BUSINESS ETHICS

READINGS AND CASES IN CORPORATE MORALITY

FIFTH EDITION

EDITED BY W. MICHAEL HOFFMAN, ROBERT E. FREDERICK, AND MARK S. SCHWARTZ

WILEY Blackwell

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Readings and Cases
in Corporate Morality

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W. Michael Hoffman
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Mark S. Schwartz

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Contents

About the Editors xi
Preface xii

General Introduction: The Nature of Business Ethics 1

Part 1 ETHICS AND BUSINESS: FROM THEORY TO PRACTICE 37

Introduction 37

1 Theories of Economic Justice 43

Justice as Fairness 43
John Rawls
Distributive Justice 49
Robert Nozick
Distributive Justice and Utilitarianism 55
J. J. C. Smart
The "Invisible Hand" 59
Jan Narveson
Corporate Ethics in a Devilish System 70
Kent Greenfield

Questions for Discussion 77

2 Ethics and Business Decision Making 78

Teaching Ethical Decision Making and Principled Reasoning 78
Michael Josephson
Business Ethics and Moral Motivation: A Criminological Perspective 86
Joseph Heath
Ethical Leadership and the Psychology of Decision Making 105
David M. Messick and Max H. Bazerman
Cost-Benefit Analysis: An Ethical Critique 120
Steven Kelman
Cost-Benefit Analysis Defended 127
Herman B. Leonard and Richard J. Zeckhauser

Questions for Discussion 130

Cases for Part 1 **131**

Mini-Cases 131

MBA Student Mini-Dilemmas 132

Cases

The Parable of the Sadhu 133
Bowen H. McCoy

The Ford Pinto 139
W. Michael Hoffman

The Analyst's Dilemma (A) 145
Joseph L. Badaracco Jr. and Jerry Useem

Walk Away From Your Mortgage! 149
Roger Lowenstein

The Ok Tedi Copper Mine 150
Manuel G. Velasquez

Part 2 THE NATURE OF THE CORPORATION **157**

Introduction 157

3 Agency, Legitimacy, and Responsibility **163**

Can a Corporation Have a Conscience? 163
Kenneth E. Goodpaster and John B. Matthews Jr.

Is Business Bluffing Ethical? 172
Albert Z. Carr

The Social Responsibility of Business is to Increase its Profits 180
Milton Friedman

Stakeholder Theory of the Modern Corporation 184
R. Edward Freeman

Ethics in Business: Two Skeptical Challenges 192
Robert E. Frederick

Commentary on the Social Responsibility of Corporate Entities: Bad and Not-so-Bad Arguments for Shareholder Primacy 202
Lynn A. Stout

Questions for Discussion 215

4 Corporate Governance and Accountability **216**

Who Rules the Corporation? 216
Ralph Nader, Mark Green, and Joel Seligman

Power and Accountability: The Changing Role of the Corporate Board of Directors 224
Irving S. Shapiro

Who Should Control the Corporation? 231
Henry Mintzberg

Tone at the Top: An Ethics Code for Directors? 243
Mark S. Schwartz, Thomas W. Dunfee, and Michael J. Kline

Do CEOs Get Paid Too Much? 264
Jeffrey Moriarty

Questions for Discussion 274

Cases for Part 2 275

Mini-Cases 275

MBA Student Mini-Dilemmas 277

Cases

Fire Destroys Malden Mills 277
Anonymous

Merck & Co., Inc. (A) 279
David Bollier and Stephanie Weiss

Bailouts and Bonuses on Wall Street 284
Kirsten Martin and Michael Scotto

Citigroup's Chief Rebuffed on Pay by Shareholders 297
Jessica Silver-Greenberg and Nelson D. Schwartz

Part 3 WORK IN THE CORPORATION 301

Introduction 301

5 Employee Rights and Duties 307

Employee Rights 307
Ronald Duska

Human Rights, Workers' Rights, and the "Right" to Occupational Safety 316
Tibor R. Machan

Whistle-Blowing 320
Richard T. De George

The Morality of Whistleblowing: A Commentary on Richard T. De George 338
W. Michael Hoffman and Mark S. Schwartz

Conflicts of Interest 350
Thomas L. Carson

The Moral Problem in Insider Trading 368
Alan Strudler

Questions for Discussion 382

6 The Modern Workplace: Obligations and Limits 383

A Kantian Theory of Meaningful Work 383
Norman E. Bowie

Organization of Work in the Company and Family Rights of the Employees 392
Domènec Melé

Workplace Wars: How Much Should *I* be Required to Meet the Needs of *Your* Children? 401
Claudia Mills

Discrimination, Harassment, and the Glass Ceiling: Women Executives as Change Agents 407
Myrtle P. Bell, Mary E. McLaughlin, and Jennifer M. Sequeira
The Debate Over the Prohibition of Romance in the Workplace 418
Colin Boyd

Questions for Discussion 431

Cases for Part 3 **432**

Mini-Cases 432

MBA Student Mini-Dilemmas 433

Cases
The Case of the Mismanaged Ms. 434
Sally Seymour
Heineken NV: Workplace HIV/AIDS Programs in Africa (A) 439
Diana Barrett and Daniella Ballou
Banking: A Crack in the Swiss Vault 450
Andy Court and Keith Sharman
Will Rewards for Whistleblowers Encourage Ethical Behavior? 454
Matthew Gilley and W. Michael Hoffman
Boeing Chief is Ousted after Admitting Affair 455
Leslie Wayne
Abuse Scandal Inquiry Damns Paterno and Penn State 457
Ken Belson
Timeline: The Penn State Scandal 460
Justin Sablich, Ford Fessenden, and Alan McLean
You've Been Tagged! (Then Again, Maybe Not): Employers and Facebook 463
William P. Smith and Deborah L. Kidder

Part 4 THE CORPORATION IN SOCIETY **475**

Introduction 475

7 The Consumer **481**

The Dependence Effect 481
John Kenneth Galbraith
The *Non Sequitur* of the "Dependence Effect" 485
F. A. von Hayek
The Ethics of Consumer Protection 488
Manuel G. Velasquez
Marketing and the Vulnerable 504
George G. Brenkert

Questions for Discussion 513

8 The Environment and Sustainability 514

Morality, Money, and Motor Cars 514
Norman Bowie
Business and Environmental Ethics 520
W. Michael Hoffman
Creating Sustainable Value 529
Stuart L. Hart and Mark B. Milstein
Rethinking the Concept of Sustainability 542
Alexis J. Bañon Gomis, Manuel Guillén Parra, W. Michael Hoffman, and Robert E. McNulty

