department of Justice. The charges were that the company had failed to implement effective controls to prevent the diversion of prescription opioids for nonlegitimate uses, in violation of the Controlled Substances Act.[1] For example, McKesson had supplied pharmacies in Mingo County, West Virginia—a poor, rural county with the fourth-highest death rate from opioid overdoses in the nation—with 3.3 million more hydrocodone pills in one year than it had in five consecutive earlier years.[2] At the time, Mingo County had just 25,000 residents. Yet, the company had not flagged these orders to federal drug enforcement officials as out-of-the-ordinary.

McKesson, which at the time was the fifth largest company in the United States—with almost $200 billion in annual revenue—played a largely unnoticed middleman role in the pharmaceutical industry. The firm's main business was shipping legal, government-approved medicines to pharmacies, hospitals, and health systems. McKesson's unmarked trucks rolled out at midnight from its 28 enormous, highly automated distribution centers, on route to their morning deliveries of one-third of all pharmaceuticals sold in North America. Although distributors like McKesson did not either manufacture or dispense opioids, they were responsible for notifying the federal Drug Enforcement Administration (DEA) and corresponding state regulators if orders suggested that controlled substances were being improperly diverted.[3]

McKesson and other drug distributors were not the only businesses implicated in the nation's burgeoning epidemic of addictive opioids. Drug companies—such as Purdue Pharma, the maker of OxyContin—had developed new prescription opioids and aggressively marketed them to doctors and patients, making vast profits for their owners. Entrepreneurs had opened pain clinics where unscrupulous doctors could write big scripts for the addictive pills, and pharmacies had looked the other way while dispensing drugs to suspicious patients. And illegal businesses, from producers of street drugs like heroin to networks of

By Anne T. Lawrence. Copyright © 2018 by the author. All rights reserved.

[1] U.S. Department of Justice, "McKesson Agrees to Pay Record $150 Million Settlement for Failure to Report Suspicious Orders of Pharmaceutical Drugs," press release, January 17, 2017.

[2] "Drug Firms Poured 780 Million Painkillers into WV Amid Rise of Overdoses," *Charleston Gazette-Mail,* December 17, 2016.

[3] "As America's Opioid Crisis Spirals, Giant Drug Distributor McKesson Is Feeling the Pain," *Fortune,* June 12, 2017.

dealers, had also played their parts. What responsibility did these businesses bear for the tragedy of opioid addiction, disability, and death?

The Opioid Epidemic

At the time of the McKesson's settlement with the Justice Department, the United States was deep in the throes of what the Centers for Disease Control and Prevention (CDC) had called "the worst drug overdose epidemic in [U.S.] history."[4]

Fueling the epidemic was addiction to prescription opioids. Opioids were a class of painkillers derived from the opium poppy. Also referred to as narcotics, opioids included legal prescription medications such as morphine, codeine, hydrocodone, oxycodone, and fentanyl, as well as illegal drugs such as heroin. Opioids worked by dulling the sensation of pain. At high doses, they could also cause feelings of intense euphoria. The journalist John Temple, author of the investigative report *American Pain,* described the "high" experienced by users of oxycodone, a strong opioid, this way:

> To understand oxycodone, imagine everything that makes a man or woman feel good, all the preoccupations and pastimes we are programmed to enjoy. Sex, love, food. Money, power, health. Synthesize all of that pleasure-seeking potency, and multiply by ten. Then cram it all into a pebble-sized blue pill. That's oxycodone—one of the most irresistible opioid narcotics ever cooked up in the six-thousand-year-old history of dope.[5]

Opioids were highly addictive, and as users developed tolerance, they required larger and larger doses to get high or just to feel normal. Withdrawal from opioids, which could occur after even a single dose, could be excruciating. Users in withdrawal often experienced intense cravings, fever, sweats, and pain—sensations that addicts referred to as "jonesing." Addiction caused physical changes in the brain, weakening a user's impulse control and making it almost impossible to quit without medical assistance.[6]

Opioids were killers. In high doses, these drugs caused breathing to slow and finally stop, bringing death by respiratory arrest. In 2015, 33,091 Americans died from an opioid overdose.[7] This was just slightly less than the number that died that year in car accidents. Between 1999 and 2015, the rate of death from opioid overdose (number of deaths per 100,000 people) quintupled, that is, it was *five times* higher in 2015 than it was a decade and a half earlier.[8]

Deaths from opioid overdose cut across all geographical regions and demographic groups, but some places and people were harder hit than others. Government data showed that although drug overdose deaths grew for all groups, those in mid-life (aged 45–54) had the highest rates. Rates were higher for non-Hispanic whites than for other ethnic groups. The states with the worst opioid problems were West Virginia, New Hampshire, Kentucky, and Ohio, with Rhode Island, Pennsylvania, Massachusetts, and New Mexico not far

[4] Quoted in Andrew Kolodny et al., "The Prescription Opioid and Heroin Crisis: A Public Health Approach to an Epidemic of Addiction," *Annual Review of Public Health,* January 2015, p. 58.

[5] John Temple, *American Pain: How A Young Felon and His Ring of Doctors Unleashed America's Deadliest Drug Epidemic* (Rowman & Littlefield: Guilford, CT, 2015), p. xi.

[6] Information about opioids and their risks is available from the National Institute of Drug Abuse, www.drugabuse.gov.

[7] Rose A. Rudd et al., "Increases in Drug and Opioid-Involved Overdose Deaths—United States, 2010–2015," Morbidity and Mortality Weekly Report, 65(50&51), December 30, 2016. This figure is for drug overdoses due to opioids only; 52,404 Americans died in 2015 from overdoses of all kinds of drugs combined.

[8] Data from the Kaiser Family Foundation, shown below in Exhibit 1.

behind.[9] Opioid use was higher where the economy was bad; as unemployment rates rose, so did overdose deaths.[10] Some researchers called these drug overdoses a "death of despair," part of a broader pattern of rising mortality among middle-aged whites in the United States. "Ultimately, we see our story as about the collapse of the white, high-school educated working class after its heyday in the early 1970s, and the pathologies that accompany that decline," these researchers wrote.[11]

Many opioid overdoses occurred in private, but a startling number occurred in full view of the community. As Margaret Talbot reported in *The New Yorker,* "At this stage of the American opioid epidemic, many addicts are collapsing in public—in gas stations, in restaurant bathrooms, in the aisles of big box stores." She related this story about the experience of two small-town paramedics, who responded to an emergency call from a softball field:

> It was the first practice of the season for the girls' Little League team, and dusk was descending. [The paramedics] . . . stopped near a scrubby set of bleachers, where parents had gathered to watch their daughters bat and field. Two of the parents were lying on the ground, unconscious, several yards apart. As [one of the paramedics] later recalled, the couple's thirteen-year-old daughter was sitting behind a chain-link backstop with her teammates, who were hugging her and comforting her. The couple's younger children, aged ten and seven, were running back and forth between their parents screaming, "Wake up! Wake up!"

The parents survived after the paramedics administered a drug called naloxone, but they were later arrested on charges of child neglect.[12]

The pain inflicted by the opioid epidemic went well beyond overdose deaths. People who were addicted to opioids stole from their neighbors to support their habit, ignored their work and family responsibilities, and strained public welfare and law enforcement systems. Some were incarcerated, filling the jails. They made more visits to hospital emergency rooms and drove up health care costs. Babies born to addicted mothers often suffered from neonatal abstinence syndrome, going through painful withdrawal after birth.[13] Grandparents, other relatives, and foster parents were raising the children of addicted parents.

The costs to local governments were often crushing. Ross County, Ohio, for example, saw its child services budget almost double from $1.3 million to $2.4 million from 2009 to 2016. "This has introduced an entirely different metric, an entirely different unpredictability in budgeting," said the top official of Indiana County, Pennsylvania, which had drawn on contingency funds to cover extra costs associated with the opioid crisis.[14]

Some research showed that opioid abuse had hurt the economy by keeping people out of the workforce. A survey of men between the ages of 25 and 54 who were not working or looking for work found that almost half had taken pain medication the previous day, and

[9] Holly Hedegaard et al., "Drug Overdose Deaths in the United States, 1999–2015," Centers for Disease Control and Prevention, NCHS Data Brief No. 273, February 2017.

[10] "Are Opioid Deaths Affected by Macroeconomic Conditions?" *NBER [National Bureau of Economic Research] Bulletin on Aging and Health,* 2017 #3.

[11] "New Research Identified a 'Sea of Despair' Among White, Working-Class Americans," *The Washington Post,* March 23, 2017. The research cited is Anne Case and Angus Deaton, "Mortality and Morbidity in the 21st Century," *Brookings Papers on Economic Activity,* Spring 2017.

[12] "The Addicts Next Door," *The New Yorker,* June 5 & 12, 2017.

[13] "Study: Rural Areas See Increase in Babies Born with Opioid Addiction," *USA Today,* December 14, 2016.

[14] "How the Opioid Crisis Is Blowing a Hole in the Finances of Small-Town America," *The Epoch Times,* September 21–27, 2017.

two-thirds of these had taken a prescription pain medication.[15] Of course, these men may have been out of the workforce because they were ill or injured, not because they were hooked on opioids. But anecdotal evidence was suggestive. The owner of an auto parts supplier in Michigan, for example, reported that she had great difficulty filling jobs at her factory. Part of the problem: when she sent new hires for a routine drug test, 60 percent failed to show up.[16]

Purdue Pharma and the Rise of OxyContin

Many observers traced the modern opioid epidemic to the introduction, in 1996, of a new prescription medication called OxyContin.[17] The company that developed it was Purdue Pharma, a privately held drug maker based in Connecticut.[18] In 1952, three brothers, Andrew, Raymond, and Mortimer Sackler—all physicians—had purchased Purdue Frederick, a small pharmaceutical firm whose main products at that time were earwax removers and laxatives. The company later introduced MS Contin, an extended-release form of morphine used mainly by cancer patients. As the patent for this drug approached expiration, Purdue turned to development of an extended-release form of another opioid, oxycodone, which had long been available as a generic. The firm spent around $40 million to develop and test its new drug, which it named OxyContin. In late 1995, the Food and Drug Administration (FDA) approved the 80-mg. dose of the drug (it later approved other doses).

Purdue's introduction of OxyContin coincided with changing attitudes in the medical community toward pain management. For many years, opioids were generally used only for end-stage cancer patients or those suffering from acute traumatic injuries or short-term post-surgical pain. Because of the risk of addiction, opioids were not considered appropriate for the treatment of chronic pain, and they were often mixed with other medicines like acetaminophen to discourage patients from taking larger amounts. In the 1980s, however, some physicians began to advocate for treating chronic pain more aggressively, saying that many patients with conditions like arthritis, back injuries, migraines, and fibromyalgia were suffering needlessly. Some campaigned to have pain recognized as the "fifth vital sign" (the other four were body temperature, pulse rate, respiration rate, and blood pressure). Because clinicians could not measure pain objectively, some adopted a one-to-ten scale, from "no pain" to "the worst pain" the patient had ever experienced.[19]

Purdue allied itself with this view, cultivating relationships with professional associations, such as the American Pain Society and the American Academy of Pain Medicine, which promoted the idea that pain was undertreated. It sponsored pain-management educational conferences in resort locations for doctors. The company also hired more sales representatives, more than doubling its sales force from 318 to 767 between 1996 and 2000. Purdue sales reps were well compensated, earning an average of $126,500 a year, including bonuses based on sales. In 2001 alone, the company paid $40 million in bonuses.

[15] Alan B. Krueger, "Where Have All the Workers Gone?" Paper prepared for the Boston Federal Reserve Bank's 60th Economic Conference, October 4, 2016.

[16] "Eager to Create Blue-Collar Jobs, a Small Business Struggles," *The New York Times,* September 3, 2017.

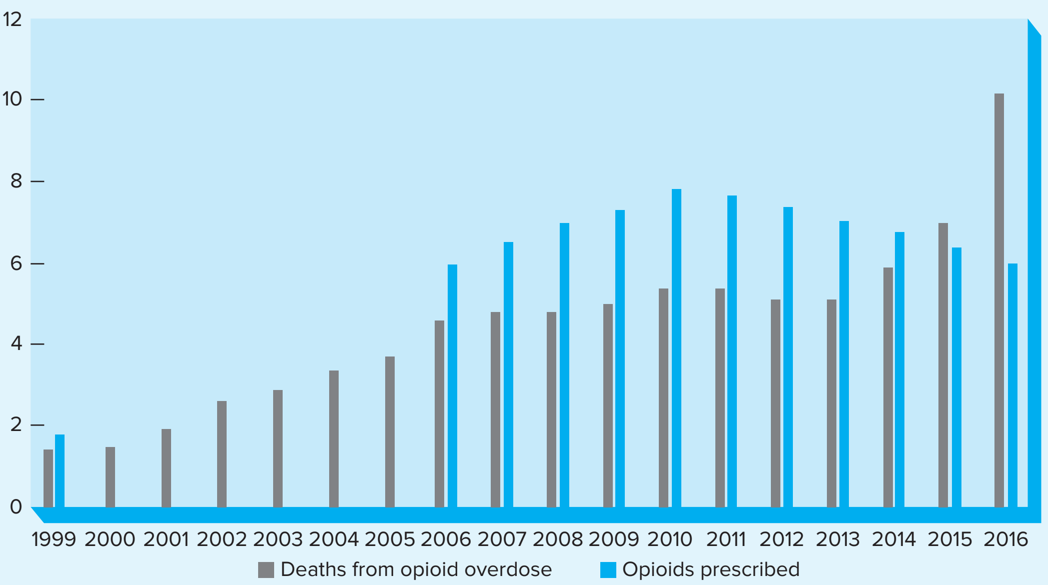
[17] This account of Purdue's development and marketing of OxyContin is based on Barry Meier, *Pain Killer: A 'Wonder' Drug's Trail of Addiction and Death* (Rodale Press, 2003); Art Van Zee MD, "The Promotion and Marketing of OxyContin: Commercial Triumph, Public Health Tragedy," *American Journal of Public Health,* 99(2), February 2009; Mike Mariani, "Poison Pill: How the American Opiate Epidemic was Started by One Pharmaceutical Company," *Pacific Standard,* February 23, 2015; and "The Family that Built an Empire of Pain," *The New Yorker,* October 30, 2017.

[18] Purdue Pharma had no relationship with Purdue University, although they shared a name.

[19] Kolodny et al., op. cit.

Exhibit A

Overdose Deaths from Prescription Opioids (per 100,000) and Opioid Prescriptions (Morphine Milligram Equivalents per 100), United States, 1999–2016



Sources: "Prescription Opioid Overdose Death Rate per 100,000 Population," The Henry J. Kaiser Family Foundation, at *www.kff.org*; Gery P. Guy, Jr. et al., "Vital Signs: Changes in Opioid Prescribing in the United States, 2006–2015," *Centers for Disease Control and Prevention Weekly,* July 7, 2017; Centers for Disease Control and Prevention, "Annual Surveillance Report of Drug-Related Risks and Outcomes, United States, 2017 and personal correspondence with Dr. Guy. Deaths from legal and illegal fentanyl cannot be distinguished, so both are included in the KFF database. Data on prescriptions in MMEs for 2000 to 2005 are unavailable, but data on opioid pain reliever sales in kilograms per 10,000 show a steady rise during this period ("Vital Signs: Overdoses of Prescription Opioid Pain Relievers, United States, 1999–2008," *Centers for Disease Control and Prevention Morbidity and Mortality Weekly Report,* November 4, 2011).

The company's detailers, as its sales representatives were known, used prescriber profiles to target general practitioners and those who were frequent prescribers of opioids. They handed out coupons for a 30-day free supply of OxyContin to doctors, who could pass them along to patients.

Purdue's sales representatives downplayed OxyContin's potential for addiction, claiming the risk was less than 1 percent. This dubious assertion was based on a five-sentence letter to the editor that had appeared in a 1980 issue of the *New England Journal of Medicine,* based on records of hospitalized patients in controlled settings. Sales representatives also argued that OxyContin's extended-release formula made it less susceptible to abuse; although the pill contained a large dose of oxycodone, users would not get a sudden rush because the drug's effects would be spread out over a 12-hour period, they told doctors.

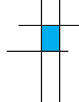
Despite the company's claims that OxyContin's extended-release mechanism made it hard to abuse, addicts quickly discovered that they could crush one of the pills and then swallow, inhale, or inject it to produce an intense high. As the number of prescriptions for opioid medications rose, so did overdose deaths. Exhibit A shows the quantity of opioids prescribed from 1999 to 2016, alongside the number of deaths from prescription opioid overdose. (The exhibit reports all opioids prescribed, not just OxyContin.)

As a private company, Purdue had no obligation to file annual reports, and its owners and managers rarely spoke publicly. But the company's senior medical director did tell a reporter in

2001, as awareness of OxyContin's risks began to spread in the public health community: "A lot of these people [addicts] say, 'Well, I was taking the medicine like my doctor told me to,' and then they start taking more and more and more. I don't see where that's my problem."[20]

Purdue Pharma's marketing campaign for OxyContin was highly effective. In 1996, the company's revenue from OxyContin was $44 million; it continued to rise, peaking at $3.1 billion in 2010. That year, it represented 90 percent of the company's total sales. The private firm's owners profited greatly from the drug's success. In 2015, *Forbes* estimated the Sackler family's net worth at around $14 billion, the 16th largest fortune in the United States.[21]

In 2007, the company settled charges brought by the U.S. Justice Department that it had lied about OxyContin's addiction risks, operating "a corporate culture that allowed this product to be misbranded with the intent to defraud and mislead." The company paid $600 million in fines—$470 million to federal and state governments and $130 million to resolve civil suits. Its top three executives personally paid $34.5 million in fines and were barred from involvement in any government health care program for 12 years.[22]



Government Regulation of Opioids

The federal government strictly regulated the manufacture and distribution of opioid medications like OxyContin under the Controlled Substances Act (CSA) of 1970.

The CSA empowered the Drug Enforcement Administration (DEA) and the FDA to create five lists, or "schedules," of certain controlled substances, ranging from one (Schedule I) to five (Schedule V). Schedule I drugs were those that had no accepted medical use and high potential for abuse; they included heroin, LSD, and MDMA ("Ecstasy"). These drugs were illegal, and physicians could not prescribe them under any circumstances. Schedule II drugs were those that *did* have an accepted medical use, but also had high potential for abuse and could lead to severe psychological and physical dependence. They included most prescription opiates, such as oxycodone, hydrocodone, codeine, and fentanyl. The DEA registered firms and individuals that handled controlled substances and required them to maintain complete and accurate inventories and records, and to store them securely. It required wholesalers, like McKesson, to maintain a system to detect and prevent the diversion of prescription drugs for nonmedical use. The DEA licensed physicians to prescribe Schedule II painkillers and could revoke a license if a doctor did not provide them for a legitimate medical purpose.

The DEA also established annual production quotas of various controlled substances. It negotiated these quotas with drug manufacturers, based on amounts considered necessary for medical, scientific, research, industrial, and export needs and to maintain sufficient reserves. This system was designed to meet legitimate needs, while preventing diversion. Although each company received its own quota, this information was proprietary, and the DEA published only the aggregate annual quota for each drug.

After the introduction of OxyContin, the DEA repeatedly raised the aggregate quota for oxycodone (its main component), as shown in Exhibit B. In 1994, the year before the FDA first approved OxyContin, the DEA limited production to 2,995 kilograms of oxycodone. The agency continued to raise the quota, reaching a peak of 153,750 kilograms in 2013—more than 50 times as high. After 2013, presumably in response to growing concern about

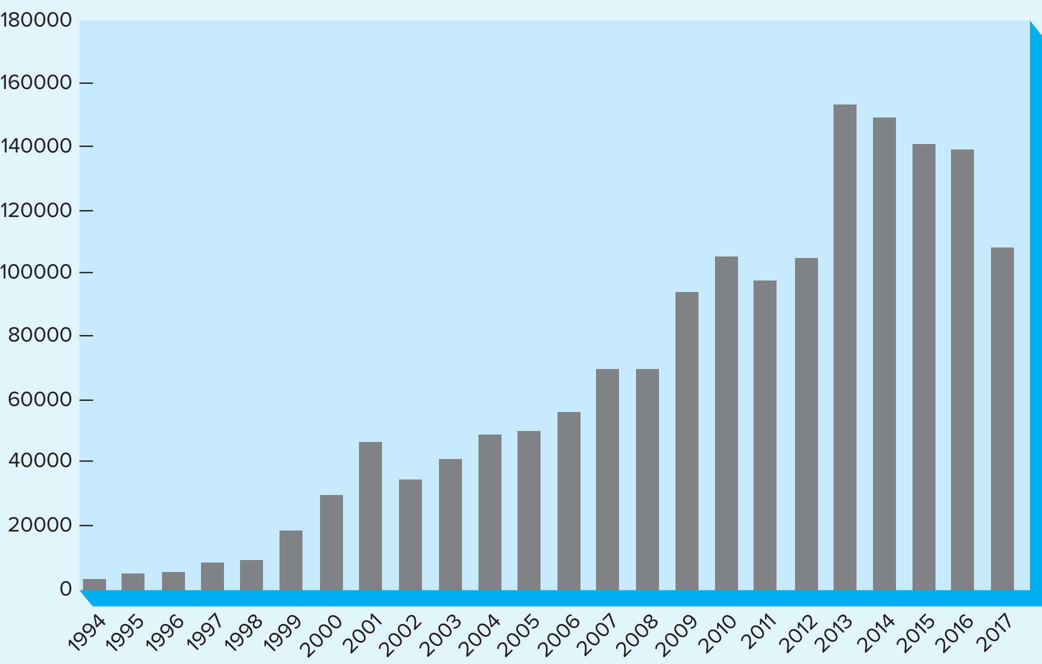
[20] Quoted in "You Want a Description of Hell? OxyContin's 12-Hour Problem," *The Los Angeles Times,* May 5, 2016.

[21] "The OxyContin Clan: The Newcomer to Forbes 200 Families," *Forbes,* July 1, 2015.

[22] "U.S. Maker of OxyContin Painkiller to Pay $600 Million in Guilty Plea," *The New York Times,* May 11, 2007; "Ruling Is Upheld Against Executives Tied to OxyContin," *The New York Times,* December 15, 2010.

Exhibit B

Drug Enforcement Agency Aggregate Production Quotas for Oxycodone (for Sale) By Year, in Kilograms, 1994–2017



Sources: Federal Register, 1994–1997; U.S. Department of Justice, Drug Enforcement Agency, Diversion Control Division, "Controlled Substances: Final Aggregate Production Quotas," 1998–2006, and "Aggregate Production Quota History for Selected Substances," 2007–2017. This chart includes only oxycodone intended for sale. The DEA maintains a separate quota for oxycodone intended for other uses, such as manufacturing other substances.

the opioid epidemic, the DEA reduced the quota, and by 2017, the amount approved had dropped to 108,510 kilograms.

Pain Clinics and Unscrupulous Physicians

A pivotal role in the opioid epidemic was played by pain clinics—known colloquially as "pill mills"—which dispensed opioids inappropriately for non-medical uses. Although pill mills sprouted up in many locations in the mid- to late-2000s, the epicenter of the trend was Broward County, Florida, home to Fort Lauderdale.

One of the most notorious was American Pain, which became for a time the largest dispenser of oxycodone in the nation.[23] American Pain was founded in 2008 by a young felon—he had done a short stint in jail for possession of steroids—who had neither a college degree nor any medical training. His business concept was to open a clinic dedicated exclusively to prescribing legal opioids. He hired physicians by running ads on *Craigslist* for doctors with a license to prescribe painkillers. He offered them $75 per patient visit plus $1,000 a week for the use of their license, which enabled the clinic to order and sell

[23] This description of American Pain is based on John Temple, *American Pain: How A Young Felon and His Ring of Doctors Unleashed America's Deadliest Drug Epidemic* (Rowman & Littlefield: Guilford, CT, 2015).

prescription medications. The physicians who took the job included retired doctors who wanted to earn more money, young doctors with high student loan debt, and graduates of marginal medical schools who had trouble finding other work. The owner hired his best friend, a beefy former construction worker, to oversee the operation, which journalist John Temple described this way:

> Outside, it looked like a bustling doctor's office, or the DMV. Inside, [a] crew of heavily inked muscle-heads and ex-strippers operated the office and pharmacy, counting out pills and stashing cash in garbage cans. Under their white lab coats, the doctors carried guns.[24]

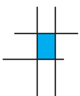
As business boomed, the clinic moved four times, each time to a larger location with more parking. At its peak, American Pain employed five full-time and several part-time doctors and a staff of about 20. It was raking in $100,000 a day—in cash. In 2009, the young owner's take-home pay was an astonishing $9 million.

Almost nine out of ten of America Pain's customers came from out of state, many from the rural counties of Kentucky and Tennessee, which by this time were in the grip of widespread opioid addiction. Patients could see a doctor with no appointment, get a prescription with few questions asked, and then get the script filled in-house. Entrepreneurial "sponsors" drove large groups of people to South Florida, giving them cash for their doctor's visit and prescription and then accepting as compensation a share of their pills, which could be sold back home on the black market. Interstate 75, the main highway connecting Florida to points north in Georgia and Tennessee, became known as "Oxy Alley" or the "blue highway," after the blue 30-mg oxycodone pills manufactured by the drug maker Mallinckrodt.

No one knew exactly how many deaths resulted from American Pain's practices. But drug enforcement officials later estimated that the clinic had prescribed almost 20 million opioids over a two-year period. More than 50 people who died of drug overdoses in Florida had been patients at American Pain. An uncounted number of the clinic's patients must have died in Georgia, Kentucky, Tennessee, Ohio, and other states.

Several factors allowed pill mills such as American Pain to flourish in Florida in the late 2000s. Unlike most other states, Florida did not operate a database that tracked opioid prescriptions, so users could obtain multiple prescriptions without detection. The state did not require pain clinics to obtain a license, or clinic owners to have any specialized training or expertise. And, crucially, it allowed doctors to both prescribe and sell medication. This meant that pill mill patrons could both obtain a prescription, and have it filled in one visit—eliminating the chance that a scrupulous pharmacy would turn them down.

In 2010, federal, state and local law enforcement officials finally shut down American Pain and prosecuted its owner, manager, and several of its doctors, sending several to prison. The same year, Florida barred convicted felons from operating pain clinics and required pain clinic doctors to have special training. The following year it established a drug database. Other states with concentrations of pill mills made similar moves around this time.



The Crackdown and Turn to Illegal Opioids

Around 2010, several factors converged to slow the diversion of prescription opioids into the hands of abusers. In addition to the crackdown on pill mills, government agencies,

[24] Ibid., p. xiii.

medical institutions, and companies all began changing their policies and practices. In 2010, Purdue changed the formulation of OxyContin, so it could not be crushed or dissolved, and it lobbied the government to require hard-to-abuse formulations of opioids. The Centers for Disease Control issued new guidelines on prescription of opioids, as did the Veteran's Administration. States and insurers placed limits on how many pills doctors could prescribe. These moves had their intended effect: data (reported in Exhibit A) showed that the number of opioid painkillers prescribed peaked in 2010.[25]

As the flow of prescription pills slowed, addicts increasingly turned to illegal street drugs—heroin, fentanyl from criminal sources, and even a powerful animal tranquilizer called carfentanil. A study of patients undergoing treatment for heroin addiction, published in 2014, found that of those who had started using drugs in the 2000s, three-quarters had first used prescription opioids, and had then switched to heroin because it was cheaper and easier to get.[26] "People eventually say, 'Why am I paying $1 per milligram for oxy when for a tenth of the price I can get an equivalent dose of heroin?'" commented one physician at a drug recovery center.[27]

As they made the shift from prescription pills, many addicts turned to so-called black tar heroin, delivered by what *The Washington Post* called a "sophisticated farm-to-arm supply chain fueling America's surging heroin appetite."[28] Relatively inexpensive, with the consistency of a Tootsie roll, black tar heroin was made from poppies grown on the Pacific coast of Mexico. Mexican poppy production rose 160 percent from 2013 to 2015.[29]

According to research by journalist Sam Quinones, most of the black-tar dealers hailed from the area around Xalisco in the state of Nayarit, Mexico. The "Xalisco Boys," as some law enforcement officers called them, devised a highly effective method of distribution. Managers recruited ambitious young men with few prospects at home and sent them north across the border. The Xalisco Boys avoided big coastal cities, where established gangs controlled the heroin trade, and instead targeted midsized communities in the heartland where couriers could blend into the local Latino population—places like Nashville, Columbus, Salt Lake City, Portland, and Denver. The couriers were trained to use rental cars, which could not be seized by authorities, and disposable mobile phones. They did not carry weapons, and they never used the product. The couriers worked on salary and sent most of their earnings to their families in Mexico. If one was arrested, he would be deported, and another would take his place.[30]

Quinones described the operations of the Xalisco Boys this way:

> An addict calls, and an operator directs him to an intersection or parking lot. The operator dispatches a driver, who tools around town, his mouth full of tiny balloons of heroin, with a bottle of water nearby to swig down if the cops stop him. . . . The driver meets the addict, spits out the required balloons, takes the money and that's that. It happens every day—from 7 a.m. to 7 p.m., because these guys keep business hours.[31]

[25] "Opioid Prescriptions Fall After 2010 Peak," CDC Report Finds," *The New York Times,* July 6, 2017.

[26] Theodore J. Cicero et al., "The Changing Face of Heroin Use in the United States," *JAMA Psychiatry,* 71(7), 2014.

[27] "Prescription Painkillers Seen as a Gateway to Heroin," *The New York Times,* February 10, 2014.

[28] "Pellets, Planes, and the New Frontier: How Mexican Drug Cartels are Targeting Small-Town America," *The Washington Post,* September 24, 2015.

[29] "Heroin Trafficking in the United States," op. cit.

[30] "Heroin Is a White-People Problem: Bad Medicine, Economic Rot, and the Enterprising Mexican Town that Turned the Heartland onto Black Tar," *Salon,* April 18, 2015.

[31] "Serving All Your Heroin Needs," *The New York Times,* April 17, 2015. See also Sam Quinones, *Dreamland: The True Story of America's Opiate Epidemic* (New York: Bloomsbury Press, 2015).

A study by the Congressional Research Service found that in 2014, 914,000 Americans had used heroin in the past year.[32] Tragically, many of them died: heroin-related overdose deaths more than doubled between 2009 and 2014.

A Flood of Lawsuits

As the opioid crisis raged, states, counties, cities and towns, and Indian tribes began bringing lawsuits against various business firms to recoup some of the escalating costs of law enforcement, health care, and child protective services. By 2017, at least 25 government entities had sued the drug companies, distributors, and pharmacy chains that had some hand in the journey of the pain pill from the factory into the addict's hands. These lawsuits relied on a range of legal theories; they variously cited laws related to public nuisance, consumer protection, negligence, and unjust enrichment.

To cite just a few examples:

- McDowell County, West Virginia, sued the three big drug distributors—McKesson, AmerisourceBergen, and Cardinal Health. "In my thinking, they [the distributors] were no different than drug dealers selling on the street," the county sheriff said.[33]
- The state of Ohio sued half-a-dozen drug makers—Purdue Pharma, Teva, Johnson & Johnson, Janssen, Endo, and Allergan—charging them with making false and misleading statements about the risks and benefits of prescription opioids. The state's legal brief stated that these drug companies had "helped unleash a healthcare crisis that has had far-reaching financial, social, and deadly consequences in the State of Ohio."[34]
- The city of Everett, Washington, sued Purdue Pharma for recklessly supplying OxyContin to suspicious physicians and pharmacies in their community, enabling illegal drug diversion and providing a "gateway" to heroin abuse.[35]
- The Cherokee Nation in Oklahoma sued distributors and pharmacies—including Walmart, CVS, and Walgreens—and called for them to reimburse the Cherokees for health care costs. "The resources of the Cherokee Nation are being spent on this crisis that otherwise should be spent on our ordinary, everyday health care needs," said the Cherokee Nation's attorney general.[36]

Some legal experts thought these lawsuits had little chance of success. Prescription opioids had a legitimate medical purpose and had been approved by the government. One expert in product liability law put it this way: "[The distributors] ship a drug that's approved by the FDA, and then a bunch of bad actors intervene—pill mills, doctors who overprescribe and the addicts themselves. It's a pretty strong argument." Other legal experts, however, thought the companies were in a weaker position. "[The pharmaceutical firms] are big companies that knew their product was doing harm," said an attorney who had been involved in the tobacco lawsuits years earlier. "Instead of helping to solve the problem, they promoted the irresponsible use of their product to improve their bottom line." Added the attorney who represented the Cherokee Nation: "These pharmaceutical companies should be scared as hell."[37]

[32] "Heroin Trafficking in the United States," *Congressional Research Service,* August 23, 2016.

[33] "As America's Opioid Crisis Spirals, Giant Drug Distributor McKesson Is Feeling the Pain," op. cit.

[34] Ohio's legal brief is available at *www.ohioattorneygeneral.gov/Files/Briefing-Room/News-Releases/Consumer-Protection/2017-05-31-Final-Complaint-with-Sig-Page.aspx*.

[35] "City of Everett v. Purdue Pharma," January 19, 2017, complaint filed in the Superior Court of the State of Washington.

[36] "Inside Cherokee Lawsuit to Fight Opioid Epidemic," *Rolling Stone,* May 26, 2017; and "Cherokee Nation Sues Wal-Mart, CVS, Walgreens Over Tribal Opioid Crisis," *NPR Now,* April 25, 2017.

[37] "Drugmakers and Distributors Face Barrage of Lawsuits Over Opioid Epidemic," *The Washington Post,* July 4, 2017.

Discussion Questions

1. How would you define the opioid epidemic referenced in the title of the case?
2. List the various businesses mentioned in this case, including drug manufacturers, distributors, clinics, and illegal drug dealers. Do you believe they acted in an ethical and socially responsible way, and why or why not?
3. What stakeholders were impacted by the actions of these businesses? Which were helped, and which were hurt, and how?
4. Do you believe that drug companies fraudulently marketed their products? Why or why not?
5. In what ways did the government regulate the production and distribution of opioids? Do you believe the government acted appropriately in doing so, and why or why not?
6. Looking at the case as a whole, what organizations or individuals do you believe bear the greatest responsibility for the opioid epidemic, and why? What should be the consequences for those responsible?

CASE TWO

Wells Fargo's Unauthorized Customer Accounts

At its September 20, 2016, hearing, the Senate Banking Committee relentlessly grilled John Stumpf, chairman and CEO of Wells Fargo, about charges that the bank had fraudulently opened unauthorized accounts for millions of customers. Senator Elizabeth Warren (D-Mass.) began with the question, "Have you returned one single nickel of the millions of dollars you were paid while the scam was going on?" As Stumpf fumbled in response, she concluded, "So you haven't resigned. You haven't returned a single nickel of your personal earnings. You haven't fired a single senior executive. Instead, evidently, your definition of accountable is to push the blame to your low-level employees who don't have the money for a fancy PR firm to defend themselves. It's gutless leadership."[1] A few days later, on September 29, congressional members at a hearing of the House Financial Services Committee echoed the views expressed in the Senate. Congressman Gregory Meeks (D-New York) said to Stumpf, "I can't believe what I'm hearing here. You're going to tell me there's not a problem with the [bank's] culture?" Patrick McHenry (R-North Carolina) accused Stumpf of being "tone deaf" for not grasping the scandal's impact on society's trust in the banking system.

The two congressional hearings followed shortly after the imposition of fines on Wells Fargo by the Consumer Financial Protection Bureau ($100 million), the Los Angeles City Attorney ($50 million), and the Office of the Comptroller of the Currency ($35 million). The reason for these fines was that the bank had opened more than two million unauthorized checking and credit card accounts without the consent of its customers between May 2011 and July 2015. Wells Fargo settled with these regulatory agencies without admitting or denying the alleged misconduct.[2] These fines were not the bank's only problems. Other lawsuits against Wells Fargo—from customers, former employees, and shareholders—had started piling up. Shareholders had filed a class action lawsuit alleging that the bank had misled investors about its financial performance and the success of its sales practices. The price of Wells Fargo's stock had fallen more than 10 percent since September 8, when it reached the

By Samir Kumar Barua, Indian Institute of Management Ahmedabad, and Mahendra R. Gujarathi, Bentley University. Copyright © 2017 by the *Case Research Journal* and the authors; all rights reserved. This case has been revised and abridged by permission of the authors for publication in this textbook. The complete case appears in the *Case Research Journal,* 37(2), Spring 2017, under the title, "Wells Fargo: Setting the Stagecoach Thundering Again." The case was prepared by the authors for the sole purpose of providing material for classroom discussion. It is not intended to illustrate either effective or ineffective handling of a managerial situation.

[1] "Elizabeth Warren Accuses Wells Fargo Chief of 'Gutless Leadership'," *New York Times,* September 20, 2016.

[2] "Federal Prosecutors Investigating Wells Fargo Over Sales Tactics," *The Wall Street Journal,* September 14, 2016.

settlement with regulators, wiping out more than $25 billion of market capitalization.[3] Stumpf and his leadership team faced a major crisis.

Wells Fargo and Company

Henry Wells and William Fargo founded Wells Fargo and Company on March 18, 1852. The company began by offering banking and express services in California, and soon afterwards, formed an overland mail service, becoming indelibly linked with the image of a stagecoach drawn by six thundering stallions. The bank survived the Great Depression as well as the difficult period of World War II. The prosperity of the 1960s saw the bank emerge as a major regional bank in the western part of the United States. By the 1980s, when it started its online banking service, Wells Fargo had become one of the top ten U.S. banks.[4]

The bank weathered the financial crisis of 2007–2008 relatively unscathed. In fact, Wells Fargo used it as an opportunity to grow by acquiring Wachovia, a bank weakened by the mortgage crisis, in 2008. Wachovia's extensive retail network in the eastern United States, which complemented Wells Fargo's, enabled the bank to double both its number of branches and total deposits. By the end of 2015, Wells Fargo had become a diversified banking and financial services company with assets of over $1.8 trillion and approximately 265,000 employees, serving one in three U.S. households.

In 2015, Wells Fargo was organized into three major, relatively autonomous, segments. These were community banking, wholesale banking, and wealth and investment management. The community banking division offered a complete suite of diversified financial products and services to consumers and small businesses. Its loan products included lines of credit, automobile inventory financing, equity lines, equipment loans, education loans, residential mortgage loans, and credit cards. Consumer and business deposit products included checking accounts, savings accounts, money market accounts, Individual Retirement Accounts, and time deposits. The wholesale banking division provided financial solutions to businesses with annual sales exceeding $5 million. It provided a complete line of business banking, commercial, corporate, capital markets, cash management, and real estate banking products and services. Finally, the wealth and investment management division provided a full range of personalized wealth management, investment, and retirement products and services to high-net worth and ultra–high-net worth individuals and families.

Between 2010 and 2015, Wells Fargo's assets grew by 46 percent and net income by more than 85 percent. By early 2015, it had posted 18 consecutive quarters of profit growth. Wells Fargo performed better than its competitors; during most of these years, the bank's return on assets and return on equity were higher than those of Bank of America, J. P. Morgan Chase, and Goldman Sachs. Its efficiency ratio (the cost incurred to generate a dollar of revenue) was low relative to that of its competitors. Of Wells Fargo's three major segments of business, community banking contributed the most. In 2015, the community banking division contributed 57 percent of revenues, 59 percent of operating income and net income, and 51 percent of total assets.[5]

Wells Fargo's financial performance was reflected in the increase in its stock price. In July 2015, with market capitalization of about $300 billion, Wells Fargo became the most valuable bank in the world. Its stock outperformed the broader benchmark, consisting of about

[3] "Wells Fargo Was Just Hit with a Shareholder Class Action Lawsuit," *Fortune,* September 27, 2016.

[4] Wells Fargo, "History of Wells Fargo," at *www.wellsfargo.com/about/corporate/history/*.

[5] Wells Fargo, Financial Overview (John Shrewsberry, Senior EVP, Chief Financial Officer) at *www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2016/financial-overview.pdf*.

24 leading national and regional banks. An investment of $100 in the bank's stock at the end of 2009 would have been worth $230 by the end of 2015, earning investors a compounded annual return of 12.4 percent over the six-year period. By contrast, for the same period, an investment in BKX (a bank index) would have produced a compounded annual return of only 9.4 percent.[6] Wells Fargo stock had also outperformed the broader stock market index over longer periods of time. For the decade ending December 2015, its stock yielded a 14.3 percent compounded annual return to the stockholders, compared with the 7.3 percent for S&P 500 index.

Corporate Governance and Senior Leadership

At the time of the Congressional hearings, Wells Fargo's board consisted of 15 directors. Except for Stumpf, every board member was an independent director as defined by the rules of the New York Stock Exchange (NYSE). All standing committees of the board, including the human resources committee that determined the compensation of senior executives, consisted solely of independent directors. The board had also adopted Wells Fargo's Code of Ethics and Business Conduct for its members. In 2016, NYSE Governance Services, a subsidiary of New York Stock Exchange, bestowed the Best Board Diversity Initiative Award on Wells Fargo in recognition of the wide breadth of experience, industry, age, ethnicity, and gender the board possessed. In 2015, the annual compensation of board members consisted of cash and stock awards ranging from $279,027 to $402,027 per director.[7]

John Stumpf served as both chairman of the board and chief executive officer. Born in 1953, Stumpft grew up as one of eleven children on a dairy and poultry farm in Minnesota. After earning an undergraduate degree from St. Cloud University and an MBA from the University of Minnesota, Stumpf joined Northwestern National Bank (later Norwest), where he worked his way up through a variety of positions, joining Wells Fargo after the bank acquired Norwest in 1998. In 2002, Stumpf was named group executive vice president of community banking and was elected to Wells Fargo's board in 2006. Stumpf succeeded Richard Kovacevich as CEO in June 2007 and become chairman in January 2010.[8] As CEO, Stumpf instituted a policy of open debate on issues concerning the bank. "Around here if you have something to say, you say it—nobody is going to be offended," he said. "We've learned how to disagree without being disagreeable."[9]

Carrie Tolstedt headed Wells Fargo's community banking division—where the unauthorized accounts had been opened—from June 2007 until July 2016. Tolstedt was a veteran in the financial services industry, with 27 years at Wells Fargo. A graduate of the University of Nebraska, she joined Norwest Bank in 1986, rising through the ranks to become a key associate of Stumpf first at Norwest and later at Wells Fargo. In ranking Tolstedt near the top of its list of the 25 Most Powerful Women in Banking in 2015, *American Banker* magazine noted the challenges she faced during integration of Wachovia with Wells Fargo. "One risk of such a large integration would be that the company's internal service culture would begin to drift," the magazine opined, "but Tolstedt thinks up ways to communicate values to the front line."[10]

Wells Fargo's impressive financial and stock performance was reflected in the compensation packages given to its senior managers. In setting executive compensation, the human

[6] The returns were calculated by the case authors using the stock prices obtained from *finance.yahoo.com*.

[7] Wells Fargo, Wells Fargo 2016 Proxy Statement, March 16, 2016.

[8] "Wells Fargo's Kovacevich to Step Down at Year's End," *Startribune.com*, September 22, 2009.

[9] "The Bank That Works," *Forbes,* January 25, 2012.

[10] "No. 4: Carrie Tolstedt, Wells Fargo," *American Banker,* September 22, 2015.

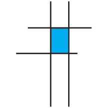
resources committee of the board considered the bank's financial performance (including comparison with peers), progress on strategic priorities, strong and effective leadership, business line performance (for business line leaders), proactive assessment and management of risks, and an independent compensation consultant's advice.[11] In 2015, Stumpf and Tolstedt received total compensation of $19.3 million and $9.1 million, respectively.

Wells Fargo's Values and Code of Ethics

Wells Fargo described its primary values as follows:

> First, we value and support our people as a competitive advantage and strive to attract, develop, retain and motivate the most talented people we can find. Second, we strive for the highest ethical standards with our team members, our customers, our communities and our shareholders. Third, with respect to our customers, we strive to base our decisions and actions on what is right for them in everything we do. Fourth, for team members we strive to build and sustain a diverse and inclusive culture—one where they feel valued and respected for who they are as well as for the skills and experiences they bring to our company. Fifth, we also look to each of our team members to be leaders in establishing, sharing and communicating our vision.[12]

Wells Fargo's Code of Ethics and Business Conduct both described the importance of ethical behavior and emphasized employees' responsibility to protect the reputation and integrity of Wells Fargo. The bank also recommended a process for employees to follow when faced with an ethical dilemma: they were instructed to contact their manager, HR advisor, or Office of Global Ethics and Integrity for help. Employees could also report any concern regarding accounting, internal accounting controls, and auditing matters directly to the audit and examinations committee of the board or could call the bank's ethics hotline (called "EthicsLine") if they saw or suspected illegal or unethical behavior.[13]



The "King of Cross-Selling"

Many analysts attributed Wells Fargo's financial success in large part to its prowess in cross-selling. Cross-selling referred to the practice of marketing related or complementary products to an organization's existing customers (as contrasted with attracting new customers). Cross-selling had several benefits. It increased a customer's reliance on the firm and decreased the likelihood he or she would switch to a competitor. It allowed a firm to extract the maximum revenue potential from each customer. Servicing one account rather than several was also more efficient. In 2006, Richard Kovacevich, Stumpf's predecessor as CEO, explained Wells Fargo's rationale for cross-selling this way:

> Cross-selling—or what we call "needs-based" selling—is our most important strategy. Why? Because it is an "increasing returns" business model. It's like the "network effect" of e-commerce. It multiplies opportunities geometrically. The more you sell customers, the more you know about them. The more you know about them, the easier it is to sell them more products. The more products customers have with you, the better value they receive and the more loyal they are. The longer they

[11] Wells Fargo, Wells Fargo Human Resources Committee Charter, November 18, 2014.

[12] Ibid.