Questions for Discussion 552

9 International Business 553

Ethical Dilemmas for Multinational Enterprise: A Philosophical Overview 553
Richard T. De George
International Business, Morality, and the Common Good 557
Manuel G. Velasquez
Values in Tension: Ethics Away from Home 567
Thomas Donaldson
The Case for Leveraged-Based Corporate Human Rights Responsibility 576
Stepan Wood
What's Wrong with Bribery 602
Scott Turow
Capitalism with a Human Face: The UN Global Compact 604
Klaus M. Leisinger

Questions for Discussion 620

Cases for Part 4 621

Mini-Cases 622

MBA Student Mini-Dilemmas 623

Cases

The Ethics of Marketing: Nestlé's Infant Formula 624
James E. Post
TransAuto Corporation Trade-offs 629
Rewritten by Mark S. Schwartz
Sony Online Entertainment: EverQuest® or EverCrack? 632
Judith W. Spain and Gina Vega
Dicing with Death? A Case Study of Guidant Corporation's Implantable Defibrillator Business 636
Martin E. Sandbu
Chiquita Accused of Funding Colombia Terrorists 642
Curt Anderson

Wal-Mart Hushed Up a Vast Mexican Bribery Case 644
David Barstow
Yahoo! and Google in China 656
John M. Kline
Google Softens Tone on China 661
Amir Efrati and Loretta Chao

Part 5 CHALLENGES AND EMERGING ISSUES 665

Introduction 665

10 Challenges and Emerging Issues 669

What's the Matter with Business Ethics? 669
Andrew Stark
Developing and Sustaining an Ethical Corporate Culture: The Core Elements 677
Mark S. Schwartz
The Ethics Officer as Agent of the Board: Leveraging Ethical Governance Capability in the Post-Enron Corporation 689
W. Michael Hoffman and Mark Rowe
Can a Company be Too Ethical? 699
Andrew W. Singer
God as a Managerial Stakeholder? 705
Mark S. Schwartz
The Fortune at the Bottom of the Pyramid 720
C. K. Prahalad and Stuart L. Hart

Questions for Discussion 733

Business Ethics in Hollywood Movies 733
Mark S. Schwartz

Cases for Part 5 735

Mini-Cases 735

Cases

Global Corporation: Running a Global Ethics and Compliance Program 736
Lisa A. Stewart
Barrick's Tanzanian Project Tests Ethical Mining Policies 743
Geoffrey York
An Ethical Approach to Crisis Management 749
Mark S. Schwartz, Wesley Cragg, and W. Michael Hoffman
Why I Am Leaving Goldman Sachs 756
Greg Smith

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Preface

The preface to the first edition of *Business Ethics: Readings and Cases in Corporate Morality* began with advice from Cicero's *De officiis*: "To everyone who proposes to have a good career, moral philosophy is indispensable." Cicero's words are as true and as timely as ever, and the fifth edition of this text represents our continuing commitment to the union of ethics and business.

The field of business ethics has grown tremendously since 1984, when the first edition was released. At that time, business ethics had just begun to gain momentum. Today it is a mature field. In a 1988 report, the Business Roundtable referred to corporate ethics as "a prime business asset," and corporations have begun to take significant steps toward integrating ethical values into their corporate cultures. In fact, the Center for Business Ethics at Bentley University was the facilitating institution for a newly formed organization made up of practicing ethics officers of major corporations. The Association to Advance Collegiate Schools of Business has strengthened its call for grounding in ethics as one of the essential elements of sound business education. Literature in business ethics continues to grow and deepen.

In the fifth edition of *Business Ethics*, we have attempted to include both the best new thinking on ethical issues in business and the first, second, third, and fourth editions' time-tested favorites. The goals of the text remain the same. We have tried to be comprehensive. In our coverage of the issues, we have selected what we believe to be the most important currently debated moral concerns in the field. We have retained many of the topics from the fourth edition and have added new material on issues such as workplace romance and business sustainability. All of the chapters have been revised to some extent. The final section has been extensively revised and now includes material on developing and sustaining an ethical corporate culture. Many cases from the fourth edition remain, but we have included timely new cases such as those on Heineken and African employees with HIV/AIDS, football coach Joe Paterno and whistleblowing obligations, and Walmart's bribery scandal in Mexico. We have also added a new feature to the fifth edition, a series of ethical mini-dilemmas faced by MBA students. The ethical dilemmas add another means for readers to consider and discuss ethical issues faced by individuals in business. As an additional feature, we have also added a list of potential Hollywood movies students can watch that contain important business ethics issues.

As with earlier editions, we have tried to be impartial. The format of the text, wherever appropriate, is point/counter-point, and we have included the strongest statements we could find of different perspectives on the issues. We have made an effort to include articles by thinkers from a wide range of constituencies – not just academics, but representatives from a variety of other professions.

Finally, we have tried to be systematic. We have retained the basic organization of earlier editions. We begin with theoretical, structural, or more widely focused issues such as economic justice, the justice of economic systems, and the nature and responsibility of business. These give a framework for discussion and understanding of more specific, concrete issues, such as employee rights, the ethics of marketing and production, environmental ethics, and multinational issues. We conclude with a chapter on current challenges and future issues. Of course, the book may be used in many different ways. Some instructors may prefer to save the more abstract topics for the end of their course. We believe that the book lends itself readily to organizational variations.

The fifth edition continues to include an introduction to each part that sets out the major themes of the articles and places them in context. This edition includes brief introductions to the mini-cases and cases, and points out which articles might be most directly relevant to them. A set of discussion questions follow each chapter. These can be used as a focus for student discussion, for review, or for tests, quizzes, or student assignments.

We would like to express our appreciation to Bentley University for its support of this and other projects in business ethics. Thanks also go to Mary Chiasson, senior associate director of the Center for Business Ethics, Jeffrey Kimball, graduate research assistant at the Center, and Faidat Olamuyiwa, Leon Sullivan Scholar at the Center, for their help in the preparation of this manuscript.

Finally, we are grateful to the following scholars for their reviews of earlier versions of this book: William C. Gentry, Henderson State University; Charles T. Hughes, Chapman University; William L. Langenfus, John Carroll University; Christopher P. Mooney, Nassau Community College; Jon W. Nelson, University of Nebraska at Kearney; and Richard Srb, Middlesex Community Technical College.

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General Introduction
The Nature of Business Ethics

Business is a complex web of human relationships – relationships between manufacturers and consumers, employers and employees, managers and stockholders, members of corporations and members of communities in which those corporations operate. These are economic relationships, created by the exchange of goods and services; but they are also *moral* relationships. Questions concerning profit, growth, and technological advance have ethical dimensions. These include the effects of pollution and depletion of natural resources on society at large, the quality and character of the work environment, and the safety of consumers. As an anthology in business ethics, this text proposes to explore the moral dimension of business.

Ethics may be defined as the study of what is good or right for human beings. It asks what goals people ought to pursue and what actions they ought to perform. Business ethics is a branch of applied ethics; it studies the relationship of what is good and right to business.[1]

But how do we know what is right or wrong or good or bad for business? Before discussing in more detail the content of the various ethical principles, it might be helpful to clarify what ethics is not.

Ethics and etiquette: For some, ethics or morality is confused with the notion of etiquette. In most cases etiquette refers to behavior that is considered socially acceptable, as opposed to morally right or wrong. Concepts such as politeness, manners, one's dress, or rules of conduct might be associated with etiquette. For example, etiquette might require one to use a handkerchief upon sneezing, or to shake hands when meeting someone for the first time. There may be cases though when proper etiquette can cross over the line into the domain of morality. For example, in some countries acceptance of gifts in business might be considered proper etiquette, although arguments can be raised that such activity is unethical.

Ethics and the law: Typically, the law tends to reflect or embody the moral norms of society, and on this basis it can be suggested that what is legal is also ethical. Although ethics and the law often overlap, this may not always be the case. Some laws could be considered amoral, such as driving on the right-hand or left-hand side of the road. Alternatively, many acts which are legal might still be considered to be unethical, such as receiving gifts from suppliers, conducting personal business on company time, or invasions of privacy. Still, in other cases, laws themselves may be determined to be unethical, such as the previous Apartheid laws in South Africa, or the previous racial discrimination laws in the USA. For this reason, it is important to realize that the law does not always equal ethics, and in most cases merely sets out the minimum standards of expected behavior.

Ethics and religion: In a number of respects, ethics and religion are related to each other. Many of our

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ethical prescriptions, such as don't kill or steal, derive from religious doctrine. The "golden rule," or "do unto others as you would want done to yourself," can be found expressed in some form across most religions. Although ethics and religion often overlap, this is also not always the case. Certain religious prescriptions have been considered by others to be immoral, such as religious decrees prohibiting abortion or euthanasia. Certain religious prescriptions regarding the role of women in society have also been considered by others as being immoral or unethical. One must therefore be careful before necessarily accepting that ethics and religion are one and the same.

It is sometimes said that business and ethics don't mix. In business, some argue, profit takes precedence. Business has its own rules and objectives, and ethical concepts, standards, and judgments are inappropriate in the context of business. But this view is fundamentally mistaken. Business is an economic institution, but like our economy as a whole, it has a moral foundation. The free-market system reflects our convictions about the nature of the good life and the good society, about the fair distribution of goods and services, and about what kinds of goods and services to distribute. It is true that the goal of business has been profit, but profit-making is not a morally neutral activity. Traditionally, we have encouraged business to pursue profits because we believed – rightly or wrongly – that profit-seeking violates no rights and is best for society as a whole. This conviction has been the source of business's legitimacy, our belief in its right to exist. In the past two decades, however, the belief that business makes an entirely positive contribution to the general welfare has been challenged. For many, business's connection with the moral foundation which justified it no longer seems clear. Distrust of business has increased; recent polls, for example, indicate that Americans believe that the ethical standards of business are lower than those of society as a whole. Many thinkers contend that business faces a crisis of legitimacy. In such a climate, an investigation of business values, of the moral dimension of business, and of the role of business in society becomes urgent. To undertake such an investigation is the task of business ethics. This anthology approaches this task on four levels:

1. An ethical investigation of the context in which American business is conducted – that is, capitalism or the free-market system. Does the system truly contribute to a good society and reflect our most important social values? In particular, is it a just system, one that reflects our beliefs about the fair distribution of goods and services? The selections included in Part 1 of this text explore the meaning of justice in a modern economy, and the question of whether capitalism embodies that ideal. It also suggests some specific ways in which ethical values have operated or should operate in business decision making.
2. An inquiry, within this broad economic context, into the nature and role of business organizations. Is the function of business activity simply to make a profit? Do businesses have other obligations because of their vast power or relationship to other elements of society? How might corporate structures best reflect the nature and responsibilities of corporations? Such questions are taken up in Part 2.
3. An examination of particular ethical issues which arise in the course of business activity, such as employee rights and duties, relationships in working life, hiring practices, advertising and product safety, obligations to the environment, and operating in foreign countries. A range of such issues is covered in Parts 3 and 4.
4. An examination and ethical assessment of the values which reside implicitly in business organizations and business activity in general, such as freedom of opportunity, economic growth, and material well-being. We pursue this endeavor throughout the text, and in Part 5 we examine the development of the corporate ethos and reflect on the future of the moral corporation.

Engaging in ethical reflection on business at each of these levels requires using ethical concepts, theories, and standards of judgment. The remainder of this General Introduction presents some of the most important principles of ethical theory. To provide a context for discussion of these principles, we begin with a brief history of the field of business ethics. We then discuss the types of business decisions we can make.

Brief History of Business Ethics

How has the field of business ethics developed over time? Is it merely a passing management fad? This hardly appears to be the case. Certainly ethics in business has been an issue since the very first business transaction. For example, the Code of Hammurabi, created nearly four thousand years ago, records that Mesopotamian rulers attempted to create honest prices. During the fourth century BC, Aristotle discusses the vices and virtues of tradesmen and merchants. The Old Testament and the Jewish Talmud discuss the proper way to conduct business, including topics such as fraud, theft, proper weights and measures, competition and free entry, misleading advertising, just prices, and environmental issues. The New Testament and the Islamic Koran also discuss business ethics as it relates to poverty and wealth. Throughout the history of commerce, these 'codes' have had an impact on business dealings. During the nineteenth century, issues such as the creation of monopolies and the use of slavery were important business ethics issues, and continue to be debated now.

In recent times, business ethics has moved through several stages of development. Prior to the 1960s, business was often considered to be an amoral activity; concepts like ethics and social responsibility were rarely mentioned. During the 1960s, a number of social issues in business began to emerge, including civil rights, the environment, safety in the workplace, and consumer issues. During the 1970s, the field of business ethics took root in academia, with most US schools offering a course in business ethics by 1980. From 1980 to 1985 the business ethics field continued to consolidate, evidenced by the flourishing of journals, research centers, and conferences. From 1985 to 1995 business ethics became integrated into large corporations, with the development of codes of ethics, ethics training, ethics hotlines, and ethics officers. Since 1995, issues related to international business activity has come to the forefront, including issues of bribery and corruption, and the use of child and slave labor abroad. Since 2001, most of the focus has been on understanding the causes of such major corporate scandals such as Enron and WorldCom, as well as preventing another 2008 financial crisis.