[13] Wells Fargo, "Wells Fargo Team Member Code of Ethics and Business Conduct," at *www.sec.gov/Archives/edgar/data/72971/000119312509127827/dex991.htm*.

Exhibit A

Wells Fargo Cross-Sell Ratios, 1998–2016

Source: Wells Fargo annual reports.

stay with you, the more opportunities you have to meet even more of their financial needs. The more you sell them, the higher the profit because the added cost of selling another product to an existing customer is often only about 10 percent of the cost of selling that same product to a new customer.[14]

Under Stumpft and Tolstedt's leadership, Wells Fargo continued to emphasize the importance of cross-selling. In addition to signing up existing customers for additional services, the bank offered customers a set of interrelated products with discounts integrated into the package. For example, its premier relationship package (called PMA) offered customers a free current account and free bill payments, together with options to add a savings account, credit card, mortgage loan, and a discount brokerage account. About 63 percent of new customers opted for such packages, with an average of four products per package.[15]

Exhibit A depicts the cross-sell ratio (number of accounts or products per customer) of Wells Fargo from 1998 to 2016. As shown, by 2009 Wells Fargo had recorded an increased cross-sell ratio for eleven consecutive years. At the time of the Wachovia acquisition in 2008, Wells Fargo's cross-sell ratio (5.95 per customer) was higher than Wachovia's (4.65). Wachovia's customers therefore provided an opportunity for Wells Fargo to offer additional products and services, further increasing the cross-sell ratio. In the 2010 annual report, Stumpf proposed a goal of eight accounts per customer, declaring the number "rhymed with 'great.'" He added, "Perhaps our new cheer should be: 'Let's go again, for ten!'" In the same report, he also mentioned the challenges of cross-selling. "If anyone tells you it's easy to earn more business from current customers in financial

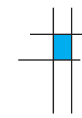
[14] Wells Fargo, The Vision and Values of Wells Fargo, at *www.wellsfargo.com/about/corporate/vision-and-values/*.

[15] Wells Fargo, Compare Checking Accounts, at *www.wellsfargo.com/checking/compare-accounts/*.

services, don't believe them. We should know. We've been at it almost a quarter century. We've been called, true or not, the 'king of cross-sell.'"[16]

Wells Fargo was not alone in using cross-selling as a marketing tool. Several other large and regional banks, including Bank of America, Citizens Bank, PNC Bank, SunTrust Bank, and Fifth Third Bank, also used this strategy. However, Wells Fargo's success in cross-selling was unparalleled. In the second quarter of 2016, the cross-sell ratio (number of products or accounts per customer) for U.S. banks in 2016 averaged 2.71; Wells Fargo's was 6.27.[17]

To improve its cross-sell ratio, Wells Fargo developed a system of incentives for its employees. Employees who cross-sold successfully were rewarded with extra compensation. Branch employees who hit sales targets could earn bonuses of $500 to $2,000 per quarter, on top of base salaries of about $25,000 to $30,000 a year.[18] District managers could earn bonuses of $10,000 to $20,000 a year. In addition to providing bonuses, the bank mandated quotas for the number and types of products to be sold by employees. One employee remarked, "If we did not make the sales quotas, we had to stay for what felt like after-school detention, or report to a call session on Saturdays."[19] Employees reported that branch managers routinely monitored their progress toward meeting their sales goals, sometimes hourly, and sales numbers at the branch level were reported to higher-ranking managers as many as seven times a day. If an employee did not meet their quota, he or she was reportedly chastised by the community banking president in front of other staff.[20]



Unauthorized Accounts

While most Wells Fargo employees tried to sell the right products to the right customers, some responded to the intense pressure to meet sales targets by opening accounts that customers had not authorized. An internal investigation later revealed that bank employees had opened as many as 1,534,280 unauthorized deposit accounts and another 565,443 unauthorized credit card accounts between 2011 and 2015.[21] How had they done this without the customers' knowledge? In some cases, employees had created phony PIN numbers and fake e-mail addresses to enroll existing customers for "Net Banking" services and had forged client signatures on paperwork.[22] Some of the questionable accounts had been created by moving a small amount of money from an existing account to open a new one for a customer. Shortly thereafter, the employees would close the new account and move the money back to the original account, thereby earning credit toward their quotas. Sometimes, customers were told by phone that Wells Fargo planned to send them a new credit card as a "thank you" for their business. If a customer didn't want the card, he or she was told to cut up the card when it arrived in the mail. However, most customers were unaware that issuing a new card required a credit check, which could potentially lower their credit scores.

[16] Wells Fargo. 2010 Annual Report, at *www08.wellsfargomedia.com/assets/pdf/about/investor-relations/annual-reports/2010-annual-report.pdf*.

[17] "What the Wells Fargo Cross Selling Mess Means for Banks," *The Wall Street Journal,* September 28, 2016.

[18] Brian Tayan, "The Wells Fargo Cross Selling Scandal," Harvard Law School, December 2, 2016.

[19] "Wells Fargo to Roll Out New Compensation Plan to Replace Sales Goals," *The Wall Street Journal,* January 6, 2017.

[20] "4 Things Former Wells Fargo Workers Revealed About Pressure to Meet Sales Goals," *Consumerist.com*, September 19, 2016.

[21] "Has Wells Fargo's Phony Account Scam Ruined Cross-Selling for The Entire Banking Industry?" *The Financial Brand,* September 12, 2016.

[22] "Wells Fargo Dumps Toxic 'Cross-selling' Metric," *CNN.com*, January 13, 2017.

In many cases, customers did not know that a new account had been opened in their name until they received a congratulatory letter. Sometimes, when the customers complained about unwanted credit cards, the branch manager would blame a computer glitch or say the card had been requested by someone with a similar name. On several occasions, upon receiving the customer complaint, Wells Fargo refunded the amount charged to the customer. However, such refund would not restore any deterioration in the creditworthiness of the customer, who might face higher interest rates or be denied access to credit in the future.[23]

Opening unauthorized accounts clearly violated the bank's rules. A 2007 internal document titled *Sales Quality Manual* stated that customer consent for each specific solution or service was required every time (including for each product in a package). The document also stated that "splitting a customer deposit and opening multiple accounts for the purpose of increasing potential Incentive Compensation (IC) is considered a sales integrity violation."[24] When the Senate Banking Committee questioned Stumpf about the unauthorized accounts, he repeatedly stated that the vast majority of employees did the right thing, and whenever an internal investigation had found that an employee had created an account and funded it on behalf of the customer without that customer's permission, the employee was terminated. He said employees who had opened unauthorized accounts had "violated the company's code of ethics, were dishonest, and did not honor our culture."

Wells Fargo's external auditors, KPMG, did not raise any red flags in their audit reports or in their reports on the effectiveness of internal controls at the bank during the period covered by the settlements.[25] However, top managers knew about the problem as early as 2011, when the bank fired 1,000 employees for opening unauthorized accounts. (The board was informed of these terminations.)[26] In December 2013, the *Los Angeles Times* published an investigative article under the title, "Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost," based on interviews with employees and a review of bank documents and court records, putting the issue in the public eye.[27] At both the 2014 and 2015 annual meetings, employees had delivered petitions with over 10,000 signatures, urging the board to recognize the link between high-pressure sales quotas and the fraudulent opening of accounts without customer permission.[28]

In August 2015, Wells Fargo hired PricewaterhouseCoopers LLP (PwC) to carry out a detailed analysis of the sales practices pertaining to all of the 82 million deposit accounts and nearly 11 million credit card accounts that had been opened between 2011 and 2015, to quantify the remediation needed to compensate customers who had suffered because of accounts fraudulently opened in their names. About a dozen PwC employees worked on the assignment for about a year and confirmed the prevalence of fraudulent sales practices at the bank.[29]

Employees Speak Out

In the wake of the congressional hearings and fines levied against Wells Fargo, dozens of employees spoke to the media about their experiences.

[23] "Wells Fargo's Unauthorized Accounts Likely Hurt Customers' Credit Scores," NPR, September 26, 2016.

[24] "Wells Fargo Workers: Fake Accounts Began Years Ago," *CNN.com*, September 26, 2016.

[25] "Wells Fargo: Where Was the Auditor?" *The Wall Street Journal,* November 1, 2016.

[26] U.S. Senate, Testimony of John Stumpf Chairman and Chief Executive Officer of Wells Fargo & Co. Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, September 20, 2016, at *www.banking.senate.gov/public/_cache/files/18312ce0-5590-4677-b1ab-981b03d1cbbb/3B18AA6E3A96E50C446E2F601B854CF1.092016-stumpf-testimony.pdf*.

[27] "Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost," *Los Angeles Times,* December 21, 2013.

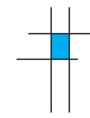
[28] Waizenegger, Dieter, CTW Investment Group, September 23, 2016.

[29] "How Wells Fargo's High-Pressure Sales Culture Spiraled Out of Control," *The Wall Street Journal,* September 16, 2016.

The *Wall Street Journal* reported the story of one employee (Scott Trainor) who said that managers suggested that employees hunt for sales prospects at bus stops and retirement homes. The employees who refused to do so were harassed, penalized, and even terminated.[30] The *New York Times* reported that another employee (Dennis Russell) said that as a telephone banker, he handled incoming customer service calls and was expected to refer 23 percent of his callers to a sales representative for additional product sales. But the customers Russell spoke with were usually in dire financial shape. Looking at their accounts, he could see mortgages in foreclosure, credit cards in collection, and cars being repossessed for overdue loan payments. "The people calling didn't have assets to speak of," Russell said. "What products could you possibly offer them in a legitimate way? It's a crock, they established the culture that made this happen—it comes down from the top." Russell was fired in 2010.[31]

CBS News reported that a former banker (Yesenia Guitron) sued Wells Fargo in 2010 claiming that intense sales pressure and unrealistic quotas drove employees to falsify documents and game the system to meet their sales goals. She did everything Wells Fargo had asked employees to do to report such misconduct. She told her manager about her concerns. She called Wells Fargo's ethics hotline. When those steps yielded no results, she went up the chain, contacting an HR representative and the bank's regional manager. After months of retaliatory harassment, Guitron was fired for insubordination.[32]

CNN Money reported that a Wells Fargo employee (Bill Bado) had called the ethics hotline and sent an e-mail to human resources in September 2013, flagging sales he was instructed to execute that he believed to be unethical. Eight days after that e-mail, he was terminated on the grounds of tardiness.[33] Another employee (Christopher Johnson) told *The New York Times* that after he started working, his manager began pressuring him to open accounts for his friends and family, with or without their knowledge. Following the instructions received during training, he called the company's ethics hotline. Three days later, Johnson was fired for "not meeting expectations."[34] The dismissals of Bado and Johnson occurred despite the bank's explicit non-retaliation policy outlined in a handbook that was given to every employee.



Wells Fargo's Response

At the congressional hearings, Stumpf apologized several times, stating, "We recognize now that we should have done more sooner to eliminate unethical conduct or incentives that may have unintentionally encouraged that conduct." He accepted full responsibility and said that the bank would take steps to address any underlying problems and restore its customers' trust. But he also insisted that "we never directed nor wanted our employees, whom we refer to as team members, to provide products and services to customers they did not want or need."[35]

The bank had already taken several remedial actions. Stumpf testified that since 2011 Wells Fargo had fired 5,300 employees who had opened unauthorized accounts, but he also emphasized that this number represented a small percentage of the bank's employees,

[30] Ibid.

[31] "Wells Fargo Workers Claim Retaliation for Playing by the Rules," *The New York Times,* September 26, 2016.

[32] "Wells Fargo Whistleblower Says She Flagged Fraud Years Ago," CBS News, October 4, 2016.

[33] "I Called the Wells Fargo Ethics Line and Was Fired," *CNN.com*, September 21, 2016.

[34] "Wells Fargo Workers Claim Retaliation for Playing by the Rules," *New York Times,* September 26, 2016.

[35] U.S. Senate, Testimony of John Stumpf Chairman and Chief Executive Officer of Wells Fargo & Co. before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, September 20, 2016.

most of whom had done nothing wrong. The bank had refunded to customers $2.6 million of wrongfully charged fees. Stumpf also revealed that he had recommended that Wells Fargo's board rescind unvested stock awards of $41 million to him and $19 million to Carrie Tolstedt, who led the bank's community banking division where the wrongful sales practices had occurred.[36] He said that the bank would eliminate sales goals ("quotas") for cross-selling, but would not back away from cross-selling completely. He also noted that although the settlements involved conduct that began in 2011, the bank's investigation was going back to 2009 and 2010, when Wachovia was being absorbed, to determine whether misconduct was taking place then.

But Stumpf's statements did little to appease the members of Congress. Many Senators and congressional members demanded Stumpf's resignation and the claw-back of his compensation of about $200 million during the years of misconduct. They also demanded a claw-back from Tolstedt, who was set to retire at the end of 2016 with a $124 million paycheck (a mix of shares, options and restricted stock).[37] "You have broken long-standing ethical standards inside the company," said Congressman Patrick McHenry (R-North Carolina). "How can you rebuild trust?"[38]

Discussion Questions

1. Describe the "unauthorized customer accounts" referenced in the title of the case. What did the bank and its employees do? Which stakeholders were helped and which were harmed by these actions?
2. Do you believe Wells Fargo demonstrated an ethical corporate culture? Why or why not? In your response, please consider both the formal ethics policies of the bank and ethical leadership as modeled by its senior executives and board of directors.
3. Describe "cross-selling." What were the benefits of cross-selling to the bank and its shareholders? In what ways did cross-selling contribute to the problems Wells Fargo later faced?
4. If you were an employee of Wells Fargo and felt pressured to cross-sell to customers, even when you felt this was inappropriate, what would you have done?
5. Did Wells Fargo respond appropriately to employees who voiced their concerns about unauthorized accounts? What should it have done differently?
6. Looking at the case as a whole, what steps would you recommend Wells Fargo, its senior managers, and its board of directors do now to prevent such events from occurring again in the future?

[36] Tolstedt also agreed not to exercise her stock options worth roughly $35 million until the board's independent investigation was completed.

[37] "$124 Million Payday for Wells Fargo Exec Who Led Fake Accounts Unit," *CNN Money,* September 13, 2016.

[38] "Wells Fargo CEO Faces Lawmakers, Apologizes Again," *PBS Newshour,* September 29, 2016.

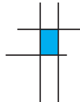
CASE THREE

The Carlson Company and Protecting Children in the Global Tourism Industry

Marilyn Carlson Nelson, in her seventh year as chief executive officer (CEO) of the Carlson Company, a global marketing, travel, and hospitality company, faced a major dilemma. In 2006, the company was considering a proposal to expand its luxury Regency accommodations and services to Costa Rica. The venture gave many indications of being strategically sound and highly profitable, and it would also provide a basis for future expansion throughout Latin America. However, during the feasibility study of a promising property located in Papagayo, a popular tourist destination along Costa Rica's northern coast, company executives learned that the surrounding area was notorious for child trafficking and prostitution. This was of particular concern to Carlson Nelson, because under her leadership Carlson had, in 2004, signed the *Code of Conduct for the Protection of Children from Sexual Exploitation in Travel and Tourism* (the Code). This global project brought together the travel and tourism industry and nongovernmental organizations to prevent sexual exploitation of children at tourist destinations.

As part of its obligations under the Code, Carlson had adopted a corporate ethics policy designed to eliminate any organizational association with sex trafficking. Carlson Nelson was confronted with the need to assess whether the proposed Regent resort could ensure compliance with the Code in an environment where sexual exploitation of children was often an integral part of doing business. Should Carlson Companies decide to abandon the project, it would certainly lose a viable opportunity to become a major player in the high-end Central American tourism market.

By Robyn Linde and H. Richard Eisenbeis. Copyright © 2011 by the *Case Research Journal* and the authors. Used by permission. All rights reserved. This case study was generously funded by the *United Front for Children Conference: Global Efforts to Combat Sexual Trafficking in Travel and Tourism,* held at the University of Minnesota in Minneapolis in April 2006. The Curtis L. Carlson Foundation was one source of funding for the conference. Interviews for the case study were conducted between 2006 and 2008 with Carlson Companies executives, including Marilyn Carlson Nelson, then president and chief executive officer of Carlson Companies; Deb Cundy, assistant dean of external relations at the Carlson School of Management at the University of Minnesota; Doug Cody, corporate vice president of public relations and communications; Kim Olson, vice president, chief communications officer; Tom Polski, vice president of global communications and external relations; Bill Van Brunt, executive vice president, Carlson Companies; and Jay Witzel, president and CEO of Carlson Hotels Worldwide. Carol Smolenski of *End Child Prostitution Child Pornography and Trafficking of Children for Sexual Purposes* (ECPAT) was an especially valuable resource during the many drafts of this case. Robyn Linde would additionally like to thank Sally Kenney, Holiday Shapiro, Kathryn Sikkink, fellow case writers in Professor Kenney's seminar on *Case Studies on Women and Public Policy* at the University of Minnesota, and the anonymous reviewers for their helpful comments on earlier drafts.



Carlson Companies, Marilyn Carlson Nelson, and the Code

Carlson's history was one of the classic business success stories in the American free enterprise system. Starting in 1938 with an idea and a $55 loan, entrepreneur Curtis L. Carlson founded the Gold Bond Stamp Company in his home town of Minneapolis. He knew that grocery stores, drug stores, gas stations, and other independent merchants could use stamps to drive customer loyalty and to distinguish themselves from their competitors. During the 1950s and 1960s, Gold Bond and its sister company, Top Value Stamps, helped revolutionize the way retail goods were marketed. Trading stamps proved to be right for the times and swept the nation in a wave of dramatic growth.[1]

In the late 1960s, when the trading stamp market reached its peak, the Gold Bond Stamp Company expanded into the hospitality industry. In the 1970s, the company acquired dozens of additional businesses, including T.G.I. Friday's and Radisson. To reflect its diversification, Gold Bond changed its name to Carlson Companies in 1973. Based in Minneapolis, Minnesota, Carlson brands generated more than $31.4 billion in gross sales system-wide and employed about 188,000 people in more than 140 countries by 1999. In 2006, to demonstrate that they were one company serving a variety of needs, the firm became known as the Carlson Company.[2]

The company had long been involved in philanthropy through its Curtis L. Carlson Family Foundation. Established in 1959, the foundation was one of many avenues Carlson Companies chose to carry out its charitable work. Curtis Carlson, the son of Swedish immigrants, became widely recognized in Sweden for his success in business as well as for his charitable endeavors. His ancestral ties to Sweden eventually led to a lasting friendship between the Carlson family and the royal family of Sweden.

Marilyn Carlson Nelson, Curtis Carlson's eldest daughter, graduated with honors from Smith College with a degree in international economics and a minor in theater. She also attended the Sorbonne in Paris and the Institute Des Hautes Etudes Economiques Politiques in Geneva, Switzerland, where she studied political science and international economics. Carlson Nelson succeeded her father as president and CEO of Carlson Companies in 1998. In this role, she was responsible for the day-to-day operations of one of the largest privately held companies in the world. Carlson Nelson led the management of a global business portfolio encompassing Carlson's major operating groups, specializing in corporate solutions and consumer services: Carlson Hospitality Worldwide (hotels, restaurants, and cruise ships); Carlson Wagonlit Travel (business travel and leisure travel brand); Carlson Leisure Group (leisure travel agencies and tour operators); and Carlson Marketing Group (incentive and loyalty marketing). By 2006, under Carlson Nelson's leadership, Carlson's annual sales exceeded $37 billion and it employed over 150,000 people worldwide. She was widely recognized as one of the world's most influential women.[3]

[1] Based on "Company History," *www.carlson.com*.

[2] Based on "Our Founder and History," *www.clcfamilyfoundation.com*.

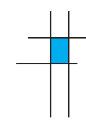
[3] Beverly Kopf and Bobbie Birleffi, "Not Her Father's Chief Executive," *U.S. News and World Report,* October 2006, *http://www.usnews.com/usnews/news/articles/061022/30nelson.htm*, last accessed February 24, 2011; Maggie Rauch, "Leading the Field: Marilyn Carlson-Nelson," *Incentive Magazine,* May 1, 2006, *http://www.incentivemag.com/News/Industry/Articles/Leading-the-Field—Marilyn-Carlson-Nelson/*, last accessed February 24, 2011; "Carlson Chair and CEO Named 'Businesswoman of the Year,'" *Travel Daily News,* April 2005; "Marilyn Carlson Nelson (Chairman & CEO, Carlson Companies)" *Ethisphere,* December 2007, *http://ethisphere.com/marilyn-carlson-nelson/*, last accessed February 24, 2011; "The Word's Most Powerful Women," *Forbes,* 2005, *http://www.forbes.com/lists/2005/11/PV8L.html*, last accessed February 24, 2011.

Carlson Nelson defined her role as president and CEO of Carlson as follows:

> A CEO has to train and operate like a jet pilot. Once the company's talented executive team is flying in formation, I'm usually raising peripheral vision issues—how a decision is going to impact other pieces of the business, how it's going to impact our shareholder relationships and our banking relationships. I really go through the various stakeholders in my mind. And I might try to impact the final outcome so that it will bring people the broadest possible ownership of the decision.

Carlson Nelson's general management style was described by other executives in the organization as being "collective." Kim Olson, vice president and chief communication officer, described Carlson Nelson as:

> . . . having a participative leadership style. When making decisions at the corporate level, we hear and discuss all points of view before arriving at a decision. We believe these collective decisions enhance our sense of global corporate citizenship.



Tourism and the Commercial Sexual Exploitation of Children

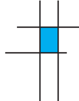
Although the commercial sexual exploitation of children occurred in countries worldwide, the growing popularity and declining cost of travel and the rise of new communication technologies had changed the nature of child exploitation by facilitating the rise of global sex tourism. The World Tourism Organization defined organized sex tourism as:

> Trips organized from within the tourism sector, or from outside this sector but using its structures and networks, with the primary purpose of effecting a commercial sexual relationship by the tourist with residents at the destination.

Prostitution, child prostitution, and sexual exploitation of children have existed throughout history. However, prior to the last quarter of the 20th century, the child segment had been confined largely to the poorer, more destitute countries of the world where selling female children for sex was often seen as an accepted means of family survival. By the 1990s, the survival dimension had changed dramatically. Trafficking children for sex had become a formidable international business and part of a multi-billion-dollar industry in which approximately two million children were exploited annually.

Basically, sex trafficking was a type of commercial trade in people, either across borders or within countries, whereby individuals were forced into sexual slavery. Children under the age of 18 made up a large portion of this trade and were trafficked for multiple reasons, including forced labor, criminal activity, and sexual exploitation. The travel and tourism industry facilitated the trafficking of children in two ways: (1) hotels, airlines, trains, and buses provided the means by which children were trafficked; and (2) more commonly, the industry transported the sex tourists to his/her destination and provided accommodations once there.

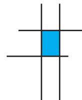
A few travel companies actually targeted sex tourists and actively sought their business. For example, an advertisement by Lauda Air, an Austrian airline, consisted of a picture of a partially clothed girl and captions reading, "From Thailand with Love," and "the tarts in the Bangkok Baby Club are waiting for us." Generally, however, companies in the travel and tourism industry downplayed their role in the sex trade and the sexual exploitation of children by turning a blind eye toward tourist industry practices that inadvertently exposed children around the world to sexual abuse and violence.



International and U.S. Law Regarding Sex Trafficking

International legal efforts to protect women and children from trafficking were first made at the beginning of the 20th century, when many conventions were established to end what was then referred to as "white slave traffic." Both international and U.S. enforcement officials had been unwavering in their condemnation of the trafficking of children. In addition, the International Criminal Court had declared it a crime against humanity, and a number of other international treaties and declarations had condemned the practice and called on states to prevent it. The most important and widely cited international agreement for the protection of children is the 1990 *Convention on the Rights of the Child,* which had been ratified by nearly every state in the international system. Article 35 of this convention provided that "States shall take all appropriate national, bilateral, and multilateral measures to prevent the abduction, sale, or traffic of children for any purpose or in any form."

Children's advocates had also targeted the demand side of child sex trafficking in hopes of curtailing the number of tourists who sexually exploited children while traveling. In 1994, the Child Sexual Abuse Prevention Act made it illegal for U.S. citizens and permanent-resident aliens to travel abroad to commit sexual acts with minors. As a result, the U.S. government was able to prosecute Americans for sexual acts with children even if those acts took place outside U.S. borders. Moreover, efforts to prosecute travel agencies that catered to sex tourists continued to increase.



Sex Trafficking and Child Sexual Exploitation in Costa Rica

By the late 1980s, Costa Rica had become one of the principal tourist destinations in Central America, and the expanding industry became the country's primary source of foreign capital. According to the U.S. Department of State, the boom in tourism had also resulted in Costa Rica becoming a "source, transit, and destination country" for sex trafficking.[4] Women and girls were trafficked into Costa Rica from Nicaragua, the Dominican Republic, Colombia, Guatemala, Russia, and Eastern Europe for sexual exploitation. Costa Rican women and girls were trafficked within the country as well as to other Central American countries, Mexico, and Japan. The problem of child prostitution in Costa Rica was so serious that one NGO, the National Institute for Children (PANI), put the number of child prostitutes at 3,000 in the capital, San Jose, alone. This group, along with other NGOs, had continued to fight against sex tourism and had condemned the practice in the West.

Nongovernmental organizations began to raise concerns about Costa Rica's problem with sex tourists and child exploitation in the late 1990s, but the Costa Rican government did not make concerted efforts to address the issue until 2006.[5] Not until 2009 did the country make

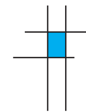
[4] Casa Alianza and ECPAT International, "Creating a Database as a Tool For Campaigning," San Jose (2002); ECPAT International, "Five Years after Stockholm," The Fifth Report on the Implementation of the Agenda for Action Adopted at the World Congress against Commercial Sexual Exploitation of Children, Sweden (2001); ECPAT International, "Informe Global de Monitoreo de las acciones en contra de la explotacion sexual comercial de ninos, ninas y adolescentes: Costa Rica" (2006); Michael B. Farrell, "Global Campaign to Police Child Sex Tourism," *The Christian Science Monitor,* April 22, 2004; Julia O'Connell Davidson and Jacqueline Sanchez Taylor, "Child Prostitution and Sex Tourism: Costa Rica," ECPAT International (1995); Susan Song, "Children as Tourist Attractions," Youth Advocate Program International Resources Paper, Washington, D.C. (2004); U.S. Department of State, "Trafficking in Persons Report" (2002); U.S. Department of State, "Trafficking in Persons Report" (2006); U.S. Department of State, "Trafficking in Persons Report" (2007); U.S. Department of State, "Trafficking in Persons Report" (2009); U.S. Department of State, "Trafficking in Persons Report" (2010); U.S. Department of State, Bureau of Democracy, Human Rights and Labor, Country Reports on Human Rights Practices, "Costa Rica" (2005).

[5] See U.S. Department of State "Trafficking in Persons Report" from 2002 to 2010 to see the evolution of Costa Rican efforts to curb child trafficking.

all forms of trafficking illegal: trafficking became punishable by prison terms of 6 to 10 years, which could be increased to 16 years if a minor was involved.[6] Despite these penalties, the U.S. Department of State determined that the government of Costa Rica did not meet the "minimum standards" for eliminating trafficking as endorsed by the United States.

The Marriott Incident

In 2002, a Marriott Resort Hotel employee in Papagayo, Costa Rica, was indicted for the aggravated pimping of minors in a case that involved a number of its hotel employees. The fallout for Marriott was next to catastrophic. The Interfaith Center on Corporate Responsibility, a coalition of faith-based investors that files shareholder actions against corporations in the name of social responsibility, organized a widespread shareholder campaign against Marriott. The First Swedish National Pension Fund (Första AP-fonde) also played a key role in drafting a shareholder resolution condemning Marriott for failing to adopt policies that would prevent similar exploitation from happening in the future. Marriott failed to respond. In 2005, immediately preceding its annual stockholder meeting, the resolution became public knowledge. Marriott was immediately subjected to severe and damaging criticism throughout the world. Although Marriott had been pressured prior to the litigation to adopt a strong policy against sexual exploitation of children, it had failed to do so. However, as a result of the international outrage stemming from the shareholder resolution, the firm undertook an internal review of its policies that eventually produced a human rights policy to combat child sex trafficking, somewhat placating its critics.[7]



Queen Silvia, the Code, and Carlson Company's Response

In 1998, in response to concerns about the ways in which the travel and tourism industry facilitated child trafficking and at the initiative of Queen Silvia of Sweden, an influential NGO (ECPAT—End Child Prostitution, Child Pornography, and Trafficking of Children for Sexual Purposes), the Scandinavian Tourism Industry, and the World Tourism Organization combined forces to create a Code of Conduct for companies in the industry. The Code was a voluntary commitment for travel and tourism companies to pledge their aid in combating child trafficking. Key elements of the code included:

1. Establishing an ethical policy regarding commercial sexual exploitation of children.
2. Training personnel in the country of origin and travel destinations.
3. Introducing a clause in contracts with suppliers, stating a common repudiation of commercial sexual exploitation of children.
4. Providing information to travelers by means of catalogs, brochures, in-flight films, ticket slips, and home pages, etc.
5. Providing information to local "key persons" at the destinations.
6. Filing annual reports to various monitoring bodies.

[6] Although 268 Costa Rican companies and organizations have become members to the code. See *www.thecode.org* for more information.

[7] Forsta AP-fonden, "Första AP-fonden Influences Marriott to Combat Child Sex Tourism," *http://www.ap1.se/en/Asset-management/Ethical-and-environmental-consideration-in-our-investments/Long-term-commitment-pays-off/Forsta-AP-fonden-influences-Marriott-to-combat-child-sex-tourism/*, last accessed February 24, 2011; Interfaith Centre on Corporate Responsibility, "Selling Innocence: Child Sex Tourism," *http://www.docstoc.com/docs/66828019/Accor-Hospitality-Asset-Management*, last accessed February 24, 2011; "Marriott Hotel Chain Combats Child Sexual Exploitation" (December 2006), *http://www.humantrafficking.org/updates/494*, last accessed February 24, 2011.

Companies that adopted the Code were required to submit annual reports on their corporate practices to international, transnational, and national monitoring bodies to demonstrate compliance with the Code, share information, build know-how about best practices, and identify problems. Companies that adopted the Code were also encouraged to monitor their employees and the practices of their contractors through documented spot checks.

As of November 2009, more than 947 companies in 37 countries had signed the Code, affecting millions of tourists who employed the services of these companies. However, only two U.S. companies had signed. The absence of signatories among U.S. companies presented a serious problem given that an estimated 25 percent of sex tourists outside of the United States were Americans who presumably utilized U.S. travel and tourism services. The majority of U.S. hoteliers, travel agencies, airlines, and tour companies had not signed the Code for fear of such consequences as:

1. Negative publicity that their adoption of the Code might generate.
2. The burden the Code imposed on companies to police their employees and contractors.
3. Litigation from trafficked children themselves.
4. Litigation initiated by guests who might witness trafficking while utilizing a company's travel and tourist services.
5. Absence of other corporate signatories.

Carlson Nelson and Queen Silvia of Sweden shared a long-held concern for at-risk children, which led to numerous collective projects over the years. Foremost among them was the establishment of the World Childhood Foundation, founded in 1999 by Queen Silvia along with 14 cofounders, including the Carlson Family Foundation. When asked by the Queen to become a signatory to the Code in 2004, Carlson Nelson enthusiastically committed. Carlson Companies thus became the first major North American travel and tourism company to sign, committing to the Code for all of Carlson's brands.[8] In signing the code, Carlson Nelson assured the tourism industry that all future decisions made by Carlson's executive team would take into consideration the next generation—"thinking about children and teens and the impact of the company's actions upon their welfare and development."

When asked about Carlson Companies' early adoption of the Code, Carlson Nelson remarked:

> We like to think that we play a leadership role on this particular issue. Sometimes I wish we weren't as far out in front as a leader because we had hoped that more travel and hotel companies would sign on to the Code.

However, initially there was not full agreement among executives within Carlson Companies that signing the Code was a good idea.[9] Concerns identified by Carlson executives essentially mirrored the concerns of other executives in the travel and tourism industry. Doug Cody, corporate vice president of public relations and communications, further questioned:

> Why should Carlson get involved in something so ugly when there are so many other worthwhile causes that we could be involved with? . . . Do we really want to associate our name with such an ugly thing? No other major travel and tourism

[8] The other North American signatories at the time were the American Society of Travel Agents and Amazon Tours. Since then, three more companies have signed the Code: Millennium Hotel St. Louis, Delta Airlines, and Hilton Hotels.

[9] However, each Carlson executive interviewed made it clear to the researcher that signing the Code was Carlson Nelson's decision and that it was adopted as policy because she advocated for it. No different or alternative views were expressed during the course of the interviews.

> company has signed the Code in North America, and the issue of child trafficking is not widely discussed in the media. My primary concern is associating with it. Even though we are fighting against it, it could backfire and hurt you. People could misunderstand it or believe that somehow we were connected with it. There were a lot of reasons to say "no."

Cody's opinion about the public relations liability of the Code abruptly changed when Carlson Nelson invited him along to witness the signing of the Code at the United Nations with Queen Silvia. Upon seeing dozens of television cameras from around the world present to witness the signing, it occurred to Cody that the media exposure would prove very beneficial to the company—indeed "the eyes of the world were watching." Even so, Cody argued that other companies in the travel and tourism industry would be "steered away from the Code because of the legal ramifications if the Code is not followed once signed."

In retrospect, Tom Polski, vice president of global communications and external relations, said:

> The shift in thinking at Carlson Companies about the Code resulted from increased awareness of the whole issue through activities at the World Childhood Foundation. Carlson Companies and the travel and tourism industry are in the "happiness" business, and child trafficking is not very pleasant and people sometimes don't want to hear unpleasant things. I supported the Code because child exploitation is a reality in the travel and tourism business.

By many accounts, Carlson's corporate culture was noticeably affected by its newfound commitment to curtailing child trafficking. Jay Witzel, president and CEO of Carlson Hotels Worldwide, said:

> Once Carlson Companies signed the Code, the level of commitment to end child trafficking throughout the entire Carlson system rose to an unbelievable level where people actually started to say, "That is not going to happen here." Once you get to that position . . . the people on the staff have come to the conclusion that they can do something about it . . . it is not a hopeless situation. Signing the Code raised our diligence. It certainly raised our commitment and it raised the involvement of the greater community of Carlson hotels, their owners, operators, and employees to do something about it.

The Dilemma

Within a few years after signing the Code, Carlson Companies began planning for development of a Regent Hotel and Resort in the Papagayo region of Costa Rica. Regent, Carlson's luxury brand, provided higher-end accommodations to its patrons than its Radisson brand, which was already established in the capital of San Jose. The venture would be Carlson's first luxury hotel and resort in Central America. It offered Carlson the opportunity to expand its luxury chain into Costa Rica's lucrative and rapidly growing high-end tourist market, as well as the potential for further expansion into Central and South America. Initially, the proposed project was well received by Carlson executives, as its Radisson Hotel in San Jose was doing well.

It was Jay Witzel, president and CEO of Carlson Hotels Worldwide, who learned during the course of his research of the extensive problem of child sex trafficking in Costa Rica and immediately brought it to Carlson Nelson's attention. Witzel's concerns were well-founded. Between the opening of the first Radisson Hotel in San Jose in 1996 and the new

opportunity in Papagayo, two important events had occurred that had a major impact on whether the project should be given the go ahead. First, Carlson had signed the Code of Conduct, creating new obligations within its companies in the fight against child sex trafficking. Concerns were raised about whether management would be able to fully enforce the Code once the resort became operational. If Carlson could not fully guarantee the protection of children within the resort complex, could or should this be considered a viable business opportunity? The second concern stemmed from the Marriott child sex trafficking case and its implications for Carlson's Regent resort. The fact that Carlson would face a similar environment in Costa Rica as Marriott was cause for alarm. Any plans to introduce the Regent brand to Costa Rica would have to be reassessed, especially in light of the proliferation of child sex trafficking in Costa Rica and new concerns over trafficking litigation.

However, the potential advantages of developing the hotel in Costa Rica were many. First, Carlson executives believed that it presented a lucrative business opportunity, one that they were hard-pressed to abandon. Additionally, the executives saw the opportunity to serve as a positive force and role model in the travel and tourism business, a prospect that was especially attractive to Carlson Nelson given her commitment to children. Witzel described his conversations about the Costa Rica project with Carlson Nelson as "robust." If they could succeed in meeting the challenges of socially responsible hotel management in a country rife with child sex trafficking, they could demonstrate the project's feasibility to others in the industry and the world.

But changes to the policies and practices of other travel and tourism companies were not the only positive externality that Carlson Nelson and her executives hoped for. They also believed that by empowering hotel employees to monitor and act against the exploitation of children in Carlson hotels, this vigilance would have a spillover effect, benefiting the communities to which the employees belonged. Carlson Nelson argued that:

> The more we train our employees, the better the potential that they will use their judgment and in a way, it becomes like a social anthropology and there is a higher likelihood that a culture will reject or self-correct around somebody who is acting inconsistently with our policy.

The goal was that the employees themselves would serve as agents of social change, improving the larger community of which they were a part.

Although the promises of both social change and increased revenue were certainly tempting, the project's disadvantages also caused Carlson management several concerns. The first arose as Carlson Nelson and the executive team watched the Marriott litigation. As the case unfolded, they became more and more aware of the impact the case would have on Carlson's future Costa Rica operations. They took special note of the Swedish National Pension Fund's blacklisting of the company and the very public international shaming of Marriott over the trafficking issue. It was disturbing that the actions of just a handful of Marriott employees brought that company international rebuke and a shareholder resolution against it. Second, there was the risk that the international community would associate Carlson's Regent Hotel with child sex trafficking simply because it was located in Costa Rica. A third concern was that the resort would fail to meet its obligations under the Code and Carlson would risk public censure from the Code's monitoring body. Indeed, a variety of powerful stakeholders, including local politicians, corrupt law enforcement officers, travel agents, and others, would benefit substantially from child sex trafficking and could pressure employees to violate the Code.

Additionally, for the Code's implementation to be successful there had to be commitment from franchise owners—no easy task. Enforcement would require employees and contractors to monitor guests, business transactions, and one another in a way that might

not be possible or even advisable. Was it worth the risk to place the reputation of Carlson, a highly respected international company, in the hands of franchise owners and untested local employees, some of whom might have multiple and conflicting loyalties? And, there was some doubt whether it would be possible for a hotel resort to create an environment intolerant of child sex trafficking without losing a significant portion of its high-end tourist trade. Was it possible that sex tourism constituted such a large share of tourism in Papagayo that by rejecting it in its hotel, Carlson would be unable to earn an acceptable return on its investment?

Yet, Carlson executives agreed that the biggest disincentive to developing the hotel was the fear of litigation, both from tourists who might witness child exploitation—despite efforts on Carlson's part to deter the practice—and from those who might be victimized by traffickers utilizing Carlson's services. If Carlson continued with the project, would it risk compromising its commitment to the Code and to eliminating the sexual exploitation of children? On the other hand, if Carlson abandoned the project, the company would forfeit a potentially lucrative business opportunity. Time was drawing near for the final decision. Should Carlson Nelson push forward with the project? Then again, were there other possible alternatives?

Discussion Questions

1. Why did the Carlson Company sign the Code of Conduct for the Protection of Children from Sexual Exploitation in Travel and Tourism? Do you agree with the company's decision, and why or why not?
2. What are the advantages and disadvantages to the Carlson Company of developing the hotel complex in Costa Rica?
3. What stakeholders would be affected by a decision to develop the hotel complex in Costa Rica, and how would they be affected? What are their interests and sources of power in this situation?
4. Would developing the hotel complex in Costa Rica be ethical, or not? Why do you think so?
5. If the Carlson Company decides to proceed with the hotel development, what steps can it take to assure that the company remains in compliance with the code of conduct it has signed?

CASE FOUR

BP Blowout: The Aftermath of the Gulf Oil Disaster

In 2010, a blowout occurred at one of BP's deepwater wells in the Gulf of Mexico, killing 11 people and causing over three million barrels of oil to spew into the ocean waters for 87 days. The oil giant BP (formerly British Petroleum), one of the world's largest multinational corporations, had annual revenues that year approaching $300 billion. The oil that surfaced and washed ashore across the five Gulf states (Alabama, Florida, Louisiana, Mississippi, and Texas) affected the lives, livelihoods, and health of millions of people. The oil also killed tens of thousands of wildlife and severely damaged natural resources.

The event was the largest offshore oil discharge and the worst environmental disaster in American history. It was also the most expensive manmade corporate disaster on record in any country. In 2018, BP announced that the aftermath had cost it some $66 billion, no small amount even for one of the richest companies in the world.

The passage of roughly a decade since the disaster first unfolded provides a wealth of opportunities to study its implications for business, government, and society.

Mayday in the Gulf

At 9:53 p.m. on April 20, 2010, Andrea Fleytas, a 23-year-old junior bridge officer, sent a "Mayday" signal from the *Deepwater Horizon,* a mobile oil rig sitting some 50 miles off the coast of Louisiana in the Gulf of Mexico. The rig was connected to a BP oil well a mile down on the ocean floor. The well had suffered a blowout—an abrupt loss of control of fluids under pressure. Like a tire blowout on a car traveling at high speed, a well blowout can be very dangerous. Drilling fluid and natural gas shot up from the well, causing an explosion on board the rig, which became engulfed in flames. Disaster had struck.

The Mayday signal was relayed to the U.S. Coast Guard. It sent two vessels, a rescue plane, and four helicopters, but their rescue effort was futile. The 11 casualties had likely occurred as a result of the explosion itself. The remaining 115 crew members, some seriously injured, survived.

Two days later, which ironically was Earth Day, the *Deepwater Horizon* sank. In the process, the pipe connecting it to the well snapped. Oil from the well started to spout uncontrollably into the Gulf's waters. The flow continued for days, then weeks, then months.

In September 2016, Lionsgate released *Deepwater Horizon,* a major motion picture with a star-studded cast that focused on the events of the last fatal day on the rig. The release of the movie coincided with the release of a book entitled *BP Blowout: Inside the Gulf Oil Disaster,* the first comprehensive account of the legal, economic, and environmental

By Daniel Jacobs, Clinical Associate Professor of Management, Loyola Marymount University. Copyright © 2018 by the author; all rights reserved. Used with permission.

consequences of the disaster. This case draws both from that book and events that have occurred since its release.[1]

Environmental Impacts

The BP well blowout took a terrible toll on the environment. Flowing profusely and for great distances, the oil had devastating ecological effects on and offshore. Ocean currents took the oil hundreds of miles from the well site, over a huge surface area of water. Ocean oil slicks covered more than 43,300 square miles, comparable to the total land area of Louisiana. Oil was also found on more than 400 square miles of the sea floor.[2]

On the surface, the oil worked its way in one direction to Texas, and in the other direction to Florida, hitting a total of some 1,300 miles of shoreline in the five Gulf states. Louisiana incurred the worst damage.[3]

Beaches and wetlands were contaminated with oil, as was wildlife. The toxic effect of the oil on animals was often deadly. The U.S. Fish and Wildlife Service initially reported recovering the carcasses of more than 6,000 birds, 600 turtles, and 150 marine mammals (whales and dolphins) within a year of the accident.[4] Those figures left open the question of how many more had died but were not discovered, especially if they perished in the ocean.

Scientists have tried to fill in that informational gap through extrapolation. In a 2015 report, the National Wildlife Federation (NWF) estimated the number of wildlife fatalities to be exponentially higher than earlier reported. It put turtle deaths in 2010 at 27,000 to 65,000. Dolphins off the Louisiana coast were reported to have died at four times historic rates in 2014, with "increasing evidence" connecting those deaths to the disaster.[5] By 2016, federal estimates of bird deaths exceeded 100,000 across 93 species.[6]

Containment and cleanup efforts caused further collateral damage. For example, the chemical dispersants used to break up the oil in the ocean risked harm to marine wildlife exposed to them. Similarly, boats entering wetlands to clean up the oil and to retrieve boom themselves caused harm to the fragile marshes.

Economic Impacts

The impact of the disaster on local economies was also devastating. Many Gulf residents still had not fully recovered from the effects of Hurricane Katrina in 2005. As the oil gushed into the water and onto the beaches, commercial fishing and tourism suffered in a part of the country that relied heavily on both.

The federal government closed large areas of the area waters to fishing out of concern that the fish might be unsafe to eat. By June 2, 2010, the peak of the fisheries closures,

[1] Daniel Jacobs, *BP Blowout: Inside the Gulf Oil Disaster* (Washington, D.C.: Brookings, 2016). Excerpts included herein with the permission of the Brookings Institution Press.

[2] Summarized from "*Deepwater Horizon* Oil Spill Final Programmatic Damage Assessment and Restoration Plan and Final Programmatic Environmental Impact Statement," Section 1.5.2. "Key Findings of the Injury Assessment," National Oceanic and Atmospheric Administration and other agencies, February 2016, at *www.gulfspillrestoration.noaa.gov/sites/default/files/wp-content/uploads/Front-Matter-and-Chapter-1_Introduction-and-Executive-Summary_508.pdf*.

[3] Ibid.

[4] See *www.fws.gov/home/dhoilspill/pdfs/ConsolidatedWildlifeTable042011.pdf*.

[5] National Wildlife Federation, "Five Years and Counting: Gulf Wildlife in the Aftermath of the Deepwater Horizon Disaster," March 30, 2015, at *www.nwf.org/~ /media/PDFs/water/2015/Gulf-Wildlife-In-the-Aftermath-of-the-Deepwater-Horizon-Disaster_Five-Years-and-Counting.pdf*.

[6] *www.fws.gov/southeast/articles/deepwater-horizon-oil-spill-killed-as-many-as-102000-birds-across-93-species/*.

36 percent of U.S. Gulf waters were closed. Tourists cancelled their trips to the region, not just to beach areas that had been hit with oil, but also to other areas they thought might be hit.