Let's now look at an example of the kind of ethical decision individuals sometimes face in business.

Types of Business Decisions

The Amalgamated Machinery dilemma

Ted Brown is worried. A salesman for Amalgamated Machinery, he is in charge of negotiating an important sale of construction equipment to the government of a small but rapidly developing nation. Deeply in debt, Amalgamated has staked its future on penetrating foreign markets. And Ted's potential contract is not only a very large one, it could open the door to even bigger sales in the future. If he lands the contract, Ted's future in the firm is bright – and he was convinced he would get the contract until he spoke with a powerful government official who is involved in the negotiations. Ted's bid, the official explained, is regarded very favorably. In fact it is the lowest. All that is needed to clinch the deal is a $100,000 "commission fee" payable in cash to the official. If Ted does not pay the fee, the official regrets that the contract will go to a competitor.

Ted knows that the sale is crucial for his company. He believes that his customers would get the best possible deal by buying Amalgamated's equipment. And he knows that $100,000 is a relatively small sum compared with the potential profits represented by the contract. Yet, although he is aware that such payments are not unusual in many countries, he has always felt that they were wrong, and has never before used them to secure a deal.

Ted Brown's dilemma is fictitious, but it is not farfetched. It illustrates a problem businesspeople often face: Should the interests of the firm override personal convictions about the right thing to do, or should one always act on one's personal convictions despite the consequences for the firm? Clearly, Ted's decision will not be easy. How should he go about deciding what to do? And if Ted were to ask you for advice, what would you say?

One thing you might point out is that Ted needs to understand the kind of decision he is making. Although he can do only one of two things – either pay the $100,000 or not – he can formulate his decision from at least three distinct perspectives or points of view. They are:

1. Which is the better decision from a *business* point of view?
2. Which is the better decision from a *legal* point of view?
3. Which is the better decision from a *moral* point of view?

A second point is that in most (but not all) cases when someone decides to do something that he or she regards as important, the decision to act comes at the end of a process of deliberation. And to deliberate about an action is (roughly) to weigh the reasons for doing it according to some standard or principle. Such standards or principles have two important features. First, they are supposed to apply to all decisions of a certain kind regardless of who makes the decision. Second, they purport to differentiate between better and worse decisions of that kind. For example, if Ted were to decide from a business point of view he would weigh the reasons for paying or not paying according to a principle that differentiates between better and worse business decisions. Often that principle is assumed to be this: In every business undertaking, one ought to do whatever maximizes long-term profits. So if Ted believes that the decision should be made from a business point of view, and if he were to judge that paying the bribe would maximize long-term profits, he would pay up.

Suppose, however, Ted believes that the decision should be made from a legal point of view. Now the principle might be: For any action to which the law applies, one ought not do that act if it is illegal. As anyone familiar with the law knows, determining whether a specific act is legal can be difficult. But assume Ted decides that it is illegal to make the payment. Then the principle instructs him not to pay. On the other hand, suppose he decides it is legal. Should he pay? Not necessarily. The standard says only, "If something is illegal, don't do it." It doesn't say, "If it is legal, do it." So in a sense the legal principle is incomplete. Once Ted decides that the act is legal, it has nothing further to tell him about what is best to do.

The third way that Ted could make his decision – the one we will be most concerned with in this General Introduction – is from a moral point of view. What is it to decide from a moral point of view? If we follow the model presented above, it is to evaluate the reasons, to deliberate about doing one thing rather than another according to some moral standard or principle that differentiates between better and worse moral decisions. So to decide from a moral point of view we need, first, to know what kind of moral principles there are; second, what kind of reasons are relevant to moral action; and, third, how to evaluate those reasons in light of the principle. For example, suppose the moral principle Ted accepts is: One always ought to do what is in one's own self-interest. Then he would consider the reasons for believing that paying the bribe, or not paying, is in his best interest. Suppose, for example, that after analyzing the business aspects of paying the bribe he finds that paying would maximize profit. This could be to his advantage since a firm that places a high value on profit is also likely to place high value on employees who contribute to profit. However, if the bribe is illegal, and if it is discovered that Ted paid the bribe, he would be in trouble. The authorities would probably impose a heavy fine on the firm, and this would not endear Ted to upper management. Furthermore, Ted might face legal sanctions himself. It seems, then, that if Ted wants to do what is in his own best interest he has a lot of thinking to do. Making the correct decision from a moral point of view will not be easy.

In fact, it is characteristic of moral decisions that they are not easy. There are three main reasons for this. First, much more often than not, moral decisions are important. They affect our lives and the lives of others in significant ways. Second, moral decisions are complex. Frequently no obvious or easy solution presents itself, and it is not unusual for there to be several alternatives that seem equally reasonable. Finally, there is often deep disagreement about which moral principle should be applied to the decision. Different people may have very different ideas about which standard is appropriate. To take a (slightly modified) famous example, suppose someone, call him Paul, faces the problem of either leaving home and joining the forces defending his country from invasion by an evil empire, or staying and comforting his mother through the last stages of a debilitating and fatal illness. Should he go or stay?

Suppose Paul accepts Ted's moral standard: One always ought to do what is in one's own best interest. And suppose Paul decides that it is in his best interest, all things considered, to avoid the problem altogether. So he decides to relieve his mother of what small savings she has accumulated and purchase a ticket on the next plane leaving for a more peaceful and prosperous kingdom. Surely, he reasons, this would be better for him than risking his life in a war or dawdling about waiting for an old woman to die.

Most people would probably be outraged by Paul's decision. Some might argue that he has duties to his mother that override his self-interest. Others might say that he should promote the common good of his fellow citizens by defending his homeland. And still others would say that his decision shows character flaws such as cowardice and ingratitude. Each of these responses makes implicit appeal to a different ethical viewpoint – a different way of understanding what Paul ought to do. In the pages to come we will discuss each of these viewpoints. But before we do so we will return briefly to the three different ways that Ted can understand his decision.

The problem of conflicting decision-making rules

We said that Ted can understand his decision from either a business, legal, or ethical point of view. The question naturally arises: Which should he choose? The question would not be hard to answer were there never any possibility of conflict between them; that is, if the best business decision were always and at the same time the best legal and ethical decision. But there is a possibility of conflict. For example, it might maximize profits to pay the bribe even if it is illegal and immoral. And bribery might be immoral, even if not illegal. So the best thing to do from a moral point of view need not be the best thing to do from a business or legal point of view. On the other hand, conflict is not always present. In many cases, perhaps in most cases, the best business decision will also be legally and morally acceptable. In addition, a growing body of empirical evidence has emerged suggesting that "good ethics is good business," or at least that "bad ethics is bad business."[2] But when conflict is present, we need some way to decide what to do. For example, companies which base their decision making on what is the best business decision will inevitably engage in unethical activity when it is profitable to do so.