Gulf residents who suffered lost income feared they would be unable to pay rent; make payments on their homes, cars, or boats; and put food on the table for their families. Perhaps the best quantifiable measures of the staggering toll of the disaster on local communities were the $20 billion BP later paid in compensation for economic damage to business and individuals, and the additional $5.9 billion in compensation to state and local governments, including for lost tax revenue.

The costs of the disaster to society at large, profound as they were, are more difficult to quantify. These societal costs include human life and health at one end of the spectrum and lost recreational opportunities at the other. They also include the diminished value of the "natural capital" provided by damaged natural resources.

Just as life is said to be priceless, how does one measure in dollar terms all the effects that the disaster brought to the daily lives of the Gulf inhabitants and visitors? How can a value be placed on the disruption of one's daily life, whether that means increased anxiety, or a lost beach vacation, boating trip, fishing trip, or sporting event? Consider, for example, the lost aesthetic value of a once-pristine beach turned into an oily mess, even if only temporarily.

The nonmarket value of natural resources is particularly difficult to quantify. One study estimated that the annual natural capital from the Mississippi Delta ecosystems should be valued in the $12–$47 billion range.[7] The study assessed the annual benefit of goods and services including hurricane and flood protection, water supply, water quality, recreation, and fisheries.

A substantial portion of the Mississippi Delta ecosystem, which comprises an area of some 520,000 acres at the mouth of the Mississippi River off the Louisiana coast, was harmed by BP's oil. Even if BP is said to be responsible for only a limited reduction in the ecosystem's annual natural capital valuation, the dollar figure attributable to the company could easily add up to tens of billions of dollars over the period of the envisioned 15-year restoration payment period. The potential annual cost of lost hurricane protection attributable to wetlands depletion alone could be in the billions of dollars—and could soar in the event of a major hurricane. Such societal costs—and many others—may be very difficult to calculate with certainty but are still very real.

Health Impacts

Residents also feared the effects of the oil—and the tons of chemical dispersants used on it—on their health and the health of their children. Cleanup workers, many of whom were poorly trained, protected, and treated, also had reason to be concerned.

Early in the disaster, physicians and public health advocates expressed concern about the effects of human exposure to the oil. Their concerns focused on short-term high-concentration exposure (such as cleanup workers experienced); potentially longer-term low-concentration exposure (such as permanent residents experienced); and psychological impacts (especially on the local communities).

Workers began reporting health problems from the very start of the cleanup. Some became sick from exposure to the oil, the chemical dispersants, or the heat. A local physician who treated dozens of victims told CNN, "What's been really unique about it is that patients have come in with a severe amount of memory loss. Very high blood pressure: blood pressures that are going sky high and then coming down to normal, and then blood sugar levels

[7] Batker, D.P., et al. *Gaining Ground—Wetlands, Hurricanes and the Economy: The Value of Restoring the Mississippi River Delta* (Tacoma, Wash.: Earth Economics, 2010).

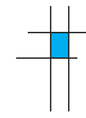
that are fluctuating. Lastly would be some pulmonary problems and some fairly serious [gastrointestinal] problems."[8]

Gina Solomon, then a physician with the Natural Resources Defense Council (and later deputy secretary for science and health at California's Environmental Protection Agency) was in the Gulf soon after the blowout. She later said, "Taking a bunch of fishermen and quasi-training them to essentially become hazmat workers is dicey."

In 2011, the National Institute of Environmental Health Sciences, part of the National Institutes of Health (NIH), began an ongoing study of the effects of the oil on residents and cleanup workers. Known as the Gulf Long-term Follow-up Study ("GuLF Study"), it is the largest-ever study of the potential health effects associated with exposure to oil. The study plans to follow more than 30,000 members of the affected communities for 10 years.[9] Preliminary results reported in 2014 revealed that cleanup workers were 30 percent more likely than non-cleanup workers to suffer from depression or anxiety.[10] Results reported in 2015 showed that the incidence of wheezing and coughing in cleanup workers was 20–30 percent higher than normal.[11] Results reported in 2017 suggested an association between long-term hematologic (blood-related) effects and exposure to the "BTEX" (benzene, toluene, ethylbenzene, and xylene) chemicals found in oil.[12]

A separate study of the nearly 9,000 Coast Guard responders published in 2017 not only confirmed the results of earlier studies, but also highlighted additional adverse short-term gastrointestinal effects and long-term dermal (skin-related) and respiratory effects from exposure to the oil and/or chemical dispersants.[13] A study of over 2,000 female residents of seven Louisiana coastal parishes published in 2018 reported a long-term correlation between exposure to the oil and depression.[14]

Did BP pay sufficient attention to health issues in responding to the disaster? Early on, CEO Tony Hayward was quoted as suggesting that perhaps the cleanup workers had gotten sick from food poisoning. Later, Richard Heron, the company's chief medical officer, responded to an article in *The Lancet,* the prestigious British medical journal, by issuing a blanket denial: "Based on extensive monitoring conducted by BP and the federal agencies, BP is not aware of any data showing worker or public exposures to oil constituents and dispersants at levels that would pose a health or safety concern."[15]



Environmental Justice

Did the BP disaster have a disproportionate impact on minority and low-income populations? There is evidence to that effect, raising important issues of environmental justice, the intersection between environmental and civil rights issues.

[8] Michael Robichaux, quoted in "Louisiana Doctor Describes Clusters of Ailments among Gulf Residents," CNN, April 21, 2011, at *www.cnn.com/2011/HEALTH/04/20/gulf.oil.illnesses/*.

[9] Kwok, et al. (2017). The GuLF Study: A Prospective Study of Persons Involved in the Deepwater Horizon Oil Spill Response and Clean-Up, *Environmental Health Perspectives,* 125(4): 570–578.

[10] Mackar, R., The GuLF STUDY Four Years After the Deepwater Horizon Oil Spill, at *https://factor.niehs.nih.gov/2014/5/spotlight-gulf/index.htm*.

[11] "Five Years Later—What Have We Accomplished?" GuLF Study, 2015 Newsletter, at *https://gulfstudy.nih.gov/en/GuLF_2015_Newsletter_Final_508.pdf*.

[12] Doherty B.T., et al. "Associations Between Blood BTEXS Concentrations and Hematologic Parameters Among Adult Residents of the U.S. Gulf States," *Environmental Research,* April 26, 2017, 156: 579–587, at *doi:10.1016/j.envres.2017.03.048.*

[13] Rusiecki J., et al., *Occupational and Environmental Medicine* 2018 (75): 165–175.

[14] Rung, A.L., et al. (2018). "The Long-Term Effects of the Deepwater Horizon Oil Spill on Women's Depression and Mental Distress," *Disaster Medicine and Public Health Preparedness:* 1–8.

[15] Heron, R.J.L., "Response to The Unknown: Respiratory Effects of Cleaning up an Oil Spill," *The Lancet* (Respiratory Medicine) 1, no. 5 (July 2013) at *http://dx.doi.org/10.1016/S2213-2600(13)70127-9).*

At the peak of the cleanup, nearly 50,000 people were engaged in the effort. Relatively few of them were BP employees. Offshore, they included fishermen who had been idled by the oil. Onshore, they included people from a variety of occupations who had lost work due to the oil, but also many others, including the unemployed, homeless, and reportedly even inmates. Many were poor. Many were minorities.

Nearly 40 percent of the 15,795 registered cleanup workers from Louisiana were black, compared with only 32 percent of the state's population in 2010.[16] Nearly 45 percent of the 13,220 registered cleanup workers from Alabama were black, compared with only 26 percent of the state's population in 2010.

CNN reported that some 4,500 of the onshore workers had been recruited though unemployment programs. Others were homeless (although it was difficult to know how many since homeless shelters in the Gulf received an influx of patrons from transients seeking work in the cleanup). Some reportedly came from a parish jail work release program (and wore BP T-shirts), as well as from a Louisiana state prison.[17]

These populations bore the brunt of the exposure to the oil and chemical dispersants. Given that vulnerable populations generally have poorer-than-average health and access to health care, they may have been at higher-than-average risk of not receiving treatment for any adverse health effects they suffered.

Legal Consequences

The legal fallout from the disaster was immense. Hundreds of thousands of private claims poured in, and the courts were flooded with lawsuits. The claims process became contentious, leaving both private parties and BP feeling at times as if they were being cheated.

The federal government brought criminal charges against BP and four of its employees. The company itself pled guilty to manslaughter and other charges to resolve the criminal case, agreeing to pay a record $4 billion. Chief Judge Sarah Vance noted BP's poor environmental record when she accepted its guilty plea: "The BP family of companies has a history of deficient safety management," she wrote. "If past is prologue, only a sentence several orders of magnitude more severe than any previously imposed on any BP company will be sufficient to achieve adequate deterrence."[18]

Two of the BP employees were acquitted, and two pled guilty to misdemeanors. None of them went to prison.

The federal government, joined by the five Gulf states, also brought a civil suit against BP. The case was tried in New Orleans in three phases that spanned from 2013–2015. A few months after the trial ended, the civil suit settled for over $20 billion. The largest three components of the deal were $8.1 billion in natural resource damage payments for Gulf restoration; $5.9 billion in state and local economic damages; and $5.5 billion in Clean Water Act civil penalties. While the total set a record for the highest settlement ever in a government case, $20 billion was only slightly higher than BP's average annual profit of $16.5 billion in the four years following the blowout.

The federal government also prosecuted hundreds of individuals for filing false claims against BP. In stark contrast to the BP employees, none of whom were incarcerated, a total

[16] "Distribution of Deepwater Horizon Responders by State of Residence and Race/Ethnicity." Centers for Disease Control/National Institute of Occupational Safety and Health. Data provided to (and on file with) author, obtained from contemporaneous rostering of cleanup workers. Comparisons based on published data from the U.S. Census Bureau, 2010 Census.

[17] Abe Louise Young, "BP Hires Prison Labor to Clean Up Spill While Coastal Residents Struggle," *The Nation,* July 21, 2010.

[18] "Reasons for Accepting Plea Agreement," *U.S. v. BP Exploration and Production, Inc.,* Criminal Action No. 12-292 (E.D. La., 1/2/9/13), p. 5. "BP" is used here to refer any BP company in the "BP family," past or present.

of 109 people received prison sentences for filing fraudulent claims, including some for as long as 15 and 17 years.[19] A three-year sentence went to the operator of a nail salon franchise in a small-town Walmart in Mississippi who pled guilty to submitting a claim in which he pretended to be a fisherman. That case prompted coverage sympathetic to the shop owner in the business magazine *Forbes,* under the headline "Feds Hit Hard against Those Making False BP Claims, Maybe Too Hard."[20] Among those who received lighter prison terms were employees at the Pensacola Beach, Florida, branch of the Hooters restaurant chain who had exaggerated the amount of their lost wages or helped others exaggerate theirs.

Costs to Shareholders and Taxpayers

The $66 billion in costs incurred by BP was more than any company has ever paid for a disaster of its making. The largest of the many sets of costs were the $25 billion in government settlements, nearly $20 billion in private economic and property claims, and over $14 billion in reported response costs.

It is straightforward to measure in broad terms how much the disaster cost BP, since the company tracks and reports that figure. Theoretically, these costs were borne by the company's shareholders, although some were able to recover their losses in shareholder litigation. Because BP has deducted from its taxes most of its disaster-related expenses (and will continue to do so), the American taxpayer is also bearing a large part of the burden.

The anticipated costs of the disaster were reflected in the company's monumental loss in share value. BP's stock plummeted immediately after the blowout. Hovering around $60 on the New York Stock Exchange when the well first exploded, the share price steadily dove as the oil streamed out, hitting a low of $27 in late June 2010. Thus, at the lowest point in the stock drop during the 87-day period before the oil well was capped, the company's share price had declined by more than 50 percent.

A company's value is measured in market capitalization, a function of the number of shares outstanding multiplied by the share price. When the well was finally plugged in mid-July 2010, the stock had recovered to around the $39 level. The loss in the company's market capitalization at this point was measured at more than $67.5 billion. Although the stock subsequently rose, University of Louisiana economists found that a year after the accident, the stock price was still about one-third lower than it would have been if the disaster had not occurred.[21]

Who were the major shareholders at the time that took the blow? "BP may be British, but Americans own half the stock," reported a June 2010 story in the *New York Times.*[22] They included American investment firms and pension plans. Hardest hit was BlackRock, the largest investment firm in the world, based in New York City. It held nearly 6 percent of the BP stock outstanding at the time of the explosion.

Whether they were American or another nationality, BP shareholders did not take the losses lightly. Institutional shareholders filed a barrage of lawsuits separate from the other civil suits, based on a variety of legal theories. They met with varied success.

In one of the most significant shareholder cases, New York State and Ohio employee pension funds holding BP stock sued the company for securities fraud. A federal judge granted

[19] Data current through FY2017. U.S. Department of Justice response to Freedom of Information Act request by [and on file with] the author, February 7, 2018.

[20] *Forbes,* July 15, 2014.

[21] Boudreaux, D.P., et al., "How Much Did the Gulf Spill Actually Cost British Petroleum Shareholders?" *Journal of International Energy Policy,* Spring 2013, at *www.cluteinstitute.com/ojs/index.php/JIEP/article/view/7891/7950.*

[22] Christine Hauser, "BP Shareholders Take It on the Chin," *The New York Times,* June 16, 2010.

class action status but limited the class members to purchasers of BP stock *after* the blowout. The theory of the suit was that these shareholders suffered losses because BP misled investors about the oil flow rate following the blowout. Under the district court's decision, affirmed by the Fifth Circuit Court of Appeals, purchasers of BP stock through U.S. exchanges for roughly the 13 months following the explosion could join the lawsuit.[23] The class action settled in June 2016 for $175 million, but the cases of over 30 institutional plaintiffs (largely pension funds) who opted out of the settlement continued years later.

The American taxpayer is essentially subsidizing a significant part of the shareholder's burden. Assuming BP succeeds in writing off all potentially deductible costs (the criminal and civil penalties totaling $9.5 billion are not deductible), based on its own cost data, it will be able to save taxes on approximately $56 billion over time. The actual net effect of such deductions will vary with BP's actual tax rate for any given year. Using the 35 percent U.S. corporate tax rate in effect from 2010–2017, the taxpayer would have absorbed nearly $20 billion of BP's total costs. With the 2018 reduction of the federal corporate income tax rate reduction to 21 percent, however, the subsidy will surely go down. Indeed, in its 2017 annual report, BP disclosed that it had reduced by some $3 billion its anticipated write-offs because of the reduced tax rate.

Crisis Management

As oil flowed uncontrollably into the Gulf, the Obama administration struggled to control its political image. Just three weeks before the explosion on board the *Deepwater Horizon,* President Obama had announced a significant expansion of oil drilling off American shores, including along much of the East Coast. The announcement was made in a major speech at Joint Base Andrews (formerly Andrews Air Force Base) outside of Washington, D.C., home to Air Force One. The venue was carefully chosen, as were the president's words, to link the expansion of offshore drilling to national security. Obama said that his administration would be lifting bans on offshore drilling along the East Coast from Delaware to the central coast of Florida, as well as in the eastern part of the Gulf of Mexico and portions of Alaskan waters. He conceded at the time that many would disagree with his decision. Indeed, they did, particularly after the blowout turned the March announcement into a major embarrassment for the administration.

Not quite four weeks later, on June 15, following a fourth trip to the Gulf, President Obama used his first-ever Oval Office address to speak about the disaster. Again, the staging was intentional. The venue alone served to convey the gravity of the situation. And, the theme of the address was again cast in national security terms.

Sitting at the same ceremonial desk in the Oval Office that was used by his predecessors to speak of warfare, President Obama framed the oil disaster in the Gulf in similar terms. After making a reference in the opening paragraph of his speech to the fight against al Qaeda, Obama referred to "the battle we're waging against an oil spill that is assaulting our shores and our citizens." Later in the speech, he pledged to "fight this spill with everything we've got for as long it takes," and laid out the "battle plan."

Like the government, BP also struggled with controlling its image immediately following the accident. From the start and at his own initiative, CEO Tony Hayward became the face of the disaster for BP. He went onto the Louisiana beaches to show his concern. Television commercials depicted him telling the audience with his British accent that "BP will make things right." His efforts did not play well with the American public or with the BP public relations team, which had been beefed up to handle the crisis.

But, Hayward was the CEO, and who was going to tell him to stop? Hayward's comments went from bad to worse when, at the end of May, he lamented, "I'd like my life

[23] *Ludlow v. BP,* 800 F.3d 674 (5th Cir. 2015).

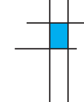
back," prompting mockery in the British press. When he was spotted sailing on his yacht in a regatta off the coast of England in late June, the press vilified him further. In late July he resigned under pressure.

The crisis management failure that came to haunt BP most involved its lowball flow rates that were presented not only to the public but also to Congress. Within a month of the blowout, footage from robotically placed cameras at the wellhead (called "Spillcam"), being broadcast in real time by media worldwide, revealed that BP had been dramatically understating the amount of oil gushing from the well. BP wound up pleading guilty to obstruction of Congress for misrepresenting the flow rates.

BP was also embarrassed, if not plagued, by its past. By the time the company appeared in U.S. District Court in New Orleans in January 2013 to plead guilty to criminal charges associated with the disaster in the Gulf, it was already a repeat offender. Its record included numerous environmental crimes, the most significant involving the deaths of workers killed in an explosion and fire at its Texas City refinery in 2005, and civil violations dating back to 1990.

Despite this poor history, BP had managed to promote itself as environmentally responsible, largely as a result of the efforts of its former CEO, Lord John Browne, who led the oil industry in acknowledging the need to address climate change. Browne was at the helm during a rebranding campaign that promoted BP as standing for "beyond petroleum," despite a very limited investment in alternative energy and a very modest effort to reduce its own greenhouse gas emissions.

After Tony Hayward took over as CEO of BP in 2007, the company made less effort to portray itself as environmentally conscious. Shortly after the disaster, BP began selling off its alternative energy assets to pay for disaster-related costs.



Regulatory Reform and the Trump Administration Rollbacks

In October 2011, the Obama Administration reorganized the Minerals Management Service (MMS), the Interior Department agency that had been blamed for lax oversight of offshore oil drilling preceding the BP disaster. Replacing the MMS would be two separate bureaus: The Bureau of Ocean Energy Management (BOEM), responsible for issuing drilling permits; and the Bureau of Safety and Environmental Enforcement (BSEE), responsible for oversight.[24] The reorganization was intended to eliminate the perceived conflict of interest in having a single agency both promote and regulate the industry.

In the years following the disaster, the Obama Administration revisited its decision about how much of the Outer Continental Shelf (OCS) (the submerged territory greater than three miles off U.S. coastlines) would be open to offshore drilling, ultimately producing a five-year plan that abandoned the expansion envisioned in the controversial March 2010 speech. But, the administration certainly did not stand in the way of drilling in permitted areas: the new BOEM under Obama issued more permits annually than MMS had ever before.

New regulations, however, did not keep up with new permits. The new BSEE did not propose new offshore safety regulations until April 2015, five years after the disaster. Announced by then-Interior Secretary Sally Jewell, the new regulations, known as the "well control rule," were intended to reduce the likelihood of another disaster.[25] For example, the regulations required the improved design and manufacture of blowout preventers.

[24] Bureau of Safety and Environmental Enforcement and Bureau of Ocean Energy Management, "Reforms since the Deepwater Tragedy" at *www.boem.gov/Reforms-since-the-Deepwater-Horizon-Tragedy*.

[25] Eric Lipton, "Trump Rollbacks Target Offshore Rules 'Written in Human Blood,'" *The New York Times*, March 10, 2018.

After completion of a one-year formal "notice and comment" and review period, the new safety rules became final in April 2016. Within a year, however, they were on the Trump Administration's chopping block, as was the Obama Administration's five-year plan. In an April 2017 Executive Order, Trump directed his Secretary of the Interior, Ryan Zinke, to reconsider the new rules, as well as to consider a vast expansion of drilling in the waters of the Gulf of Mexico, Arctic, and Atlantic coast.[26]

Just after New Year's in 2018, Zinke (who attracted media attention by riding a horse to work in Washington, D.C., on his first day in office) announced an almost complete reversal of the Obama plan. The new five-year plan would put over 90 percent of the OCS *in bounds* for offshore oil drilling instead of 94 percent *off limits,* essentially flipping the Obama plan on its head.[27] The Department of the Interior listed the unprecedented expansion as one of its major first quarter 2018 accomplishments under Zinke's "Top Ten Priorities" list.[28]

In April 2018, the Trump Administration announced that the well control rule was being loosened. Overseeing the rollback was the new BSEE director, Scott Angelle, a long-time advocate of offshore oil drilling. As lieutenant governor of Louisiana during the BP disaster, Angelle had vociferously opposed the Obama moratorium on new drilling in the Gulf in the months following the blowout. Blogging about eliminating some of the rule's provisions, Angelle cast the agency's mission first and foremost in terms of the "promotion of offshore energy production," a characterization that contrasted sharply with the vision of the agency as it was first defined by the Obama Administration.[29] Michael Bromwich, a former Justice Department Inspector General whom President Obama had tapped to be the first BSEE director and change the paradigm of lax government oversight, decried the new vision that accompanied the rollback: "This is a safety and environmental agency. It is not part of the agency's mission or mandate to increase production of oil or gas. This is inappropriate."[30]

Discussion Questions

1. What stakeholders were impacted by BP's actions, and how were they impacted?
2. What were the environmental costs of the disaster, and how can these be measured?
3. Do you think that the legal consequences faced by BP, its employees, and the false claimants were appropriate, and why or why not?
4. Do you think it is a company's responsibility to prevent a disaster of this type or the government's (or both)? Why?
5. Describe changes in the U.S. regulation of deepwater drilling since the disaster. What approach to regulation do you support, and why?
6. What lessons should the oil industry, business in general, government, and civil society draw from this case?

[26] "Implementing an America-First Offshore Energy Strategy," Exec. Order 13795, April 28, 2017. 82 Fed. Reg. 20815 (May 3, 2017).

[27] Press Release, U.S. Department of the Interior, "Secretary Zinke Announces Plan for Unleashing American's Offshore Oil and Gas Potential," January 4, 2018.

[28] Press Release, U.S. Department of the Interior, "Quarter 1 in Review: Interior Releases Comprehensive List of First Quarter 2018 Accomplishments Under President Trump and Secretary Zinke," April 16, 2018.

[29] Compare April 27, 2018, blog by Scott Angelle on BSEE.gov website, "It Took a Team Effort to Revise the Well Control Rule," with Secretary of the Interior Order 3299, Amendment No. 2, August 29, 2011.

[30] Eric Lipton, "Trump Rollbacks Target Offshore Rules 'Written in Human Blood,'" *The New York Times,* March 10, 2018.

CASE FIVE

Google and the Right to Be Forgotten

In 2009, Mario Costeja Gonzalez, a self-employed attorney living in a small town outside Madrid, Spain, casually "googled" himself and was startled by what came up on his computer screen. Prominently displayed in the search results was a brief legal notice that had appeared more than a decade earlier in a local newspaper, *La Vanguardia,* which listed property seized and being auctioned by a government agency for nonpayments of debts. Among the properties was a home jointly owned by Costeja and his wife.

Costeja immediately realized that this information could damage his reputation as an attorney. Equally troubling, the information was no longer factual. He had paid his debt nearly a decade earlier. Abanlex, Costeja's small law firm, depended on the Internet to gain much of its new business, which was often generated by a Google search. Potential clients might choose not to hire him, based on the old auction notice, he reflected. His mind then turned to the possible effects of this kind of information on other people's livelihoods. "There are people who cannot get a job because of content that is irrelevant," he thought.[1] "I support freedom of expression and I do not defend censorship. [However, I decided] to fight for the right to request the deletion of data that violates the honor, dignity and reputation of individuals."[2]

The next week, Costeja wrote to *La Vanguardia* and requested that it remove the article about his debt notice, because it had had been fully resolved a number of years earlier and reference to it now was therefore entirely irrelevant.[3] In doing so, he was making use of his rights under Spain's strong data protection policies, which recognized the protection and integrity of personal data as a constitutional right under Section 18 of the nation's Data Protection Act.[4] In response, the newspaper informed him that it had recently uploaded to the Internet all its past archives, dating back to 1881, to allow them to be searched by the public. It also noted that the auction notice had originally been publicly posted in order to secure as many bidders as possible. The newspaper refused Costeja's request, stating that the information was obtained from public records and had thus been published lawfully.[5]

By Cynthia E. Clark, Bentley University. Copyright © 2015 by the author. Used by permission.

[1] "Google Privacy Campaigner Praises Search Engine for Bowing to EU," *Financial Times,* May 30, 2014.

[2] "The Man Who Sued Google to Be Forgotten," *Newsweek,* May 30, 2014.

[3] European Parliament. Judgment of the Court, May 13, 2014, at *http://curia.europa.eu/juris/document/document.jsf?docid=152065&doclang=EN*.

[4] "The Unforgettable Story of the Seizure to the Defaulter Mario Costeja González that Happened in 1998," *Derechoaleer,* May 30, 2014, at *http://derechoaleer.org/en/blog/2014/05/the-unforgettable-story-of-the-seizure-to-the-defaulter-mario-costeja-gonzalez-that-happened-in-1998.html*.

[5] "Will Europe Censor this Article?" *The Atlantic,* May 13, 2014, *www.theatlantic.com/international/archive/2014/05/europes-troubling-new-right-to-be-forgotten/370796/*.

To be sure, the real problem for Costeja was not that the notice had appeared in *La Vanguardia*'s digital library, but that it had shown up in the results of the most widely used search engine in the world, Google, where potential clients might use it to judge his character.[6] Following this reasoning, Costeja then wrote to Google Spain, the firm's Spanish affiliate, only to be told that the parent company, Google Inc., was the entity responsible for the development of search results.[7] Costeja was taken aback by this development. "The resources Google has at their disposal aren't like those of any other citizens," he reflected.[8] Costeja felt he would be at a disadvantage in a lawsuit against an industry giant like Google.

In March 2010, after his unsuccessful attempts with the newspaper and Google Spain, Costeja turned to Spain's Data Protection Agency (SDPA), the government agency responsible for enforcing the Data Protection Act. "Google in Spain asked me to address myself to its headquarters in the U.S., but I found it too far and difficult to launch a complaint in the U.S., so I went to the agency in Spain to ask for their assistance. They said I was right, and the case went to court," he explained.[9] In a legal filing, Costeja requested, first, that the agency issue an administrative order requiring *La Vanguardia* either to remove or alter the pages in question (so that his personal data no longer appeared) or to use certain tools made available by search engines in order to shield the data from view. Second, he requested that the agency require that Google Spain or Google Inc. remove or conceal his personal data so that it no longer appeared in the search results and in the links *to La Vanguardia.* Costeja stated that his debt had been fully resolved.[10]

With these steps, a small-town Spanish lawyer had drawn one of the world's richest and best-known companies, Google, into a debate over the right to be forgotten.

Google, Inc.

Google Inc. was a technology company that built products and provides services to organize information. Founded in 1998 and headquartered in Mountain View, CA, Google's mission was to organize the world's information and make it universally accessible and useful. It employed more than 55,000 people and had revenues of $45 billion. The company also had 70 offices in more than 40 countries.

The company's main product, *Google Search,* provided information online in response to a user's search. Google's other well-known products provided additional services. For example, *Google Now* provided information to users when they needed it, and its *Product Listing Ads* offered product image, price, and merchant information. The company also provided *AdWords,* an auction-based advertising program and *AdSense,* which enabled websites that were part of the Google network to deliver ads. *Google Display* was a display advertising network; *DoubleClick Ad Exchange* was a marketplace for the trading display ad space; and *YouTube* offered video, interactive, and other ad formats.

[6] "The Unforgettable Story of the Seizure to the Defaulter Mario Costeja González that Happened in 1998," *Derechoaleer,* May 30, 2014, *http://derechoaleer.org/en/blog/2014/05/the-unforgettable-story-of-the-seizure-to-the-defaulter-mario-costeja-gonzalez-that-happened-in-1998.html*.

[7] B. Van Alsenoy, A. Kuczerawy, and J. Ausloos. "Search Engines after Google Spain: internet@liberty or privacy@peril?" ICRI Working Paper Series, September 6, 2013, at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2321494*.

[8] "Spain's Everyday Internet Warrior Who Cut Free from Google's Tentacles," *The Guardian,* May 13, 2014, *http://www.theguardian.com/technology/2014/may/13/spain-everyman-google-mario-costeja-gonzalez*.

[9] "The Man Who Sued Google to Be Forgotten," op. cit.

[10] Court of Justice, Judgment in Case C-131/12 Google Spain SL, *Google Inc. v. Agencia Española de Protección de Datos, Mario Costeja González.*

Search Technology

In its core business, Google conducted searches in three stages: crawling and indexing, applying algorithms, and fighting spam.

Crawlers, programs that browsed the web to create an index of data, looked at web pages and followed links on those pages. They then moved from link to link and brought data about those web pages back to Google's servers. Google would then use this information to create an index to know exactly how to retrieve information for its users. Algorithms were the computer processes and formulas that took users' questions and turned them into answers. At the most basic level, Google's algorithms looked up the user's search terms in the index to find the most appropriate pages. For a typical query, thousands, if not millions, of web pages might have helpful information. Google's algorithms relied on more than 200 unique signals or "clues" that made it possible to guess what an individual was really looking for. These signals included the terms on websites, the freshness of content, the region, and the page rank of the web page.[11] Lastly, the company fought spam through a combination of computer algorithms and manual review. Spam sites attempted to game their way to the top of search results by repeating keywords, buying links that passed Google's Page Rank process, or putting invisible text on the screen. Google scouted out and removed spam because it could make legitimate websites harder to find. While much of this process was automated, Google did maintain teams whose job was to review sites manually.[12]

Policy on Information Removal

Google's policy on the general removal of information was the following:

> Upon request, we'll remove personal information from search results if we believe it could make you susceptible to specific harm, such as identity theft or financial fraud. This includes sensitive government ID numbers like U.S. Social Security numbers, bank account numbers, credit card numbers and images of signatures. We generally don't process removals of national ID numbers from official government websites because in those cases we consider the information to be public. We sometimes refuse requests if we believe someone is attempting to abuse these policies to remove other information from our results.[13]

Apart from this general policy, Google Inc. also removed content or features from its search results for legal reasons. For example, in the United States, the company would remove content with valid notification from the copyright holder under the Digital Millennium Copyright Act (DMCA), which was administered by the U.S. Copyright Office. The DCMA provided recourse for owners of copyrighted materials who believed that their rights under copyright law had been infringed upon on the Internet.[14] Under the notice and takedown procedure of the law, a copyright owner could notify the service provider, such as Google, requesting that a website or portion of a website be removed or blocked. If, upon receiving proper notification, the service provider promptly did so, it would be exempt from monetary liability.

Google regularly received such requests from copyright holders and those that represented them, such as the Walt Disney Company and the Recording Industry Association

[11] Information on PageRank is available online at *http://infolab.stanford.edu/ backrub/google.html*.

[12] Information about Google search is available online at *www.google.com/insidesearch/howsearchworks/index.html*.

[13] http://www.google.com/insidesearch/howsearchworks/policies.html.

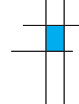
[14] Information about Digital Millennium Copyright Act ("DMCA") notice procedure is available at *www.fosterinstitute.com/legal-forms/dmca-notice*.

of America. Google produced and made public a list of the domain portions of URLs that had been the subject of a request for removal, and noted which ones had been removed. As of July 2015, it had removed more than 600,000 URLs out of more than 2.4 million requests.[15]

Likewise, content on local versions of Google was also removed when required by national laws. For example, content that glorified the Nazi party was illegal in Germany, and content that insulted religion was illegal in India.[16] The respective governments, via a court order or a routine request as described above, typically made these requests. Google reviewed these requests to determine if any content should be removed because it violated a specific country's law.

When Google removed content from search results for legal reasons, it first displayed a notification that the content had been removed and then reported the removal to *www.chillingeffects.org*, a website established by the Electronic Frontier Foundation and several law schools. This website, which later changed its name to *lumendatabase.org*, collected and analyzed legal complaints and requests for removal of a broad set of online materials. It was designed to help Internet users know their rights and understand the law. Researchers could use the data to study the prevalence of legal threats and the source of content removals. This database also allowed the public to search for specific takedown notifications.[17]

Google removed content quickly. Its average processing time across all copyright infringement removal requests submitted via its website was approximately 6 hours. Different factors influenced the processing time, including the method of delivery, language, and completeness of the information submitted.



The Right to Be Forgotten

The right to be forgotten can be understood as peoples' right to request that information be removed from the Internet or other repositories because it violated their privacy or was no longer relevant. This right assumed greater prominence in the digital era, when people began finding it increasingly difficult to escape information that had accumulated over many years, resulting in expressions such as *"the net never forgets," "everything is in the cloud," "reputation bankruptcy,"* and *"online reputation."*[18] According to Jeffrey Rosen, professor of law at George Washington University, the intellectual roots of the right to be forgotten could be found in French law, "which recognizes *le droit* à *l'oubli*—or the 'right of oblivion'—a right that allows a convicted criminal who has served his time and been rehabilitated to object to the publication of the facts of his conviction and incarceration."[19]

Although the right to be forgotten was rooted in expunging criminal records, the rise of the Internet had given the concept a new, more complex meaning. Search engines enabled users to access information on just about any topic with considerable ease. The ease with which information could be shared, stored, and retrieved through online search raised issues of both privacy and freedom of expression. On the one hand, when opening a bank account, joining a social networking website, or booking a flight online, a consumer would voluntarily disclose vital personal information such as name, address, and credit card numbers. Consumers were often unsure of what happened to their data and were concerned that it might fall into the wrong hands—that is, that their privacy would be violated.

[15] Information about the removal process is available online at *www.google.com/transparencyreport/removals/copyright/*.

[16] *http://www.google.com/insidesearch/howsearchworks/policies.html*.

[17] The Berkman Center for Internet & Society at *https://cyber.law.harvard.edu/research/chillingeffects*.

[18] "The Unforgettable Story of the Seizure to the Defaulter Mario Costeja González that Happened in 1998," op. cit.

[19] "Will Europe Censor this Article?" op. cit.

On the other hand, by facilitating the retrieval of information, search engines enhanced individuals' freedom to receive and impart information. Any interference with search engine activities could therefore pose a threat to the effective enjoyment of these rights.[20] As Van Alsenoy, a researcher at the Interdisciplinary Center for Law and Information Communication Technology, argued, "In a world where search engines are used as the main tool to find relevant content online, any governmental interference in the provisioning of these services presents a substantial risk that requires close scrutiny."[21]

Europe

Since the 1990s, both the European Union and its member states (such as Spain) had enacted laws that addressed the right to privacy and, by extension, the right to be forgotten.

A fundamental right of individuals to protect their data was introduced in the EU's original data protection law, passed in 1995. Specifically, the European Data Protection Directive 95/46 defined the appropriate scope of national laws relating to personal data and the processing of those data. According to Article 3(1), Directive 95/46 applied "to the processing of personal data wholly or partly by automatic means, and to the processing otherwise than by automatic means of personal data which form part of a filing system or are intended to form part of a filing system."[22] Article 2(b) of the EU Data Protection Directive 95/46 defined the processing of personal data as

> any operation or set of operations which is performed upon personal data, whether or not by automatic means, such as collection, recording, organization, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination or otherwise making available, alignment or combination, blocking, erasure or destruction.

Individual countries within the European Union also enacted their own laws, which were sometimes stronger than those of the EU. For example, in Spain, the protection of data was a constitutional right. The Spanish Constitution recognized the right to personal privacy, secrecy of communications, and the protection of personal data. These rights were protected through the Data Protection Act (the "Act"), passed in 1999, which incorporated the 1995 European Directive on data protection, and was enforced by the Spanish Data Protection Agency (SDPA). Created in 1993, this agency was relatively inactive until the passing of the Act, which gave it more powers and a mandate to enforce privacy rules in a wide range of situations.[23]

The Spanish agency exercised its powers broadly. For example, in 2013, it fined telecom firm Telefonica SA €20,000 for twice listing an individual's phone number in local phone books without the individual's prior consent. In 2008, the agency fined a marketing company €600 for using "recommend this to a friend" icons on websites, saying that senders of recommendation e-mails had to first request the recipient's permission. The agency had also successfully required anyone using security cameras to clearly mark their presence with a recognizable icon. Supporters of this move have highlighted the importance of transparency in protecting one's privacy.[24]

Over time, however, differences in the way that each EU country interpreted privacy rights led to an uneven level of protection for personal data, depending on where an

[20] Alsenoy et al., 2013.

[21] Alsenoy et al., 2013.

[22] Alsenoy et al., 2013.

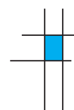
[23] "Data Protection in Spain" June 24, 2010, at *www.i-policy.org/2010/06/data-protection-in-spain.html*.

[24] "Spanish Agency Behind the Google Ruling Lauded by Some, Hated by Others," *The Wall Street Journal,* June 26, 2014.

individual lived or bought goods and services. This led the European high court to take a second look, in 2013, at the original law.[25] A European Commission memo at that time noted that the right "is about empowering individuals, not about erasing past events or restricting freedom of the press."[26] The changes were intended to give citizens more control over their personal data, making it easier to access and improve the quality of information they received about what happened to their data once they decided to share it. An unanswered question, however, was the latitude given to national courts and regulators across Europe to set the parameters by which these requests could be made.[27]

The United States

U.S. courts had taken a very different approach to privacy and to the right to be forgotten. A few U.S. laws recognized the right to be forgotten; the Fair Credit Reporting Act of 1970, for example, gave individuals the right to delete certain negative information about their credit—such as late payments, tax liens, or judgments—seven years from the date of the delinquency. But, for the most part, fundamental differences in legal philosophy made this right less likely to become widely supported in the United States. In an article published in the *Atlantic* in May 2014, Matt Ford suggested that in the U.S. context, one person's right to be forgotten logically imposed a responsibility to forget upon someone else, a notion that was alien to American law. The First Amendment to the Constitution barred the government from interfering with free speech. Law professor Rosen argued that the First Amendment would make a right to be forgotten virtually impossible, not only to create but to enforce. For example, the U.S. Supreme Court ruled in 1989 that penalizing a newspaper for publishing truthful, lawfully obtained information from the public record was unconstitutional.[28]



The Lawsuit and Court Decision

The main focus of Costeja's complaint before Spanish Data Protection Agency (SDPA) was his request that *La Vanguardia* remove the debt notice from its archives. In doing so, he was claiming his constitutional right to protect the integrity of his personal data. Costeja's request had two parts: that (1) *La Vanguardia* be required either to remove or alter the pages in question or to use certain tools made available by search engines in order to protect the data and (2) that Google Spain or Google Inc. be required to remove or conceal the personal data relating to him so that the data no longer appeared in search results.

In July 2010, two months after Costeja's original request, the SDPA ordered Google Spain and Google Inc. to take "all reasonable steps to remove the disputed personal data from its index and preclude further access," upholding that part of the complaint.[29] However, the SDPA rejected Costeja's complaint as it related to *La Vanguardia,* because it considered that the publication by it of the information in question was legally justified.[30]

[25] "What is the 'Right to Be Forgotten?'" *The Wall Street Journal,* May 13, 2014.

[26] European Commission, "LIBE Committee Vote Backs New EU Data Protection Rules", October 22, 2013, at http://europa.eu/rapid/press-release_MEMO-13-923_en.htm.

[27] "What is the 'Right to Be Forgotten?'" op. cit.

[28] "Will Europe Censor This Article?" op. cit.

[29] Audiencia Nacional. Sala de lo Contencioso, Google Spain SL y Google Inc., S.L.c. Agencia de Protección de Datos, paragraph 1.2, at *www.poderjudicial.es*.

[30] "Spanish Agency behind the Google Ruling Lauded by Some, Hated by Others," *Wall Street Journal,* June 23, 2014 at *http://online.wsj.com/articles/spanish-agency-behind-the-google-ruling-lauded-by-some-hated-by-others-1403795717?cb=logged0.03531818146039811*.

A year later, Google filed an appeal against the decision by the SDPA before the Audiencia Nacional in Madrid, Spain's highest national court. In March 2012, this court referred the case to the European Court of Justice, the EU's high court, for a preliminary ruling.[31]

In their briefs, Google Spain and Google Inc.'s argument hinged on the meaning of "personal data" and "crawling." Crawling, as noted above, was the use of software programs to find multiple websites that responded to requests for information online.[32] These programs were configured to look for information on the Internet, according to a set of criteria that told them where to go and when.[33] Once the relevant web pages had been copied and collected, their content was analyzed and indexed.[34] Google compared its search engine index to an index at the back of a textbook, in that it included information about words and their locations.[35]

Specifically, Google argued before the European Court of Justice that because it crawled and indexed websites "indiscriminately" (that is, without a deliberate intent to process personal data as such), no processing of personal data within the meaning of Article 2 (b) of the EU Data Protection Directive 95/46 actually took place. This absence of intent, the company argued, clearly distinguished Google's activities as a search engine provider from the processing of personal data as interpreted by the Court.

Google's other main argument was that the publisher of the information should be the sole controller of data, not the search engine. After all, its attorneys argued, Google's intervention was purely accessory in nature; it was merely making information published by others more readily accessible. If a publisher, for whatever reason, decided to remove certain information from its website, this information would (eventually) be removed from Google's index and would no longer appear in its search results. As a result, Google's counsel argued, the role of a search engine should be thought of as an "intermediary."

In May 2014, the European Court of Justice ruled against Google. The court found the Internet search provider was responsible for the processing of personal data that appeared on web pages published by third parties. It further required Google to remove links returned in search results based on an individual's name when those results were deemed to be "inadequate, irrelevant or no longer relevant, or excessive." At the heart of the court's logic was the process that Google used to produce its search results. The official ruling explained the court's rationale:

> The Court points out in this context that processing of personal data carried out by such an operator enables any Internet user, when he makes a search on the basis of an individual's name, to obtain, through the list of results, a structured overview of the information relating to that individual on the internet. The Court observes, furthermore, that this information potentially concerns a vast number of aspects of his private life and that, without the search engine, the information could not have been interconnected or could have been only with great difficulty.[36]

In essence, the Court ruled that an activity, "whether or not by automatic means" could be considered to be the "processing of personal data" within the meaning of Article 2(b), even

[31] Van Alsenoy et al., 2013.

[32] See *http://answers.google.com/answers/threadview/id/33696.html*.

[33] Matt Cutts (Google Quality Group Engineer), *How Search Works,* s30–s44, available at *http://www.youtube.com/watch?v=BNHR6IQJGZs*.

[34] Alsenoy et al., 2013.

[35] More information about crawling is available online at *https://www.google.com/search/about/*.

[36] Court of Justice. Judgment in Case C-131/12 Google Spain SL, *Google Inc. v Agencia Española de Protección de Datos, Mario Costeja González.*

if no intention to process such data existed.[37] The court's ruling applied to any search engine operators that had a branch or a subsidiary in any of the 28 member states of the EU.[38]

Costeja's lawyer, Joaquín Muñoz, was pleased with the ruling. "When you search for something in Google, they don't scour the entire Internet for you and then give you a result. They've stored links, organized them, and they show them based on a criteria they've decided upon."[39] As for Costeja, he expressed satisfaction with the result of his four-year legal crusade. Speaking of the court's decision, he said, "I think this is the correct move. You have to provide a path for communication between the user and the search engine. Now that communication can take place."[40]

Google's Application of the Ruling

For its part, Google—although disappointed with the ruling—set about complying with it. Soon after the court decision, it removed Costeja's disputed information from its search results. But, the company also took more general action.

The Court's decision recognized Google as a data controller, or the operator of the search engine and the party responsible for its data. As such, the court said, Google was required to police its links and put into place a mechanism to address individual concerns. Accordingly, shortly after the ruling was announced, Google set up an online form for users (from the European Union only) to request the right to be forgotten. The company website stated that each request would be evaluated individually and that Google would attempt to "balance the privacy rights of the individual with the public's interest to know and the right to distribute information."[41] Once an individual had filled out the form, he or she received a confirmation. Each request was assessed on a case-by-case basis. Occasionally, Google would ask for more information from the individual. Once Google had made its decision, it notified the individual by e-mail, providing a brief explanation if the decision was against removal. If so, the individual could request that a local data protection authority review Google's decision.

In evaluating a request, Google looked at whether the results included outdated or inaccurate information about the individual. It also weighed whether or not the information was of public interest. For example, Google generally retained the information if it related to financial scams, professional malpractice, criminal convictions, or a government official's public conduct.[42]

At the same time, Google invited eight independent experts to form an advisory council expressly to "advise it on performing the balancing act between an individual's right to privacy and the public's interest in access to information."[43] The committee included three professors (two of law and one of ethics), a newspaper editorial director, a former government

[37] European Parliament. Judgment of the Court. May 13, 2014, at *http://curia.europa.eu/juris/document/document.jsf?docid=152065&doclang=EN*.

[38] European Commission, "Fact sheet on the Right to be Forgotten," at *http://ec.europa.eu/justice/data-protection/files/factsheets/factsheet_data_protection_en.pdf*.

[39] "Spain's Everyday Internet Warrior Who Cut Free from Google's Tentacles," op. cit.

[40] "Google Privacy Campaigner Praises Search Engine for Following to EU," *Financial Times,* May 30, 2014.

[41] "Search Removal Request under Data Protection Law in Europe," at *https://support.google.com/legal/contact/lr_eudpa?product=websearch*.

[42] Frequently Asked Questions, at *http://www.google.com/transparencyreport/removals/europeprivacy/faq/?hl=en#how_does_googles_removals*.

[43] The Advisory Council to Google on the Right to be Forgotten, February 6, 2015, at *https://drive.google.com/file/d/0B1UgZshetMd4cEI3SjlvV0hNbDA/view?pli=1*.

official, and three privacy and freedom of speech experts (including one from the United Nations). Google's CEO and chief legal officer served as conveners. The committee's job was to provide recommendations to Google on how to best implement the EU court's ruling.

The majority recommendation of the advisory council, published on February 6, 2015, was that the right to be forgotten ruling should apply only within the 28 countries in the European Union.[44] As a practical matter, this meant that Google was only required to apply removals to European domains, such as Google.fr or Google.co.uk, but not Google.com, even when accessed in Europe. Although over 95 percent of all queries originating in Europe used European domains, users could still access information that had been removed via the Google.com site.

The report also explained that once the information was removed, it was still available at the source site (e.g., the newspaper article about Costeja in *La Vanguardia*). Removal meant merely that its accessibility to the general public was reduced because searches for that information would not return a link to the source site. A person could still find the information, since only the link to the information had been removed, not the information itself.

The advisory council also recommended a set of criteria Google should use in assessing requests by individuals to "delist" their information (that is, to remove certain links in search results based on queries for that individual's name). How should the operator of the search engine best balance the privacy and data protection rights of the subject with the interest of the general public in having access to the information? The authors of the report felt that whether the data subject experienced harm from such accessibility to the information was relevant to this balancing test. Following this reasoning, they identified four primary criteria for evaluating delisting requests:

- First, what was the data subject's role in public life? Did the individuals have a clear role in public life (CEOs, politicians, sports stars)? If so, this would weigh against delisting.
- Second, what type of information was involved? Information that would normally be considered private (such as financial information, details of a person's sex life, or identification numbers) would weigh toward delisting. Information that would normally be considered to be in the public interest (such as data relevant to political discourse, citizen engagement, or governance) would normally weigh against delisting.
- Third, what was the source of the information? Here, the report suggested that journalistic writing or government publications would normally not be delisted.
- Finally, the report considered the effect of time, given that as circumstances change, the relevance of information might fade. Thus, the passage of time might favor delisting.

The advisory council also considered procedures and recommended that Google adopt an easily accessible and easy-to-understand form for data subjects to use in submitting their requests.

The recommendations of the advisory council were not unanimous. Jimmy Wales, the cofounder of Wikipedia and one of the eight group members, appended a dissenting comment to the report. "I completely oppose the legal situation in which a commercial company is forced to become the judge of our most fundamental rights of expression and privacy, without allowing any appropriate procedure for appeal by publishers whose work in being suppressed," Mr. Wales wrote. "The recommendations to Google contained in this report are deeply flawed due to the law itself being deeply flawed."[45]

[44] "Limit 'Right to Be Forgotten' to Europe, Panel Tells Google," *The New York Times,* February 6, 2015.

[45] Ibid.

Discussion Questions

1. In what ways has technology made it more difficult for individuals to protect their privacy?
2. Do you believe an individual should have the right to be forgotten, that is, to remove information about themselves from the Internet? If so, should this right be limited, and if so, how?
3. How does public policy with respect to individual privacy differ in the United States and Europe, and what explains these differences?
4. Do you think Google should be responsible for modifying its search results in response to individual requests? If so, what criteria should it use in doing so? Are there limits to the resources the company should be expected to expend to comply with such requests?
5. If you were a Google executive, how would you balance the privacy rights of the individual with the public's interest to know and the right to distribute information?

CASE SIX

General Motors and the Ignition Switch Recalls

In November 2004, Candice Anderson was driving her boyfriend, Gene Erickson, to pick up his car when her Saturn Ion swerved off the road at a slight curve and hit a tree, killing her passenger. The couple was not wearing seat belts, and the air bags did not deploy. The Texas State Police found traces of an antianxiety medication in Anderson's system, and she was fined and charged with criminally negligent homicide. Over the next 10 years, Anderson constantly relived the nightmare and wondered how she lost control on such an easy curve.

On a cloudy Wisconsin night in October 2006, Megan Ungar-Kerns was driving with her friends Amy Rademaker and Natasha Weigel in a 2005 Chevy Cobalt. The vehicle suddenly lost power and veered off the road into a utility pole and several trees. The air bags failed to operate, the driver was seriously injured, and both passengers died on the spot. The state police report noted that at the time of the crash the key was in "accessory" mode.

Brooke Melton was driving in Georgia on a rainy March evening in 2010. It was her 29th birthday. Her 2005 Chevy Cobalt suddenly stalled, slid into an oncoming vehicle, rolled, and dropped 15 feet into a creek. Melton was wearing her seat belt, but the air bags did not operate and she died on the way to the hospital. Police recorded driving too fast for conditions as the cause of the accident; she was going 58 mph in a 55 mph zone.

These tragic accidents had little in common except for three commonalities: in all of these cases (and, as it turned out, dozens more like them), the driver had for some reason lost control of the car, the built-in air bag protection systems had failed to deploy—and the vehicles were made by General Motors (GM).

In February 2014, nearly a decade after Gene Erickson died, GM began a series of recalls that eventually affected 2.6 million vehicles whose model years ranged from 2003 to 2011. The reason for the recalls was a faulty ignition switch that easily shifted the key from "run" into the "off" or "accessory" positions. When the key was not in "run," the cars lost power, including to the steering, braking, and protective air bag systems. This reduced the driver's control and increased the risk of injury in the event of an accident. In addition to facing individual and class action lawsuits, the company was under investigation by the National Highway Traffic Safety Administration (NHTSA), the U.S. Congress, and the

By Debra M. Staab and Anne T. Lawrence. Copyright © 2015 by the authors. All rights reserved. The authors developed this case for class discussion rather than to illustrate effective or ineffective handling of the situation. Materials in this case are drawn from testimony at the hearings on the GM ignition switch recall held by the Energy & Commerce Committee, Subcommittee on Oversight and Investigations, on April 1, 2014, and June 18, 2014; the GM study known as *The Valukas Report;* the General Motors website; the House of Representatives Committee on Energy and Commerce *Staff Report on the GM Ignition Switch Recall: Review of NHTSA;* and from articles in *The New York Times, The Wall Street Journal, Automotive News, About.com*, *NewWorldEncyclopedia.org*, *Bloomberg.com*, *gmignitioncompensation.com*, *nationallawjournal.com*, *fortune.com*, *money.cnn.com*, *Nasdaq.com*; and the NHTSA Recall Database. A full list of references appears in the instructor's manual that accompanies this book.

Justice Department. By May 2014, 47 accidents and more than a dozen fatalities had been linked to the ignition switch defect. But many questions regarding the decade-long delay in repairing the defective part remained unanswered.

General Motors

General Motors was America's largest automaker with a 2014 profit of $2.8 billion, 21,000 dealerships, and a workforce of over 200,000 across six continents. GM produced several well-known brands including Chevrolet (Chevy), Buick, GMC, Cadillac, Saturn, Saab, Pontiac, Oldsmobile, and Hummer. Founded in 1908 by William "Billy" Durant, the company motto was "a car for every purse and purpose." GM was known for innovative styling, exemplified by models such as the 1953 Chevrolet Corvette and the 1959 Cadillac El Dorado.

Over several decades, GM repeatedly changed with the times, enjoying a run of successes. During WWII, GM diverted 100 percent of its manufacturing to the production of $12 billion worth of airplanes, trucks, and tanks for the war effort. In the 1970s, GM responded to rising gasoline prices with engines that ran on unleaded fuel, offered air bags for protection, and introduced the first emission-reducing catalytic converter. In the 1980s, GM added Saab and Hummer to its product line and expanded its global footprint through joint ventures with China and India. GM partnered with Toyota in the NUMMI joint venture in the 1990s to cocreate trucks and SUV's that satisfied emerging consumer demand. By the mid-2000s, GM's push for innovation led to the development of the Chevy Volt, one of the first electric vehicles, as well as the concept of a hybrid vehicle that switched from electric to gasoline.

Still, GM was not as agile as the German, Japanese, and Korean automakers and began to lose market share, especially in fuel-efficient vehicles. The recession and credit crisis of 2008 significantly undermined GM's operating budget, and the firm, along with its financial arm GMAC, agreed to a government bailout. On June 1, 2009, the old General Motors Corporation filed for bankruptcy and transferred most of its assets to the new General Motors Company, whose major shareholders included the U.S. and Canadian governments and the United Auto Workers (UAW) medical trust fund. The new owners replaced then-CEO Rick Wagoner with Fritz Henderson, who was then almost immediately dismissed in favor of the chairman of the board, Ed Whitacre. They also demanded increased fuel efficiency levels to compete with foreign automakers, and required the firm to streamline operations. GM sold the Saab line, discontinued the Saturn and Hummer models, and restructured GMAC into Ally Financial.

The company became profitable once again by the end of 2009. In 2010, Whitacre stepped down and Dan Akerson became the CEO until Mary Barra, a 35-year veteran of GM and the first female CEO in the auto industry, took over in January 2014. The bailout, which also included Chrysler Motors, ended in December 2014 with a net loss to taxpayers of $9.2 billion, with only $1.3 billion attributed to Chrysler. Justification for the bailout hinged on the "too big to fail" concept, as the auto industry had contributed 3.6 percent of the total U.S. Gross Domestic Product (GDP), and every additional 30 percent decline in auto sales meant a corresponding 1 percent decline in GDP.[1]

The Ignition Switch Defect

The ignition switch at the center of the recall was first introduced in the late 1990s. Between 1997 and 2001, GM designed a new low-current switch, formally named the

[1] "Auto Industry Bailout (GM, Ford, Chrysler)," *About.com*, February 6, 2015.

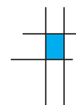
Discrete Logic Ignition Switch (DLIS). Concurrently, GM implemented cost-saving manufacturing efficiencies through a baseline design, called a platform, which allowed the use of common parts across vehicle makes, models, and production years. The Delta Platform included the Saturn Ion, Chevrolet Cobalt, Chevrolet HHR, and the Pontiac G5, and the Kappa Platform included the Saturn Sky and Pontiac Solstice.

The recalled ignition switch, a part shared across the Delta and Kappa platforms, was embedded in the steering column and had four positions. The driver turned the key to "start" (technically referred to as "crank") to turn on the engine, and once started, the key automatically toggled into the "run" position to indicate that the vehicle had power. When the key was moved to "accessory," the system signaled an engine shutdown, which turned off the air bags, power steering, and power brakes, and left only small electrical features, like the radio, operable. In the "off" or "lock" position, the switch cut power to all vehicle functions. Inside the ignition switch, a plunger cap and coiled spring unit that fit into a small groove called a "detent" kept the key in the selected mode. The driver applied enough pressure, or torque, to move the key between positions. The longer the plunger and more tightly coiled the spring, the harder it was to shift key slots.

The DLIS ignition switches were manufactured for GM by another company, Eaton Corporation (acquired by Delphi Mechatronics in 2001). GM's switch specifications recommended a target amount of pressure that a driver would have to apply to toggle the key from "run" to "accessory." But, as early as 1999, the parts manufacturer reported that prototype switches did not meet GM's specifications. Subsequent mechanical tests conducted by Delphi in 2001–2002 also showed that switches within every sample set had a "torque problem," tending to slip out of position when inadvertently jostled.

Despite the test failures, the GM engineer in charge of the part authorized production of the switch in 2002, signing his approval e-mail as "Ray (tired of the switch from hell) DeGiorgio." DeGiorgio's decision was based on Delphi's advice that a fix for the torque problem, such as a longer plunger, would take time, add costs, and could compromise the switch's electrical components, which he had already redesigned several times. The GM engineer apparently believed that the torque issue did not pose a safety problem, because he later told an investigator that he had "no awareness that the below-specification torque would have an impact on the safe operation of the car."[2]

However, this was not the case. The ignition switch defect compromised safety because if the car lost power while in motion, as a result of the key slipping out of position, it went into what was called a moving stall. Drivers in a moving stall would be less able to navigate the car because they no longer had access to power steering or braking (although they retained manual control). Then, if an accident occurred, the air bags would not deploy, because they no longer had power. GM used special sensors to control the air bag system. To avoid accidental inflation, the sensors were programmed to shut down when the ignition switch moved to the "off" or "accessory" position. All GM vehicles in the Delta and Kappa platforms used the same air bag sensor systems.



The First Indications of a Problem and GM's Response

The 2003 Saturn Ion was the first GM vehicle to roll off the assembly line with the DLIS switch. Within the first year of its release, the Ion had logged over 200 warranty incidents related to its ignition switch. The two most common problems were the car stalling while

[2] "Report to Board of Directors of General Motors Company Regarding Ignition Switch Recalls (The Valukas Report)," *Jenner & Block,* May 29, 2014.

in motion because the key slipped out of position, and the car refusing to start under cold weather conditions. DeGiorgio, still in charge of the ignition switch, focused on finding a fix for the latter problem. In 2004, he approved use of a different type of grease within the ignition to resolve most of the nonstart issues. Despite several reports of moving stalls issued by both internal GM test teams and external drivers; however, company engineers made no effort to correct the key slippage problem.

Nonetheless, in February 2005, GM released a warning message to dealers, referred to as Preliminary Information, which identified possible stalls as a problem and suggested that drivers remove unnecessary items from the key ring to avoid weighing down the key and inadvertently knocking the ignition out of the "run" position. One such message stated that "there is potential for the driver to inadvertently turn off the ignition due to low key ignition cylinder torque/effort. The concern is more likely to occur if the driver is short and has a large heavy key chain."[3] Presumably, a short driver would be more likely to move the seat forward, increasing the risk of jostling the key with his/her knee or leg.

One month later, however, GM's related internal issue tracking report was closed with no action taken. In 2014, an investigative review of the decision to close the report without a fix disclosed significant finger-pointing within the organization. During repeated fact-finding interviews, GM managers folded their arms, hands together, and pointed their fingers outward in a gesture that suggested someone else was responsible; this behavior became known as the "GM salute."

By June 2005, the company had received multiple customer complaints about moving stalls in the Cobalt and the Solstice, which triggered a new non–safety-related defect report. This time, engineers recommended a plug that reduced the size of the key slot. This solution was sent out to dealers as an updated Preliminary Information notice.

But, even after this bulletin was released, complaints kept piling up, and several negative news articles decried the problem and GM's inadequate response. For example, journalist Gary Heller reported in *The Daily Item,* a Pennsylvania newspaper, "Unplanned engine shutdowns happened four times during a hard-driving test [of the Chevy Cobalt] last week. . . . I never encountered anything like this in 37 years of driving, and I hope I never do again." This quote was later picked up by *The New York Times.*[4]

As a direct result of the negative press, GM's Product Investigations (PI) team conducted tests that reproduced the moving stalls. In spite of these results, the PI team recommended the release of a Technical Service Bulletin (TSB) to dealers rather than a recall. The TSB applied to the 2005–06 Chevy Cobalt, 2006 Chevy HHR, 2005–06 Pontiac Pursuit, 2006 Pontiac Solstice, and the 2003–06 Saturn Ion. The bulletin repeated the message used in the Preliminary Information notice, including the key insert fix, with one notable difference: the word "stall" was removed from the text. During investigative interviews, GM quality manager Steve Oakley later stated that the term "stall" was not typically used in bulletins because it might sound like a safety issue and cause NHTSA to question why the company did not issue a recall. Oakley also revealed that he did not want to "push hard on safety issues" because the previous quality manager, Courtland Kelley, was demoted—allegedly due to a failed 2003 whistle-blowing lawsuit over a leaky fuel line in the Chevy Trailblazer.[5]

The TSB provided a solution for any customer who complained, but did not address switch defects in the production of new vehicles. When GM was unable to resolve price and quality disputes with their supplier of keys, they cancelled the plan to use a key designed with a small hole instead of a wide slot and continued to build new cars with the same

[3] "Engine Stalls, Loss of Electrical Systems, and No DTCs LSJ phantom #PIC3421," *General Motors,* February 28, 2005.

[4] "Making a Case for Ignitions That Don't Need Keys, *The New York Times,* June 19, 2005.

[5] "How GM Silenced a Whistle-Blower," *Bloomberg Business,* June 18, 2014.

defective key and switch parts. The 2014 investigations revealed that internal GM e-mails from 2005 noted that the cost per vehicle to increase the torque by 10 percent was $0.57 and to increase the torque by 50 percent was about $1.00 per vehicle.

The National Highway Traffic Safety Administration

The federal regulatory agency in charge of automobile safety issues such as those experienced by GM drivers was the National Highway Traffic Safety Administration (NHTSA). In 1966, U.S. legislators enacted the National Highway Traffic and Motor Vehicle Safety Act and the Highway Safety Act, and also created the Department of Transportation (DOT) reporting to the U.S. secretary of commerce. Through the subsequent Highway Safety Act of 1970, the NHTSA was established within the DOT. NHTSA's mission was to protect public safety by reducing deaths, injuries, and monetary loss associated with motor vehicle accidents. To accomplish their goals, NHTSA developed Federal Motor Vehicle Safety Standards (FMVSS) for new vehicle design, manufacturing, and performance as related to crash prevention (warning systems), crashworthiness (structural soundness), and postcrash survivability of the occupants. In 2000, the Transportation Recall Enhancement, Accountability, and Documentation Act (TREAD) was passed to expand the reporting requirements of auto manufacturers regarding potential safety concerns as well as establish penalties for noncompliance. NHTSA also maintained the public website *www.safercar.gov* to assist consumers with vehicle safety information.

One of the responsibilities of the agency was setting the rules governing air bags and other passive safety devices. These devices played an important role in protecting occupants; the agency reported that the risk of serious head injury in a crash was reduced by 83 percent when both seat belts and air bags were used.[6] The NHTSA first mandated the installation of driver-side air bags in motor vehicles for models produced after April 1, 1989; and in 1998, they further required advanced dual front air bags that used the size and position of each occupant to properly adjust the bag's inflation pressure. This feature was introduced to prevent injury or death caused by the opening force of the air bag itself.

Within NHTSA, the Office of Defects Investigations (ODI) was responsible for screening and investigating motor vehicle deficiencies that allegedly violated its regulations, as well as overseeing the recalls issued by automakers. Under ODI, the Defects Assessment Division (DAD) performed the screening step using data from the Early Warning Reporting (EWR) system that captured TREAD reports, direct customer complaints collected by the Correspondence Research Division (CRD), and data from the Special Crash Investigations (SCI) team who performed in-depth analysis of specific crash conditions. By 2014, NHTSA had overseen the recall of, on average, around nine million vehicle per year since 2000. The agency had also annually reviewed from 45,000 to 55,000 consumer complaints, around 6,000 death and injury reports, and had conducted between 100 and 125 special crash investigations. NHTSA's operations and research division employed 519 full-time equivalent workers and operated under a budget of $257.5 million.[7]

When one of the first reports of air bag nondeployment in the Cobalt was sent to NHTSA in 2005, the SCI conducted an investigation. The researchers concluded that the air bags failed because the vehicle had decelerated gradually by first impacting smaller trees prior to crashing into a large tree. No questions were raised as to why the power mode was in "accessory," and the case was closed with no further action. By 2007, NHTSA's

[6] "Air Bag," *New World Encyclopedia,* September 8, 2012.

[7] "FY2015 NHTSA Budget Justification," March 5, 2014, at *www.nhtsa.gov*.

Early Warning team noted high warranty claim rates for the Cobalt and the Ion and asked the DAD to review. The request mentioned 43 accidents that caused 27 injuries and four deaths, and indicated that the number of claims for the Cobalt were higher than other GM vehicles, and also greater than those of other automakers.

The DAD chose the Rademaker/Weigel case (from Wisconsin), but the packet of case documents related to the crash did not include some critical items, even though they were stored in the agency's own files. These included an earlier SCI study conducted by the Indiana University Transportation Resource Center, which had correctly linked the issues of low torque keys, power loss, and air bag failure, and the 2007 Wisconsin State Police report that had noted that the key had been in "accessory" mode. The packet also did not include GM's TSB related to the key slip problem. Failing to consider these reports, the team ultimately placed the blame for the Rademaker/Weigel crash on air bag nondeployment due to off-road conditions. Despite a recommendation from its associate administrator of enforcement to expand research, the ODI decided not to pursue a formal investigation. In 2014, the Energy and Commerce Committee's review of NHTSA's decision found no written documentation explaining why the agency had chosen not to pursue its GM study.

Over the next two years, the media published a number of reports criticizing the NHTSA for its lack of oversight regarding air bag failures. The *Kansas City Star* printed a series of scathing articles with headlines such as *Air Bag Recall Process Drags On, Crash Kills Another Driver,* and *Taking Air Bag Cases to Court Can be Tricky.* The NHTSA publicly complained to the editor that the paper "ignored warnings by the [NHTSA's] experts that the underlying premise of its recent air bag story was fundamentally flawed." Nonetheless, these news reports prompted NHTSA to further examine frontal crash safety, including another look at the Cobalt. But, the DAD examined minimal data and again concluded that there was no pattern of failure, which brought the investigation to a standstill. After declining three times to cite GM, the agency would not revisit the air bag nondeployment issue again until 2014, after the GM recalls started.

The GM Engineer's Secret Fix

As the NHTSA investigated—and failed to take action—the GM engineer in charge of the ignition switch, Ray DeGiorgio, apparently set about fixing the torque problem on his own, in secret, and without fully documenting his process.

General Motors followed a formal approval process for development of all vehicle parts, called the Production Part Approval Process (PPAP). This process required official sign-off from both the supplier and GM personnel. DeGiorgio had followed this process in 2004 when he approved a different type of grease to fix the cold start problem. But, in 2006, he worked secretly with the switch supplier, Delphi, to completely replace the short, problematic spring-plunger with a longer, more tightly coiled version, a design GM had originally rejected in 2001. DeGiorgio approved the low-cost plunger replacement as part of another electrical update for the cold start problem, but made no change to the part number and did not communicate the change internally. Under GM policy, a new part number should have been assigned.

During investigative interviews in 2014, DeGiorgio claimed that he did not remember approving the plunger-spring part change. Documents discovered in the supplier's files suggested otherwise. In one internal e-mail, sent in 2005, a Delphi engineer stated, "Cobalt is blowing up in their face in regards to turning the car off with the driver's knee."[8]

[8] "Report to Board of Directors of General Motors Company Regarding Ignition Switch Recalls (The Valukas Report)," *Jenner & Block,* May 29, 2014.

The corrected switch was put into new vehicle production part way through the 2007 model year. The secret fix later confounded company investigators, as they tried unsuccessfully to research and document the ignition switch problem.

Victim Lawsuits and GM's Response

As the number of accidents caused by the defective ignition switch rose, victims and their families began filing lawsuits.

These lawsuits were dealt with internally by GM's legal department, which managed both product litigation and safety matters. The legal department worked, in turn, with the Field Performance Assessment (FPA) team, customer claim administrators, and outside counsel. A committee known as the "Roundtable" met weekly to review and approve claims where the payout was in the range of $100,000 to $2 million. For larger awards—those between $2 million and $5 million—a group called the Settlement Review Committee (SRC) convened on a monthly basis. Only the general counsel could approve payouts of more than $5 million.

By 2006, GM had received several wrongful death lawsuits related to nondeployment of air bags in Ions and Cobalts. The Roundtable determined that in cases lacking a frontal crash event, the air bags were not expected to deploy, and settled without admitting guilt. Throughout 2007 and 2008, GM continued to settle wrongful death cases without acknowledging any defects (although it did add the newer 2007 model to its technical service bulletin and added the Saturn Sky). On June 1, 2009, GM filed for bankruptcy and all pending litigation was placed on hold.

Bankruptcy notwithstanding, the FPA team continued researching why data recorded by the vehicles' sensors sometimes indicated that the ignition switch was in the "off" or "accessory" position just before a crash in which the air bags did not deploy. The team also noted one odd fact: no reports had emerged of air bag failures for the model year 2008 or later. But, they could find no part change records. Even when questioned directly, DeGiorgio stated that there had been no ignition switch alterations that would have addressed loss of power. The FPA research seemed to have run into a dead end.

By late 2010, some air bag-related lawsuits began blaming "sensing anomalies" as the cause of improper air bag operation. This implied a serious vehicle malfunction that would be difficult to defend and could lead to significant punitive damages. Consequently, the SRC requested more information from product investigators about this anomaly. But the PI team apparently felt no sense of urgency, because it set no timetable and never assigned responsibility to a specific individual. This behavior was later characterized by new CEO Mary Barra as the "GM nod," which she defined as "when everyone nods in agreement to a proposed plan of action, but then leaves the room with no intention to follow through, and the nod is an empty gesture."[9] The product investigation team's lack of commitment resulted in delays and incomplete work efforts for another year.

Finally, in May 2012, the PI team concluded from junkyard tests that the air bags had failed to deploy due to mechanical rather than electrical reasons and wondered if this was because the ignition switch had moved out of the "run" position. Once again, in June 2012, DeGiorgio denied knowledge of any changes to the switch that would have affected rotational torque. Hence, in September 2012, the PI team requested help from a specialized group known as Red-X, which included experts in parts differentiation, to assess why the torque measurements differed between 2007 and 2008 Cobalt models. However, since the

[9] "Report to Board of Directors of General Motors Company Regarding Ignition Switch Recalls (The Valukas Report)," *Jenner & Block*, May 29, 2014.

Red-X team had been instructed by the GM legal department that all cars in question were under quarantine, they were unable to secure a vehicle to evaluate. The study was cancelled, and the investigation was mired yet again.

In the meantime, Brooke Melton's parents were convinced that she had not been driving too fast for conditions, and that there must have been something wrong with her 2005 Cobalt. In fact, just days before the fatal accident, Brooke had taken her vehicle to a GM dealership to research a worrisome and unexpected moving stall. In 2010, her bereaved parents hired an independent engineer named Mark Hood to review the accident. Hood inspected the ignition with particular focus on the plastic and metal switch, to no avail. Next, he purchased a $30 replacement part from a GM dealer and repeated the inspection. To his surprise, the newer part had a longer plunger and a tighter spring, and required a notable increase in torque to rotate the key. The details of this study were presented to GM at a deposition for the Melton case in April 2013. During the deposition, DeGiorgio acknowledged the differences between the original plunger-spring and the replacement part, but again disavowed any knowledge of a change to the parts. The evidence was then presented to the SRC, and in September 2013, they authorized a $5 million settlement with the Meltons.

GM also hired an outside investigator to repeat Hood's research, and six months later in October 2013, the study concluded that there had been a definite design change in the ignition switch between 2006 and 2007, and that earlier versions of the switch did not meet GM specifications. Given this compelling evidence, the partmaker, Delphi, turned over documents that explicitly showed DeGiorgio's approval for the change in April 2006. Finally, GM understood that the ignition switch was defective, and when it slipped into a moving stall, the resulting lack of power disabled the air bags and risked the occupants' safety.

In December 2013, the SRC sent its conclusions regarding the flawed switch to the Executive Field Action Decision Committee (EFADC), which was responsible for considering a recall. Their first meeting on the topic was inconclusive and a decision was delayed for another six weeks. Finally, starting on February 7, 2014, EFADC ordered a succession of recalls that eventually included over 2.6 million defective vehicles.

Congressional Hearings

Congressional hearings followed the recalls, the first on April 1 and the second on June 18, 2014. GM CEO Mary Barra and NHTSA acting director David Friedman testified at the April hearing.

For his part, Friedman admitted shortcomings within NHTSA, but placed the blame on GM, stating that the automaker withheld critical information such as the failure to change the switch part number and the fact that defect discussions were covertly held with the supplier. Government interrogators suggested that NHTSA had ample information and might have been too soft on GM. Senator Claire McCaskill opined in the hearing that the agency was "more interested in singing Kumbaya with the manufacturers than being a cop on the beat." Representing GM, Ms. Barra promised full disclosure and indicated that the company and its board of directors had retained outside counsel, the law firm Jenner & Block, to conduct a full investigation.

In May, immediately following the hearings, Senator Ed Markey introduced stricter legislation related to the Early Warning system and commented:

> At almost every juncture for the past decade, whenever NHTSA was made aware of possible safety issues with the GM vehicles, it chose to take no action. As damaging as the "GM nod" that is said to have embodied the culture of ineptitude at the company, the "NHTSA shrug," when confronted by evidence of this fatal safety

> defect, was also responsible for keeping these deadly vehicles on the road. It is time to pass legislation to ensure that information about possible deadly defects is made public so American families can be protected even if NHTSA abdicates its responsibility to public safety again in the future.[10]

In May 2014, NHTSA slapped GM with the maximum $35 million penalty for failure to disclose the defect in a timely manner.[11] The same month, GM fired 15 employees, including engineer Ray DeGiorgio and several high-level lawyers, and disciplined five more.

The Valukas Report, named after its lead author Anton R. Valukas of Jenner & Block, was released on June 5. In preparing the 325-page report, Valukas and his team had reviewed over 41 million documents and interviewed 230 witnesses. The report concluded that the delayed recall was due to a pattern of "incompetence and neglect," a dysfunctional organization, and a culture driven by cost over safety. The report exonerated senior leadership, including the board of directors.

However, the Valukas report also described a culture of mixed messages from management. On one hand, management promoted a message of safety first, saying "when safety is at issue, cost is irrelevant;" while on the other hand, it also promoted a message of "cost is everything," seeming to suggest the opposite. A quality training course from 2004 instructed employees to demand excellence:

> The harsh reality is—we are competing in a new world, one that demands a culture where there is no tolerance for defects an any point during in [sic] the vehicle development and manufacturing process. Because the marketplace has zero tolerance for defects, this organization will have no tolerance for defects.

Yet, statements from GM workers indicated that cost-containment measures in the 2000s overshadowed the "zero tolerance" directive, noting that a cost-control focus "permeates the fabric of the whole culture." Leading up to GM's 2009 bankruptcy, the company was clearly concerned about costs when they instituted workforce reductions in 2006, 2008, and 2009 that shrank a 1979 peak headcount of around 468,000 to just 66,000.[12] The Valukas Report concluded by stating that there had been no intentional cover-up related to the ignition switch defect.

The June hearing included testimony from Ms. Barra and Mr. Valukas, who were both grilled by members of Congress over the findings of the Valukas Report. The hearings were opened by House Representative Tim Murphy, who suggested that the Valukas Report could have been subtitled "Don't Assume Malfeasance When Incompetence Will Do." Murphy went on to state that:

> Even when a good law, like the TREAD Act of 2000, is in place, it requires people to use common sense, value a moral code, and have a motivation driven by compassion for it to be effective. Here, the key people at GM seemed to lack all of these in a way that underscores that we cannot legislate common sense, mandate morality, nor litigate compassion, and at some point it is up to the culture of the company that has to go beyond paperwork and rules.

Congresswoman Diana DeGette pressed Mr. Valukas about management's role, saying:

> The report singles out many individuals at GM who made poor decisions or failed to act, but it doesn't identify one individual in a position of high leadership who

[10] "Markey on GM Recall: While GM Nods, NHTSA Shrugs," June 18, 2014, at *Markey.senate.gov*.

[11] "GM Gets Record Penalty for Failing to Report Defect," *The Wall Street Journal,* May 16, 2014.

[12] "GM Layoffs: Thousands of Factory Jobs Likely To Be Cut," *Huffington Post,* September 3, 2009.

> was responsible for these systemic failures. The report absolves previous CEOs, the legal department, Ms. Barra, and the GM Board from knowing about the tragedy beforehand. This is nothing to be proud of. That the most senior GM executives may not know—have known about a defect that caused more than a dozen deaths is, frankly, alarming and does not absolve them of responsibility for this tragedy.

Mr. Murphy went on to question Mr. Valukas about a possible cover-up:

Mr. Murphy: Does an employee who acts alone, or who hides or doesn't share information, a cover-up?

Mr. Valukas: If the individual knows that the information is a—for instance, a safety information, and understands that and deliberately decides to conceal that, that is a cover-up, yes, it is.

Mr. Murphy: I just find it hard to believe that of 210,000 employees, not a single one in that company had the integrity to say, I think we are making a mistake here. Not a single one. That is puzzling to me.

Despite the intense scrutiny, Ms. Barra remained composed and promised to turn the company around:

> We are currently conducting, and I believe—what I believe is the most exhaustive comprehensive safety review in the history of our company. We are leaving no stone unturned, and devoting whatever resources it takes to identify potential safety issues in all of our current vehicles and on vehicles no longer in production. Our responsibility is to set a new norm and a new industry standard on safety and quality. I have told our employees it is not enough to simply fix this problem; we need to create a new standard, and we will create a new norm.

Discussion Questions

1. Who or what was responsible for the ignition switch defect and the resulting deaths and injuries? In your response, please consider the roles of General Motors and its managers and employees, U.S. auto safety regulators, and the drivers of the vehicles themselves and their representatives.
2. If you were a GM employee, what would you do if you had knowledge of a safety defect? If your manager told you to ignore the problem, would you go outside the company to blow the whistle? What might be the cost of keeping silent to the employee and the employer?
3. If you were the CEO of General Motors, what changes would you implement to avoid similar problems from arising in the future?
4. What actions do you recommend that policymakers and regulators take to avoid similar problems from occurring in the future?
5. As a consumer, what can you do to ensure safety in your own vehicle, before and after purchase?

The Upper Big Branch Mine Disaster

On Monday, April 5, 2010, just before 3:00 in the afternoon, miners at Massey Energy Corporation's Upper Big Branch coal mine in southern West Virginia were in the process of a routine shift change. Workers on the evening shift were climbing aboard "mantrips," low-slung electric railcars that would carry them into the sprawling, three-mile-wide drift mine, cut horizontally into the side of a mountain. Many day shift workers inside the mine had begun packing up and were preparing to leave, and some were already on their way to the portals. At one of the mine's main "longwalls," one thousand feet below the surface, a team of four highly experienced miners was operating a shearer, a massive machine that cut coal from the face with huge rotating blades. The shearer had been shut down for part of the day because of mechanical difficulties, and the miners were making one last pass before the evening shift arrived to take their places.

Suddenly, a spark thrown off as the shearer's blades cut into hard sandstone ignited a small pocket of flammable methane gas. One of the operators immediately switched off the high-voltage power to the machine. Seconds later, the flame reached a larger pocket of methane, creating a small fireball. Apparently recognizing the danger, the four miners on the longwall crew began running for the exit opposite the fire. They had traveled no more than 400 feet when coal dust on the ground and in the air ignited violently, setting off a wave of powerful explosions that raced through the mine's seven miles of underground tunnels. When it was over three minutes later, 29 miners (including all four members of the longwall crew) were dead, and two were seriously injured. Some had died from injuries caused by the blast itself, others from carbon monoxide suffocation as the explosion sucked the oxygen out of the mine. It was the worse mining disaster in the United States in almost 40 years.

An evening shift miner who had just entered the mine and boarded a mantrip for the ride to the coal face later told investigators what he had experienced:

> All of a sudden you heard this big roar, and that's when the air picked up. I'd say it was probably 60-some miles per hour. Instantly black. It took my hardhat and ripped it off my head, it was so powerful.

This miner and the rest of his group abandoned the mantrip and ran for the entrance, clutching each other in the darkness. On the outside, stunned and shaken, they turned to the most senior member of their crew for an explanation. "Boys . . . , I've been in the mines a long time," the veteran miner said "That [was] no [roof] fall. . . . The place blew up."[1]

By Anne T. Lawrence. Copyright © 2012 by the author. All rights reserved. This case was presented at the 2012 annual meeting of the Western Casewriters Association Annual Meeting.

[1]Governor's Independent Investigation Panel, *Report to the Governor,* p. 26. This account of the disaster is based on a reconstruction of the events of April 5, 2010, by federal and state investigators and by the United Mine Workers Union.

Massey Energy Corporation

At the time of the explosion, Massey Energy Corporation, the owner and operator of the Upper Big Branch mine, was one of the leading coal producers in the United States. The company, which specialized in the production of high-grade metallurgical coal, described itself as "the most enduring and successful coal company in central Appalachia," where it owned one-third of the known coal reserves. Massey extracted 37 million tons of coal a year, ranking it sixth among U.S. producers in tonnage. The company sold its coal to more than a hundred utility, metallurgical, and industrial customers (mostly on long-term contracts) and exported to 13 countries. In 2009, Massey earned $227 million on revenue of $2.7 billion. The company and its subsidiaries employed 5,800 people in 42 underground and 14 surface mines and several coal processing facilities in West Virginia, Kentucky, and Virginia.

Massey maintained that it brought many benefits to the nation as a whole and to the Appalachian region. The coal industry in the United States, of which Massey was an important part, provided the fuel for about half of the electricity generated in the United States, lessening the country's reliance on imported oil. The company provided thousands of relatively well-paying jobs in a region that had long been marked by poverty and unemployment. Economists estimated that for every job in the coal industry, around three and a half jobs were created elsewhere. The company donated to scholarship programs, partnered with local schools, and provided emergency support during natural disasters, such as severe flooding in West Virginia in May 2009. "We recognize that it takes healthy and viable communities for our company to continue to grow and succeed," Massey declared in its 2009 report to shareholders.

But critics saw a darker side of Massey. The company was one of the leading practitioners of mountaintop removal mining, in which explosives were used to blast away the tops of mountains to expose valuable seams of coal. The resulting waste was frequently dumped into adjacent valleys, polluting streams, harming wildlife, and contaminating drinking water. In 2008, Massey paid $20 million to resolve violations of the Clean Water Act, the largest-ever settlement under that law. In an earlier incident, toxic mine sludge spilled from an impoundment operated by the company in Martin County, Kentucky, contaminating hundreds of miles of the Big Sandy and Ohio rivers, necessitating a $50 million cleanup. Worker safety was also a concern. An independent study found that Massey had the worst fatality rate of any coal company in the United States. For example, in the decade leading up to the Upper Big Branch disaster, Peabody Coal (the industry leader in tons produced) had one fatality for every 296 million tons of coal mined; Massey's rate was one fatality per 18 million tons—more than 16 times as high.

Donald L. Blankenship

At the time of the Upper Big Branch mine disaster, the chief executive officer and undisputed boss of Massey Energy was Don Blankenship. A descendant of the McCoy family of the famous warring clans the Hatfields and the McCoys, Blankenship was raised by a single mother in a trailer in Delorme, a railroad depot in the coalfields of West Virginia. His mother supported the family by working 6 days a week, 16 hours a day, running a convenience store and gas station. Michael Shnayerson, who wrote about Blankenship in his book, *Coal River,* reported that the executive had absorbed from his mother the value of hard work—as well as contempt for others who might be less fortunate. "Anyone who didn't work as hard as she did deserved to fail," Shnayerson wrote. "Sympathy appeared to play no part in her reckonings."[2]

[2]Michael Shnayerson, *Coal River: How a Few Brave Americans Took on a Powerful Company—and the Federal Government—to Save the Land They Love* (New York: Farrar, Straus, and Giroux, 2008), p. 155.

Blankenship graduated from Marshall University in Huntington, West Virginia, with a degree in accounting. As a college student, he worked briefly in a coal mine to earn money for tuition. In 1982, at age 32, he returned to the coalfields to join Massey Energy, taking a job as an office manager for a subsidiary called Rawls. Soon after, Massey announced it intended to spin off its subsidiaries as separate companies and re-open them as nonunion operations. The United Mine Workers, the union that then represented many Massey workers, struck the company. Jeff Goodell, a journalist who profiled Blankenship in *Rolling Stone,* described the young manager's technique for defeating the union at Rawls:

> Blankenship erected two miles of chain link fence around the facility, brought in dogs and armed guards, and ferried nonunion workers through the union's blockades. The strike, which lasted more than a year, grew increasingly violent—strikers took up baseball bats against the workers trying to take their jobs, and a few even fired shots at the scabs. A volley of bullets zinged into Blankenship's office and smashed into an old TV. . . . For years afterward, Blankenship kept the TV with a bullet hole through it in his office as a souvenir.[3]

The union's defeat at Massey (by 2010, only about 1 percent of Massey's workers were union members, all of them in coal preparation plants rather than mines) contributed to the overall decline of the United Mine Workers in the coalfields. In the 1960s, unions represented nearly 90 percent of the nation's mine workers; by 2010, they represented just 19 percent.

Blankenship quickly moved through the management ranks. In 1990, only eight years after he joined the company, he became president and chief operating officer of the Massey Coal Company and in 1992 was promoted to CEO and chairman. (The company was renamed Massey Energy in 2000 when it separated from its parent, Fluor Corp.) By some measures, he was a successful CEO. Between 2001, the first full year of Massey's in-dependent operation, and 2009, annual revenue increased from $1.2 billion to $2.7 billion. During this period, employment rose from around 3,700 to 5,800. Blankenship more than doubled the company's coal reserves, mainly through acquisitions of smaller firms. Massey shareholders, like all investors, were buffeted by the extreme volatility of the stock market during the 2000s. Nevertheless, an investor who purchased $10,000 worth of Massey stock in December 2004 would have a holding valued at $12,800 in December 2010—a rate of return close to that of the coal industry as a whole during this period.[4]

As CEO, Blankenship developed a reputation as a hands-on, detail-oriented manager. He lived in the coalfields and ran the company out of a double-wide trailer in Belfry, Kentucky, just over the West Virginia line. He signed off on all hires, all the way down to janitors. One manager expressed amazement when he learned that the CEO would have to approve a tankful of gasoline for his truck. Managers were required to fax production figures to Blankenship every half hour. Red phones connected mine managers directly to the CEO. "If the report was late or the numbers weren't good, or the mine was shut down for any reason," Shnayerson reported, "the red phone would ring. The terrified manager would pick it up to hear Mr. B demanding to know why the numbers weren't right."[5] Blankenship told an interviewer, "People talk about character being what you do when no one else is looking. But the truth of the matter is character is doing that which is unpopular if it's right, even if it causes you to be vilified."[6]

[3]Jeff Goodell, "The Dark Lord of Coal Country," *Rolling Stone,* December 9, 2010.

[4]Massey, 2009 Annual Report, "Shareholder Information," p. 23.

[5]Michael Shnayerson, quoted in United Mine Workers of America, *Industrial Homicide: Report on the Upper Big Branch Mine Disaster,* p. 80.

[6]Jim Snyder, "Q&A with Don Blankenship," November 16, 2009, *http://thehill.com*.

Exhibit A

Don Blankenship, Total Compensation 2007–2009, in Dollars

Year	Salary	Bonus	Stock Awards	Option Awards	Incentive Plan	Change in Pension Value	Other(*)	Total Compensation
2009	933,369	300,000	3,869,819	—	11,549,156	573,618	609,875	17,835,837
2008	1,000,000	300,000	390,000	2,160,000	6,022,447	691,415	357,129	11,020,991
2007	1,000,000	300,000	604,800	1,700,000	5,257,576	111,794	386,480	9,361,000

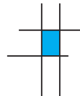
Note: "Other" includes personal use of company cars, aircraft (Challenger 601 corporate jet), housing, and related costs and services.

Source: Massey Energy 2010 Proxy, "Compensation Discussion and Analysis" and "Compensation of Named Executive Officers."

As CEO, Blankenship maintained a laser focus on productivity. In 2005, he sent a memo titled "RUNNING COAL" to all Massey underground mine superintendents that stated:

> If any of you have been asked by your group presidents, your supervisors, engineers, or anyone else to do anything other than run coal (i.e., build overcasts, do construction jobs, or whatever) you need to ignore them and run coal. This memo is necessary only because we seem not to understand that coal pays the bills.

A week later, after this memo had been widely circulated, he followed up with another one which referred to the company's S-1, P-2 (safety first, production second) program. He wrote: "By now each of you should know that safety and S-1 is our first responsibility. Productivity and P-2 are second."



Executive Compensation

Blankenship was well compensated for running Massey. As shown in Exhibit A, his total compensation in 2009 was almost $18 million; this was up from $11 million in 2008 and $9 million in 2007. Blankenship's base salary in all three years was close to $1 million. By far the greatest proportion of his total pay came from a performance-based incentive system established by Massey's board of directors. In its filings with the SEC, the board described its philosophy of compensation this way:[7]

> We compensate our named executive officers in a manner that is meant to attract and retain highly qualified and gifted individuals and to appropriately incentivize and motivate the named executive officers to achieve continuous improvements in company-wide performance for the benefit of our stockholders.[8]

[7]At the time of the UBB disaster, Massey was governed by a nine-person board of directors chaired by Blankenship. The other members were Baxter Phillips, Jr., Massey's president; Stanley Suboleski, formerly Massey's chief operating officer and later commissioner of the Federal Mine Safety and Health Review Commission under President George W. Bush; Lady Judge, an attorney and former commissioner of the Securities and Exchange Commission; Bobby R. Inman, a retired naval admiral and former director of the National Security Agency; James Crawford, a former coal industry executive; Robert Fogelsong, president and executive director of the Appalachian Leadership and Education Foundation; Richard Gabrys, formerly vice chairman of Deloitte and Touche; and Dan Moore, a retired banker. In 2009, directors earned $39,600 in cash and $90,000 in stock, plus $2,000 for each meeting attended, plus extra compensation for special duties (e.g., lead director). (Massey, Form 8-K, November 2009).

[8]Massey Energy, 2010 Proxy, p. 25.

Exhibit B

Incentive Compensation Plan for Massey Energy's CEO, 2009

The calculation of incentive plan compensation was based on achievement of specific targets in these areas:

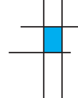
EBIT (earnings before interest and taxes)	15%
Produced tons	15%
Continuous miner productivity (feet/shift)	5%
Surface mining productivity (tons/man-hour)	5%
Environmental violations (% reduction)	10%
Fulfillment of contracts	15%
Nonfatal days lost due to injury and accident (% reduction)	10%
Identification of successors	5%
Employee retention	15%
Diversity of members	5%

Source: Massey Energy 2010 Proxy.

Note: A "continuous miner" is a large machine that extracts coal underground.

Accordingly, the compensation committee of the board established an incentive plan for Massey's CEO. (Similar plans were in place for other senior executives as well.) The plan set specific performance measures for "areas over which Mr. Blankenship was responsible and positioned to directly influence outcome." These areas, and the proportion of his incentive compensation based on them, are shown in Exhibit B.