To resolve potential conflicts, consider the following rules:

1. Whenever there is a conflict between ethics and the law, one ought always to do what the law requires.
2. Whenever there is a conflict between ethics and business principles, one ought always to do what business principles require.

These rules tell us what to do in situations in which ethical and legal or business principles give different instructions. Thus they resolve cases of conflict between ethics and law, and ethics and business. But should we follow them? Might there be circumstances in which it would be wrong to follow them?

There are many examples which seem to show that ethical obligations can outweigh legal obligations, and that in certain circumstances it is permissible to break the law. For instance, in the American civil rights movement laws were deliberately broken when it appeared that no alternative was available to change an intolerable situation. These laws (e.g. laws preventing African-Americans from voting) were clearly unjust. They perpetuated and enforced social arrangements that were deliberately intended to deprive African-Americans and other minorities of the opportunity to participate meaningfully in the economic, educational, and political system. Since many legislatures were controlled by persons unwilling to change the laws, civil disobedience was, in our view, both justified and necessary.

Two things follow from this example. First, in some circumstances breaking the law is justified. Such circumstances may be rare, but they do occur. Second, the justification for such acts derives from ethical principles, e.g. principles of justice. Thus rule number 1 is not acceptable as a general rule for resolving conflicts between the law and ethics. Sometimes we ought to follow ethical principles even though what we do is against the law.

There are also many cases, a number of them in this book, which seem to show that ethical principles sometimes take precedence over the business principle of maximizing profit. For instance, suppose a paper company were to move to a country that has few laws protecting the environment. To minimize costs, and thus enhance profits, the company legally dumps the toxic waste it produces into a nearby river. Eventually this causes health problems for the local inhabitants. The company's actions may be both legal and warranted by considerations of profit. In our view, however, they are ethically unacceptable. Corporate profit does not justify causing harm to persons, particularly when such harm is both foreseeable and preventable.

If this is correct, then profit maximization in business is not always justified. And on occasion the justification for not doing so derives from ethical principles, e.g. the principle that one should not cause preventable harm. Thus, rule number 2 is not acceptable as a general principle for resolving conflicts between ethical and business principles. Sometimes one should follow ethical principles even when profit suffers.

The above examples show that legal and business principles do not always take precedence over ethical principles. But the examples do not show that ethics always comes first. That is, they do not show that:

3. Whenever there is a conflict between ethical principles and business or legal principles, one ought always to do what ethical principles require.

Should we accept rule number 3? If someone were to do so, then for that person obeying the law and maximizing profits would always be secondary to ethics. As we will see, many philosophers have defended ethical principles that imply rule number 3 or something very close to it. The content of these principles, and the arguments for them, is our next topic.

Ethical Subjectivism

Understanding subjectivism

Ethical subjectivism is a viewpoint which is sometimes expressed as "what is right for me may not be right for you." This statement is open to various interpretations. For instance, it could mean: Given our different circumstances, it would be morally right for me to do *X*, but it would not be morally right for you to do *X*. Suppose, for example, that Smith is very wealthy and Brown is very poor. Then it might be morally right for Smith annually to donate a considerable sum to charity, but wrong for Brown to do so because it would deprive her children of basic necessities. Understood this way, the statement highlights an important truth, namely, that the morally correct decision often depends on the circumstances of the person making it. If the circumstances of different persons are very different, then the right decision for them may be different even though they accept the same moral standards.

The statement might also mean: What I think is right may not be what you think is right. Once again this expresses a truth, for, as the debate over abortion abundantly shows, there are many disagreements about what is ethically right.

Neither of the interpretations mentioned so far is objectionable. But there is a third interpretation that is much more controversial. It is this: The correct ethical principle for me may not be the correct ethical principle for you. Unlike the other two interpretations, this one is not obviously true. One reason it is not true, many people would argue, is that ethical principles such as "do unto others as you would have them do unto you" apply to everyone. Whether all ethical principles apply to everyone is a difficult issue that we will discuss briefly later. However, we will try to show that subjectivism is not an acceptable account of ethics even if ethical principles do not apply universally. To explain why, we must examine it in more detail. We begin with a basic statement of the subjectivist position:

> Ethical Subjectivism: What is ethically right or wrong is strictly a matter for individuals to decide based on ethical principles they have chosen. This is because (1) each individual is the sole judge of whether the principle he or she has chosen is the right one for him or her, and (2) each individual is the sole judge of whether his or her action is ethically permissible according to his or her principle.

If ethical subjectivism is true, then what is ethically right or wrong is entirely a personal matter. Each person is the single source and only authority concerning the selection and applicability of his or her own moral standards. There are no valid public standards of moral accountability – no standards that apply to more than one person except insofar as different people choose the same principle by chance. For example, suppose Green and Robinson are thinking about whether some action *X* is morally permissible. Based on standards he has chosen, Green decides it is permissible and does *X*. Based on standards she has chosen, Robinson decides *X* is not morally permissible and does not do it. If Robinson accepts the argument given above, she is in no position to say to Green, "What you did is ethically wrong." Since she acknowledges that each person is sovereign in his or her choice of ethical principles, and that each person is the exclusive judge of whether his or her action conforms to the principle, the best she can do is say, "What you did is wrong according to my standards." But this is simply a statement of fact. It makes no moral evaluation of Green's action.

Subjectivism has great appeal in our diverse society, where all persons are expected to think seriously about ethical issues and to come to their own conclusions. Furthermore, within limits they have a right to express and to act on those conclusions. We expect that even when citizens very seriously disagree with one another, each will treat the other with respect. Ethical subjectivism seems to capture this attitude of tolerance and respect for diversity.

First objection to subjectivism

An objection to ethical subjectivism is that it has unacceptable consequences. For example, in the Smith and Brown example given above, it was said to be ethically permissible for Smith to give a large sum to charity, but not ethically permissible for Brown because it would deprive her children of basic necessities. This judgment rests on the ethical standard "It is wrong for parents voluntarily to deprive their children of basic necessities." But suppose that Brown is an ethical subjectivist and that she accepts quite a different standard, one such as "I should give to charity regardless of how it affects the welfare of my relations." Then from her point of view it would be ethically right for her to give to charity; indeed, it would be wrong of her to choose not to give on the grounds that her children would suffer.