By one estimate, in the 10 years leading up to the disaster Blankenship received a total of $129 million in compensation from Massey.[9] "I don't care what people think," he once said during a talk to a gathering of Republican Party leaders in West Virginia, speaking of himself in the third person. "At the end of the day, Don Blankenship is going to die with more money than he needs."[10]



Government Regulation of Mining Safety and Health

Coal mining had always been a hazardous occupation. Methane gas, an odorless and colorless by-product of decomposing organic matter that was often present alongside coal, was highly flammable. Methane explosions had contributed to the deaths of more than 10,000 miners in the United States since 1920. To mine safely, methane levels had to be constantly monitored, and ventilation systems had to be effective enough to remove it from the mine. Coal dust itself—whether on the floor or other surfaces, or suspended in the air—was also highly flammable. The standard practice was to apply layers of rock dust (crushed limestone) over the coal dust to render it inert. In addition to the ever-present danger of fire, miners had long contended with the threat of collapsing roofs and walls, dangerous mechanical equipment, and suffocation. Miners often developed coal workers' pneumoconiosis, commonly called black lung, a chronic, irreversible disease caused by breathing coal dust. (Black lung was preventable with proper coal dust control.)

[9] David Roberts, "Grist" [blog], April 9, 2010, *www.grist.org*.

[10] Goodell, op. cit.

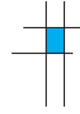
Health and safety in the mining industry had long been regulated at both the federal and state levels. Over the years, lawmakers had periodically strengthened government regulatory control, mostly in response to mining disasters.

- In 1910, following an explosion at the Monongah mine in West Virginia in which 362 men died, Congress established the *U.S. Bureau of Mines* to conduct research on the safety and health of miners.
- The Federal Coal Mine Health and Safety Act, known as the *Coal Act*—which passed in 1969 after the death of 78 miners at the Consol Number 9 mine in Farmington, West Virginia—greatly increased federal enforcement powers. This law established fines for violations and criminal penalties for "knowing and willful" violations. It also provided compensation for miners disabled by black lung disease.
- The 1977 *Mine Act* further strengthened the rights of miners and established the Mine Safety and Health Administration, MSHA (pronounced "Em-shah") to carry out its regulatory mandates. The law required at least four full inspections of underground mines annually.
- Then in 2006, after yet another string of mine tragedies focused public attention on the dangers of mining, Congress passed the Mine Improvement and New Emergency Response Act, known at the *MINER Act.* This law created new rules to help miners survive underground explosions and accidents.[11]

States like West Virginia that had significant mining industries also had their own regulatory rules and agencies.

Although MSHA was empowered to inspect mines unannounced and to fine operators for violations, the agency had limited authority to shut down a mine if a serious problem was present or if the operator refused to pay its fines. Criminal violations of mine safety laws were normally considered misdemeanors rather than felonies.

Over time, fatalities in the industry had declined. At the turn of the 20th century, around 300 to 400 miners died every year in the nation's coal mines; by the 1980s, this number had dropped to less than 50. Injuries and illnesses had also dropped. In part, these declines reflected tougher government regulations. They also reflected the rise of surface mining (mostly in the western United States), which tended to be safer, and the emergence of new technologies that mechanized the process of underground mining. The unionization of the mining industry had also given workers a greater voice and the right to elect safety representatives in many workplaces.



The Upper Big Branch Mine

Massey had bought the Upper Big Branch mine in 1993 from Peabody Coal. It was a particularly valuable property because its thick coal seam produced the high-grade metallurgic coal favored by utilities and the steel industry. Two hundred employees worked there on three, round-the-clock shifts. In 2009, Upper Big Branch produced 1.2 million tons of coal, about 3 percent of Massey's total. The mine, like all of those operated by Massey, was nonunion.

The regulatory record revealed a widespread pattern of safety violations at the Upper Big Branch mine and an increasingly contentious relationship between its managers and government regulators. As shown in Exhibit C, government inspectors had issued an increasing number of violations over time, with a sharp spike upward the year before the

[11]"History of Mine Safety and Health Legislation," Mine Safety and Health Administration, *www.msha.gov*.

Exhibit C

Safety and Health Citations, Upper Big Branch Mine, Assessed Penalties and Amount Paid, 2000–2009

Year	Number of Citations	Assessed Penalty ($)	Amount Paid ($)
2000	240	55,325	55,325
2001	398	48,761	48,761
2002	221	64,726	64,726
2003	175	41,934	41,405
2004	238	48,371	48,371
2005	143	32,577	32,576
2006	173	191,249	84,411
2007	271	253,984	61,745
2008	197	239,566	105,965
2009	515	897,325	292,953

Source: MSHA data, reported in the appendices of *Industrial Homicide: Report on the Upper Big Branch Mine Disaster.*

disaster. These data also showed that around 2006, management had begun to contest regulatory penalties rather than pay them. The state investigation reported the story that at one point Massey's vice president for safety—an attorney—"took a violation written by an inspector, looked at her people, and said, 'Don't worry, we'll litigate it away.'" Appealing the citations not only allowed the company to delay or avoid paying; it also blocked tougher sanctions, such as shutting down the mine.

Miners testified that they were intimidated or disciplined if they complained about safety. When one foreman told his men not to run coal until a ventilation problem was fixed, he was suspended for three days for "poor work performance." Another miner, who was killed in the blast, had told his wife that a manager had told him when he complained about conditions, "If you can't go up there and run coal, just bring your [lunch] bucket outside and go home." The father of a young miner who was still a trainee when he was killed at Upper Big Branch related his son's experience to investigators. The young man had told his father that when he had expressed concerns about safety to his supervisor, he was told, "If you're going to be that scared of your job here, you need to rethink your career."[12] Miners who were hurt on the job were told not to report their injuries, so an NFDL (non-fatal day lost) would not be recorded. A former Massey miner who testified before a Senate committee explained, "If you got hurt, you were told not to fill out the lost-time accident paperwork. The company would just pay guys to sit in the bathhouse or to stay at home if they got hurt."[13]

Investigators found that the company had kept two sets of books at UBB, one for its own record keeping and the other to show inspectors. "If a coal mine wants to keep two sets of books, that's their business," the administrator for MSHA later commented. "They can keep five sets of books if they want. But they're required to record the hazards in the official set of books."[14] Conditions that were recorded in the company's own books—but not the official set—included sudden methane spikes, inoperative safety equipment, and other dangers.

[12] UMW, op. cit., p. 81.

[13] UMW, op. cit., p. 78.

[14] "Mine Owners Misled Inspectors, Investigators Say," *The New York Times,* June 29, 2011.

The mine also had a system in place, set up by its chief of security, to warn underground managers that an inspector was on the way—a clear violation of the law. A miner who survived the explosion later told Congress, "The code word would go out we've got a man [government inspector] on the property. . . . When the word goes out, all effort is made to correct the deficiencies."[15] A surviving miner testified:

> Nobody shuts one of Don Blankenship's mines down. It has never happened. Everyone knows when mine inspectors are coming, you clean things up for a few minutes, make it look good, then you go back to the business of running coal. That's how things work at Massey. When inspectors write a violation, the company lawyers challenge it in court. It's just all a game. Don Blankenship does what he wants.[16]

After the disaster, Blankenship stated, "Violations are unfortunately a normal part of the mining process. There are violations in every coal mine in America, and UBB was a mine that had violations."

Causes of the Disaster

In the months following the tragedy at Upper Big Branch, three separate investigations—conducted by the federal MSHA, a commission established by the governor of West Virginia, and the United Mine Workers—examined the causes of the fatal explosion. All came to the same conclusion: that a spark from the longwall shearer had ignited a pocket of methane, which had then set off a series of explosions of volatile coal dust that had raced through the mine. Such events could only have happened in the presence of serious, systematic safety violations. Among the problems cited by the investigators were these:

- *Rock Dust.* Investigators found that the company had failed to meet government standards for the application of rock dust. As a result, explosive coal dust had built up on surfaces and in the air throughout the mine.

The state commission reported that the Upper Big Branch mine had only two workers assigned to rock dusting, and they typically worked at the task only three days a week and were frequently called away to do other jobs. Moreover, their task was often impossible because the mine's single dusting machine, which was about 30 years old, was broken most of the time. Federal investigators later determined that more than 90 percent of the area of the mine where the explosion occurred was inadequately rock dusted at the time of the explosion. They also found that the area of the longwall where the explosion began had not been rock dusted a single time since production started there in September 2009. The presence of large amounts of floating coal dust in the mine was also suggested by medical evidence. Seventy-one percent of the autopsied victims showed clinical signs of black lung disease, caused by breathing airborne coal dust. Nationally, the rate of black lung disease in underground coal miners was around 3 percent.

- *Ventilation.* Investigators found that the Upper Big Branch Mine did not have sufficient ventilation to provide the miners with fresh, breathable air, and to remove coal dust as well as methane and other dangerous gases.

Upper Big Branch, like many mines, used a so-called push-pull system in which large fans at the portal blew fresh air into the mine, and a fan on the other end pulled air out. The state

[15]UMW, op. cit., p. 77.

[16]Jeff Goodell, op. cit.

investigation found that this system did not work very well at Upper Big Branch. The fans were powerful enough, but the plan was not properly engineered.

> The push-pull ventilation system at Upper Big Branch . . . had a design flaw: its fans were configured so that air was directed in a straight line even though miners worked in areas away from the horizontal path. As a result, air had to be diverted from its natural flow pattern into the working sections. . . . Because these sections were located on different sides of the natural flow pattern, multiple diversionary controls had to be constructed and frequently were in competition with one another.[17]

Poor ventilation had likely caused methane to build up near the longwall shearer, providing the fuel for the initial fireball, investigators found.

- *Equipment Maintenance.* Investigators concluded that water sprays on the longwall shearer were not functioning properly, and as a result were unable to extinguish the initial spark.

After the disaster, investigators closely studied the longwall shearer where the initial fire had started. They found that several of the cutting teeth on the rotating blades (called "bits") had worn flat and lost their carbide tips, so they were likely to create sparks when hitting sandstone. The investigators also examined the water nozzles on the shearer, which normally sprayed water onto the coal face during operation to cool the cutting bits, extinguish sparks, and push away any methane that might have leaked into the area. They found that seven of the nozzles were either missing or clogged. Tests found that the longwall shearer did not have adequate water pressure to keep the surface wet and cool. As a result, any small sparks thrown off during the mining process could not be extinguished.

In short, a series of interrelated safety violations had combined to produce a preventable tragedy. The United Mine Workers called the disaster "industrial homicide" and called for the criminal prosecution of Massey's managers.

For its part, Massey had a completely different interpretation of the causes of the events of April 5. An investigation commissioned by the company and headed by Bobby R. Inman, its lead independent director, said that the explosion was caused by a sudden, massive inundation of natural gas through a crack in the mine's floor—an Act of God that the company could not have anticipated or prevented. The company report stated:

> . . . the scientific data that [Massey] has painstakingly assembled over the last year with the assistance of a team of nationally renowned experts so far compels at least five conclusions. *First,* a massive inundation of natural gas caused the UBB explosion and coal dust did not contribute materially to the magnitude or severity of the blast; *second,* although an ignition source may never be determined, the explosion likely originated in the Tailgate 21 entries, but certainly not as a result of faulty shearer maintenance; *third,* [the company] adequately rock dusted the mine prior to the explosion such that coal dust could not have played a causal role in the accident; *fourth,* the mine's underground ventilation system provided significantly more fresh air than required by law and there is no evidence that ventilation contributed to the explosion; and *fifth,* MSHA has conducted a deeply flawed accident investigation that has been predicated, in part, upon secrecy, protecting its own self-interest, witness intimidation, obstruction of [company] investigators, and retaliatory citations.[18]

[17] Governor's Independent Investigation Panel, op. cit., p. 61.

[18] *http://www.usmra.com/download/MasseyUBBReport.pdf.*

In a conversation with stock analysts six months after the disaster, Blankenship stated that he had a "totally clear conscience" and that he did not believe Massey had "contributed in any way to the accident."[19]

Discussion Questions

1. What were the costs and benefits to stakeholders of the actions taken by Massey Energy and its managers?
2. Applying the four methods of ethical reasoning (utilitarianism, rights, justice, and virtue), do you believe Massey Energy behaved in an ethical manner? Why or why not?
3. Who or what caused the Upper Big Branch mine disaster, and why do you think so?
4. What steps could be taken now to reduce the chances of a similar tragedy occurring in the future? In your answer, please address the appropriate roles of mining companies (and their directors and managers), government regulators and policymakers, and the workers and their union in assuring mine safety.

[19]"CEO says Massey has 'Clear Conscience' over Upper Big Branch," *Charleston Gazette,* October 27, 2010.

CASE EIGHT

After Rana Plaza

Around nine in the morning on April 24, 2013, Rana Plaza, an eight-story building in Savar, Bangladesh, collapsed catastrophically in a hail of twisted concrete, steel bar, and sewing machinery. At the time, more than 3,000 garment workers were on duty in five separate factories, located on the building's third to eighth floors. Photographs of the scene showed hundreds of people—community members, workers from other nearby factories, and police and firefighters—furiously moving debris and pulling people out of rubble. When the rescue and recovery effort was finally suspended more than a week later, 1,134 workers, most of them women, had been found dead; 2,500 others had been hurt, many with amputations and severe head and back injuries.[1] Most of the victims were under 30, and a fifth of them were teenagers. They had earned in the range of $38 to $102 a month.[2] It was the worst industrial disaster in the history of the global garment industry.

The collapsed building was owned by Sohel Rana. Rana, 35, was described as a "gun-toting politician" who "traveled by motorcycle, as untouchable as a mafia don, trailed by his own biker gang." In 2007, he had obtained the permit to build the plaza directly from the mayor of Savar, a political ally, bypassing the standard procedure. The building, which was partly situated on a drained swamp, was initially permitted for five stories; Rana illegally added three more floors between 2008 and 2012 and was in the process of constructing another when the structure collapsed.[3] The architect later said the building had not been designed for industrial use. "If I had known that it was to be an industrial building, I would have taken other measures," he told an investigator.[4] Analysis showed that the building was carrying almost six times more weight than it was designed to bear. Poor-quality concrete and steel used in construction and uneven settlement on saturated soils may also have contributed to the structural failure.[5]

The day before, workers reported that large cracks had opened up in the building's walls. An engineer called in to inspect the cracks told Rana that the building needed to

By Anne T. Lawrence. Copyright © 2015 by the author. All rights reserved. An earlier version of this case was presented at the 2014 annual meeting of the Western Casewriters Association.

[1] "Report on Deadly Factory Collapse in Bangladesh Finds Widespread Blame," *The New York Times,* May 22, 2013.

[2] Clean Clothes Campaign and the International Labor Rights Forum, *Still Waiting: Six Months after History's Deadliest Apparel Industry Disaster, Workers Continue to Fight for Compensation,* 2013.

[3] "The Most Hated Bangladeshi, Toppled from a Shady Empire," *The New York Times,* April 20, 2013; and "Bangladesh's Paradox for Women Workers," *Bloomberg BusinessWeek,* May 15, 2013.

[4] "Bangladesh: Rana Plaza Architect Says Building Was Never Meant for Factories," *Telegraph (U.K),* May 3, 2013.

[5] "Analysis: Wake-Up Call for Bangladesh's Building Industry," *IRIN, UN Office for the Coordination of Humanitarian Affairs,* May 6, 2013; and "Bangladesh Building Collapse Due to Shoddy Construction," *National Geographic News,* April 25, 2013.

be shut down immediately. Managers of a bank and retail shops operating on the first and second floors told their employees to stay home until the building was declared safe. But Rana himself dismissed the engineer's conclusion, saying, according to witnesses, "The plaster on the wall is broken, nothing more. It is not a problem."[6]

Managers of the five Bangladeshi-owned factories operating in rented space in the building—New Wave Style, New Wave Bottoms, Phantom Apparels, Phantom Tac, and Ether Tex—all of which manufactured apparel for export to Western firms, apparently agreed with Rana. The next morning, when garment workers arrived for work, they were greeted by a loudspeaker: "All the workers of Rana Plaza, go to work. The factory has already been repaired." Workers who objected were threatened with the loss of a month's pay. Shortly after the workday started, factory managers turned on large electric generators located on the third and fourth floors, a common occurrence because of regular power failures in the building. A government report later found that vibrations from the generators had shaken the building, triggering a massive structural failure as the already compromised concrete walls failed, floors began collapsing onto the ones below, and the entire building buckled outward.[7]

Several dozen well-known U.S. and European retailers and brands—including Walmart, Benetton, Primark, Children's Place, Loblaw, and Mango—were at the time or had recently sourced products from factories in Rana Plaza. The extensive news coverage of the disaster repeatedly mentioned these companies and displayed photos of their labels. One particularly gruesome photograph showed a dust-covered human corpse, partially buried in rubble, surrounded by clothing tags displaying the logo of the brand Joe Fresh, owned by the Canadian retailer Loblaw. "I am troubled," Galen Weston, the executive chairman of Loblaw, told reporters, "that despite a clear commitment to the highest standards of ethical sourcing, our company can still be part of such an unspeakable tragedy."[8] Now, Loblaw—and all the other companies that sourced apparel from suppliers in the low-wage and notoriously unsafe Bangladeshi garment industry—faced a stark and immediate challenge: What should they do now, after Rana Plaza?

The Emergence of Bangladesh's Garment Industry

At the time of the Rana Plaza collapse, Bangladesh was the site of one of the fastest-growing garment industries in the world.

Located between India on the west, north, and east and Burma (Myanmar) on the southeast, Bangladesh (meaning "the Country of Bengal" in the native Bengali language) sat on a vast delta formed by the confluence of the Ganges, Brahmaputra, and Meghna Rivers, which emptied into the Bay of Bengal. The country, which was predominantly Muslim, had become independent of Pakistan in 1971. With almost 164 million people in a country about the size of Iowa, Bangladesh in 2013 was one of the most densely populated nations in the world. It was also one of the poorest. The United Nations ranked the country 146th (out of 187) on its human development index. Fifty-eight percent of the population was estimated to live in multidimensional poverty, defined by the United Nations as "overlapping deprivation in health, education, and standard of living." Forty-three percent lived on $1.25 or less a day. In 2013, the country was still predominantly rural; almost half of

[6] "The Most Hated Bangladeshi, Toppled from a Shady Empire," op. cit.

[7] "Report on Deadly Factory Collapse in Bangladesh Finds Widespread Blame," *The New York Times,* May 22, 2013.

[8] "Global Report: The Uncomfortable Truth about Bangladesh," *Canadian Business,* June 6, 2013.

Bangladeshis lived off the land, mostly growing rice.[9] The low-lying nation was particularly vulnerable to natural disasters and regularly suffered punishing typhoons and floods.[10]

The Bangladeshi ready-made garment industry had its origins in the worldwide quota systems that emerged shortly after the country's independence. The Multi-Fibre Arrangement (MFA) of 1974 capped the volume of textile and apparel exports to the United States and other developed nations from various countries, especially in East Asia. One consequence of the MFA was a shift of manufacturing to other countries, like Bangladesh, that had no prior history of garment production and were therefore not covered by the quotas. In 1978, Desh Garments, headed by Bangladeshi businessman Noorul Quader, negotiated an agreement with Daewoo, a Korean firm, to teach the Bangladeshis how to manufacture apparel.[11] After training in Korea, Quader and his team returned to set up the first export-oriented garment factory in Bangladesh. Development of the industry was further spurred by structural reforms in the 1980s that privatized and deregulated markets, opened the nation to foreign investment, and permitted garment companies to take loans secured by contracts from foreign buyers.[12]

Once established, the ready-made garment industry in Bangladesh grew steadily. Entrepreneurs flooded into the industry, drawn by low capital requirements, readily available workers, and cheap industrial rents in communities, like Savar, on the outskirts of Dhaka and Chittagong. Large operators secured contracts with Western apparel companies, and small ones emerged to handle their overflow as subcontractors. By 2013, Bangladesh had become the largest garment exporter in the world, after China, employing 4 million workers in 5,600 factories, as shown in Exhibits A and B. Bangladesh exported more than $20 billion of garments annually, accounting for 10 percent of its GDP and more than three-quarters of its total exports by value. (Other exports included frozen shrimp, jute, and leather.) The United States and Canada were the destination of 25 percent of Bangladesh-made garments; more than half went to Europe.

Political Influence

The burgeoning garment industry wielded great political power in the developing nation. Employers were organized into a powerful trade association, the Bangladesh Garment Manufacturers and Exporters Association (BGMEA), founded in 1983. Almost every garment manufacturer joined, because only members were permitted to export garments. With control of the lion's share of exports, the trade association came to function almost as a branch of government. *The New York Times* reported that the organization performed many official functions, such as regulating and administering exports and collecting fees. BGMEA members sat on government committees on labor and security.[13] A similar organization, the Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA), represented employers in factories making knitwear, such as sweaters.

[9] Nations Development Programme, *Human Development 2013.*

[10] "Bangladesh," *CIA Fact Book;* and World Bank, "Bangladesh Overview." The history of Bangladesh is recounted in Willem van Schendel, *A History of Bangladesh* (Cambridge, U.K.: Cambridge University Press, 2009).

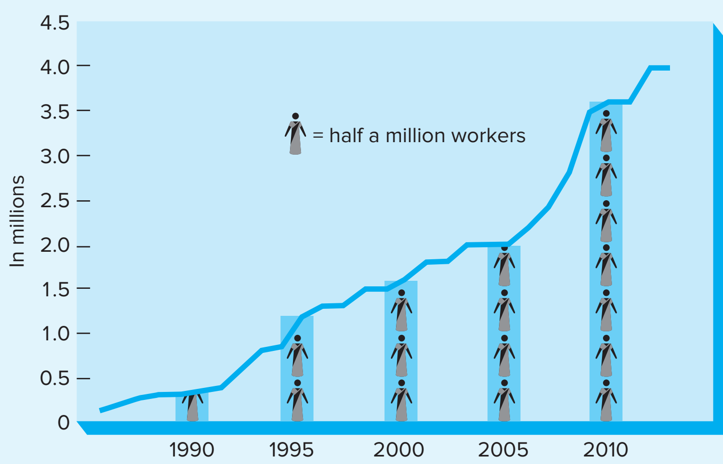
[11] Zoe Chace, "Nixon and Kimchi: How the Garment Industry Came to Bangladesh," *Planet Money,* aired on National Public Radio December 2, 2013; and "History of Desh Group," at *www.deshgroup.com*.

[12] Although the Multi-Fibre Arrangement and its successor agreements expired in 2004, international trade rules continued to support the country's garment industry. Under the European Union's "everything but arms" rules, designed to benefit poor countries, all apparel imports from Bangladesh were duty-free. The United States also offered Bangladesh trade preferences on a number of products (although not apparel). See the testimony of Lewis Karesh, Assistant U.S. Trade Representative, June 6, 2012, before the Senate Foreign Relations Committee.

[13] "Garment Trade Wields Power in Bangladesh," *The New York Times,* July 24, 2013.

Exhibit A

Ready-made Garment Industry in Bangladesh Employment in Millions, 1984–2013



Source: Bangladesh Garment Manufacturers and Exporters Association, 2013. Graphic design by Colorbox Industries. © 2015. All rights reserved. Used by permission.

Factory owners also exercised political power directly. Sixty percent of the 300 members of Bangladesh's parliament were active in business, and 31 members or their family members owned garment factories.[14] A. K. Azard, president of the Bangladesh Chambers of Commerce and Industry and owner of one of Bangladesh's largest garment factories, also owned a newspaper and a television station.[15] Garment employers were major political donors. The director of Transparency International's (TI's) country office explained the reality this way: "Politics and business [are] so enmeshed that one is kin to the other. There is a coalition between the [garment] sector and people in positions of power."[16] In 2012, TI ranked Bangladesh next to last among 14 garment-exporting countries on their corruption perceptions index.[17]

Garment manufacturers were heavily favored by the government; tax breaks and subsidies to the industry were estimated to exceed tax revenues by $17 million a year. Speaking of garment factory owners, the secretary of the Bangladesh nonprofit Citizens for Good Governance stated, "They extract all kinds of subsidies. They influence legislation. They influence the minimum wage. And because they are powerful, they can do, or undo, almost anything, with impunity."[18]

Worker Safety

The tragedy at Rana Plaza, while exceptional in its death toll, was not an isolated event. The safety record in Bangladesh's garment industry was one of the worst in the world, with

[14] "Garment Trade Wields Power in Bangladesh," op. cit.

[15] "Export Powerhouse Feels Pangs of Labor Strife," *The New York Times,* August 23, 2012.

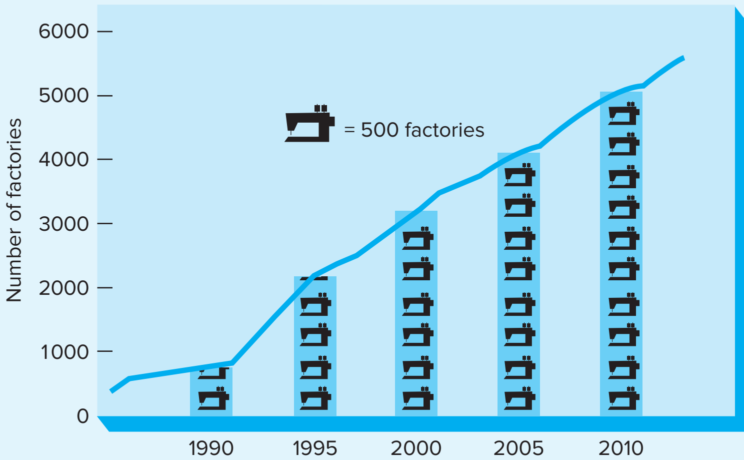
[16] Ibid.

[17] Transparency International, "Call on Clothing Companies to Tackle Corruption, Factory Safety" (press release), June 11, 2013. TI's annual corruption perceptions index is available at *www.transparency.org*.

[18] "Garment Trade Wields Power in Bangladesh," op cit.

Exhibit B

Ready-made Garment Industry in Bangladesh Number of Factories, 1984–2013



Source: Bangladesh Garment Manufacturers and Exporters Association, 2013. Graphic design by Colorbox Industries. © 2015. All rights reserved. Used by permission.

high numbers of both fires and building collapses. Between 2000 and 2012, at least 1,000 garment workers were killed and 3,000 injured in industrial accidents.[19] In November 2012, a fire at the nine-story Tazreen factory, located in a suburb of Dhaka, which began in a ground-floor storage area, killed at least 112. A reporter offered this description of the Tazreen fire:

> The fire alarm: waved off by managers. An exit door: locked. The fire extinguishers: not working and apparently "meant just to impress" inspectors and customers. That is the picture survivors painted of the garment-factory fire Saturday that killed 112 people who were trapped inside or jumped to their deaths in desperation.[20]

Eighty percent of factory fires in Bangladesh were believed to be caused by faulty electrical wiring.[21] Once a fire had broken out, the toll of deaths and injuries was driven higher—as at the Tazreen factory—by missing fire suppression equipment, barred windows and doors, and insufficient emergency exits. In 2005, the Spectrum factory collapsed, killing 64 workers. Like Rana Plaza, this factory was built on filled wetlands, and cracks had appeared in the walls in the days before the collapse.[22]

A major contributor to both fires and collapses was the inadequacy of the structures where manufacturing was taking place. The hectic growth of the industry and the lack of affordable land in densely populated urban areas meant that many nonindustrial buildings

[19] International Labor Rights Forum, *Deadly Secrets: What Companies Know about Dangerous Workplaces and Why Exposing the Truth can Save Workers' Lives in Bangladesh and Beyond,* p. 10.

[20] Farid Hossain, "Bangladesh Fire Alarm Ignored, Extinguishers Inoperable," *MSN News,* November 24, 2012.

[21] Clean Clothes Campaign/SOMO, *Fatal Fashion: Analysis of Recent Factory Fires in Pakistan and Bangladesh: A Call to Protect and Respect Garment Workers' Lives,* March 2013, p. 40.

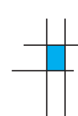
[22] Clean Clothes Campaign, *Hazardous Workplaces: Making the Bangladesh Garment Industry Safe,* November 2012, p. 23.

were repurposed for use as factories. A study by a European NGO, the Clean Clothes Campaign, noted:

> The rapid expansion of the industry has led to the conversion of many buildings, built for other purposes, into factories, often without the required permits. Other factories have had extra floors added or have increased the workforce and machinery to levels beyond the safe capacity of the building. Many factories run day and night in order to meet production targets. The establishment of factories, or the conversions of other buildings into garment factories, has often been done as quickly and as cheaply as possible, resulting in widespread safety problems including faulty electrical circuits, unstable buildings, inadequate escape routes and unsafe equipment.[23]

The country's weak and often corrupt regulatory apparatus simply could not keep up. The director of Bangladesh's Housing and Building Research Institute said after the Rana Plaza disaster that the country's building codes were "good enough," but the problem was they were rarely enforced. An architect involved in drafting the codes commented, "Dhaka has limited space. Developers are in this market for money and want to squeeze as much as they can into any space. Yes, we have a law, but who is implementing it?"[24]

Bangladesh law established occupational health and safety standards and gave government inspectors the right to shut down any factory that presented an imminent danger to human life.[25] However, the country employed just 52 factory inspectors, and the maximum fine for noncompliance was just $309.[26] In early 2013, Bangladesh's commerce minister offered this explanation: "The ready-made garments industry grew in Bangladesh all of a sudden, at a very high pace. The industry grew out of proportion compared to our facilities or our controlling capacities."[27]



Workers and Labor Rights

Who were the workers toiling in these hastily converted factories? Eight-five percent were women, many of them immigrants from poor, rural areas to the major urban manufacturing districts around Dhaka and Chittagong. In a survey of garment workers in more than 40 factories, War on Want, a British NGO, found that almost nine in ten were between 18 and 32 years old. Just 22 percent had a high school degree. Many lived in "mess housing," shared accommodations for single people that had sprung up near the factories. Verbal and sexual abuse in the workplace was common. The War on Want survey found that 73 percent of workers reported being sworn at by managers. Forty-five percent had been beaten, 43 percent hit in the face, and 30 percent sexually harassed.[28]

Wages in the industry were the lowest in the world. In 2013, the legal minimum wage in the garment industry was $37 a month. (The average monthly wage, including overtime, was higher—about $91.) A great majority of garment workers put in overtime; the War on Want survey found that only 14 percent of garment workers worked less than 40 hours a week, and 80 percent started work at 9 a.m. and left the factory between 8 and 10 p.m.

[23] *Fatal Fashion,* op. cit.

[24] "Analysis: Wake Up Call for Bangladesh's Building Industry," op. cit.

[25] Bangladesh Labour Act, 2006, Section VI.

[26] Testimony of Lewis Karesh, Assistant U.S. Trade Representative, June 6, 2012, before the Senate Foreign Relations Committee, June 6, 2013.

[27] "The Hidden Cost of Fast Fashion," *Bloomberg BusinessWeek,* February 11–17, 2013.

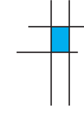
[28] War on Want, *Stitched Up: Women Workers in the Bangladeshi Garment Sector,* July 2011.

at night.[29] Although conditions were often brutal, the garment industry offered one of the few socially acceptable jobs for women in the predominantly Muslim country. Many women sought jobs in the garment sector, preferring work as a sewing machine operator to domestic or farm labor. And, although low, wages for women in the garment industry were 14 percent higher than wages for women with comparable schooling and experience in other industries.[30]

The Bangladesh constitution guaranteed the right to join unions. If 30 percent or more of the workers in a factory joined a union, the employer was required to recognize and bargain with it; if more than one union was present, an election would be held to determine the workers' bargaining representative. As a practical matter, however, these rights were routinely ignored by factory owners and their political allies. The Ministry of Labor informed employers of the names of workers applying for union registrations; they were usually promptly fired. Worker strikes and protests were routinely met by riot police. The U.S. State Department concluded in a review of human rights in Bangladesh that although the law provided the right of citizens to form associations, "government action [makes] it nearly impossible to form new trade unions in many sectors, for example, in the ready-made garment [industry]."[31]

A labor union called the Bangladesh Garment and Industrial Workers' Federation (BGIWF) had organized committees in some factories and had participated in a successful campaign in 2010 to raise the minimum wage, but by 2013 had not succeeded in negotiating a single union contract. BGIWF's leaders had been persecuted, harassed, and even murdered. In 2012, the federation's president, Aminul Islam, disappeared from Savar (the industrial suburb of Dhaka where Rana Plaza was located), where he had been organizing workers. Four days later, his dead body was found, showing signs of torture. Garment manufacturers were believed to have colluded with the NSI (National Security Intelligence, the military intelligence agency) in his death.[32] After the Rana Plaza tragedy, Islam's successor as president of the BGIWF noted, "With collective bargaining power, tragedies like Rana Plaza would not happen, since owners would not be able to force workers to work in unsafe conditions."[33]

Nongovernmental organizations that sought to advocate for worker rights were also harassed. The Bangladesh Center for Worker Solidarity (BCWS), for example, an NGO run by former garment workers, was regularly monitored by intelligence agencies and subjected to government restrictions that impeded its work.[34]



The Rise of Fast Fashion

The rapid growth of the ready-made garment industry in Bangladesh in the decade before the Rana Plaza tragedy was intimately connected to retailing trends in the West, and in particular to the rise of "fast fashion."

Fast fashion referred to a garment retailing strategy characterized by low prices, high volume, and rapid turnover of inventory and styles.[35] Leading fast fashion brands included

[29] Ibid.

[30] "After Horror, Apologies," *Dollars and Sense,* September/October 2013.

[31] U.S. Department of State, *2012 Country Reports on Human Rights Practices: Bangladesh.*

[32] Ibid.

[33] "Bangladesh Opens Door to More Unions," *The Wall Street Journal,* May 13, 2013.

[34] Human Rights Watch, *Bangladesh Country Summary,* January 2012.

[35] Elizabeth L. Cline, *Overdressed: The Shockingly High Cost of Cheap Fashion* (New York: Penguin, 2012), Chapter 4.

H&M, Zara, Old Navy, Topshop, Forever 21, and Mango. For these retailers, fast fashion was a successful strategy: its purveyors enjoyed twice the average profit margins of traditional clothing stores. For example, H&M (which sourced about a quarter of its garments from Bangladesh) had enjoyed gross margins of over 50 percent in the decade preceding the collapse of Rana Plaza.

Shoppers at these establishments were drawn in by fast-breaking trends. Fashion cycles were incredibly short; trendy colors, styles, hem lengths, and embellishments would come and go almost on a weekly basis. Cobalt blue, for example, would be here today, gone tomorrow. Zara and H&M introduced new styles every two weeks.[36] "What is so astonishing today is the breakneck pace of change, which has shifted from seasonal and focused to constant and schizophrenic," commented author Elizabeth L. Cline in her book, *Overdressed: The Shockingly High Cost of Cheap Fashion.*[37]

Shoppers were also drawn in by low prices. Fast fashion was cheap; indeed, retailers pursued a strategy they sometimes called "extreme pricing." Customers could drop by the mall and pick up a shirt for $10, a pair of trousers for $15, or a jacket for under $30. Since 1998, women's clothing prices in the United States had fallen overall by 7 percent; men's, by 6 percent. In the United Kingdom, the drop was even sharper; there, prices had dropped 20 percent since 2005—at a time when the prices of many other consumer goods were rising.

Enticed by fast-changing styles and low prices, shoppers simply bought more. Americans purchased an average of 64 items of clothing a year, more than one a week. They spent $1,700 annually, making clothing the second largest consumer sector after food. The quality of much fast fashion was low; but this mattered little to the customer, who might wear and launder an item just a few times before discarding it. For many customers, particularly young people, clothes shopping became a favorite leisure activity. The average Zara's customer, for example, visited the store 17 times a year.

Most clothing customers in the United States and Europe were completely unaware of the conditions under which their clothing was made. Even in the wake of the extensive media coverage given the Rana Plaza collapse, most consumers seemed unconcerned; a study by America's Research Group a few days after the tragedy reported that it had observed "no consumer reaction to any charges about harmful working conditions."[38]

A very small number of clothing brands—among them, yoga-wear maker PrAna—had sought Fair Trade certification. American Apparel, which was based in Los Angeles and manufactured in the United States, sought a competitive advantage by advertising its products as "sweatshop free."[39] Overall, however, less than 1 percent of global fashions were explicitly marketed as ethically sourced. Although most garments had a tag showing the country of origin, customers had no way of knowing anything about the specific factory where the item was made. "For the consumer, it's virtually impossible to know whether the product was manufactured in safe conditions," commented the president of a retail consultancy.[40] Two organizations, Not for Sale and GoodGuide, rated apparel brands on their labor and human rights records and offered mobile phone apps that allowed a consumer to scan a barcode for more information. But, in 2013, these were not widely used.

[36] "The Hidden Cost of Fast Fashion," *Bloomberg BusinessWeek,* February 11, 2013.

[37] Cline, op. cit., p. 103.

[38] "Shoppers Face Hurdles in Finding Ethical Clothing," *Bloomberg BusinessWeek,* April 30, 2013.

[39] Ibid.

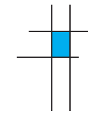
[40] Ibid.

The "Next Hot Spot"

As Western customers increasingly embraced fast fashion, brands and retailers continued to search the world for suppliers that could produce garments at low cost with fast turnaround and good-enough quality.

Bangladesh seemed perfectly positioned to meet their needs. Eighty-nine percent of chief purchasing agents in U.S. and European apparel firms, surveyed by McKinsey in 2011, named Bangladesh as one of their three "sourcing country hot spots" for the next five years, ahead of all other countries. One reason for the country's popularity was capacity: Bangladesh had more garment factories than Indonesia, Vietnam, and Cambodia combined. But the primary reason cited by the purchasing agents was price: it was simply cheaper to source garments from Bangladesh than from any other place in the world. Bangladesh offered clothing manufacturers the lowest labor costs in the world—at a time when costs in some other countries, particularly China, were increasing. For example, in 2011, monthly wages in the garment industry averaged $325 in China, $182 in Vietnam, $360 in Thailand, $359 in Honduras, and $150 in India—all major exporting countries. By comparison, monthly wages in Bangladesh averaged just $91.[41] (Wages, of course, did not represent the full cost of a finished garment. By one estimate, direct wages comprised just 2 percent of the retailer's cost; other expenses included materials, laundering and pressing, factory overhead, import duties, middleman fees, and transportation.)[42] McKinsey concluded that garment exports from Bangladesh would double by 2015 and nearly triple by 2020.[43]

Although the low cost of production in Bangladesh remained a powerful draw for Western apparel companies and retailers, even before Rana Plaza many were becoming increasingly concerned about the impact of poor working conditions on their reputations. In June 2012, the U.S. ambassador said in a speech to the Bangladesh Garment Manufacturers and Exporters Association that he had been called by the CEO of one of the industry's leading buyers—an unnamed retailer—to say that "the tarnishing Bangladesh brand may be putting his company's reputation at risk." The CEO also told the ambassador that his company's reputation was worth more than "saving a few cents per shirt from Bangladesh."[44]



Companies in the Crossfire

At the time of the Rana Plaza collapse, major U.S. and European retailers and brands sourcing apparel from Bangladesh, in addition to Loblaw, included the following:

Walmart, the multinational retailer, was the largest single buyer of garments from Bangladesh. More than 200 factories there produced more than $1 billion worth of jeans, sweatshirts, underwear, T-shirts, and other apparel for Walmart annually.

Marks & Spencer, the leading clothing retailer in Britain, had sourced from Bangladesh, where it had local buyers and a compliance office, for more than 10 years. It had contracts with 60 factories in Bangladesh.

Carrefour SA was a major multinational retailer, based in France. More than 50 percent of apparel sold by Carrefour in Europe was made in Bangladesh by more than 40 suppliers.

[41] Worker Rights Consortium, *Global Wage Trends for Apparel Workers, 2001–2011,* July 2011.

[42] "What Does That $14 Shirt Really Cost? Bangladesh Disaster Raises Tough Questions about Cheap Clothes," *Maclean's Magazine,* May 1, 2013. Data are from the O'Rourke Group.

[43] McKinsey & Company, *Bangladesh's Ready-Made Garment Landscape: The Challenge of Growth,* November, 2011.

[44] "Mozena Fears 'Perfect Storm' in Garment Sector," *The Daily Star* (Bangladesh), June 17, 2012.

MNG Holding SL, the Spanish company behind the Mango brand, contracted with 260 factories in Bangladesh.

Hennes & Mauritz, the second-largest clothing retailer in the world had contracts with 166 factories in Bangladesh and the Swedish-based H&M planned to increase production there in the future.

Inditex, the world's largest apparel company, made the popular Zara brand. The Spanish firm contracted with about 350 factories in Bangladesh.

Gap, the U.S. specialty retailer, which owned the Gap, GapKids, Banana Republic, and Old Navy brands, did business with 78 factories in Bangladesh.

As these companies, and others, faced the challenge of responding to Rana Plaza, they faced a complex set of issues.

By 2013, almost all brand-name clothing companies, including most of those doing business in Bangladesh, had adopted codes of conduct governing labor conditions in their global supply chains. These were typically based on labor standards adopted by the International Labour Organization (ILO) or developed by the Fair Labor Association (FLA), Worker Rights Consortium (WRC), Fair Wear Foundation, or Social Accountability International (SAI). Companies usually instituted internal processes and management systems to qualify new suppliers and assess their capabilities, and also monitored existing suppliers on an ongoing basis to ensure compliance. Many companies contracted with independent third-party auditors to assure compliance with both their codes of conduct and local laws in their supply chains.

While audits were often helpful, they also had disadvantages. On-site inspections were expensive and time-consuming, and therefore could not be scaled to cover a brand's entire supply chain. While companies usually had close ties with their direct suppliers, lower-tier suppliers, and subcontractors were often not directly accessible. Sometimes, companies did not even know where their products were being made. At Rana Plaza, for example, after the collapse Walmart had initially indicated that it did not produce at the ill-fated factory, but later had to correct itself, saying that one of its supplies had subcontracted work there without its knowledge.[45] Suppliers were sometimes resistant to cooperating with audits, particularly if they served multiple customers, each with their own distinct requirements. Audits were not always unannounced; in many cases, suppliers received advance notice and were able to stage conditions to pass inspection.

The exigencies of production often militated against compliance, even when suppliers were willing. As brands and retailers moved toward the fast fashion model, production cycles accelerated. Compelled to come up with something new every few weeks, companies like Inditex (the owner of Zara) learned to design, prototype, manufacture, and distribute clothing items in just two weeks. Brands often waited as long as possible before placing an order, to be more responsive to fickle consumer tastes. This pattern put tremendous pressure on suppliers, which were expected to respond to constant design changes and demands for rapid turnaround—even if it meant forced overtime and abusive supervision. "Flexible supply chains are great for multinationals and consumers," commented James Surowiecki, writing in *The New Yorker.* "But they erode already thin profit margins in developing world factories and foster a pell-mell work environment in which getting the order out the door is the only thing that matters."[46]

The owner of Plummy Fashions, a Bangladeshi garment supplier, told *Bloomberg BusinessWeek:* "It's like a chain reaction. Consumers always want new designs; they

[45] "Wal-Mart Fires Supplier after Bangladesh Revelation," *ABC News,* May 15, 2013.

[46] James Surowiecki, "After Rana Plaza," *The New Yorker,* May 20, 2013.

always want to stay in season. Clothing companies follow the new trend, and we pay the price."[47]

Moreover, relationships between brands and suppliers were often unstable, reducing incentives for the manufacturer. The Clean Clothes Campaign noted:

> Buyers shift orders continuously from supplier to supplier, blocking the economic security needed for suppliers to make investments in building safety. Instead of building stable trading relations with multi-year contracts and placing substantial orders, buyers generally look for the cheapest options and allow for the expansion of orders even when factories are knowingly unsafe, or when it can be reasonably expected that high production volumes will override the capacity of factories.[48]

The NGO noted that transitory relationships reduced the supplier's motivation to improve working conditions and safety, and reduced the buyer's leverage to force the supplier to do so.

A final problem facing the apparel companies was that most of their codes of conduct were missing a critical element—requirements for fire and structural safety. Codes typically required suppliers to comply with all relevant local laws and established standards for wages, hours of work, minimum age, and overtime. In most cases, however, the fundamental safety of the factory itself had simply been assumed to be the responsibility of the supplier. After Rana Plaza, this assumption no longer seemed valid. "Our audits align with those of industry around the world," Loblaw acknowledged in a public statement, after its clothing labels were found in the rubble of Rana Plaza. "But we recognize that these measures do not address the issue of building construction or integrity."[49]

Discussion Questions

1. Who was responsible for the collapse of Rana Plaza, and why do you think so? In your answer, please address the responsibility, if any, of the building owner, factory owners, Bangladeshi government, U.S. and European governments, Bangladeshi workers and their advocates, clothing customers, and apparel retailers and brands in the United States, Canada, and Europe.
2. What could be taken now to reduce the chances of a similar tragedy occurring in the future? In your answer, please consider what actions, if any, the various individuals and groups mentioned in question 1 could take.
3. Of the various options you mentioned in response to question 2, which do you think is most likely to be effective, and why?
4. Develop a typology of corporate strategies to prevent worker abuse by contractors in complex supply chains (e.g., put political pressure on local governments to develop stronger regulations; develop codes of conduct).
5. Under what conditions are different corporate strategies appropriate? Can you predict why different companies might respond in different ways?

[47] "The Hidden Cost of Fast Fashion," op. cit.

[48] *Fatal Fashion,* op. cit., p. 15.

[49] "Global Report: The Uncomfortable Truth about Bangladesh," op. cit.

CASE NINE

The Boycott of Stoli Vodka

Just a few months after being named the new president of the Stoli Group USA, John Esposito woke up on a bright July morning in 2013 and was alarmed to learn that one of his company's most popular products—Stoli vodka—was being bombarded by heavy criticism on social media. The hashtag, #DumpStoli, coined by Dan Savage, a prominent gay-rights blogger, had gone viral overnight.

Savage asserted that Stoli vodka, because of its Russian heritage, should be boycotted along with other Russian-made products. In his view, consumers should refuse to buy Stoli vodka to show solidarity with the Russian gay community because the Russian government, under the leadership of Vladimir Putin, had recently passed a series of discriminatory laws. One law enabled police officers to arrest tourists and foreign nationals suspected of being gay or pro-gay and to detain them for up to 14 days. Another law imposed heavy fines on citizens and deportation of foreigners who held gay pride parades or provided information to minors about "nontraditional sexual relations." Yet another law prohibited same-sex couples, as well as singles and unmarried couples living in a country that recognized gay marriages, from adopting Russian-born children.[1] Savage's message to his followers included the following directive:

> If you drink a Russian Vodka like Stoli [or] Russian Standard . . . switch to another brand from another country, or even a local brand from a local distillery. Stoli is the iconic Russian Vodka and it's returning to Russian ownership in 2014. Other brands like Russian Standard should also be boycotted. Do not drink Russian vodka. Do not buy Russian vodka. Ask your bartender at your favorite bar—gay or otherwise—to **DUMP STOLI** and **DUMP RUSSIAN VODKA.**

Historical Twitter data showed that on the first day of his blog, hashtags with references to Stoli were tweeted or retweeted 1,046 times; on the second day, the number of tweets rose to 2,572; on the third day, the number of tweets increased to 4,156.[2]

Esposito was dismayed. He was aware of Stoli's historical support of the lesbian, gay, bi-sexual, and transgender (LGBT) community, and he knew that the brand had no

By Grishma Shah, Janet L. Rovenpor, and Musa Jafar, O'Malley School of Business, Manhattan College. Copyright © 2016 by the *Case Research Journal* and the authors; all rights reserved. This case has been revised and abridged by permission of the authors for publication in this textbook. The full case appears in the *Case Research Journal,* 36(2), Spring 2016, under the title, "A Brand Under Attack: The Boycott of Stoli Vodka and the Power of Social Media." The case was prepared by the authors for the sole purpose of providing material for classroom discussion. It is not intended to illustrate either effective or ineffective handling of a managerial situation. Used by permission.

[1] "Russia's Anti-Gay Crackdown," *The New York Times,* July 21, 2013.

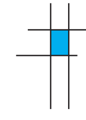
[2] The daily counts included multiple tweets by the same person. The authors purchased a license directly from Twitter's subsidiary, Gnip, which provided access to all relevant historical tweets for such hashtags as #dumpstoli and #dumprussian-vodka for a 40-day period covering July 24–September 1, 2013. The total number of tweets analyzed was 53,900.

influence on, or cooperative relationship with, the Putin government. In fact, both the owner and top executives at SPI Group, the parent company of Stoli Group USA, had had progressively adversarial relationships with the Putin government for more than 10 years. Nonetheless, the #DumpStoli hashtag was gaining traction. Esposito needed to act quickly. He noted, "The firestorm hits, the reaction is swift, and your head is spinning. Before you know it, bars are pouring your product onto the street."[3]

Along with Esposito, the primary responsibility for managing the crisis fell to Lori Tieszen, Stoli USA's senior vice president and chief marketing officer. She had the challenging task of leading a team effort to neutralize the social media campaign and inform the company's many stakeholders of its supportive position on gay rights. Tieszen later reflected on the dramatic day Savage launched the boycott:

> It was kind of a scary day. I had just joined the company in June. . . . When you think about when Dan Savage put his hashtag #dumpstoli out there, that was D-Day . . . it was growing and growing . . . that one tweet from him really set everything afire. It was a bit of a panic . . . we tweeted a lot, our phones starting ringing. . . .

How should Esposito, Tieszen, and the rest of their team respond? What should be the team's next steps? They knew that they had the full backing of Stoli Group USA's parent company, SPI Group, as well as access to its vast resources. Tieszen soon began to work under Esposito's directive to, as she put it, "do whatever it takes."



Stolichnaya (Stoli) Vodka

Stolichnaya (Stoli) was a storied brand. Stolichnaya's most popular alcoholic beverages were its classic 80-proof vodka label, as well as its fruit flavored and premium vodka blends. It was the drink of choice for many well-known figures—from former Russian President, Boris Yeltsin, to Patsy Stone, a character in the popular BBC sitcom *Absolutely Fabulous.* During the Apollo-Suyuz mission in 1975, a Russian cosmonaut offered his American counterparts two tubes labeled "Vodka Extra" and "Vodka Stolichnaya" to celebrate their meeting in space (the tubes really contained borscht, a Russian soup made from beets). A bottle of Stolichnaya vodka appeared in the James Bond movie, *A View to a Kill,* at the end of a chase scene, when Roger Moore took it out of his bag to share with another spy on a floating iceberg.

Stoli vodka was originally distilled in Russia around 1938. In 1973, the product made its first appearance in the United States, when PepsiCola Company formed a barter agreement with the Soviet government. Under their arrangement, the U.S. firm exchanged Pepsi beverages for Stoli vodka, which its wine subsidiary imported into the United States and distributed as a premium brand. The Stoli brand remained under the ownership of the Soviet government and union collectives.

When the Soviet Union broke up in the early 1990s, local business people began to purchase government assets. An entrepreneur, Yuri Shefler, started to acquire percentages of Stolichnaya and achieved full ownership of the brand in 1997. He reportedly paid $300,000 for the rights to several vodka brands, including Stolichnaya.[4] Shefler's company became known as SPI Spirits.

Soon, the popularity of Stoli made it a primary target for re-nationalization. In 2001, the Russian government legally recaptured domestic rights to the vodka. But the government

[3] Esposito, John, *Manhattan College Horan Lecture on Stoli.* University Club, New York, NY, December 13, 2013.

[4] "Dutch Court Confirms Russia's Rights to Vodka Brands," Russian Legal Information Agency, February 19, 2014.

did not stop there. In 2002, Russian customs officers seized $40 million worth of Stoli vodka produced in a Kaliningrad factory. Masked police officers raided SPI's headquarters in Moscow, reportedly saying that they were there to destabilize the business.[5] Prosecutors also opened a criminal investigation of Shefler, charging him with forging and destroying documents that enabled him to purchase the Stolichnaya brand for a small percentage of its true market value. They even accused Shefler of threatening to kill a government official.

Shefler fled the country and went into de facto exile. SPI criticized the Russian officials for "backtracking on legal privatization" and acting "like Soviet-era thugs."[6] Shefler shifted operations to Latvia and relocated SPI's headquarters to Luxembourg. (Formerly a republic within the Union of Soviet Socialist Republics, Latvia had declared its independence as a nation in 1990.) SPI continued to manufacture the raw alcohol in Tambov, Russia. The raw alcohol was then shipped to Latvia to be blended, filtered, and bottled. Since Stoli was bottled in Latvia, it changed its label from "Russian vodka" to "premium vodka." Russian authorities continued to contest SPI's rights to the brand, however. In 2012, a court in The Hague ruled that the trademarks to Stolichnaya belonged to the Russian state-owned distillery in three countries outside Russia: Netherlands, Belgium, and Luxembourg.[7] SPI vowed to appeal the decision.

Between 2000 and 2013, distribution of Stoli vodka in the United States passed among a series of companies, including Allied Domecq, Pernod Ricard USA, and William Grant & Sons. In November 2012, SPI Group announced a major change in its U.S. importation, marketing, and distribution strategy. It created its own importing arm, Stoli Group USA, and hired John Esposito as its new incoming president.

U.S. Alcoholic Beverages Industry

When Esposito took over at Stoli Group USA, the outlook for the U.S. alcoholic beverage industry remained strong. In 2012, alcoholic beverages accounted for about $197.8 billion in retail sales, an increase of 3.1 percent from 2011.[8] The industry was comprised of three markets: beer, wine, and distilled spirits. Beer accounted for almost 50 percent of total alcoholic beverage revenues. Spirits were classified as white goods (e.g., vodka, gin, rum, and tequila), brown goods (e.g., whiskey and bourbon), and specialties (e.g., cognac, brandy, cordials, and liqueurs). Vodka, in the white goods category, accounted for about a third of U.S. distilled spirits consumption in 2012.

Growth opportunities in the spirits industry could be exploited by targeting certain demographic "sweet spots" (in terms of specific ages and ethnic groups), by marketing to warehouse clubs and supermarkets, and by engaging in brand innovation.[9] Millennials were a favorite target market for alcoholic beverage companies; they preferred their drinks to be somewhat sweet. U.S. census data showed that the number of consumers reaching the legal drinking age was steadily increasing, and a Nielsen survey reported that while young consumers still preferred beer, they purchased more wine and spirits than the older generation had at the same age.[10]

[5] "Putin Targets Stoli Boss in the Battle for Vodka Billions," *The Guardian,* August 3, 2002.

[6] "A. Allied Domecq Caught in Stoli Vodka Dispute," *Financial Times,* March 25, 2002.

[7] "Netherlands: SPI Group Condemns Court's Stolichnaya Ruling," *Just-Drinks,* August 2, 2012.

[8] Kwon, E. Y. *Industry Surveys: Alcoholic Beverages & Tobacco,* November 2013. Standard & Poor's Financial Services LLC.

[9] Ibid.

[10] Ibid.

Unique package design and product positioning were particularly important in the vodka industry.[11] Newer brands like Svedka and Pinnacle were successful in grabbing consumer attention and holding shelf space with their unique bottle designs and bold colors, detracting from the brand equity of older brands, such as Smirnoff and Stolichnaya.[12] Absolut's bottle design was popular among consumers over 35 because it was seen as "fun, friendly and approachable."[13] To target women pursuing healthy lifestyles and low-calorie diets, Diageo introduced Smirnoff Sorbet Light Vodka with only 78 calories per serving in three flavors: raspberry pomegranate, mango passion fruit, and lemon.

Industry market research showed that LGBT consumers had strong purchasing power. Gay households had 23 percent higher median income and 24 percent more equity in their homes compared to non-gay households.[14] LGBT consumers were very brand conscious; in a national sample, 49 percent of gay respondents, compared to 41 percent of heterosexual respondents, said they ordered alcoholic beverages by brand name.[15] Male same-sex partnered households spent more than other households on alcoholic beverages.[16]

Russia's Anti-Gay Laws and the Public's Reaction

In the summer of 2013, Russian president Vladimir Putin aggressively expanded his country's anti-gay agenda. In June, the Russian parliament unanimously passed a law against "propaganda of non-traditional sexual relations," making it illegal to teach minors about homosexuality. A few weeks later, Putin banned the adoption of children by gay parents. Around the same time, the media reported numerous unwarranted arrests, persecution, and bullying of members of the LGBT community. Some powerful images of the atrocities committed by Russian officials toward the LGBT community made their rounds on social media, of which the most popular was titled, "36 photos from Russia that everyone needs to see."[17] In response, the international LGBT community was becoming increasingly vigilant and distressed about human rights violations in Russia.

Stephen Fry, a British actor, author, and journalist, demanded that the United Kingdom boycott the upcoming 2014 Winter Olympics in Sochi, Russia. Other activists began to pressure corporate sponsors of the Olympic games—including Coca-Cola, GE, and Procter & Gamble—to issue strong statements condemning Russia's anti-gay stance. Celebrities cancelled planned trips to Russia. Wentworth Miller, star of the TV show *Prison Break,* decided not to attend a film festival in St. Petersburg saying, "I cannot in good conscience participate in a celebratory occasion hosted by a country where people like myself are being systematically denied their basic right to live and love openly."[18] City council members across the country were asked to sign petitions ending their sister city relationships with their counterparts in Russia. Even President Obama weighed in on the issue. On Jay Leno's *Tonight Show,* Obama declared that he "had no patience for countries that try to treat gays or lesbians or transgender persons in ways that intimidate or are harmful to them."[19]

[11] "Consumer Trends: Design Important in Vodka Industry," *Food Manufacturing,* September 9, 2013.

[12] Ibid.

[13] Ibid.

[14] "Here's How Some Brands Have Subtly Won Over the LGBT Community," *Rivet Global,* June 23, 2013.

[15] "Gay Consumers' Brand Loyalty Linked to Corporate Philanthropy and Advertising," *PR Newswire,* undated.

[16] "US LGBT Households Make 16% More Shopping Trips Than the US Average," *Nielsen,* January 30, 2013.

[17] Stopera, M. "36 photos from Russia that everyone needs to see," BuzzFeed, July 22, 2013, at *https://www.buzzfeed.com/mjs538/photos-from-russia-everyone-needs-to-see.*

[18] "Prison Break Star Wentworth Miller Reveals He's Gay," *Telegraph.co.uk*, August 22, 2013.

[19] "President Obama Has 'No Patience' for Russia's Anti-Gay Stance," *The Washington Post,* August 8, 2013.

The Boycott of Stoli

Dan Savage's #DUMPSTOLI campaign arose against the backdrop of these events. In his blog, Savage wrote at length about Putin's vindictive agenda toward the LGBT community.[20] He initially called for a boycott of the 2014 Sochi Olympics in Russia. However, acknowledging that the Olympic boycott might not come to fruition, he turned his attention to Russian vodka. He asserted that Stoli, as well as other Russian vodka brands, should be boycotted "to show our solidarity with Russian queers and their allies and to help to draw international attention to the persecution of gay men, lesbians, bisexuals, trans people, and straight allies in Putin's increasingly fascistic Russia."

Other influential LGBT groups such as Queer Nation followed, and the campaign gained significant momentum on social media. The *New York Times* reported that dozens of bars in major cities such as Seattle, Chicago, and Los Angeles would no longer sell Stoli vodka.[21] The Stonewall Inn, a prominent gay bar in New York City's West Village and the site of the 1969 Stonewall riots, also confirmed to *Time* magazine that Stoli vodka was no longer on its shelves.[22] The boycott extended to bars in smaller cities, such as Provincetown, MA. In bars still offering Stoli vodka, many LGBT patrons voluntarily avoided ordering Russian brands.

Despite initial support for Savage's rallying cry, over the course of the summer members of the LGBT community became increasingly split on the issue of the boycott. Queerty, a satirical website promoting LGBT interests, argued that the boycott was misguided. It noted that Stoli had not been a Russian company for the past 12 years. The website portrayed Putin as an evil empire-builder intent on hunting down Shefler to the ends of the earth and seizing his vodka company. Russia was cited for its talent for usurping and then ruining good brands.

When Savage was informed that Stoli was not technically a Russian brand, he reportedly replied, "Whatever. At the end of the year Stoli will be a Russian company again."[23] Savage believed that Russia would eventually resume complete control of the brand. Chris Cannon, a writer in Vancouver, called on Savage to "stop bullying LGBT-ally Stoli" and to target true state-owned Russian brands instead.[24] Andrew Higgins, a reporter for *The New York Times,* also distinguished between the Stolichnaya consumed within Russia and the Stoli imported into the United States and consumed by Americans. The vodka imported into the United States was distilled in Latvia. Higgins pointed out:

> The exact nationality of Stolichnaya, like many global brands, is hard to pin down. It was made for a time in Russia and simply bottled in Riga (capital of Latvia) but has in recent years been filtered and blended in Latvia . . . while its water comes from Latvian springs, its main ingredient, raw alcohol distilled from grain, still comes from Russia. Its bottles are from Poland and Estonia, its caps from Italy.[25]

The Riga factory, operated by Latvijas Balzams, was a century-old enterprise that ranked as one of the country's biggest taxpayers and employers. Approximately 900 Stoli employees were in Latvia, and 600 in Russia.

[20] For full text of the blog, see http://slog.thestranger.com/slog/archives/2013/07/24/why-im-boycotting-russian-vodka.

[21] "Facing Fury Over Antigay Law, Stoli Says "Russian? Not really," *The New York Times,* September 7, 2013.

[22] "The Faulty Logic of the Russian-Vodka Boycott. *Time,* August 5, 2013.

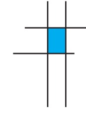
[23] http://www.queerty.com/understanding-the-history-of-stoli-20130813

[24] "Queer Eye for the Sochi Guy," *The Ottawa Citizen,* August 10, 2013.

[25] "Facing Fury," op. cit.

Many employees working in Stoli's Riga production facility, along with members of the small LGBT community in Latvia, expressed their deep concern over the boycott. They feared that gays might face the anger of their neighbors. "If the boycott works, Latvians will lose their jobs, who are they going to blame? Putin? No, they are going to blame gays."[26] While discrimination against gays was banned in Latvia (since it was a member of the European Union), *de facto* discrimination was rampant, and the LGBT community often faced verbal and physical abuse. Mr. Zalitis, an advocate for gay rights in Latvia, wrote an open letter requesting that the Americans behind the vodka boycott reconsider, but Queer Nation, a New York City based LGBT group, refused.[27]

ACT UP, an HIV-awareness and activist group, supported the boycott. It sent protestors to disrupt Stoli Vodka's "Most Original Stoli Guy" event at the Splash Bar in the Chelsea section of New York City. The event involved a competition between 13 contestants from around the country who were vying to become Stoli's national LGBT ambassador. The activists entered the bar and positioned themselves in front of an audience of 150 participants (including Stoli executives), shouting and holding signs that read, "Russia Kills Gays," "Boycott Russia," and "Dump Stoli." They were removed from the club. Activists from ACT UP and Queer Nation also disrupted the competition's finale held at the Marquee NY on September 19. Stoli Group USA was not deterred. The company stayed the course and continued its marketing campaign and other scheduled events.



The SPI and Stoli Group USA Response

In mid-June, executives at SPI and Stoli Group USA received forewarning that a threat to its brand might be brewing. Stoli's public relations firm, the Magrino Agency, detected a meme on Facebook asking people to boycott Stolichnaya, especially in gay bars. A few days later, the firms' LGBT media partner, Gay Cities, began to see negative comments about the "Stoli Guy" on Twitter. The owner of a Seattle bar sent an e-mail to Stoli salespeople asking them why they were promoting the brand when Russia had just "outlawed homosexuality."[28] Stoli took a "wait and see" approach and vowed to take quick action should the situation escalate. Executives began to work on a statement, which would be released if they got a call from a mainstream media outlet or a well-respected LGBT site.

The catalyst for immediate action was Dan Savage's blog and hashtag. Val Mendeleev, CEO of the SPI Group (Stoli USA's parent organization), published an open letter to the LGBT community just one day after Savage posted the hashtag. In it, he acknowledged that Stoli vodka included some Russian ingredients (wheat, rye, and raw alcohol) but was distilled, blended, and bottled at its facility in Riga, Latvia.[29] Mendeleev also highlighted the strained relationships with the Putin government, saying, "The Russian government has no ownership interest or control over the Stoli brand that is privately owned by SPI Group, headquartered in Luxembourg in the heart of Western Europe."

Moreover, Mendeleev noted, Stoli had been a longtime supporter of the LGBT community. As he pointed out in his letter, "In the US, the brand's commitment to the LGBT community has been ongoing for years. Among the best examples, I can cite the series produced by Stoli in 2006 called 'Be Real: Stories from Queer America,' which featured

[26] Ibid.

[27] K. Zalitis, "Letter to Latvian LGBT Activists," August 1, 2013, at *http://queernationny.org/post/57204296175/letter-to-latvian-lgbt-activists*.

[28] Stoli USA e-mail dated June 18, 2013.

[29] "Stoli Responds to LGBT Boycott of Russian Products," *Advocate,* July 25, 2013.

short documentaries on real life stories depicting the challenges and accomplishments of the LGBT community in the United States."

In addition to his open letter, Mendeleev travelled to the United States, appeared on radio shows, and granted interviews to the press. He described himself as an "ex-Russian" who had left the country 20 years earlier. He reiterated that SPI Group was not allowed to sell its brand inside Russia and that it had been reducing its workforce and operations in that country.[30] In a *New York Times* article, he stated, "Stolichnaya . . . is no more a proxy for the Russian state than Google, whose co-founder Sergey Brin was born in Moscow."[31] Stoli Group USA president Esposito said, "Hurting Stoli in the U.S. is actually probably going to make the Russian government happy, given that they've been fighting us for the last 13 years. They're probably going to be sitting there chuckling."[32]

Back at Stoli Group USA, Esposito reached out with an e-mail to the firm's business partners (distributors, bartenders, and retailers). In it, he wrote:

> As you are probably aware the attitudes and actions of the Russian Government against the LGBT had understandably ignited a passionate response from all of us who believe in human rights for all. . . . In an attempt to call attention to the situation in Russia, which we fully agree is outrageous, boycotting Stoli, is being singled out as a way to express outrage. While I understand this reaction, I want to set the record straight and ask that each of you share with your organizations Stoli's position and reinforce our longstanding support of the LGBT community.

Despite Stoli's early efforts to appease its critics, Savage and others in the LGBT community continued to push the boycott in the United States. The hashtag gained followers. On their end, Stoli's marketing and public relations employees, led by Tieszen, were busy monitoring all news media channels. They received and evaluated analytics daily to shed light on both the level of activity and the sentiment of the reporters who were reflecting and commenting on the Dump Stoli message. One of the marketing department's conclusions was that activity on Twitter was more intense than on Facebook. A tracking of the daily tweets across time showed that social media activity was most intense during the first 15 days of the crisis.

John Esposito joined Tieszen in community outreach activities. As Tieszen recalled:

> He did not want to just send out press releases. . . . John personally talked to key accounts. He actually tried to get Dan Savage on the phone (who would not talk to him). We attended meetings and we attended some town hall meetings . . . we got to the open forum and we got to the check-in and they knew who we were. It was like we were on a most-wanted list. And they said, 'Well, you can attend but you can't speak.' We attended, we listened.

Esposito added:

> Our initial reaction was to come to the defense of our brand. People were attacking our brand, hurting our family. The team in our global home office was focused on the WORDS. Our initial response was to get the facts straight . . . but in the end, this was the wrong response.

It was time for Esposito and Tieszen to intensify their activities. They were faced with the difficult task of challenging what they believed was an unwarranted boycott in the age of social media. What more should they do?

[30] "Val Mendeleev, Stoli CEO, Speaks Out on Gay Community's Vodka Boycott," *Huffington Post,* July 31, 2013.

[31] "Facing Fury," op. cit.

[32] "The Faulty Logic of the Russian-Vodka Boycott," *Time,* August 5, 2013.

Discussion Questions

1. Describe the issue facing the managers of Stoli USA. Was this a corporate crisis, and why or why not?
2. Identify the market and nonmarket stakeholders in the case. What were their interests, sources of power, and likely coalitions?
3. Should Stoli vodka be considered a Russian brand? In an age of globalized supply chains, what qualifies a brand's national authenticity? Does it matter?
4. In what ways did the nature of social media pose specific challenges to the company?
5. Evaluate the crisis management response so far of both the SPI group and Stoli USA. What more should they do to restore the brand's reputation?

GLOSSARY

This glossary defines technical or special terms used in this book. Students may use it as a quick and handy reference for terms that may be unfamiliar without having to refer to the specific chapter(s) where they are used. It also can be a very helpful aid in studying for examinations and for writing term papers where precise meanings are needed.

A

acid rain Rain that is more acidic than normal; occurs when emissions of sulfur dioxide and nitrogen oxides from utilities, manufacturers, and motor vehicles combine with natural water vapor in the air and fall to earth as rain or snow.

advocacy advertising A political tool used by companies to promote their viewpoint through the media.

affirmative action A positive and sustained effort by an organization to identify, hire, train if necessary, and promote minorities, women, and members of other groups who are underrepresented in the organization's workforce.

air pollution When more pollutants, such as sulfur dioxide or particulates, are emitted into the atmosphere than can be safely absorbed and diluted by natural processes.

alternative dispute resolution A method for resolving legal conflicts outside the traditional court system, in which a professional mediator (a third-party neutral) works with the two sides to negotiate a settlement agreeable to both parties.

anti-Americanism Opposition to the United States of America, or to its people, principles, or policies.

antitrust laws Laws that seek to preserve competition in the marketplace and prohibit unfair, anticompetitive practices by business.

artificial intelligence (AI) The ability of a digital computer or computer-controlled robot to perform tasks commonly associated with intelligent beings.

autonomous vehicles Vehicles capable of sensing the surrounding environment and navigating without human input or control. (Also known as driverless or self-driving cars.)

B

B corporation A business that explicitly seeks to blend its social objectives with its financial goals.

behavioral addiction Refers to a compulsion to engage in rewarding behaviors, such as checking one's Facebook feed, despite negative consequences.

behavioral advertising Advertising that targets particular customers based on their observed online behavior.

big data When business uses technology to assist in the collection of massive amounts of information about its stakeholders.

biodiversity The number and variety of species and the range of their genetic makeup.

biotechnology Uses biological processes in the development or manufacture of a product or in the technological solution to a problem.

bitcoin A digital currency that operates independently of the banking system and uses encryption techniques to verify the transfer of funds.

blowing the whistle (See whistle-blowing.)

board of directors An elected group of individuals who have a legal duty to establish corporate objectives, develop broad policies, and select top-level personnel for a company.

bottom of the pyramid The world's poor; also refers to creative business actions to develop products and services that meet the needs of the world's poor.

boundary-spanning departments Departments, or offices, within an organization that reach across the dividing line that separates a company from groups and people in society.

brand management When managers use techniques to increase the perceived value of a product line or brand over time.

bribery A questionable or unjust payment often to a government official to ensure or facilitate a business transaction.

bundling The collection of political contributions made by an organization's stakeholders to increase the organization's ability to influence a political agent.

business An organization that is engaged in making a product or providing a service for a profit.

business and society The study of the relationship between business and its social environment.

business ethics The application of general ethical ideas to business behavior.

C

campaign finance reform Efforts to change the rules governing the financing of political campaigns, often by limiting contributions made or received.

capability building When a firm chooses to invest time and resources to build their supplier's capabilities.

cap-and-trade Allows businesses to buy and sell permits that entitle the bearer to emit a certain amount of pollution. The government or international agency issues these permits and caps the total amount of pollution that may be produced.

carbon neutrality When an organization or individual produces net zero emissions of greenhouse gases.

carbon offsets (carbon credits) Investments in projects that remove carbon dioxide or its equivalent from the atmosphere.

carrying capacity The maximum population that the Earth's ecosystem can support at a certain level of technological development.

central state control (system) A socioeconomic system in which economic power is concentrated in the hands of government officials and political authorities. The central government owns the property that is used to produce goods and services, and most private markets are illegal.

CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act). The major U.S. law governing the cleanup of existing hazardous-waste sites, popularly known as Superfund.

chief information officer (CIO) Manager who has been entrusted with the responsibility to manage the organization's technology with its many privacy and security issues.

chief sustainability officer (CSO) Manager responsible for the organization's sustainability activities and performance.

child care The care or supervision of another's child, such as at a day-care center; offered as a benefit by some employers to working parents.

child labor The hiring of children in a way that deprives them of their childhood, their potential, and their dignity, and is harmful to their physical and mental development.

circular economy A production system that is regenerative by design, by recycling or reusing all waste generated during production, all packaging, and all products at the end of their useful life.

***Citizens United* decision** A U.S. Supreme Court ruling that allowed corporations and unions to contribute directly to candidates for public office.

civic engagement The active involvement of businesses and individuals in changing and improving communities.

civil society Nonprofit, educational, religious, community, family, and interest-group organizations; social organizations that do not have a commercial or governmental purpose. (See also nongovernmental organization.)

clean economy Sectors of the economy that produce goods and services with an environmental benefit.

climate change Changes in the Earth's climate caused by increasing concentrations of carbon dioxide and other pollutants produced by human activity.

codes of conduct Codes of conduct that seek to define acceptable and unacceptable behavior for corporations or their partners.

collaborative partnerships Voluntary alliances among business, government, and civil society organizations that draw on the unique capabilities of each to achieve special, often social, objectives.

command and control regulation A regulatory approach where the government "commands" business to comply with certain standards (such as amounts of particular pollutants) and often directly "controls" their choice of technology to achieve these standards.

commons Any shared resource, such as land, air, or water, that a group of people use collectively.

community A company's area of local business influence. Traditionally, the term applied to the city, town, or rural area in which a business's operations, offices, or assets were located. With the rise of large, complex business organizations, the meaning of the term has expanded to include multiple localities.

community relations The organized involvement of business with the communities in which it conducts operations.

community relations manager (or community involvement manager) Manager delegated to interact with local citizens, develop community programs, manage donations of goods and services, work with local governments, and encourage employee volunteerism.

competition A struggle to survive and excel. In business, different firms compete with one another for customers' dollars, employees' talents, and other assets.

competitive intelligence The systematic and continuous process of gathering, analyzing, and managing external information on the organization's competitors.

Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) (See Superfund.)

conflicts of interest Occur when an individual's self-interest conflicts with acting in the best interest of another, when the individual has an obligation to do so.

consumer affairs officer Manages the complex network of consumer relations.

consumer movement A social movement that seeks to augment the rights and powers of consumers. (Also known as consumerism.)

consumer privacy A consumer's right to be protected from the unwanted collection and use of information about that individual for use in marketing.

consumer protection laws Laws that provide consumers with better information, protect consumers from possible hazards, encourage competitive pricing, protect privacy, or permit consumer lawsuits.

consumer rights The legitimate claims of consumers to safe products and services, adequate information, free choice, a fair hearing, competitive prices, and privacy.

consumerism (See consumer movement.)

Convention on Climate Change First negotiated in 1992, an annual conference hosted by the United Nations to negotiate agreements to cut fossil fuel emissions that cause global warming.

corporate citizenship This term refers to the actions corporations take to put their commitments to corporate social responsibility into practice worldwide.

corporate crisis A significant business disruption that stimulates extensive news media or social networking coverage.

corporate culture A blend of ideas, customs, traditional practices, company values, and shared meanings that help define normal behavior for everyone who works in a company.

corporate foundations Organizations chartered as nonprofits, and funded by companies, for the purpose of administering contribution programs uniformly and providing a central group of people that handles all grant requests.

corporate giving (See corporate philanthropy.)

corporate governance The process by which a company is controlled or governed.

corporate identity The way an organization presents itself to an audience.

corporate image The way organizational members believe others see the organization.

corporate philanthropy The voluntary and unconditional transfer of cash or other assets by private firms for public purposes.

corporate political strategy Those activities taken by an organization to acquire, develop, and use power to achieve a political advantage.

corporate power The capability of corporations to influence government, the economy, and society, based on their organizational resources.

corporate reputation Desirable or undesirable qualities associated with an organization or its actors that may influence the organization's relationships with its stakeholders.

corporate social reporting The public reporting of information collected by the organization or another party during a social audit.

corporate social responsibility The idea that businesses should act in a way that enhances society and their stakeholders and be held accountable for any of its actions that affect people, their communities, and their environment.

corporation Legally, an artificial legal "person," created under the laws of a particular state or nation. Socially and organizationally, it is a complex system of people, technology, and resources generally devoted to carrying out a central economic mission as it interacts with a surrounding social and political environment.

cost–benefit analysis A systematic method of calculating the costs and benefits of a project or activity.

crisis management The process organizations uses to deal with a major event that threatens to harm the organization, its stakeholders, or the general public.

crisis plan A strategy developed in advance by an organization to respond to a corporate crisis. See: corporate crisis.

crowd-sourced audit Gathering information about factory conditions directly from workers using their mobile phones.

cybercrime Criminal activity done using computers and the Internet.

cyberspace A virtual location where information is stored, ideas are described, and communication takes place in and through an electronic network of linked systems.

D

dark money Political contributions made to tax-exempt organizations that are not required to report the donor's name and size of contribution to the Federal Election Commission.

dark site A website that is fully developed and uploaded with critical information but remains dormant or "dark" until activated by the firm when needed in response to a crisis.

debt relief The idea that the world's richest nations should forgive poor nations' obligation to pay back loans.

deceptive advertising An advertisement that makes false or misleading claims about the company's own product or its competitor's product, withholds relevant information, or creates unreasonable expectations; generally illegal in most countries.

democracy A form of government in which power is vested in the people and exercised by them directly or by their elected representatives; refers broadly to the presence of political freedom.

deregulation The removal or scaling down of regulatory authority and regulatory activities of government.

digital divide The gap between those that have access to the Internet and those that do not.

Digital Millennium Copyright Act The U. S. law that made it a crime to circumvent antipiracy measures built into most commercial software agreements between the manufacturers and their users.

directors (See board of directors.)

discrimination (in jobs or employment) Unequal treatment of employees based on non–job-related factors such as race, sex, age, national origin, religion, color, and physical or mental handicap.

diversity Variation in the characteristics that distinguish people from one another, such as age, ethnicity, gender, mental or physical abilities, race, and sexual orientation.

diversity council A group of managers and employees responsible for developing and implementing specific action plans to meet an organization's diversity goals. (See also diversity.)

divestment Withdrawing and shifting to other uses the funds that a person or group has invested in the securities (stocks, bonds, notes, etc.) of a company. Investors sometimes have divested the securities of companies doing business in countries accused of human rights abuses.

dividend A return-on-investment payment made to the owners of shares of corporate stock at the discretion of the company's board of directors.

Dodd–Frank Act Legislation passed in the United States in 2010 in response to the financial crisis; reformed the regulation of financial institutions such as banks and credit rating agencies, established a new consumer financial protection bureau, and changed corporate governance and executive compensation rules.

drug testing (of employees) The testing of employees, by the employer, for the presence of illegal drugs, sometimes by means of a urine sample, saliva, or hair follicle analyzed by a clinical laboratory.

E

e-business Electronic business exchanges between businesses and between businesses and their customers via the Internet.

ecological footprint The amount of land and water an individual or group needs to produce the resources it consumes and to absorb its wastes, given prevailing technology.

ecologically sustainable organization (ESO) A business that operates in a way that is consistent with the principle of sustainable development. (See also sustainable development.)

economic leverage A political tool where a business uses its economic power to threaten to relocate its operations unless a desired political action is taken.

economic regulation The oldest form of regulation in the United States, aimed at modifying the normal operations of the free market and the forces of supply and demand.

ecosystem Plants and animals in their natural environment, living together as an interdependent system.

egoist (See ethical egoist.)

elder care The care or supervision of elderly persons; offered as a benefit by some employers to working children of elderly parents.

electronic monitoring (of employees) The use by employers of electronic technologies to gather, store, and monitor information about employees' activities.

emissions charges or fees Fees charged to business by the government, based on the amount of pollution emitted.

emissions standard A kind of environmental regulation in which businesses are allowed to emit no more than certain amounts of pollutants.

employee and privacy Protecting an individual's personal life from unwarranted intrusion by the employer.

employee assistance programs (EAPs) Company-sponsored programs to assist employees with alcohol abuse, drug abuse, mental health, and other problems.

employee ethics training Programs developed by businesses to further reinforce their ethical expectations for their employees.

employee privacy Protecting an individual employee's personal life from unwanted intrusion by the employer.

employment-at-will The principle that workers are hired and retain their jobs solely "at the will of" (that is, sole discretion of) the employer.

enlightened self-interest The view that holds it is in a company's self-interest in the long run to provide true value to its stakeholders.

environmental analysis A method managers use to gather information about external issues and trends.

environmental intelligence The acquisition of information gained from analyzing the multiple environments affecting organizations.

environmental justice The efforts to prevent inequitable exposure to risk, such as from hazardous waste.

environmental partnerships A voluntary, collaborative partnership between or among businesses, government regulators, and environmental organizations to achieve specific environmental goals.

Environmental Protection Agency (EPA) The U.S. federal government agency responsible for most environmental regulation and enforcement.

environmental scanning Examining an organization's environment to discover trends and forces that could have an impact on the organization.

environmental quality standard A kind of environmental regulation in which a geographical area is allowed to have no more than a certain amount or proportion of a pollutant in the air.

equal employment opportunity The principle that all persons otherwise qualified should be treated equally with respect to job opportunities, workplace conditions, pay, fringe benefits, and retirement provisions.

Equal Employment Opportunity Commission (EEOC) The U.S. federal government agency charged with enforcing equal employment opportunity laws and executive orders.

ergonomics Adapting the job to the worker, rather than forcing the worker to adapt to the job.

ethical climate An unspoken understanding among employees of what is and is not acceptable behavior based on the expected standards or norms used for ethical decision making.

ethical egoist A person who puts his or her own selfish interests above all other considerations.

ethical principles Guides to moral behavior, such as honesty, keeping promises, helping others, and respecting others' rights.

ethical relativism A belief that ethical right and wrong are defined by various periods of time in history, a society's traditions, the specific circumstances of the moment, or personal opinion.

ethics A conception of right and wrong conduct, serving as a guide to moral behavior.

ethics and compliance officer A manager designated by an organization to investigate breaches of ethical conduct, promulgate ethics statements, and generally promote ethical conduct at work.

ethics policies or codes A written set of rules used to guide managers and employees when they encounter an ethical dilemma.

ethics reporting mechanisms A program that enables employees, customers, or suppliers to report an ethical concern directly to someone in authority in an organization.

European Union (EU) The political and economic coalition of countries located in the greater European region.

executive compensation The compensation (total pay) of corporate executives, including salary, bonus, stock options, and various benefits.

extended product responsibility The idea that companies have a continuing responsibility for the environmental impacts of their products and services, even after they are sold.

external stakeholder Individuals or groups that may have important transactions with a firm but are not directly employed by the firm, such as customers or suppliers.

F

family-friendly workplace A work environment that fully supports both men and women in their efforts to balance work and family responsibilities.

family leave A leave of absence from work, either paid or unpaid, for the purpose of caring for a family member, such as an elderly relative.

Federal Communications Commission The U.S. federal government agency created in 1934 to regulate interstate and international communications; specifically regulates business advertisement.

fiscal policy The patterns of government collecting and spending funds intended to stimulate or support the economy.

527 organizations Groups organized under section 527 of the Internal Revenue Service tax code for the purpose of donating money to candidates for public office and influencing elections.

flexible work schedule A plan that allows employees limited control over scheduling their own hours of work, usually at the beginning and end of the workday.

focal organization The organization from whose perspective a stakeholder analysis is conducted.

foreign direct investment (FDI) When a company, individual, or fund invests money in another country.

fraud Deceit or trickery due to the pursuit of economic gain or competitive advantage.

free enterprise system A socioeconomic system based on private ownership, profit-seeking business firms, and the principle of free markets.

free market A model of an economic system based on voluntary and free exchange among buyers and sellers. Competition regulates prices in all free market exchanges.

G

General Data Protection Regulation (GDPR) A European law regulating the processing of personal information of European Union residents by an individual, a company, or an organization.

general public Broadly defined as individuals or groups in society.

general systems theory A theory that holds that all organisms are open to, and interact with, their external environments.

genetic engineering A process by which scientists insert virtually any gene into a plant or other living organism in order to create a new crop or an entirely new species.

genetically modified foods Food crops grown from genetically engineered seeds or food processed from such crops.

glass ceiling An invisible barrier to the advancement of women, minorities, and other groups in the workplace.

global action network (GAN) A collaborative, multisector partnership focused on particular social issues or problems in the global economy.

global corporate citizenship Refers to putting an organization's commitment to social and environmental responsibility into practice worldwide.

global warming The gradual warming of the Earth's climate, believed by most scientists to be caused by an increase in carbon dioxide and other trace gases in the Earth's atmosphere resulting from human activity, mainly the burning of fossil fuels.

globalization The movement of goods, services, and capital across national borders.

greenhouse effect The warming effect that occurs when carbon dioxide, methane, nitrous oxides, and other gases act like the glass panels of a greenhouse, preventing heat from the Earth's surface from escaping into space.

grey hatters Hackers working on their own, often seeking media attention, but inclined to share their hacking exploits with the businesses they hacked.

H

hackers Individuals, often with advanced technology training, acting alone or in groups, who, for thrill or profit, breach a business's information security system.

hacktivist Individual or group that invades a secure computer network and releases the information stored there to embarrass or gain leverage against the organization.

hazardous waste Waste materials from industrial, agricultural, and other activities capable of causing death or serious health problems for those persons exposed for prolonged periods. (See also toxic substance.)

hedge funds Pools of private capital, so-called because of the aggressive strategies used to earn high returns for their investors.

honesty tests Written psychological tests given to prospective employees that seek to predict their honesty on the job.

human genome Strands of DNA developing a unique pattern for every human.

human rights An ethical approach emphasizing a person or group's entitlement to something or to be treated in a certain way, such as the right to life, safety, or to be informed.

human trafficking (or forced labor) The illegal recruitment and movement of people against their will, usually to exploit them for economic gain.

I

ideology A set of basic beliefs that define an ideal way of living for an individual, an organization, or a society.

image advertisements Used by businesses to enhance their public image, create goodwill, or announce a major change, such as a merger, acquisition, or new product line.

inclusion Policies and practices that tap into the diverse perspectives, life experiences, and approaches that every individual brings to the workplace.

industrial ecology Designing factories and distribution systems as if they were self-contained ecosystems, such as using waste from one process as raw material for another.

in-kind contributions Corporate charitable contributions of products or services, rather than cash.

innovation Creating a new process or device that adds value.

insider trading Occurs when a person gains access to confidential information about a company's financial condition and then uses that information, before it becomes public knowledge, to buy or sell the company's stock; generally illegal.

institutional investor A financial institution, pension fund, mutual fund, insurance company, university endowment, or similar organization that invests its accumulated funds in securities offered for sale on stock exchanges.

integrated report The combining of legally required financial information with social and environmental information into a single report.

integrated supplier scorecard When suppliers are rated on multiple dimensions including traditional measures (costs, quality, timeliness) and newer measures (social, ethical, and environment performance).

intellectual property Ideas, concepts, and other symbolic creations of the human mind that are recognized and protected under a nation's copyright, patent, and trademark laws.

interactive social system The closely intertwined relationships between business and society.

internal stakeholder Individuals who are employed by the firm, such as employees and managers.

international financial and trade institutions (IFTI) Institutions, such as the World Bank, International Monetary Fund, and World Trade Organization, that establish the rules by which international commerce is transacted.

International Monetary Fund (IMF) An international financial institution that seeks to stabilize the system of currency exchange rates and international payments to enable member countries to participate in global trade.

Internet A global network of interconnected computers, enabling users to share information.

Internet censorship Government control of Internet access or content often on political, security, or religious grounds.

iron law of responsibility The belief that those who do not use their power in ways that society considers responsible will tend to lose their power in the long run.

issue advertisements A technique used by businesses to influence the public's opinion of a political or legislative issue of concern to the company.

issue management The active management of public issues once they come to the attention of a business organization.

issue management process A five-step process where managers identify the issue, analyze the issue, generate options, take action, and evaluate results.

J

justice An ethical approach that emphasizes whether the distribution of benefits and burdens among people are fair, according to some agreed-upon rule.

L

labor force participation rate The proportion of a particular group, such as women, in the paid workforce.

labor union An organization that represents workers on the job and that bargains collectively with the employer over wages, working conditions, and other terms of employment.

laws Society's formal written rules about what constitutes right and wrong conduct in various spheres of life.

legal challenges A political tool that questions the legal legitimacy of a regulation.

legal obligations A belief that a firm must abide by the laws and regulations governing the society.

license to operate The right to do business informally conferred by society on a business firm; must be earned through socially responsible behavior.

life-cycle analysis Collecting information on the lifelong environmental impact of a product in order to minimize its adverse impacts at all stages, including design, manufacture, use, and disposal.

living wage A wage that enables workers, paid for a standard work week, to support half of the basic needs of an average-sized family based on local prices near the workplace; generally above the legal-mandated minimum wage.

lobbying The act of trying to directly shape or influence a government official's understanding and position on a public policy issue.

local sourcing When a company seeks to use nearby suppliers when practical.

M

marine ecosystems Oceans and the salt marshes, lagoons, and tidal zones that border them, and well as the diverse communities of life that they support.

market-based mechanism A form of regulation, used in environmental policy, based on the idea that the market is a better control than standards imposed on corporate behavior.

market failure Inability of the marketplace to properly adjust prices for the true costs of a firm's behavior.

market stakeholder A stakeholder that engages in economic transactions with a company.

material sustainability issues Issues that are particularly relevant to an evaluation of a particular company or industry's sustainability practices.

m-commerce Commerce conducted by using mobile or cell phones, allowing consumers to use their mobile or cell phones as electronic wallets.

media The collective means of communicating to an audience; traditionally included television, radio, and newspapers, but has grown to include influential networks found on the Internet and through social media.

media training The education of executives and employees, who are likely to have contact with the media, in how to communicate effectively with the press.

microfinance Occurs when financial organizations provide loans to low-income clients or a community of borrowers who traditionally lack access to banking or related services.

minimum wage A wage employers must pay a worker, usually an hourly rate, as required by law.

mobile telephones (or cell phones) Communication devices that use radio technology to enable users to place calls from random locations.

monetary policy Government actions that affect the supply, demand, and value of a nation's currency.

monopoly Occurs when one company dominates the market for a particular product or service.

Montreal Protocol An international treaty limiting the manufacture and use of chlorofluorocarbons and other ozone-depleting chemicals. (See also ozone.)

moral development stages A series of progressive steps by which a person learns new ways of reasoning about ethical and moral issues. (See stages of moral development.)

moral intensity A person's perception of how morally severe an ethical issue is.

morality A condition in which the most fundamental human values are preserved and allowed to shape human thought and action.

multinational enterprise (MNE) Corporations that operate and control assets across national boundaries.

N

natural capital The world's natural assets, including its geology, soil, air, water, and all living things.

natural monopolies Where a concentration of the market is acquired by a few firms due to the nature of the industry rather than because of company practices.

negative externalities (or spill-over effects) When the manufacture or distribution of a product gives rise to unplanned or unintended costs (economic, physical, or psychological) borne by consumers, competitors, neighboring communities, or other business stakeholders.

net neutrality Government rules based on the principle that Internet service providers should give customers equal access to their products and services.

nongovernmental organizations (NGOs) Organizations that do not have a governmental or commercial purpose, such as religious, community, family, and interest-group organizations. Also called civil society or civil sector organizations.

nonmarket stakeholder A stakeholder that does not engage in direct economic exchange with a company, but is affected by or can affect its actions.