One would think that Brown should have moral commitments to the welfare of her children that place reasonable restrictions on her choice of other ethical principles. She should accept principles that confirm those commitments and reject those that ignore them. However, since Brown is an ethical subjectivist, there are in principle no constraints on her choice of ethical principles other than the ones she accepts. If she chooses principles compatible with the welfare of her children, then that is all well and good. If not, then, if one is an ethical subjectivist, there is no moral reason to complain of her choice.

The main point of the Brown example is this. Ethical subjectivism places no limitations on the *content* of the principles individuals choose. It is consistent with subjectivism that individuals choose principles that license behavior detrimental to the interests and welfare of people, that ignore their rights, and that abjure personal responsibility. So Brown can choose to ignore the welfare of her children, or accept other principles such as "it is permissible for me to lie when I want to" and violate no stricture of ethical subjectivism. In short, as far as subjectivism is concerned, *any* behavior by an individual is ethically permissible as long as the behavior is permitted by a principle that individual has chosen.

But this cannot be correct. It is an unacceptable consequence of subjectivism that it places no restrictions on the kind of ethical principle an individual might select. Principles of the sort mentioned above, e.g. ones that permit harm to others, are not ethical principles; rather, they are anti-ethical principles. They are the antithesis of ethics. It may be true that the ethical principles a person lives by are ultimately chosen by that individual, but it does not follow from this that any principle an individual might choose is rendered ethically acceptable by the mere fact that it was chosen. Persons can choose principles of evil as well as good. Since ethical subjectivism does not distinguish between such choices, it is not an acceptable account of ethics.

Second objection to subjectivism

Suppose a subjectivist were to respond to our argument as follows: You may be right that choosing evil principles is compatible with subjectivism, but that has nothing to do with me. My principles are good, not evil, so your argument is not relevant to the choices I have made. I have no qualms about being a subjectivist. It is those other people that you need to worry about.

This response points to a second and equally important reason to reject subjectivism. To see what it is, suppose we were to ask Brown why she follows a principle that obligates her to give to charity at the expense of her children's welfare. She could give one of two answers. The first is that the choice was arbitrary. There is no reason why she chose that principle instead of another one. Since her choice is arbitrary, tomorrow she might decide, again for no reason, to select a different principle. Arbitrary choices imply no commitment. Since they are made for no reason, there is no reason not to change them on a whim.

People who make arbitrary choices that affect their interests and welfare, or the interests and welfare of other people, are not rational. Since one can never tell what they might do from one minute to the next, the best policy for the rest of us would be to avoid them whenever possible so that we are not harmed by their unpredictable actions. A subjectivist who arbitrarily chooses principles that guide his or her behavior would be a dangerous person. And he or she would not be someone who takes the importance and complexity of moral decisions seriously.

A subjectivist might reply that *of course* the choice is not made arbitrarily. It is based on reasons, which is the second of the two possible answers mentioned above. And the reasons cannot be arbitrary. Otherwise they could be changed on a whim, and the same problem would occur. They must be good reasons. But what is a good reason?

A complete answer would take us far beyond the bounds of this General Introduction. At least we know, however, that a good reason is not an arbitrary reason. So it would help if we knew more about the difference between good reasons and arbitrary reasons. Let us try this. The mark of a good reason – one that is not arbitrary – is that it withstands scrutiny and criticism by other reasonable people. Put another way, the goodness, so to speak, of a good reason is public in the sense that it is open to inspection and evaluation by more than one person. Thus, if a subjectivist offers good reasons for choosing an ethical principle, those reasons are available for other people to judge. If they judge that the reasons offered are not good, then a subjectivist can do one of three things. First, she might try to convince people that the reasons are good after all. Second, she might try to find different reasons that support her choice and are judged good. Finally, she might abandon her choice of ethical principles. What she cannot do, and still maintain that her choice is based on good reasons, is refuse to defend or modify her position. Were she to do so she would be deciding arbitrarily, which is something she is committed not to do.

Is engaging in a public process of evaluating reasons for choosing ethical standards compatible with ethical subjectivism? The answer is clearly "no." For subjectivists the choice of ethical standards is supposed to be entirely personal. No person, other than the one making the choice, has any legitimate say in the matter. But subjectivists are committed to giving good reasons for their choice. Since good reasons are public, not private, other people do have a role in judging the worth of reasons. If the reasons offered are not good, subjectivists cannot refuse to modify their position without violating their own intellectual commitments. Hence, the choice is not entirely private. Other people are involved in the process.

This is the second problem with subjectivism. It is unacceptable because it is inconsistent. On the one hand, subjectivists claim that the choice of ethical standards is completely personal. On the other, if they claim that their choice of principles is based on good reasons, they acknowledge that other people have a role to play in the choice. They cannot have it both ways; at least, not if they claim that subjectivism is a rational ethical viewpoint.

There are two ways that subjectivists could try to avoid this conclusion. The first is to say that the choice of principles is arbitrary, and not based on good reasons. But, as we argued earlier, this position is also irrational. The second is to provide a plausible account of good reasons that does not make the reasons for choosing ethical principles open to public evaluation. No subjectivist has attempted this, nor, we suggest, would they be likely to succeed were they to try. We conclude, then, that subjectivism is not a defensible ethical view.

Recall for a moment the subjectivist's complaint that she has chosen good principles, so the argument that subjectivism has unacceptable consequences does not apply to her. We can now see where her complaint goes wrong. A good ethical principle, whatever else it might be, is one which is acceptable for good reasons. And what counts as a good reason is in large part determined by public standards. The public nature of ethics is inescapable. It cannot be, as subjectivists would have it, an entirely private matter.

Characteristics of discussions about ethics

Let us stop for a moment and review the discussion of ethical subjectivism. We began by trying to give a clear statement of subjectivism. We then tried to show that subjectivism has implausible consequences. To avoid these consequences we attempted to modify the original statement of subjectivism. But this failed because the modification leads to an inconsistency, i.e. the inconsistency that for a subjectivist the choice of ethical principles both is and is not an entirely personal matter. Thus, we claimed, subjectivism should be rejected.

In the pages to come the general pattern of this discussion will be repeated, sometimes with slight alterations, in the analysis of other ethical principles and viewpoints. The reason is that underlying the pattern are several common assumptions and shared ideas about how to judge the validity and adequacy of ethical principles or viewpoints. These assumptions and ideas provide a context for the debate about ethics. They are the "rules of the game" that prevent it from degenerating into a pointless shouting match. It is important to know something about them for two reasons. First, it is much easier to follow the debate when one understands the rules. In the context of the rules the pattern of the discussion makes sense. And it makes sense of why some points for or against a certain ethical principle are thought to be more telling than others. Second, not everyone who tries to be a part of the discussion accepts all the rules. They are playing a different game, which explains why the things they say about ethics may seem so peculiar.