O

Occupational Safety and Health Administration (OSHA) The U.S. federal government agency empowered to set and enforce worker safety and health standards.

occupational segregation The inequitable concentration of a group, such as minorities or women, in particular job categories.

omnichannel The idea that every distribution channel must work together to deliver a unified and consistent customer experience.

ozone A bluish gas composed of three bonded oxygen atoms. Ozone in the lower atmosphere is a dangerous component of urban smog; ozone in the upper atmosphere provides a shield against ultraviolet light from the sun. (See also Montreal Protocol.)

P

paid content When a business pays to have online or print publishers create and distribute information.

parental leave A leave of absence from work, either paid or unpaid, for the purpose of caring for a newborn or adopted child.

Paris Agreement A global agreement, negotiated in Paris in 2015, which aimed to limit the rise in the average global temperatures.

pay gap The difference in the average level of wages, salaries, and income received by two groups, such as men and women (called the gender pay gap) or whites and persons of color (called the racial pay gap).

performance–expectations gap The perceived distance between what a firm wants to do or is doing and what the stakeholder expects.

philanthropy (See corporate philanthropy.)

phishing The practice of stealing consumers' personal identity data and financial account credentials by using fake e-mails.

political action committee (PAC) An independently incorporated organization that can solicit contributions and then channels those funds to candidates seeking political office.

predatory pricing The practice of selling below cost to drive rivals out of business.

privacy (See right to privacy.)

private equity firms Organizations that manage pools of money invested by very wealthy individuals and institutions.

private property A group of rights giving control over physical and intangible assets to private owners. Private ownership is the basic institution of capitalism.

private regulation (also private governance) Nongovernmental institutions that govern—that is, enable and constrain—economic activities; occurs when private companies or groups of companies voluntarily establish codes of conduct governing working conditions, human rights, and environmental practices within global supply chains.

privately held corporation A corporation that is privately owned by an individual or a group of individuals; its stock is not available for purchase by the general investing public.

product liability The legal responsibility of a firm for injuries caused by something it made or sold.

product recall Occurs when a company, either voluntarily or under an agreement with a government agency, takes back from its distribution channels all items found to be dangerously defective.

profits The revenues of a person or company minus the costs incurred in producing the revenue.

proxy A legal instrument giving another person the right to vote the shares of stock of an absentee shareholder; in effect, an absentee ballot for shareholders who do not attend the annual meeting in person.

proxy access Changes in the nomination process for a company's board of directors that allows shareholders to nominate their own candidates

proxy statement A statement sent by a board of directors to a corporation's stockholders announcing the company's annual meeting, containing information about the business to be considered at the meeting, and enclosing a proxy form for shareholders not attending the meeting to vote.

public (See general public.)

public affairs department Manages an organization's interactions with government at all levels to promote the firm's interests in the political process.

public issue An issue that is of mutual concern to an organization and its stakeholders, sometimes called a social or sociopolitical issue.

public policy A plan of action undertaken by government officials to achieve some broad purpose affecting a substantial segment of a nation's citizens.

public relations A program that sends a constant stream of information from the company to the public and opens the door to dialogue with stakeholders whose lives are affected by company operations. (Also known as media relations.)

public relations department Manages the firm's public image and, more generally, its relations with the public.

public service announcements (PSAs) Advertisements that address critical social issues.

publicly held corporation A corporation whose shares of stock are available for purchase by the general investing public (as contrasted with a privately held firm).

Q

quality management All measures taken by an organization to assure quality, such as defining the customer's needs, monitoring whether or not a product or service consistently meets these needs, analyzing the quality of

finished products to assure they are free of defects, and continually improving processes to eliminate quality problems.

questionable payments Something of value given to a person or firm that raises significant ethical questions of right or wrong in the host nation or other nations.

R

race to the bottom When businesses move operations from one country to another seeking to pay workers the lowest wages possible or to avoid strong government regulations.

racial harassment Harassment in the workplace based on race, such as ethnic slurs, derogatory comments, or other verbal or physical harassment that creates an intimidating, hostile, or offensive working environment or that interferes with an individual's work performance. (See also sexual harassment.)

rain forest Woodlands that receive at least 100 inches of rain a year. They are among the planet's richest areas in terms of biodiversity.

ransomware attacks A kind of cyberattack in which malware (short for malicious software) locks the data on a victim's computer and demands payment to regain access to the data.

regulation The action of government to establish rules by which industry or other groups must behave in conducting their normal activities.

renewable resources Natural resources, such as fresh water or timber, that can be naturally replenished. (See also nonrenewable resources.)

reputation The desirable or undesirable qualities associated with an organization or its actors that may influence the organization's relationships with its stakeholders.

reregulation The increase or expansion of government regulation on activities, especially in areas where the regulatory activities had previously been reduced.

return on social investment Benefits of a business's social actions that accrue to both business and society.

revolving door The circulation of individuals between business and government positions.

right (human) A concept used in ethical reasoning that means that a person or group is entitled to something or is entitled to be treated in a certain way.

right to privacy A person's entitlement to protection from invasion of his or her private life by government, business, or other persons.

right to be forgotten An individual's right to have their personal information removed from online search results upon request.

root cause analysis Analysis undertaken to determine the underlying cause of repeated violations of particular code requirements or standards in global supply chains.

S

salience Causes a stakeholder to stand out as important and to receive managers' attention; based on the stakeholder's power, legitimacy, and urgency. (See stakeholder salience.)

Sarbanes-Oxley Act U.S. law enacted in 2002 that greatly expanded the powers of the SEC to regulate information disclosure in the financial markets and the accountability of an organization's senior leadership regarding the accuracy of this disclosure. (See also Securities and Exchange Commission.)

say-on-pay U.S. regulation requiring public companies to hold an advisory shareholder vote on executive compensation at least once every three years; also required in several other countries.

Securities and Exchange Commission (SEC) The U.S. federal government agency whose mission is to protect stockholders' rights by making sure that stock markets are run fairly and that investment information is fully disclosed.

sexual harassment Repeated unwanted and uninvited sexual attention or when on-the-job conditions are hostile or threatening in a sexual way. (See also racial harassment.)

shared value Benefits created when the company invests in suppliers and employees, exchanges knowledge, and collaborates on improvements.

shareholder A person, group, or organization owning one or more shares of stock in a corporation; the legal owners of the business. (Also investor or stockholder)

shareholder lawsuit A lawsuit initiated by one or more shareholders to recover damages suffered due to alleged actions of the company's management.

shareholder resolution A proposal made by a shareholder or group of shareholders and included in a corporation's notice of its annual meeting that advocates some course of action to be taken by the company.

shareholder theory of the firm A theory that holds that the purpose of the firm is to maximize its long-term market value. (Also known as ownership theory of the firm.)

skill-based volunteerism A form of corporate philanthropy in which employee skills are matched to

the specialized needs of the community or nonprofit organizations.

social assistance policies Government programs aimed at improving social welfare in such areas as health care and education.

social audit A systematic evaluation of an organization's social, ethical, and environmental performance.

social capital The norms and networks that enable collective action; goodwill engendered by social relationships.

social contract An implied understanding between an organization and its stakeholders as to how they will act toward one another.

social entrepreneurs Like traditional entrepreneurs, individuals who act boldly to pursue opportunities, attract support, and build new organizations to create and sustain social rather than economic value.

social entrepreneurship A person or group of people who identify a social need and use their entrepreneurial skills to address this need.

social investment The use of stock ownership as a strategy for promoting social, environmental, and governance objectives. (Also called socially responsible investment or sustainable, responsible, and impact investment, or SRI.)

social media influencers A user of social media who has established credibility in a specific industry with access to a large audience and can persuade others by virtue of their authenticity and reach.

social networking A system using technology to enable people to connect, explore interests, and share activities around the world.

social regulation Regulations aimed at important social goals such as protecting consumers and the environment, promoting equal employment opportunity, protecting pension benefits, and providing health care for citizens.

social responsibility (See corporate social responsibility.)

social responsibility shareholder resolution A resolution on an issue of corporate social responsibility placed before shareholders for a vote at a company's annual meeting.

social ventures Organizations founded by social entrepreneurs.

society Refers to human beings and to the social structures they collectively create; specifically refers to segments of humankind, such as members of a particular community, nation, or interest group.

soft money Unlimited political contributions to a national political party by individuals or organizations to support party-building activities.

software piracy The illegal copying of copyrighted software.

sound bite Information, often 30 seconds or less, used by the media in its broadcast to the public.

spam Unsolicited e-mails (or junk e-mails) sent in bulk to valid e-mail and mobile accounts.

spirituality (personal) A personal belief in a supreme being, religious organization, or the power of nature or some other external, life-guiding force.

stages of moral development A sequential pattern of how people grow and develop in their moral thinking, beginning with a concern for the self and growing to a concern for others and broad-based principles.

stakeholder A person or group that affects, or is affected by, a corporation's decisions, policies, and operations. (See also market stakeholder and nonmarket stakeholder.)

stakeholder analysis An analytic process used by managers that identifies the relevant stakeholders in a particular situation and seeks to understand their interests, power, and likely coalitions.

stakeholder coalitions Alliances among company's stakeholders to pursue a common interest; generally are not static relationships.

stakeholder dialogue Conversations between representatives of a company and its stakeholders about issues of common concern.

stakeholder engagement An ongoing process of relationship building between a business and its stakeholders.

stakeholder interests The nature of each stakeholder group, its concerns, and what it wants from its relationship with the firm.

stakeholder map A visual representation of the relationships among stakeholder interests, power, and coalitions with respect to a particular issue.

stakeholder materiality Adaptation of an accounting term that focuses on the importance or significance of stakeholders for the firm.

stakeholder networks A connected assembly of concerned individuals or organizations defined by their shared focus on a particular issue, problem, or opportunity.

stakeholder power The ability of one or more stakeholders to make an event happen or to secure a desired outcome in their interactions with a company. The five types are voting power, economic power, political power, legal power, and informational power.

stakeholder salience A stakeholder's ability to stand out from the background, to be seen as important, or to draw

attention to itself or its issue. Stakeholders are more salient when they possess power, legitimacy, and urgency. (See also salience.)

stakeholder theory of the firm A theory that holds that the purpose of the firm is to create value for society.

stem cell research Research on nonspecialized cells that have the capacity to self-renew and to differentiate into more mature cells.

stock option A form of compensation. Options represent the right (but not obligation) to buy a company's stock at a set price (called the strike price) for a certain period of time. The option becomes valuable to its holder when, and if, the stock price rises above this amount.

stock screening Selecting stocks based on social or environmental criteria.

strategic philanthropy A form of corporate giving that is linked directly or indirectly to business goals or objectives.

strict liability A legal doctrine that holds that a manufacturer is responsible (liable) for injuries resulting from the use of its products, whether or not the manufacturer was negligent or breached a warranty.

Superfund (CERCLA) A U.S. law, passed in 1980, designated to clean up hazardous or toxic waste sites. The law established a fund, supported mainly by taxes on petrochemical companies, to pay for the cleanup. (Also known as the Comprehensive Environmental Response, Compensation, and Liability Act [CERCLA].)

super PAC (political action committee) An organization that raises and spends money focusing on political issues but is not directly affiliated with any political campaign; also called an independent expenditure-only committee.

supplier An organization that provides goods or services to another organization.

supplier development Activities undertaken by companies to improve the performance of firms in their supply chain.

supply chain The multiple steps involved in the movement of a product or service from the most distant supplier to the customer.

supply chain audit An assessment of a supplier's performance to determine if it is in compliance with a relevant code of conduct.

supply chain codes of conduct A public set of rules, adopted by a firm or group of firms, that establishes mandatory standards governing labor, human rights, environmental, and related practices for suppliers.

supply chain map Graphically depicts the movement of a product or service along the supply chain.

supply chain transparency Occurs when a company's supply chain is fully disclosed to its stakeholders.

sustainability report A single report integrating a business's social and environmental results.

sustainable development Development that meets the needs of the present without compromising the ability of future generations to meet their own needs; ensuring a better quality of life for everyone, now and for generations to come.

sweatshops Factories where employees—sometimes including children—are forced to work long hours, at low wages, and often under unsafe working conditions.

T

tariff A tax on an imported (or sometimes exported) product by a government to protect their own industries from foreign competition.

technology A broad term referring to the practical applications of science and knowledge to commercial and organizational activities.

technology cooperation Long-term partnerships between companies in developed and developing countries to transfer environmental technologies to attain sustainable development.

The Business Roundtable Founded in 1972, an organization of chief executive officers from leading corporations involved in various public issues and legislation.

tier-1 suppliers (or contractors) Organizations hired to manufacture products for or provide services directly to a company.

tier-2 suppliers (or subcontractors) Organizations hired to manufacture products for or provide services to tier-1 suppliers (contractors).

tissue engineering The growth of tissue in a laboratory dish for experimental research.

toxic substance Any substance used in production or in consumer products that is poisonous or capable of causing serious health problems for those persons exposed. (See also hazardous waste.)

tradable permits A market-based approach to pollution control in which the government grants companies "rights" to a specific amount of pollution (permits), which may be bought or sold (traded) with other companies.

trade association A coalition of companies in the same or related industries seeking to coordinate their economic or political power to further their agenda.

trade policy A government action that governs imports from and exports to foreign countries.

transparency Clear public reporting of an organization's performance to various stakeholders.

U

undocumented immigrant workers Noncitizens employed by businesses without having the legally required work documents.

U.S. Corporate Sentencing Guidelines Standards to help judges determine the appropriate penalty for criminal violations of federal laws and provide a strong incentive for businesses to promote ethics at work.

U.S. Foreign Corrupt Practices Act Federal law that prohibits executives of U.S.–based companies from paying bribes to foreign government officials, political parties, or political candidates.

user-generated content Sources of information provided by users through social media sites that can be supportive or critical of a business.

utilitarian reasoning An ethical approach that emphasizes the consequences of an action and seeks the action or decision where the benefits most outweigh the costs.

V

values Fundamental and enduring beliefs about the most desirable conditions and purposes of human life.

virtue ethics Focuses on character traits to define a good person, theorizing that values will direct a person toward good behavior.

volunteerism The efforts of people to assist others in a community through unpaid work.

W

Wall Street A customary way of referring to the financial community of banks, investment institutions, and stock exchanges centered in the Wall Street area of New York City.

water pollution When more wastes are discharged into waterways, such as lakes and rivers, than can be naturally diluted and carried away.

whistle-blowing An employee's disclosure of alleged organizational misconduct to the media or appropriate government agency, often after futile attempts to convince organizational authorities to take action against the alleged abuse.

white hatters Individuals employed by businesses or governments to hack their own information security systems deliberately to discover possible vulnerabilities.

workforce diversity Diversity among employees, a challenge and opportunity for business. (See also diversity).

World Bank An international financial institution that provides economic development loans to member nations.

World Trade Organization (WTO) An organization of member nations that establishes the ground rules for trade among nations.

Part One: Chapters 1–4

Ackerman, Robert. *The Social Challenge to Business.* Cambridge, MA: Harvard University Press, 1975.

Albrecht, Karl. *Corporate Radar: Tracking the Forces That Are Shaping Your Business.* New York: American Management Association, 2000.

Barth, Regine, and Franziska Wolff (eds.). *Corporate Social Responsibility in Europe—Rhetoric and Realities.* Cheltenham, UK: Edward Elgar Publishing, 2009.

Bhagwati, Jagdish. *In Defense of Globalization.* New York: Oxford University Press, 2007.

Bowen, Howard R. *Responsibilities of the Businessman.* New York: Harper, 1953.

Carroll, Archie B.; Kenneth J. Lipartito; James E. Post; and Patricia H. Werhane. *Corporate Responsibility: The American Experience.* Cambridge, UK: Cambridge University Press, 2012.

Chamberlain, Neil W. *The Limits of Corporate Social Responsibility.* New York: Basic Books, 1973.

Clarkson, Max B.E. (ed.). *The Corporation and Its Stakeholders: Classic and Contemporary Readings.* Toronto: University of Toronto Press, 1998.

Crane, Andrew; Dirk Matten; and Jeremy Moon. *Corporations and Citizenship.* Cambridge, UK: Cambridge University Press, 2008.

Davis, Gerald F. *The Vanishing American Corporation: Navigating the Hazards of a New Economy.* Oakland, CA: Berrett-Koehler Publishers, 2016.

Elkington, John. *Cannibals with Forks: The Triple Bottom Line of 21st Century Business.* London: Thompson, 1997.

Fombrun, Charles. *Reputation.* Boston: Harvard Business School Press, 1996.

Frederick, William C. *Corporation Be Good!* Indianapolis, IN: Dog Ear Publishing, 2006.

Freeman, R. Edward. *Strategic Management: A Stakeholder Approach.* Cambridge, UK: Cambridge University Press, 2010.

Jamali, Dima; Charlotte Karam; and Michael Blowfield (eds.). *Development-Oriented Corporate Social Responsibility: Multinational Corporations and the Global Context,* Volume 1. Sheffield, UK: Greenleaf Publishing, 2015.

Jamali, Dima; Charlotte Karam; and Michael Blowfield (eds.). *Development-Oriented Corporate Social Responsibility: Locally Led Initiatives in Developing Economies,* Volume 2. Sheffield, UK: Greenleaf Publishing, 2015.

Kolb, Robert W. (ed.). *Encyclopedia of Business Ethics and Society.* Thousand Oaks, CA: SAGE Publications, 2008.

Korten, David C. *When Corporations Rule the World,* 2nd edition. San Francisco, CA: Berrett-Koehler, 2001.

Lawrence, Paul R., and Nitin Nohria. *Driven: How Human Nature Shapes Our Choices.* San Francisco, CA: Jossey-Bass, 2002.

Leipziger, Deborah. *The Corporate Responsibility Code Book,* 3rd edition. Sheffield, UK: Greenleaf Publishing, 2015.

Lindgreen, Adam; Philip Kotler; Joelle Vanhamme; and Francois Maon. *A Stakeholder Approach to Corporate Social Responsibility.* Farnham, UK: Gower Publishing, 2012.

Orlitzky, Marc, and Diane Swanson. *Toward Integrative Corporate Citizenship: Research Advances in Corporate Social Performance.* New York: Palgrave Macmillan, 2008.

Phillips, Robert. *Stakeholder Theory and Organizational Ethics.* San Francisco: Berrett-Koehler Publishers, Inc., 2003.

Phillips, Robert A., and R. Edward Freeman (eds.). *Stakeholders.* Northampton, MA: Edward Elgar Publishing, 2010.

Porter, Michael. *The Competitive Advantage of Nations.* New York: Basic Books, 1991.

Post, James E.; Lee E. Preston; and Sybille Sachs. *Redefining the Corporation: Stakeholder Management and Organizational Wealth.* Palo Alto, CA: Stanford University Press, 2002.

Scherer, Andreas Georg, and Guido Palazzo (eds.). *Handbook of Research on Global Corporate Citizenship.* Northampton, MA: Edward Elgar Publishing, 2008.

Svendsen, Ann. *The Stakeholder Strategy: Profiting from Collaborative Business Relationships.* San Francisco: Berrett-Koehler Publishers, 1998.

Thompson, Anne Bahr. *Do Good: Embracing Brand Citizenship to Fuel Both Purpose and Profit.* New York: American Management Association, 2018.

Vogel, David. *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility.* Washington, DC: Brookings Institution Press, 2005.

Waddell, Steve. *Global Action Networks: Creating Our Future Together.* New York: Palgrave Macmillan, 2011.

Waddock, Sandra. *The Difference Makers: How Social and Institutional Entrepreneurs Created the Social*

Responsibility Movement. Sheffield, UK: Greenleaf Publishing, 2008.

Waddock, Sandra and Andreas Rasche. *Building the Responsible Enterprise.* Palo Alto, CA: Stanford University Press, 2012.

Waibel, Piera. *Putting the Poor First: How Base-of-the-Pyramid Ventures Can Learn from Development Approaches.* Sheffield, UK: Greenleaf Publishing, 2012.

Yankelovich, Daniel. *The Magic of Dialogue: Transforming Conflict Into Cooperation.* New York: Simon & Schuster, 1999.

Yaziji, Michael, and Jonathan Doh. *NGOs and Corporations: Conflict and Collaboration.* New York: Cambridge University Press, 2009.

Yunas, Muhammad. *Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs.* Philadelphia: Perseus Books Group, 2010.

Part Two: Chapters 5–6

Callahan, David. *The Cheating Culture.* Orlando: Harcourt, 2004.

Carreyrou, John. *Bad Blood: The Rise and Fall of the Biotech Startup Theranos.* New York: Alfred A. Knopf, 2018.

Cavanaugh, Gerald F. *American Business Values: With International Perspectives,* 6th edition. Upper Saddle River, NJ: Prentice-Hall, 2009.

Christina, Alexandra, and Timothy L. Fort. *The Sincerity Edge: How Ethical Leaders Build Dynamic Businesses.* Palo Alto, CA: Stanford University Press, 2017.

Colby, Anne, and Lawrence Kohlberg. *The Measurement of Moral Judgment: Volume I, Theoretical Foundations and Research Validations.* Cambridge, MA: Harvard University Press, 1987.

Comer, Debra R., and Gina Vega. *Moral Courage in Organizations: Doing the Right Thing at Work.* Armonk, NY: M.E. Sharpe, 2011.

Dempsey, Alison. *Evolutions in Corporate Governance: Towards an Ethical Framework for Business Conduct.* Sheffield, UK: Greenleaf Publishing, 2013.

Donaldson, Thomas, and Thomas W. Dunfee. *Ties that Bind: A Social Contracts Approach to Business Ethics.* Cambridge, MA: Harvard Business School Publishing, 1999.

Fluker, Walter Earl. *Ethical Leadership: The Quest for Character, Civility, and Community.* Minneapolis, MN: Augsburg Fortress, 2009.

Gentile, Mary C. *Giving Voice to Values: How to Speak Your Mind When You Know What's Right.* New Haven, CT: Yale University Press, 2010.

Hamington, Maurice, and Maureen Sander-Staudt (eds.). *Applying Care Ethics to Business.* New York: Springer, 2011.

Jackall, Robert. *Moral Mazes: The World of Corporate Managers.* New York: Oxford University Press, 1988.

Kochan, Nick, and Robin Goodyear. *Corruption: The New Corporate Challenge.* New York: Palgrave Macmillan, 2011.

Kyle, Richard. *Ethical Business: Cultivating the Good in Organizational Culture.* Winona, MN: Anselm Academic, 2016.

Payne, Brian K. *White-Collar Crime.* Thousand Oaks, CA: Sage, 2012.

Rapoport, Nancy B., and Jeffrey D. Van Niel. *Corporate Scandals and their Implications,* 3rd edition. St. Paul, MN: West Academic Publishing, 2018.

Rawls, John. *A Theory of Justice.* Cambridge, MA: Harvard University Press, 1971.

Singh, Nitish, and Thomas J. Bussen. *Compliance Management: A How-to Guide for Executives, Lawyers and other Compliance Professionals.* Santa Barbara, CA: Praeger, 2015.

Stone, Christopher D. *Where the Law Ends: The Social Control of Corporate Behavior.* Prospect Heights, IL: Waveland Press, 1975.

Werhane, Patricia H., and R. Edward Freeman. *The Blackwell Encyclopedic Dictionary of Business Ethics,* 2nd edition. Malden, MA: Blackwell, 2005.

Part Four: Chapters 7–8

Coen, David; Wyn Grant; and Graham Wilson (eds.). *The Oxford Handbook of Business and Government.* New York: Oxford University Press, 2011.

Epstein, Edwin M. *The Corporation in American Politics.* Englewood Cliffs, NJ: Prentice-Hall, 1969.

Foundation for Public Affairs. *The State of Corporate Public Affairs 2017–2018.* Washington, DC: Foundation for Public Affairs, 2017.

Healy, Robert. *Corporate Political Behavior: Why Corporations Do What They Do in Politics.* New York: Routledge, 2014.

Lodge, George C. *The New American Ideology.* New York: Alfred A. Knopf, 1978.

_____. *Comparative Business-Government Relations.* Englewood Cliffs, NJ: Prentice-Hall, 1990.

_____, and Ezra F. Vogel (eds.). *Ideology and National Competitiveness.* Boston: Harvard Business School Press, 1998.

Mayer, Jane. *Dark Money: The Hidden History of the Billionaires Behind the Rise of the Radical Right.* New York: Anchor Books, 2017.

Miller, Brian, and Mike Lapham. *The Self-Made Myth: And the Truth About How Government Helps Individuals and Businesses Succeed.* San Francisco: Berrett-Koehler, 2012.

Nance, Malcolm. *The Plot to Destroy Democracy: How Putin and His Spies Are Undermining America and Dismantling the West.* New York: Hachette Books, 2018.

Parker, Christine, and Vibeke Lehmann Nielsen (eds.). *Explaining Compliance: Business Responses to Regulation.* Northampton, MA: Edward Elgar Publishing, 2011.

Sorkin, Andrew Ross. *Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System—and Themselves.* New York: Viking, 2009.

Vogel, David. *Kindred Strangers: The Uneasy Relationship between Politics and Business in America.* Princeton, NJ: Princeton University Press, 1996.

Yadav, Vineeta. *Political Parties, Business Groups and Corruption in Developing Countries.* New York: Oxford University Press, 2011.

Part Five: Chapters 9–10

Anderson, Ray C., with Robin White. *Business Lessons from a Radical Industrialist.* New York: St. Martin's Griffin, 2011.

Cline, Elizabeth L. *Over-dressed: The Shockingly High Cost of Cheap Fashion.* New York: Penguin, 2012.

Daly, Herman E. *Beyond Growth: The Economics of Sustainable Development.* Boston: Beacon Press, 1996.

Delmas, Magali A., with David Colgan. *The Green Bundle: Pairing the Market with the Planet.* Palo Alto, CA: Stanford University Press, 2018.

Ehrenfeld, John R., and Andrew J. Hoffman. *Flourishing: A Frank Conversation About Sustainability.* Stanford, CA: Stanford Business Press, 2013.

Esty, Daniel C., and Andrew S. Winston. *Green to Gold: How Smart Companies Use Environmental Strategy to Innovate, Create Value, and Build Competitive Advantage,* revised edition. Hoboken, NJ: John Wiley & Sons, 2009.

Foreman, Jr., Christopher H. *The Promise and Perils of Environmental Justice.* Washington, DC: Brookings Institution, 2000.

Frederick, William C. *Natural Corporate Management: From the Big Bang to Wall Street.* Sheffield, UK: Greenleaf Publishing, 2012.

Friedman, Frank B. *Practical Guide to Environmental Management,* 11th edition. Washington, DC: Environmental Law Institute, 2011.

Friedman, Thomas L. *Hot, Flat, and Crowded: Why We Need a Green Revolution—and How It Can Renew America.* New York: Farrar, Strauss, and Giroux, 2008.

Hammond, Allen. *Which World? Scenarios for the 21st Century.* Washington, DC: Island Press, 1998.

Hart, Stuart L. *Capitalism at the Crossroads: The Unlimited Business Opportunities in Solving the World's Most Difficult Problems.* Philadelphia, PA: Wharton School Publishing, 2005.

Hawken, Paul; Amory Lovins; and L. Hunter Lovins. *Natural Capitalism: Creating the Next Industrial Revolution.* Boston: Little Brown, 1999.

Hoffman, Andrew J. *Finding Purpose: Environmental Stewardship as a Personal Calling.* London: Routledge, 2017.

Kurucz, Elizabeth C.; Barry A. Colbert; and David Wheeler. *Reconstructing Value: Leadership Skills for a Sustainable World.* Toronto, Canada: University of Toronto Press, 2013.

Laszlo, Chris, and Judy Sorum Brown. *Flourishing Enterprise: The New Spirit of Business.* Stanford, CA: Stanford Business Press, 2014.

Lenox, Michael, and Aaron Chatterji. *Can Business Save the Earth? Innovating Our Way to Sustainability.* Stanford, CA: Stanford University Press, 2018.

Russo, Michael V. *Companies on a Mission: Entrepreneurial Strategies for Growing Sustainably, Responsibly, and Profitably.* Stanford, CA: Stanford University Press, 2010.

Schendler, Auden. *Getting Green Done: Hard Truths from the Front Lines and Sustainability Revolution.* New York: Foundation for Public Affairs, 2009.

Speth, James Gustaveth, *The Bridge at the Edge of the World.* New Haven, CN: Yale University Press, 2008.

Stead, Jean Garner, and W. Edward Stead. *Management for a Small Planet,* 3rd edition. Armonk, NY: M.E. Sharpe, 2009.

Stoner, James A.F., and Charles Wankel (eds.). *Managing Climate Change, Business Risks and Consequences: Leadership for Global Sustainability.* New York: Palgrave Macmillan, 2012.

Visser, Wayne. *Sustainable Frontiers: Unlocking Change through Business, Leadership and Innovation.* Sheffield, UK: Greenleaf Publishing, 2015.

Waddock, Sandra, and Malcolm McIntosh. *SEE Change: Making the Transition to a Sustainable Enterprise Economy.* Sheffield, UK: Greenleaf Publishing, 2011.

Winston, Andrew S. *The Big Pivot: Radically Practical Strategies for a Hotter, Scarcer, and More Open World.* Boston: Harvard Business Press, 2014.

Part Six: Chapters 11–12

Christiano, Joseph. *Stem Cell Revolution.* Lake Mary, FL: Siloam, 2018.

Doudna, Jennifer A., and Samuel H. Sternberg. A Crack in Creation: Gene Editing and the Unthinkable Power to Control Evolution. Boston: Houghton Mifflin Hardcourt, 2017,

Galloway, Scott. *The Four: The Hidden DNA of Amazon, Apple, Facebook, and Google.* New York: Portfolio/Penguin, 2017.

Heinberg, Richard. *Cloning the Buddha: The Moral Impact of Biotechnology.* San Juan Capistrano, CA: Quest Books, 1999.

Horn, Tom, and Nita Horn. *Forbidden Gates: How Genetics, Robotics, Artificial Intelligence, Synthetic Biology, Nanotechnology, and Human Enhancement Herald the Dawn of Techno-Dimensional Spiritual Warfare.* Crane, MO: Defender Publishing, 2010.

Jenkins, McKay. *Food Fight: GMOs and the Future of the American Diet.* New York: Penguin Random House, 2018.

Koppel, Ted. *Lights Out: A Cyberattack, A Nation Unprepared, Surviving the Aftermath.* New York: Broadway Books, 2015.

Lang, John T. *What's So Controversial about Genetically Modified Food?* London: Reaktion Books, 2016.

Levy, Steven. *Hackers: Heroes of the Computer Revolution.* Sebastopol, CA: O'Reilly Media, 2010.

Muller, Hunter. *The Transformational CIO.* Hoboken, NJ: John Wiley & Sons, 2011.

Park, Alice. *The Stem Cell Hope: How Stem Cell Medicine Can Change Our Lives.* New York: Hudson Street Press, 2011.

Rosen, Larry D. *Understanding our Obsession with Technology and Overcoming Its Hold on Us.* Hampshire, UK: Palgrave Macmillan, 2012.

Schneider, Bruce. *Data and Goliath: The Hidden Battles to Collect Your Data and Control Your World.* New York: W.W. Norton, 2015.

Smith, Hein, and Hilary Morrison. *Ethical Hacking: A Comprehensive Beginner's Guide to Learn and Master Ethical Hacking.* Published by Hein Smith and Hilary Morrison, 2018.

Tapscott, Don, and Alex Tapscott. *Blockchain Revolution: How the Technology Behind Bitcoin Is Changing Money, Business and the World.* New York: Portfolio/Penguin, 2018.

Wadhwa, Vivek, and Alex Salkever. *The Driver in the Driverless Car: How our Technology Choices Will Create the Future.* Oakland, CA: Berrett-Koehler, 2017.

Part Seven: Chapters 13–19

Andvliet, Luc, and Mary B. Anderson, *Getting It Right: Making Corporate-Community Relations Work.* Sheffield, UK: Greenleaf, 2009.

Bainbridge, Stephen M. *Corporate Governance after the Financial Crisis.* New York: Oxford University Press, 2012.

Bebchuk, Lucian A., and Jesse M. Fried. *Pay without Performance: The Unfulfilled Promise of Executive Compensation.* Cambridge, MA: Harvard University Press, 2004.

Buffett, Howard W., and William B. Eimicke. *Social Value Investing: A Management Framework for Effective Partnerships.* New York: Columbia University Press, 2018.

Bugg-Levine, Antony, and Jed Emerson. *Impact Investing: Transforming How We Make Money While Making a Difference.* San Francisco: Jossey-Bass, 2011.

Carter, Colin B., and Jay W. Lorsch. *Back to the Drawing Board: Designing Corporate Boards for a Complex World.* Boston: Harvard Business School Press, 2004.

Coombs, W. Timothy. *Ongoing Crisis Communication.* Thousand Oaks, CA: Sage, 2012.

Dine, Philip M. *State of the Unions: How Labor Can Strengthen the Middle Class, Improve Our Economy, and Regain Political Influence.* New York: McGraw-Hill, 2008.

Dorff, Michael B. *Indispensable and Other Myths: Why the CEO Pay Experiment Failed and How to Fix It.* Berkeley, CA: University of California Press, 2014.

Eccles, Robert G., and Michael P. Krzus. *The Integrated Reporting Movement: Meaning, Momentum, Motives, and Materiality.* Hoboken, NJ: John Wiley & Sons, 2015.

Ewing, Jack. *Faster, Higher, Farther: The Volkswagen Scandal.* New York: W.W. Norton, 2017.

Fagan, Colette; Maria Gonzalez Menendez; and Silvia Gomez Anson (eds.). *Women on Corporate Boards and in Top Management.* New York: Palgrave Macmillan, 2012.

Ferracone, Robin A. *Fair Pay, Fair Play: Aligning Executive Performance and Pay.* San Francisco, CA: Jossey-Bass, 2010.

Gordon, Averill Elizabeth. *Public Relations.* New York: Oxford University Press, 2011.

Grant, Peter. *The Business of Giving.* New York: Palgrave Macmillan, 2011.

Greenhouse, Steven. *The Big Squeeze: Tough Times for the American Worker.* New York: Anchor Books, 2009.

Herman, R. Paul. *The HIP Investor: Make Bigger Profits by Building a Better World.* Hoboken, NJ: John Wiley & Sons, 2010.

Hilts, Philip J. *Protecting America's Health: The FDA, Business, and One Hundred Years of Regulation.* New York: Alfred A. Knopf, 2003.

Jordan-Meier, Jane. *The Four Stages of Highly Effective Crisis Management.* Boca Raton, FL: Taylor & Francis Group, 2011.

Kalleberg, Arne L. *Good Jobs, Bad Jobs: The Rise of Polarized and Precarious Employment Systems in the United States, 1970s to 2000s.* New York: Russell Sage Foundation, 2013.

Kelly, Marjorie. *The Divine Right of Capital: Dethroning the Corporate Aristocracy.* San Francisco: Berrett-Koehler Publishers, Inc., 2003.

Lakin, Nick, and Veronica Scheubel. *Corporate Community Involvement: The Definitive Guide to Maximizing your Business' Societal Engagement.* Sheffield, UK: Greenleaf, 2010.

Lewis, Michael. *The Big Short: Inside the Doomsday Machine.* New York: W.W. Norton, 2010.

Locke, Richard M. *The Promise and Limits of Private Power: Promoting Labor Standards in a Global Economy.* New York: Cambridge University Press, 2013.

Lorsch, Jay W. *The Future of Boards: Meeting the Governance Challenges of the Twenty-First Century.* Boston: Harvard Business Review Press, 2012.

Miceli, Marcia P.; Janet Pollex Near; and Terry M. Dworkin. *Whistle-Blowing in Organizations.* London: Routledge, 2008.

Mitroff, Ian I. *Managing Crises Before They Happen.* New York: American Management Association, 2005.

Monks, Robert A. G., and Nell Minow. *Corporate Governance,* 5th edition. Hoboken, NJ: John Wiley & Sons, 2011.

Piketty, Thomas. *Capital in the Twenty-First Century.* Cambridge, MA: The Belknap Press of Harvard University Press, 2014.

Rivoli, Pietra. *The Travels of a T-Shirt in the Global Economy: An Economist Examines the Markets, Power, and Politics of World Trade,* 2nd edition. Hoboken, NJ: John Wiley & Sons, 2015.

Rosen, Jeffrey. *The Unwanted Gaze: The Destruction of Privacy in America.* New York: Random House, 2000.

Rotenberg, Marc; Julia Horwitz; and Jeramie Scott (eds.). *Privacy in the Modern Age: The Search for Solutions.* New York: The New Press, 2015.

Schlosser, Eric. *Fast Food Nation: The Dark Side of the All-American Meal.* New York: Perennial, 2002.

Schneider, Bruce. *Data and Goliath: The Hidden Battles to Collect Your Data and Control Your World.* New York: W.W. Norton, 2015.

Siegel, Lucy B. (ed.). *Public Relations Around the Globe: A Window on International Business Culture.* New York: Bridge Global Strategies, 2012.

Stout, Lynn. *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public.* San Francisco, CA: Berrett-Koehler, 2012.

Ton, Zeynap. *The Good Jobs Strategy: How the Smartest Companies Invest in Employees to Lower Costs and Boost Profits.* Boston: Houghton Mifflin Harcourt, 2014.

Weil, David. *The Fissured Workplace: Why Work Became So Bad for So Many and What Can Be Done to Improve It.* Cambridge, MA: Harvard University Press, 2014.

A

Adler, Carlye, 419n
Adler, Paul S., 400n
Agle, Bradley R., 16n
Agnes, Melissa, 428, 428n
Agrahari, Shishir, 241n
Albrecht, Karl, (fig.) 29, 29n, 30n
Allen, Jodi, 437
Alsenoy, Van, 481n, 486n
Altaf, Amal, 104n
Alter, Adam, 242
Altura, Thomas G., (fig.) 385n, 385
Alzola, Miguel, 108n, 164n
Amengual, Matthew, 387n
Amin, Chirag, 388n
Amos, Don, 124
Anderson, Ray C., 225, 225n
Aragon-Correa, J. Alberto, 229n
Aristotle, 107
Arneault, Ted, 175
Arnold, Denis, 101n
Ausloos, J., 481m
Awan, Mohammad Atif, 104n

B

Baase, Sara, 122n
Barbulescu, Bogdan, 340
Baric, Andrija, 56n
Barickman, Richard, 100n
Barra, Mary, 497–499
Barrett, George, 169
Barua, Samil Kuman, 453n
Batker, D.P., 473n
Beauchamp, Tom L., 101n
Beaupre, Ryan, 181n
Bebchuk, Lucian A., 294, 294n
Bell, Gardner, 86n
Benioff, Marc, 416, 418n
Benn, Suzanne, 224n
Berenbeim, Ronald C., 124n
Berkley, Seth, 257
Bertrand, Marianne, (exh.) 406n
Bezos, Jeff, 3
Bhagwati, Jagdish, 81n
Bier, David, 373n
Birleffi, Bobbie, 463n
Blair, Margaret, 4n
Blankenship, Donald L., 501–504, (exh.) 503
Blumenthal, Neil, 60
Boatright, John R., 102n, 108n, 110n, 120n
Bolton, John, 172
Bombardini, Matilde, (exh.) 406n
Bonardi, Jean-Philippe, 164n
Bond, James T., 344n
Bonilla, Susan, 24
Boudreaux, Denis P., 476n
Boutilier, Robert, 16n
Bowie, Norman E., 101n
Branch, Charles, 256
Brewer, Rosalind, 357
Brooks, Leonard J., 119n
Brown, Daniel, 372
Brynjolfsson, Erik, 240n
Buffet, Warren, 421
Bullard, Robert D., 217n
Burke, Edmund M., (fig.) 398n
Byrne, Erica Salmon, 116, 116n

C

Carlson, Gretchen, 420
Carnegie, Andrew, 51
Carter, Colin, 289, 289n
Case, Anne, 444n
Casey, Michael J., (exh.) 383n
Cattaneo, Olivier, 376n
Chace, Zoe, 512n
Chan, Priscilla, 51
Cicero, Theodore J., 450n
Clark, Cynthia, 480n
Clarke, Richard, 250
Cline, Elizabeth L., 516n, 517n
Cody, Doug, 467–468
Cohen, Michael, (exh.) 166
Colao, Vittorio, 397
Colby, Anne, 106n
Coll, Steve, 50n
Comey, James, 259
Connerly, Ward, 362n
Cook, Tim, 259–260, 371–372
Cosio, Daniel, 185
Cox, Christopher, 301
Crapo, Michael, 45
Crossler, Robert E., 112n
Cuili, Qian, 55n
Cullen, John B., (fig.) 116n, 118n
Cutts, Matt, 486n

D

Dalton, Dan R., 98n
Daly, Herman E., 194n
Daniels, Tracy, 368–369
Davidson, Julie O'Connell, 465n
Davidson, Paul, 70
Deaton, Angus, 444n
DeGette, Diana, 498–499
Dell, Michael, 146
Dent, Charlie, (exh.) 169
DesJardins, Joe, 101n, 107n
DiIulio, Jr., John J., 154–155
Dimon, Jamie, 274
Dixon, Pam, 274–275
Doh, Jonathan, 42n
Doherty, Betty T., 474n
Donaldson, Thomas, 4n
Dorff, Michael, 295, 295n
Dowling, Grahame R., (exh.) 427n
Dudley, Susan, (fig.) 154n
Dunfee, Thomas W., 411n
Dunn, Paul, 119n
Dunn, Steven C., 389n
Dunphy, Dexter, 224n

E

Eagan, Nicole, 273
Eccles, Robert G., 228n, 232n
Eichstaedt, Peter, 91n
Eisenbeis, H. Richard, 462n
Elonis, Anthony, 251, 251n
Epstein, Edwin, 50n, 177n
Erkman, Turhan, 56n
Esen, Emel, 56n
Esposito, John, 522n, 527
Esty, Daniel C., 229n
Ewing, Jack, 325n

F

Fantazy, Kamal, 395n
Farook, Syed Rizwan, 259–260
Farooq, Omer, 100n
Farrell, Michael B., 465n
Feroli, Michael, 3n
Feuerstein, Aaron, 57
Fink, Laurence, 4, 4n
Fishman, Charles, 231n
Fishman, Raymond, (exh.) 406n
Fleisher, Craig S., 426n
Fombrun, Charles J., 56n, 421n, 423n
Ford, Henry, 51
Foreman, Jr., Christopher H., 217n
Fox, Steven, 270, 270n
Frederick, William C., 52, 52n, (fig.) 52n
Freeman, R. Edward, 8n, 12n
Fried, Jesse M., 294, 294n
Friedman, Milton, 57, 57n, 59n
Friedman, Thomas, 72n
Fuller, Steve, 422

G

Galinsky, Ellen, 344n
Galloway, Scott, 3, 3n
Gat, Azar, (exh.) 84n
Gaurango, Banerjee, 99n

Gautier, Arthur, 403n
Gentile, Mary, (exh.) 128
Gereffi, Gary, 376n, 384n, 385n
Ghosh, Dipayan, 314n
Ghosn, Carlos, 292
Gibson, Kim, 119
Gill, David W., 57n
Gillespie, Janet, 106n
Gillia, Barchi, 389n
Glasmeier, Amy K., 338n, (exh.) 339n
Goggins, Bradley K., 62n, (fig.) 63
Goldstein, Jerry D., 51n
Gong, Yu, 395n
Gonzalez, Doris, 55, 56n
Gonzalez, Mario Costeja, 480–481
Goodell, Jeff, 502, 502n, 504n, 507n
Gordon, Eric, 45
Gorski, David, (exh.) 109
Griffin, Karen, 125
Griffiths, Andrew, 224n
Gross, Kenneth A., 177n
Guislain, Marie-Laurie, 114
Gujarathi, Mahendra R., 453n
Guy, Gery P., (exh.) 446n

H

Haden, Jeff, 435n
Hammond, Allen, 79n
Handfield, Robert, (exh.) 389n
Hardin, Garrett, 196n
Harknett, Kristin, (exh.) 329n
Hart, Stuart L., 86n, 224n
Hartman, Laura P., 101n, 107n
Hauser, Christine, 476n
Hawken, Paul, 190n
Hayes, Tom, 35
Hedegaard, Holly, 444n
Hefley, Joel, 168
Henderson, Lisa Leslie, 433, 433n
Hendricks, Kevin B., 383n
Heron, Richard J.L., 474n
Hess, David, 411n
Hewitt, Jillian, 98n
Higgins, Andrew, 525
Higgins, Colin, 66n
Hill, John W., 98n
Hillman, Amy J., 164n, (fig.) 165n
Hitt, Michael A., (fig.) 165n
Hoag, Matthew, 99n
Holbrook, Wanda, 333
Hollinger, Richard C., 344n
Hong, Ki P., 177n
Hooghiemstra, Reggy, 422n, 423n
Hossain, Farid, 514n
Houck, John, 336n
Howe, Steve, 366
Hyland, Shiela, (exh.) 430n

I

Iacobelli, Alphons, 101, 106, 111
Ibsen, Marlene, 401
Ioannou, Ioannis, 232n
Isaacs, William, 41n
Iyer, Kedar, 365

J

Jacobs, Daniel, 471n, 472n
Jae-Yong, Lee, 131
Jafar, Musa, 521n
Jobs, Steve, 90
John, Steve, 179n
Jones, David A., 409n
Jones, Hannah, 391n
Jones, Thomas, 111n
Joy, Bill, 253, 253n

K

Karesh, Lewis, 512n, 515n
Karsten, Paul, 100n
Kaya, Halil D., 99n
Keim, Gerald D., 164n
Kelly, Larry, 332
Kerry, John, 156
Khan, Mozaffar, 232n
Kidder, Rushworth, 107n
Kohlberg, Lawrence, (fig.) 105n, 106n
Kolodny, Andrew, 443n, 445n
Kopf, Beverly, 463n
Kordsmeier, John, 64
Korten, David C., 50n
Kovacevich, Richard, 456–457
Kramer, Mark R., 411n
Krause, Daniel R., 389n
Krueger, Alan B., 445n
Krugman, Paul, 146
Krzus, Michael P., 228n
Kuczerawy, A., 481n
Kumar, Manohar, 346n
Kwang-Ho, Kim, 55n
Kwok, Richard K., 474n
Kwon, E.Y., 523n
Kwon, S.W., 400n

L

Labelle, Huguette, 130
LaPierre, Wayne, 44
Lauren, Francine, 395n
Lawrence, Anne T., 27n, (fig.) 39n, 41n, (fig.) 385n, 385, 388n, 442n, 490n, 500n, 510n
Le, Vananh, 16n
Lehman, Tom, 141n
LeVeness, Frank P., 110n
Levine, Diana, 319
Lewis, Arthur, 82, 82n
Linde, Robyn, 462n
Linden, Lawrence. (exh.) 169
Lipton, Eric, 478n, 479n
Locke, Richard M., 377, 377n, 386, 390n
Lodge, George, 141n
Longhi, Mario, 184–185
Loraas, Tina M., 112n
Lorsch, Jay, 289, 289n
Lovins, Amory, 190n
Lovins, L. Hunter, 190n
Luca, Michael, 14n

M

Macchiaroia, Frank, 177
MacDonald, Chris, 101n, 107n
Mackar, Robin, 474n
MacLaury, Bruce K., 4n
Madoff, Bernard, 301
Mahon, John F., 56n, 164n
Makower, Joel, 230, 230n
Malone, Patricia, 181n
Manchester, Geoff, 230n
Marcelo, Sheila Lirio, 368
Mariani, Mike, 445n
Markey, Ed, 497–498
Matos, Kenneth, 344n
Mayer, Frederick, 384n, 385n
Mazutis, Daina, 57n
McAfee, Andrew, 240n
McGowan, Richard A., 164n
McKibben, Bill, (exh.) 192n
McMylor, Peter, (fig.) 108n
Meade, Paul, 31
Meier, Barry, 445n
Merunka, Dwight, 100n
Metzger, Michael B., 98n
Mezharich, Frank, 332
Miglani, Anil, 427n
Miles, Samantha, 8n
Miller, William F., 112n
Milliman, John F., 104n
Milne, Markus J., 66n
MinChung, Kim, 55n
Mintz, Steven, (fig.) 108n, 119n
Mirvis, Philip H., 60n, (fig.) 63
Mitchell, Ronald K., 16n
Mitroff, Ian I., 427n
Mittal, Lakshmi, 185
Mohamad, Mostafa Haji, 114
Moodhi, James, 300
Morris, Roselyn, 119n
Moser, Klaus, 100n
Muhler, Charles, 335n
Munoz, Oscar, 439
Murphy, Tim, 498
Musk, Elon, 262
Mvistendahl, Mara, (exh.) 321
Myring, Mark, 99n

N

Najib, Malaysian Prime Minister, (exh.) 170
Neal, Alfred C., 50n
Neck, Christopher P., 104n
Nelson, Marilyn Carlson, 462–470
Nelson, Ryan, 86n
Nest, Michael, 91n
New, Steve, (exh.) 383n
Nilson, Victor, 265
Noble, Lawrence M., 177n

O

Olson, Kim, 464
Ong, Josh, 424

P

Pache, Anne-Claire, 403n
Paine, Lynn, 123–124, 124n
Palmer, Daniel E., 7n
Paludi, Michelle, 100n
Pant, Muktesh, (exh.) 248
Parnell, Stewart, 95
Paul, Rand, 176
Payoud, Marielle, 100n
Peck, Josh, (exh.) 152, 152n
Peltz, Nelson, 289, 296
Penn, Mark, 177
Perelmuter, Rimma, 246–247
Phillips, Robert, 7n
Piketty, Thomas, (fig.) 338n
Polman, Tom, 226
Polski, Tom, 468
Porteous, Angharad, 389n, 391n
Porter, Michael E., 411n
Post, James E., 4n, 38n, 336n
Postel, Sandra, 200n
Prahalad, C.K., 85, 86n
Preston, Lee E., 4n, 38n
Price, Dan, 69–70
Primeaux, Patrick, 110n
Putman, Robert D., 400n

Q

Quinones, Sam, 450, 450n

R

Rai, Kavita Joshi, 395n
Rajaratnam, Raj, 300
Raman, Mythili, 130
Rammohan, Sonali, 389n, 391n
Rands, Gordon P., 225n
Rankin, Caddie Putnam, 60n
Rasche, Andreas, 38n
Rauch, Maggie, 463n
Regmi, Krishna, 328
Restogi, Shruti, 241n
Richardo, David, 78
Rivas, Daniel, 300
Rivoli, Pietra, 378n
Roberts, David, 504n
Robichaux, Michael, 474n
Rodrik, Dani, 81n
Rogovski, Nikolai, 411n
Roman, Ronald M., (fig.) 385n, 385n, 388n
Rovenpor, Janet L., 521n
Rowley, Timothy J., 10n
Rudd, Rose A., 443n
Rung, Ariane Lisann., 474n
Rusiecki, Jennifer., 474n

S

Saba, Sally, 366
Sachs, Sybille, 4n
Saez, Emmanuel, (fig.) 338n
Saiia, David, 16n
Salomon, Robert, 72n
Samuelson, Judith, 359, 359n
Sanders, Bernie, 175–176
Sandoval, Adriana, 365–366
Santoro, Daniele, 346n
Sanyal, Rajib, 132n
Savage, Dan, 521, 522
Schmidt, Stephen, 272
Schneider, Daniel, (exh.) 329n
Schoenberger, Karl, 385n
Schroeder, Joe, 99n
Schultz, Howard, 48
Scott, Ben, 314n
Seijts, Jana, 429n
Serafeim, George, 232n, 232n
Shah, Grishma, 521n
Shapiro, Joshua, 48
Sharma, Sanjay, 227n
Shawver, Tara J., 112n
Sheehy, Lisa Pike, 176
Shnayerson, Michael, 501n, 502n
Shrivastava, Paul, 427n
Sibilia, Joe, 434n
Silver, David, (exh.) 174n
Simha, Aditya, 118n
Singh, Anchal, 241n
Singhal, Vinod R., 383n
Sjoquist, Darrion, 328–329
Slat, Boyan, 203
Smith, Brad, (exh.) 126, 245
Smith, Jeffrey D., 101n, 108n, 110n
Smith, John L., 304n
Snyder, Jim, 502n
Solomon, Robert C., 107, 107n, (fig.) 109n
Song, Susan, 465n
Sonnenfeld, Jeffrey, 297
Spence, Michael, 240n
Speth, James Gustave, 194n
Spinello, Richard, 122n
Staab, Debra, 490n
Starik, Mark, 225n
Staritz, Cornelia, 376n
Stiglitz, Joseph E., 81n
Stopera, M., 524n
Stumpf, John, 290, 459n, 460n
Suarez-Villa, Luis, 50n
Sun, Qiang, 256
Surowiecki, James, 519n
Svendsen, Ann, 41n

T

Talbot, Margaret, 444
Tayan, Brian, 458n
Taylor, Bob, 189n
Taylor, Jacqueline Sanchez, 465n
Temple, John, 443, 443n, 448n, 449, 449n
Thompson, Stuart, 179n
Tieszen, Lori, 527
Toffler, Alvin, 240n
Ton, Zeynep, 339n
Trebbi, Francesco, (exh.) 406n
Trevino, Linda Klebe, 124n
Trump, Donald J., (exh.) 78, 145, 149, 164, 185, 371
Tyler, Beverly, B., 389n

U

Ulukaya, Hamdi, 360

V

Valdez, Robert, 275
Valette-Florence, Pierre, 100n
Van Gramberg, Bernadine, 66n
Van Riel, C.B.M., 422n
Van Riel, Cees, 421n, 422n, 423n
Van Schendel, Willem, 512n
Velasquez, Manual G., (fig.) 108n, 110n, 346n
Verma, Ashish Swarup, 241n
Vestager, Margrethe, 150
Victor, Bart, (fig.) 116n
Votaw, Dow, 50n
Voudy, Frank, 362

W

Waddell, Steven, 87n, (fig.) 88n
Waddock, Sandra, 38n, 195–196, 196n
Wahab, Surja, 209
Wallberg, Elin, 61
Walton, Clarence C., 55n
Walzenegger, Dieter, 459n
Warren, Melinda, (fig.) 154n
Wasieleski, David, 7n, 8n, 10n, 52n, 57n, 60n, 106n, (fig.) 123n, 196n
Weaver, Gary R., 124n
Weber, Axel, 51, 51n
Weber, James, 7n, 8n, 10n, 52n, 57n, 60n, 104n, 106n, 112n, 118n, (fig.) 123n, 196n
Weber, Larry, 433, 433n
Whitaker, Victoria, 66
Whitcomb, Robert, 10n
Whitehead, Clare, 416
Whitmore, Justin, 226
Wicks, Andrew C., 51n
Williams, Geisha, 354
Williams, Oliver, 336n
Williams, Wendy, 10n
Winston, Andrew S., 229n
Winterkorn, Martin, 324
Witzel, Jay, 468
Wong, Pindar, (exh.) 383n
Wood, Donna J., 16n
Wynn, Steve, 303–304

Y

Yaziji, Michael, 42n
Yoon, Aaron, 232n
Young, Abe Louise, 475n
Young, Richard R., 389n

Z

Zadek, Simon, 62n, 64
Zaditis, K., 526n
Zakhem, Abe J., 7n
Zeithaml, Carl, 86n
Zivan, David, 323n
Zuckerberg, Mark, 51, 158–159, 242, 432
Zweibel, Patricia M., 177n

SUBJECT INDEX

A

Aaron's, Inc., 363–364
Acid rain, 215, 215n, 219n
Act Blue, 173
Ad Council, 436, 436n, (www) 438
Advocacy advertising, 176
AeroFarms, 401–402, 402n
Affirmative action, 361–362
Affordable Care Act, (exh.) 152, 178
AFL-CIO, (fig.) 293n, (www) 347
Agenda 2030, 189, 189n
Airbus Group, 189–190
Alcoholic beverage industry, U.S., 523–524
Alstom, 130
Alternative dispute resolution (ADR), 319
Amazon, 3–4, 267
American Business Association of University Women (AAUW), 437
American Business Collaboration for Quality Dependent Care, (www) 371
American Civil Liberties Union (ACLU), (www) 347
American Institute for Certified Public Accountants (AICPA), (exh.) 119
American Lung Association, 214n
American Marketing Association (AMA), (exh.) 121
American Medical Association, (www) 277
American Medical Institute, (www) 438
American Petroleum Institute (API), 176–177
Anadarko Petroleum, 220–221
Anti-Americanism, 81
Antibiotics, 33–36
Anti-Phishing Working Group, 244, (www) 258
Antitrust laws, 150–151, (exh.) 151
Apple, 259–260, 283, 371–373
Archer Daniels Midland (ADM), 202
Artificial intelligence, 268–269
Association of Information Technology Professionals (AITP), (exh.) 121
Association of International Product Marketing and Management, (www) 438
As You Sow, 294, 294n
AT&T, (exh.) 151, 402–403, 403n
Australian Council of Superannuation Investors, 295n
Authoritarian capitalism, (exh.) 84
Autodesk, 229n
Autonomous automobiles, 278–280
Aviation Plan, The, 156

B

Bangladesh, 380
Bangladesh Garment Manufacturers and Exporters Association, (exh.) 513n, (exh.) 514n
Bangladesh Labor Act, 515
Bank of America, 368
Barclay's PLC, 119–120
Barlow, et al. v. A.P. Smith Manufacturing, 55
B corporation, 60, 60n, (www) 68
Behavioral addiction, 242
Behavioral advertising, 315
Berkman Center for Internet and Society, 483n
Better Business Bureau, (www) 324
Better Cotton Initiative, 395n
Big data, 264–265
Biodiversity, 201–202
Biotechnology, 241, 256
Biotechnology Industry Organization, (www) 258, 497, 497n
Bitcoin, 248, (exh.) 249
BlackBerry, 246
BlackRock, 269
Bloomberg, (www) 23
BMW, 364
Board of directors, 287–289
Bottom of the Pyramid, 85–86
Boundary-spanning departments, 19–20, (fig.) 19
BP, 215–216, 471–479
Brand management, 426
Bribery, 129–132
Brookings Institute, 337n
BSR, (www) 68
BTNP, 86
Bundling, 179
Bureau of Ocean Energy Management, 478n
Bureau of Safety and Environmental Enforcement, 478n
Business, 4
Business and government:
  legitimacy issues, 141
  seeking a collaborative partnership, 139–140
  working in opposition, 140–141
Business and society, 4–5, (fig.) 5
  a systems perspective, 5–6
Business.com, (www) 347
Business ethics, 96–97
  across organizational functions, 118–122, (exh.) 119, (exh.) 121, (exh.) 122
Business Fights Poverty, (www) 416
Business in Society Gateway, (www) 68
Business Roundtable, 168–169, 169n, (www) 183
Business Software Alliance (BSA), (www) 277

C

California Public Employees Retirement System (CalPERS), (www) 303
California Teachers' Retirement System (CalSTRS), 283
Capacity building, 389
Cap-and-trade, 219
Carbon Disclosure Project, 199n
Carbon neutrality, 204
Carbon offsets, 204
Carlson Company, 462–470
Carrying capacity, 194
Casa Alianza, 465n
Catalyst.org, (www) 371
Cato Institute, (www) 157
CEMEX, 402, 402n
Center for Business Ethics, (fig.) 123n
Center for Corporate Citizenship at Boston College, (exh.) 401n, 409n, 409n, (www) 416
Center for Disease Control, (exh.) 318n
Center for Public Integrity, 178n
Center for Responsive Politics, (fig.) 167n
Center for Spirituality at Work, (www) 113
Central state control, 83
Century Fox, 283
CFA Institute, (exh.) 119
Chief Information Officer, 269–271, (fig.) 270, (www) 277
Chief Sustainability Officer, 225–226
Child care, 367
Child labor, 380–381
Chile, 151
Climeworks, 195
China, (exh.) 84, 145, 181, 193–194, 252, 263, 317
Chlorofluorohydrocarbons (HCFCs), 199
Chowbotics, 262
Chrysler, 320
Circular economy, 204
Cisco Systems, 410
Citizens United, 173, (exh.) 174, 176
Civic engagement, 399–400
Civil society, 87, (fig.) 88
Class Action Fairness Act, 318–319
Clean Clothes Campaign, 379, 510n, 514n, 515, 520

Clean cooking, 208–210
Clean economy, 223
Climate change, 196
Clove cigarettes, 80, 80n
CNN Money, (www) 23
Coal Mine Health and Safety Act, 148
Coca-Cola, (exh.) 37
Codes of Environmental Conduct, 206–207
Collaborative partnerships, building, 414–415
Colorbox Industries, (exh.) 378n
Command and control regulation, 219
Committee Encouraging Corporate Philanthropy, (www) 416
Common Cause, (www) 183
Commons, 196
Community:
- business case for involvement in the, 399–400
- business relationship, 398–399, (fig.) 398, (fig.) 398, (exh.) 399
- relations, 400–403

Community relations manager, 401
Competitive intelligence, 31–32
Comprehensive Environmental Response Compensation Liability Act (CERCLA) (*See* Superfund), 217
ConAgra, 382, 382n
Conference Board, The, 359n
Conflict diamonds, 88
Conflict minerals, 90–91
Conflicts of interest, 102
Congressional Research Service, 377n
Conscious Company Media, (www) 68
Consumer affairs officer, 322
Consumer Federation of America, 308, (www) 324
Consumer Financial Protection Bureau, (exh.) 313, 319n
Consumer Goods Forum, 202n
Consumer movement, 308
Consumer privacy, 314
Consumer Product Safety Commission, (www) 324
Consumer Products Forum, 201–202
Consumer protection laws, 309
Consumer Reports, (www) 324
Consumers:
- achievements, 323
- business responses to, 320–323, (exh.) 321
- courts and product liability, 316–319, (exh.) 318
- government protection, 309–314, (fig.) 309, (fig.) 312, (exh.) 313
- privacy in the digital age, 314–316
- rights, 307–308, (fig.) 307
- self-advocacy for, 308

Consumers International (CI), 308, (www) 324
Convention on Biological Diversity, 202
Convention on Climate Change, 198
Corporate citizenship (*See* Corporate Social Responsibility), 51
- stages of, 62–64, (fig.) 63

Corporate crisis, 427
Corporate culture, 116–117
Corporate foundations, 406–407
Corporate giving, 403–413, (fig.) 404, (fig.) 405, (exh.) 406, (exh.) 409, (fig.) 410, (fig.) 413
Corporate governance, 287
- principles of good, 289–291

Corporate identity, 421–422
Corporate image, 422
Corporate philanthropy, 403–404
Corporate political strategy, 164–165, (fig.) 165
- constituency-building, (fig.) 165, 175–178
- financial-incentive, (fig.) 165, (exh.) 170, 170–175, (fig.) 171, (exh.) 174
- global challenge, 180–182
- information, (fig.) 165, (exh.) 166, 166–170, (fig.) 167, (exh.) 169
- levels of involvement, 178–179, (fig.) 179
- managing the political environment, 179–180, (exh.) 180
- political action tactics, 165–166, (exh.) 166

Corporate power and responsibility, 49–50, (fig.) 49
Corporate reputation, 421–423, (fig.) 423
Corporate Responsibility Magazine, (www) 133
Corporate Social Responsibility and Citizenship, 51–53, (fig.) 52
- assessing social performance, 64–67, (exh.) 66, (exh.) 67
- balancing multiple responsibilities, 53
- evolving phases, (fig.) 52
- management systems, 60–61
- origins, 51–53
- professional associations, (exh.) 62
- question, 53–59, (fig.) 54, (fig.) 59

Corporate Social Responsibility Newswire, (www) 68
Cost-benefit analysis, 154
Council of Institutional Investors, 296, (www) 303
Council on Foreign Relations, (www) 44
Crisis management, 427–430, (exh.) 429, (exh.) 430
Crisis plan, 428
Crowd-sourced audit, 388
CSRwire, 434, 434n
CSX, 198–199
Curitiba (Brazil), (exh.) 192
Cybercrime, 271–273, (fig.) 271
- costs of, 272–274
- government efforts to combat, 275–276

D

DACA (Deferred for Childhood Arrivals), 371–373
Dark money, 173
Dark site, 429
Day Zero, 200
Debt relief, 76
Deceptive advertising, 310
Defense Industry Initiative on Business Ethics and Conduct, (www) 133
Deloitte, 31–32
Deloitte and the Alliance for Board Diversity, 288n
Deloitte Consulting, 364n
Deloitte Global Center for Corporate Governance, (fig.) 358n
Democracy, 82
Democratic Republic of the Congo (DRC), 90–91
Deregulation, 155
DeVry University, 310
Diageo, 163
Digital Advertising Alliance, 316n
Digital Divide Institute, (www) 258
Digital divide, the, 245–246
Digital Millennium Copyright Act, 263, 263n, 482, 482n
Distracted driving, 142–144
Diversity, (*See* Workplace diversity) 351
Diversity council, 366
Diversity, Inc., (www) 371
Dodd-Frank Act, 149
Drone makers and operators, 140
Drug Enforcement Administration (DEA), 447–448, (exh.) 448
Drug testing, 342–343
Dynamic environment of business, 20–22, (fig.) 20

E

Eat Right Pro, 421n
E-business, 266–267, (fig.) 266
E-cigarettes, 139
Ecological challenges, (*See* Natural environment).
Ecological footprint, 194
Ecologically Sustainable Organization (ESO), 225
E-commerce Times, (www) 258, (www) 277
Economic leverage, 175
Economic Policy Institute, 337n
Economic regulations, 149
Economist, The, (www) 23
Economy Watch, (www) 157
Ecosystem, 190
EcoVadis, 388–389, 389n
ECPAT International, 465n

Edelman Trust Barometer Global Report, (fig.) 431n
Elder care, 367–368
Electronic Communications Privacy Act, 341
Electronic Frontier Foundation, (www) 258
Electronic Industry Citizenship Coalition (EICC) (*See* Responsible Business Alliance)
Electronic medical records, 257
Electronic monitoring, 340–341
Employee assistance programs (EAPs), 344
Employee privacy, 339–340
Employees:
  as corporate stakeholders, 343
  employment relationship, 329–330
  fair wages and income equality, 337–339, (fig.) 338, (fig.) 339
  privacy in the workplace, 339–345
  whistleblowing and free speech, 345–346
  workplace rights, (fig.) 330, 330–336, (fig.) 331
Employment-at-will, 334–335
End Citizens United, 122, (exh.) 122
Enlightened self-interest, 53
Environmental analysis, 28–31, (fig.) 30
Environmental Defense Fund, 212, 212n
Environmental intelligence, 29
Environmental justice, 217
Environmental partnerships, 228
Environmental Protection Agency (EPA), 213, 216n, 222, (www) 234
Equal employment opportunity, 360–361
Equal Employment Opportunity Commission (EEOC), 363, 364n, (www) 371
Equator Principles, 206–207, 207n
Equifax, 133–135
Ergonomics, 333
Ethical climates, 117–118, (fig.) 117
Ethical egoist, 101
Ethical principles, 95
Ethical problems, analyzing, 106–111
Ethical problems occur in business, why, 101–103, (fig.) 101
Ethical reasoning, 106, (fig.) 107
Ethical relativism, 96
Ethics:
  and compliance officers, 125–126, (exh.) 126
  in accounting, 118, (exh.) 119
  in a global economy, 129–132
  in finance, 119–120, (exh.) 119
  in information technology, 121–122, (exh.) 121
  in marketing, 120–121, (exh.) 121
  in supply chain, 122, (exh.) 122
  meaning of, 95–97
  policies or codes, 124–125, (exh.) 125
  reporting mechanisms, 126–127
  safeguards, (fig.) 123, 123–124
  top management commitment and involvement, 124
  training programs, 127–128, (exh.) 128, (fig.) 128
  why should businesses be, 97–100, (fig.) 97, (fig.) 98
Ethics and Compliance Initiative, (www) 113
Ethics and Compliance Officers Association, 125, (www) 133
Ethics and Policy Integration Centre, (www) 133
Ethics Resource Center, 97n, (fig.) 123n, (www) 133
Ethisphere Institute, 97, (fig.) 98n, (www) 133
European Academy of Business in Society, 37n
European Agency for Fundamental Rights, 363n
European Commission, 355, 485n, 487n
European Consumer Organization, (www) 324
European Corporate Governance Institute, (www) 303
European Labor Force Survey, 355n
European Parliament, 480n, 487n
European Union, 147–148, 150, 363
Executive compensation, 291–295, (fig.) 292, (fig.) 293
Extended product responsibility, 204, (exh.) 205
EY Center for Board Matters, 289n, 298n

F

Facebook, 158–160, 239, 250–251
Fair scheduling, (exh.) 329
Fair Wage Network, (www) 347
Families and Work Institute, 367n, 369n, (www) 371
Family-friendly workplace, 369
Family leave, 368
Federal Aviation Administration (FAA), 140
Federal Bureau of Investigation (FBI), 259–260
Federal Communications Commission (FCC), (www) 438
Federal Reserve System, Board of Governors, (www) 157
Federal Trade Commission (FTC), (www) 157, (www) 277, (www) 324, (www) 438
Fiat Chrysler, 21
Financial Reporting Council, 118
Financial Times (London), (www) 23
Fiscal policy, 145
Food and Drug Administration (FDA), 139, 239, 311, 313, 313n
Food labeling, 54
Forced Labor in Supply Chains, (www) 393
Foreign direct investment, 74
Foresight Institute, (www) 277
Forsta AP-fonden, 466n
Fortune, (www) 23
Forum for Sustainable and Responsible Investment, (www) 303
Foundation Center, (www) 416
Foundation for Public Affairs, (exh.) 180n, 180n, 424n
Fracking, 234–235
Freedom House, 82, 82n
Free enterprise systems, 83
Free speech issues, 251–252

G

Gap, 387n, 390, (fig.) 392n
GapJumper, 365
General Data Protection Regulation (GDPR), 159, 263, 267, 316, 316n
General Electric (GE), 224, (exh.) 321
General Motors, 490–499
General public (*See* Public), 420
General systems theory, 5–6
Genetically modified foods (GM foods), 253–255
Genome Projects (U.S. Department of Energy), (www) 258
Giving in Numbers, 406n, 407n, (fig.) 410n
Giving Institute, (www) 416
Giving USA Foundation, (fig.) 404n, (fig.) 405n, (www) 416
Giving Voice to Values, (exh.) 128
Glass ceiling, 357–358, (fig.) 358
GlaxoSmithKline (GSK), 132
Global action networks (GAN), 87–88
Global Electoral Organization Conference, 181–182
Global Footprint Network, 194n
Globalization:
  benefits and costs of, 78–81, (fig.) 81
  collaborative partnerships, 86–88, (fig.) 88
  comparative political and economic systems, 82–84, (exh.) 84
  global inequality and the bottom of the pyramid, 84–86, (fig.) 85
  international financial and trade institutions, 75–78, (exh.) 77, (exh.) 78
  major transnational enterprises, 73–75, (fig.) 74
  process of the, 72–73
Global Policy Forum, (www) 89
Global Reporting Initiative, (exh.) 66, (www) 68
Global Retail Theft Barometer, 344, 344n
Global Sustainable Investment Alliance, 297n
Global warming, 196–199, (fig.) 197
Global wealth pyramid, 84–85, (fig.) 85
Globe Scan/SustainAbility, (fig.) 232n

Google, 166, 181, 480–489
Government regulation:
continuous reform, 155–156, (exh.) 155
effects, 154–155, (fig.) 154
global context, 156
of business, 147–149
types of, 149–154, (exh.) 151, (exh.) 152, (fig.) 153
Gravity Payments, 69–70
Greece, 76
GreenBiz, (www) 393
Green Business Network, (www) 234
Greenhouse Gas Protocol, 206
Guardian, The, (www) 234

H

Hacker Combat Community, (www) 277
Hackers, 271–272, (fig.) 271
Hackers List, 271–272
H & M, 379, 379n
Harris Poll, (fig.) 423n
Hedge funds, 296
Heidrick & Stuggles, 288n
Hemoba Foundation, 425
Heritage Foundation, 84
Hewlett-Packard (HP), (exh.) 205
Hobby Lobby, 178
Home Depot, 38
Honest Ads Act, 162
Human genome, 255–256
Human Genome Project, 255
Human rights, (*See* Rights reasoning), 82–83
Human Rights Campaign Foundation, (exh.) 370n, (www) 371
Human Rights Watch, 516n
Human trafficking, 380–381, 462–470
Hydraulic fracking (*See* Fracking)

I

IBM, 55–56, 231, 414
IdleAir, 215–216, 216n
IKEA, 393–395, 395n
Image advertisements, 436–437, (fig.) 437
Inclusion, 364
Industrial ecology, 203
Information security, business responses to invasions, 274–275
Information Systems Security Association, (www) 277
In-kind contributions, 407
Insider trading, 300–301
Institute for a Drug-Free Workplace, (www) 347
Institute for Crisis Management, 428n
Institute for Global Ethics, (www) 133
Institute for Policy Studies, (fig.) 293n
Institute for Supply Management (ISM), 122n,
Institute of Business Ethics, (www) 113
Institute of Medicine, (exh.) 318n
Institutional investors, 285, (fig.) 285
rise of, 296–297
Insurance Institute for Highway Safety, 143n, 144
Integrated reports, 66
Integrated supplier scorecards, 391
Intel, 90–91, 413, 413n
Intellectual property, 263
Interactive social system, 6
Interface, 225, 225n
Interfaith Centre on Corporate Responsibility (ICCR), 466n
Intergovernmental Panel on Climate Change, 197, (www) 208
International Business Ethics Institute, (www) 113, (www) 133
International Chamber of Commerce, 206
International financial and trade institutions (IFTIs), 75
International Forum on Globalization, (www) 89
International Labor Rights Forum, 510n, 514n
International Labour Organization (ILO), 380n
International Maritime Organization, 382n
International Monetary Fund (IMF), 76, (www) 89
International Society for Stem Cell Research, (www) 258
Internet, 241–243, (fig.) 243
Internet Society, (www) 258
Intrepid Travel, 229
Iran, 156, 252–253
Iron law of responsibility, 50
ISIS in Syria, 113–114
ISS (formerly Institutional Shareholder Services), (www) 303
Issue Management Council, (www) 44
Issue management process, 33–36, (fig.) 34
organizing for effective, 36–37, (exh.) 37

J

Jana Partners, 283
Japan, 181
JBS, 117
JetBlue, (exh.) 409
Johnson & Johnson, 55
Justice reasoning, (fig.) 107, 110

K

Kaiser Family Foundation, 443n
Kalundborg (Denmark), 203–204, 204n
Kentucky Fried Chicken (KFC), (exh.) 248
Keurig Green Mountain, 409
Kids Eat Right, 421
Kimberley process, 88
Kobe Steel Limited, 122
Korn Ferry Institute, 290n
KPMG, 365, 365n

L

Labor force participation rate, 353, (fig.) 353
Labor unions, 330–333, (fig.) 331
LafargeHolcim, 113–114
Laws, 96
Leadership in Energy and Environmental design (LEED), (exh.) 230
Lending Club, 298–299
Levi Strauss, 212, 212n
LGBT equality, (exh.) 370
License to operate, 400
Life-cycle analysis, 203
Light Bulb Finder, 195
Living wage, 338–339, (fig.) 339
L.L. Bean, 422
Lobbying, 166–168, (exh.) 166, (fig.) 167
Local Governments for Sustainability, (www) 208

M

Madagascar, 391
Malaysian campaign finances, (exh.) 170
Malcolm Baldridge National Quality Award, 320
Manufacturing Jobs Initiative, 164
Marine ecosystems, 202
Market-based mechanisms, 219–220
Market failure, 147
Marks & Spencer, 204–205, 205n
Massey Energy, 500–509, (exh.) 504n
Material sustainability issues, 232
Mattel Toy Company, 376–377
McCutcheon v. Federal Election Commission, 173–174
McDonald's, 189, 189n, 433–434
McKeeson, 442–443
McKinsey & Company, 224n, 268, 518n
Media, 421
Mercatus Center, (www) 157
Merck, (exh.) 41
Meta Group, (fig.) 270
Microfinance, 86
Microsoft, (exh.) 126n, 205–206, 245
Millennials, 408
Millennium Project, The, (www) 44
Mine Safety and Health Administration, 505–507, 505n, (exh.) 506n
Minha Casa, Minha Vida, 147
Minimum wage, 331–332
Mobile telephones (M-commerce), 246–248, (fig.) 247, (exh.) 248
Modern Slavery Act, 149
Monetary policy, 146

Monsanto, (www) 258
Monster Beverage, 375
Montreal Protocol, 199, 199n
Moral development, stages of, 105–106, (fig.) 105
Moral intensity, 111–112
Morgan Stanley Institute for Sustainable Investing, 297n
MSCI, 359n
Multinational enterprises, 73–75, (fig.) 74

N

Nail salon and care, 348–349
National Cannabis Industry Association, 162
National Center for Crisis Management, (www) 438
National Conference of State Legislators, 144n
National Drug-Free Workplace Alliance, 344n
National Federation of Independent Businesses, (www) 183
National Highway Traffic Safety Administration (NHTSA), 311, 494–495
National Institute of Drug Abuse, 443n
National Issues Forum, (www) 44
National Rifle Association, 44–45
National Transportation Safety Board (NTSB), 140
National Whistleblowers Center, (www) 347
National Wildlife Federation, 472n
National Workrights Institute, (www) 347
Nations Development Programme, 512n
Natural capital, 190
Natural environment, business and society and the, 190, (fig.) 191
  Earth's carrying capacity, 194–196
  forces of change, 192–194, (fig.) 193
  global issues, 196–203, (fig.) 197
  international community response, 203–207, (exh.) 205
  sustainable development, 190–191, (exh.) 192
  threats to the Earth's ecosystem, 191–192
Natural monopolies, 148
Negative externalities, 148
Nestlé, 32, 32n, (fig.) 33, 53, 148–149, 381
Netflix, 322
Net neutrality, (exh.) 264, 264
Networking Academy, 410n
New American Economy, 360n
New York Stock Exchange, (www) 303
New York Times, The, (www) 23, 362–363
Nike Corporation, 42, 42n, 388n, 391n
Nongovernmental organizations (NGOs), 87
North Korea, 253
Northrup Grumman, 366, 366n
Norway, 220
Novo Nordisk, 435
Novozymes, 228, 228n
Nuclear Information and Resource Service, 217n

O

Obesity, 151, (exh.) 318
Ocean Cleanup, The, 203
Occupational Safety and Health Administration (OSHA), 334, (www) 347
Occupational segregation, 354–355
Office of Foreign Asset Control, 141n
Omnichannel, 267
Opensecrets.org, 183, (fig.) 184
Opioid epidemic, U.S., 442–452, (exh.) 446, (exh.) 448
Organization for Economic Cooperation and Development (OECD), 290, 290n
Outcome Health, 120
Ozone, 199

P

Paid content, 434
Pakistan, 252
P & G, 296, 426, 426n
Panek Precision, 268
Paraquat, 102–103
Parental leave, 368
Paris Agreement, 198
Patagonia, 176, 375
Pay gap, 354, (fig.) 355
Peanut Corporation of America, 95
Pepsi, 420
Performance-expectations gap, 26, (fig.) 27
Petroeo Brasileiro, 130
Pew Charitable Trusts, 203n
Pew Research Center, 354n, (fig.) 425n
Pfizer, 116, 397
Phishing, 244
Points of Light Foundation, (www) 416
Political action committees (PACs), 170–172, (fig.) 171
Political environment:
  arguments for and against business involvement, (fig.) 163
  managing the, 179–180, (exh.) 180
  participants in the, 163–164
Political involvement, levels of, 178–179, (fig.) 179
Politico, (www) 183
Politics.co.uk, (www) 183
Predatory pricing, 150
PricewaterhouseCoopers, 118
Privacy Rights Clearinghouse, 341n
Private equity firms, 296
Private regulation, 384
Product liability, 316–317, (exh.) 318
Product recall, 322–323
Professional Crisis Management Association, (www) 438
Professional sport franchises, (exh.) 399
Proxy, 287
Proxy access, 289
Public:
  brand management, 426–427, (exh.) 427
  corporate reputation, 421–423, (fig.) 423
  crisis management, 427–430, (exh.) 429, (exh.) 430
  engaging key stakeholders, 430–437, (fig.) 431, (fig.) 435, (fig.) 437
  general, 420–421
  relations department, 424–426, (fig.) 425
Public Affairs Council, (www) 44, (www) 183
Public affairs department, 179–180, (exh.) 180
Public Disclosure Commission, (www) 183
Public issue, 26–28
Public policy:
  elements of, 142–144
  role of government, 141–142
  types of, 145–147
Public Private Alliance for Responsible Minerals Trade, 90, 91n
Public Relations Society of America (PRSA), (www) 438
Public service announcements (PSAs), 436
Publix, 36, 36n, 38
Puma, 227n
Purdue Farms, 35
Purdue Pharma, 445–447

Q

Qualcomm, 95, 150
Quality management, 320

R

Race to the bottom, 80
Racial harassment, 363
Rana Plaza, 380, 510–520
Ransomware attacks, 273
Regeneron, 407, 407n
Regulation, 147
Regulations.gov, (www) 157
REI, 422
Renault, 204n
Reputation, 56
Reputation Institute, 56, (www) 438
Reregulation, 155–156
Responsible Business Alliance (RBA), 65, 65n, (exh.) 386, 386n, (www) 393

Responsible Sourcing Network, (www) 393
Return on social investment, 412, (fig.) 413
Revolving door, 168, (exh.) 169
Right to be forgotten, 262–263, 480–489
Right to privacy, 250
Right to try, (exh.) 109
Rights reasoning, (fig.) 107, 109–110
Robots, 267–269
Robotics Industries Association, (www) 277
Rocky Mountain Institute, (exh.) 230n
Rolls-Royce, 130
Root cause analysis, 390
Roundtable on Sustainable Palm Oil, 382n
Royal Bank of Scotland, 120
Royal Dutch Shell, 269
Russia, 524

S

SAI Global, (www) 133
Salesforce, 200, 416–418, 418n
Samsung, 131
Sarbanes-Oxley Act, 99, 99n, (www) 113
Sarbanes Oxley Compliance Professionals Association, (www) 113
Say-on-pay, 294–295
S.C. Johnson, 86, 367n
SeaWorld Parks, 283
Securities and Exchange Commission (SEC), 298, 299, (www) 303, 346n
Sexual and racial harassment, 362–364
Shareholder lawsuits, 298–299
Shareholders:
  activism, 295–299
  and corporate governance, 287–291
  and the corporation, 301–302
  around the world, 283–284, (fig.) 284
  defined, 284–285, (fig.) 285
  government protection of, 299–301
  legal rights and safeguards, 286–287, (fig.) 286
  objectives of stock ownership, 285–286
Sharing economy, (exh.) 337
Silicon Valley Community Foundation, 408n
Skilled-based volunteerism, 408
Social assistance policies, 145
Social audit, standards of, 64–65, (exh.) 66
Social capital, 400
Social contract, 335–336
Social entrepreneurs, 59–60
Social entrepreneurship, 59
Social investment, 297–298
Social Media Association, (www) 438
Social media influencers, 424–425
Social Media Today, (www) 258
Social networking, 248–250, (fig.) 249, (www) 258
Social regulations, 151–154, (exh.) 151
Social reporting, corporate, 65–67, (exh.) 67
Social responsibility shareholder resolutions, 298
Social ventures, 59
Society, 4
Society of Corporate Compliance and Ethics, (www) 133
Sodexo, 56–57, 57n
Soft money, 173
Software piracy, 263
Sonoco, 31n, 32
Spam (unsolicited commercial e-mail), 243, (fig.) 244
Spirituality in the workplace, 104–105
Stakeholder:
  analysis, 11–18, (fig.) 12
  are managers, (exh.) 9
  coalitions, 15–16
  concept of, 8
  dialogue, 41–43
  engagement, 38–40, (fig.) 39
  interests, 12–13, (exh.) 16–17
  internal and external, 10
  mapping, 16–18, (fig.) 18
  market and nonmarket, 9–11, (fig.) 11
  materiality, 32, (fig.) 33
  networks, 41–42
  power, 13–15, (exh.) 16–17
  salience, 15–16
  theory of the firm, 6–8
Stanford University Research on Responsible Supply Chain, (www) 393
Starbucks, 38–39, 48, 228, 328–329
Star Model, 436–437, (fig.) 437
Statistic Brain Research Institute, (www) 258
Statistics Portal, (fig.) 435n
Stem cell research, 256
Stock options, 291
Stoli Group, 521–528
Strategic and Competitive Intelligence Professionals, 32n, (www) 44
Strategic philanthropy, 410
Strict liability, 317
Subaru, 229, 229n
Superfund, 217
Super PACs, 172
Supplier development, 389
Suppliers, 376–378, (fig.) 378
  development and capability building, 389–392, (fig.) 392
  global supply chain issues, 378–383, (exh.) 383
  private regulation of, 384–387, (fig.) 385, (exh.) 386, (fig.) 387
  supply chain auditing, 387–389
Supply chain, 376
Supply chain audit, 387
Supply chain codes of conduct, 385
Supply chain map, 378, (fig.) 378
Supply chain risk, 383
Supply chain transparency, (exh.) 383
Supply Chain World (SCW), (fig.) 387n
SustainAbility, (www) 234
Sustainability Consortium, 203n
Sustainability, managing for:
  competitive advantage, 228–233, (exh.) 230, (fig.) 232
  costs and benefits of environmental regulation, 222–224, (fig.) 223
  ecologically sustainable organization, 225–228
  role of government, 213–222, (fig.) 214, (exh.) 218, (fig.) 221
  stages of corporate environmental responsibility, 224
Sustainability report, 227
Sustainable cotton supply chain, 393–395
Sustainable development, 190–191, (exh.) 192
Sweatshops, 379
Sweden, 216
Symrise, 391, 391n
Syngenta, 201

T

Taproot Foundation, (www) 416
Tariff, 77, (exh.) 78
Tax-exempt organizations, 172–173
Taylor Guitars, 189
Technology:
  chief information, security, technology officer, 269–271, (fig.) 270
  defined, 239–240
  digital divide in the United States and worldwide, 245–246
  ethical challenges, 250–252
  government censorship, 252–253
  government regulation of, 262–264, (exh.) 264
  mobile telephones, 246–248, (fig.) 247, (exh.) 248
  phases of, 240–241, (fig.) 240
  robots and artificial intelligence, 267–269
  role in business, 264–267
  role in our daily lives, 241–244, (fig.) 243, (fig.) 244
  scientific breakthroughs, impact of, 253–257
  social networking, 248–250
Technology cooperation, 205
Tenet Healthcare, 102
Tesla, 140, 278
Textile Excellence, 379n
3M, (exh.) 125
Three Square Market, 265
Tier-1 suppliers, 376
Tier-2 suppliers, 376

Time Warner, (exh.) 151
Toffler, Alvin, 240n
Towers Watson, 352n
Toxic Release Inventory, 220n
Toyota, 231n
Trade associations, 177–178
Trade policy, 145
Transparency International, 129–130, 129n, (www) 133, 167–168, 513n
Travelers, 401
Trian Partners, 296
21st Century Fox, 420
Tyson Foods, 35, 226

U

Uber, 23–24, 72, 139
Ultimate Software, 351
Undocumented (unauthorized) immigrant workers, 352
UNICEF, (www) 68, 83n
Unilever, 391
United Airlines, 439–440
United for a Fair Economy, (fig.) 293n
United Kingdom, 405–406
United Kingdom Bribery Act, 131, 131n
United Nations and Civil Society, (www) 89
United Nations Conference on Trade and Development, 73n, 74n
United Nations Convention to Combat Desertification, 201n
United Nations Development Programme, 82n
United Nations Environmental Program, 200n, (www) 208
United Nations Framework Convention on Climate Change, (www) 208
United Nations Global Compact, (www) 68
United Nations Global Issues, (www) 44
United Nations International Law, (www) 157
United Nations Population Division, (fig.) 193n
U.S. Bureau of Labor Statistics, 332n, 333n, 336n, 352n, (fig.) 353n, (fig.) 355n, 355n, (fig.) 357, 367n
U.S. Census Bureau, 216n, 282n, 360n
U.S. Chamber of Commerce, 177, 177n
U.S. Consumer Financial Protection Bureau, (www) 157
U.S. Corporate Sentencing Guidelines, 98–99, 99n
U.S. Department of Interior, 479n
U.S. Department of Justice, 317n, 442n
U.S. Department of Labor, Glass Ceiling Commission, 359n
U.S. Department of State, 465n, 516n
U.S. False Claims Act, 346
U.S. Federal Election Commission (FEC), (www) 183
U.S. Federal Trade Commission (FTC) (*See* Federal Trade Commission)
U.S. Foreign Corrupt Practices Act (FCPA), 131
U.S. Green Building Council, (exh.) 230, 230n
U.S. House of Representatives Lobbying Disclosure, (www) 183
U.S. Office of Government Ethics, (www) 113
U.S. Office of Information and Regulatory Affairs, (www) 157
U.S. Sentencing Commission, (www) 113
U.S. Small Business Administration, 360n, (www) 371
U.S. steel industry, 183–186, (fig.) 184
U.S. Substance Abuse and Mental Health Services Administration, 344n
U.S. Surgeon General, (exh.) 318n
Universal Declaration of Human Rights, 83n
Unocal, 14n
Unsolicited commercial e-mail (*See* Spam)
Upper Big Branch Mine, 500–509
UPS, 257
User-generated content, 433
Utilitarian reasoning, (fig.) 107, 108–109
Utility Workers Union of America (UWUA), 332

V

Values, manager's, 103–104
Virtue ethics, 107–108, (fig.) 107, (fig.) 108
Vodafone, 397, 397n
Volkswagen, 215, 324–326
Volunteering in the United States, 408n
Volunteerism, 407–408, (exh.) 409
Volvo, 278
VTech, 121–122
Vulture funds, (exh.) 77

W

Walmart, 375, 400
Warby Parker, 60
Wells Fargo, 116, 345, 408, 453–461
Wendy's, (exh.) 429
WEN Haircare, 306, 306n
Western Climate Initiative, 212, 212n
Western Growers Association, 321
Whole Foods Market, 397
Wir Zusammen, 75
Worker Rights Consortium, 518n
Work flexibility, 368–370, (exh.) 370
Workforce diversity, 351
Workforce, the changing face of the, 351–353
  gender and race at work, 353–354, (fig.) 353
  gender and racial pay gap, 354–356, (fig.) 354, (exh.) 356
  glass ceiling, breaking the, 356–359, (fig.) 358
  women and minority business ownership, 359–360
  women and persons of color, 356, (exh.) 357
Working Mother magazine, 369n, (www) 371
Workplace diversity, 364–367
Workplace Fairness, (WWW) 347
World Bank, 75, (www) 89, 400n, 512n
World Business Council on Sustainable Development (WBCSD), (www) 208
World Economic Forum, 99, (www) 393
World Future Society, (www) 44
World Resources Institute, (www) 208
World Tourism Organization, 464
World Trade Organization (WTO), 76, (www) 89
Worldwatch Institute, (www) 208
World Wildlife Fund, 201n
W.R. Grace, 38
Wyeth v. Levine, 319
Wynn Resorts, 303–304