We have divided the assumptions and ideas into three categories. The first category is essential for any discussion, regardless of the topic.

1. All parties to the debate are rational in the minimal sense that (a) they believe that it is relevant and appropriate to give reasons for what one believes; (b) if given good reasons for believing something, reasons that withstand public scrutiny, then, *ceteris paribus*, they will believe it; and (c) they are able to see that statements have logical consequences, i.e. they recognize that if some statements are true (or false), other statements are true (or false).
2. No logically inconsistent position is rationally acceptable. To have a logically inconsistent belief amounts to believing that some statement both is and is not true. Logically inconsistent ethical beliefs are not rationally acceptable because they will entail, for every action, both that it is ethically right or good and that it is not ethically right or good.

The second category relates more directly to ethics. It has to do with the nature of ethical judgments, and with the kinds of reasons relevant to ethical judgments.

3. Ethical judgments apply primarily to the actions of moral agents. The paradigm example of a moral agent is a person who is rational and who has enough intelligence and background information about the world to recognize that (a) persons have interests and welfare that can be enhanced or harmed; and (b) certain actions are likely to have consequences affecting the interests and welfare of persons. If someone, e.g. a child, does not fit this characterization of a moral agent, then his or her actions are not properly subject to moral judgments.
4. Ethical judgments are a part of a public system for evaluating actions of moral agents that affect themselves or other persons. Actions are evaluated as ethically right or wrong, good or bad, praiseworthy or blameworthy. These evaluations are made according to reasons and principles subject to public appraisal. Thus, whether an evaluation is fitting is also open to public inspection and appraisal. Just as one's choice of ethical principles is an appropriate topic of public debate, so one's evaluation of an act is an appropriate topic of public debate.
5. Since ethical judgments are about actions of moral agents that affect the interests and welfare

of persons, statements that describe the interests and welfare of persons, or describe or anticipate the effects of acts on interests and welfare, are relevant to ethical judgments. These statements (if true) are morally relevant facts. In conjunction with ethical principles, these facts give us reasons for acting one way rather than another. In addition, statements describing the intentions, motives, and character of moral agents are relevant to ethical judgments. Such statements are vital for understanding the reasons for an action, and understanding the reasons for an action is germane to making ethical judgments about it. Since intentions, motives, and character are in part the cause or source of action, they are also subject to moral evaluation.

The third set of ideas and assumptions directly relate to methods for evaluating ethical principles.

6. Ethical principles are impartial in the sense that they do not allow special exceptions that benefit or harm a specific person or group. This does not necessarily imply that ethical principles are invariably neutral between the interests and welfare of persons. It may be morally permissible, for instance, to be partial to the interests and welfare of one's children. However, an ethical principle that allows partiality of this kind must allow each person to be partial to the interests of his or her children. It must not allow, say, Jones to be partial to his children, but prohibit Smith from being partial to hers.
7. Ethical principles (a) are rules for deciding between alternative courses of action involving the interests and welfare of moral agents; (b) do not require conflicting acts; and (c) prescribe no act or course of action that in considered belief systematically worsens the long-term welfare of persons, or is clearly detrimental to reasonable individual or group interests.

The third provision of the last assumption requires some comment. It is unavoidable, in our opinion, that one test of an ethical principle is how well it fits with considered beliefs about what is right and wrong. It cannot help but count against an ethical principle if it prescribes acts that seem plainly wrong. But one must be cautious here, for even the most carefully considered beliefs about right and wrong are not always reliable. Prejudice and bias are common human failings, as is the ability to rationalize unacceptable behavior or simply to refuse to see that a moral issue is at stake. Given all of this, often it is our judgments that need to be changed, not the principle in question. Still, there comes a time when argument, criticism, and evaluation come to an end. That time may be put off as long as possible, but eventually a choice of principles must be made.

Ethical Relativism

Relativism explained

The next ethical viewpoint we will discuss is ethical relativism. This is the position that there is no universal ethical principle or set of principles by which to judge the morality of an action. Instead, each society or social group has its own set of moral rules. Furthermore, since a particular society's rules are justified by internal procedures and standards specific to and distinctive of that society, it is inappropriate, relativists argue, to evaluate one society's rules using the procedures and standards of other societies. Thus, relativists claim, ethics cannot be reduced to some master list of rules applicable to everyone. There are no ethical principles that everyone should follow. There are only local ethical principles that apply locally.

Ethical relativism, if true, implies that no culture's ethical code has the special status of being "better" or "truer" than another. Each culture's code is on a par with every other culture's code. For example, in Ted's situation a colleague who is an ethical relativist might argue that although bribery is immoral in the USA, it is an acceptable practice in the country in which he is trying to sell machinery. Different countries have different ethical principles, and different ways in which those principles are justified and agreed upon. Since Ted is not a member of the culture in which he is trying to do business, he is in no position to pass judgment, either favorable or unfavorable, on their ethical views.

In the bribery example the relativist's argument may seem reasonable. After all, if the members of a certain society believe bribery is ethically permissible, who are we to tell them otherwise? But in other cases this attitude of "ethical neutrality" is much less plausible. For instance, if a culture were to practice slavery, then, if ethical relativism is correct, it would be inappropriate for us to say, "What you are doing is ethically wrong" because we would be applying our standards to the practices of a culture with a different ethical code. The best we could do is say, "What you are doing is wrong according to our standards." This is not an ethical judgment, but a statement of fact. In this respect ethical subjectivists and ethical relativists are similar. Just as subjectivists cannot legitimately make ethical judgments about the practices of other individuals, so ethical relativists cannot legitimately make ethical judgments about the practices of other cultures.

This is a disturbing consequence of relativism. Although we may be reluctant to make judgments about things like bribery, most of us are convinced that slavery and other acts that unjustifiably harm people are plainly wrong regardless of where they occur or who does them. And most of us feel that we are justified in condemning such practices when they occur. Since ethical relativism seems to prevent us from making judgments about these practices in other cultures, there need to be powerful reasons for us to put aside our convictions and accept relativism. Are there such reasons?

The evidence for relativism

It is undeniable that different societies have different ethical practices, i.e. that acts permissible in some societies are impermissible in others. And in many cases differences in practice seem to derive from differences in ethical principles. This is often taken to be conclusive evidence in favor of ethical relativism. However, the evidence is not unequivocal. Differences in ethical practices may turn not on differences in ethical principles, but on a variety of other things such as different physical environments, levels of social wealth, or beliefs about morally relevant facts. In one society, for instance, the practice was to kill one's parents as they began to grow old. This was morally permissible because it was thought that one would spend the afterlife in the physical state in which one died. If one were to die in a body racked by pain and disability, one would suffer torment for eternity. It was a kindness, a mark of concern for the welfare of one's parents, to ensure that they did not live to experience the infirmities of old age. Thus, despite very different practices in that culture and ours, there are underlying similarities of principle, e.g. the principle that one ought to honor one's parents. We can understand and appreciate the motives for such acts while at the same time we may disagree about the facts of existence in the hereafter, assuming there is a hereafter.

Let us suppose, however, that a society S_1 has an ethical standard permitting acts of type A, society S_2 has an ethical standard prohibiting acts of type A, and that the difference cannot be explained by differences in environment, wealth, or beliefs about morally relevant facts. Does this show that ethical relativism is true?

Not unless several other possibilities can be eliminated. One of them is that neither S_1 nor S_2 has made an error in logic. For example, suppose the members of S_1 falsely believe that a statement logically entails (or does not entail) some other statement, and that this belief plays an important role in their justification of the principle permitting the acts in question. If they were to find or be convinced that they were wrong about the entailment, they might also abandon the principle since it no longer is justified for them. In this case the difference between S_1 and S_2 is more a matter of logic than ethics.

Another possibility is that the error is epistemic rather than logical. For instance, suppose that according to their own canons of evidence the members of S_1 have incorrectly evaluated their reasons for holding the principle. They have either made a mistake in judging the weight of the various reasons, or they omitted reasons that should have been taken into account, or included in the justification reasons that should not have been included. The error here is one which, by S_1's own standards, they would admit were they to become aware of it.

A third possibility is that they are not aware that certain practices should be ethically evaluated. For example, in the recent past many societies, our own among them, were not concerned with environmental problems caused by pollution, disposal of toxic wastes, and so on. It was not that they had carefully thought about these issues and decided that they were unimportant, but rather that they had not thought about them at all. It was only when they became aware that ethical issues were involved that they began to see environmental practices from an ethical point of view.

A final possibility is that S_1 and S_2 attach different meanings to ethical words we might try to translate as "good,""justice," or "rights." If they do not realize that they are using these or similar words in different senses, then what may look like a difference in ethical principles could turn out to be a difference in the use of key ethical words. The possibility of misunderstanding or miscommunication should never be overlooked. Subtle differences in meaning can have important consequences for how one culture interprets the principles and justifications another culture gives for its ethical practices.

If any of these possibilities is realized, the fundamental disagreement is not about ethical principles. There is a prior point of contention or confusion – logical, epistemic, or semantic – that needs to be resolved before the discussion about ethics can begin. If it cannot be resolved, then the ethical differences are a consequence of disagreement about a nonethical matter. If it can be resolved, then S_1 and S_2 might come to agree about the basic principles of ethics.

Relativism and the possibility of error

Some ethical relativists claim that if members of a society *believe* that acts of a certain type are ethically correct, then they *are* correct for that society. Thus, in ethics, unlike, say, science, there is no difference between what is believed to be true and what is true. However, this claim is not convincing because it overlooks the possibility that social groups, like individuals, can make errors. A social group might have incorrect factual beliefs, make invalid inferences, mistakenly weigh evidence, or make some other error. In their own discussions about ethics or in conversation with other groups they may come to realize that their ethical beliefs are unacceptable on their own standards of logic and evidence. Were this to happen it is likely that their ethical beliefs would change. People certainly have the capacity to make errors. Happily, they also have the capacity to recognize their errors and eliminate them by changing their beliefs.

It is not hard to find examples of this. At one time, for instance, blatant racial and sexual discrimination were common in the USA. Much of this discrimination, though not all of it, was based on the false belief that African-Americans and women are intellectually inferior to white men. As these false beliefs are replaced by true ones we can reasonably hope and expect that discrimination will gradually disappear, for once this belief is gone, a major obstacle to living up to our own ideal of equal opportunity for all will be gone as well.

Ethical relativists who deny or ignore the possibility that social groups can make errors also counsel us to be tolerant of the beliefs of other societies. This is good advice. Our experience with discrimination shows that our society is as vulnerable to error as any other. It is a mistake to assume that our way of doing things is the only ethically acceptable way. But the reason relativists advise us to be tolerant is that they believe there is little basis for rational discussion between societies with different ethical viewpoints. After all, if a society cannot be mistaken about what it believes, there is no reason for it to subject its beliefs to critical evaluation by outsiders. Thus, relativists seem to think, since rational discussion is impossible, the only alternative modes of ethical interaction available, given the close proximity of different societies in the modern world, are tolerance and conflict. Since tolerance is much the better of the two choices, we should be tolerant. For the reasons given above, however, the fact that different societies have different ethical beliefs does not show that there is no basis for rational discussion between them. Nor does tolerance warrant indifference or inattention to the practices of other societies. If there is good reason to believe that an ethical practice is based on false beliefs about the facts, incorrect reasoning, etc., we may have a duty to speak out, or even take action in extreme cases, regardless of where the practice occurs. As history amply shows, the consequences of not doing so can be horrendous.

Bedrock ethical differences

But what if, after all the possible nonethical areas of disagreement are eliminated, S_1 and S_2 still have different ethical principles? Now should we accept ethical relativism?

As far as we know, there are no noncontroversial examples of this kind of disagreement. But let us imagine that S_1 and S_2 have completely different principles. Every principle S_1 accepts is rejected by S_2 and vice versa. And suppose S_2 is a culture very much like our own, with ethical values and principles we can understand and appreciate. What would S_1 be like?

In S_1 lying, cheating, and random violence would be the norm. There would be no strictures against murder, robbery, rape, or other acts of violence. In business there could be no contracts since there would be no trust or expectation of fair dealing. There would be little or no family life since no one would be committed to the welfare of others. There would be no religion, law, or social institutions of any kind, for if such institutions are to work, people must have basic respect for themselves and others. Nor could S_1 have traditions, shared ideals, social organization, or even a history that is anything other than a series of random events. In short, S_1 would not be a human culture at all. It would not have, and could not sustain, the minimum social structure needed to support a viable culture.

We mentioned earlier that relativists cite diversity of ethical practice as evidence for diversity of ethical standards. However, if the above argument is correct, there could not be a complete diversity of principles. And, as it turns out, it does seem that all societies have certain ethical rules in common, e.g. rules that promote reciprocity and fair play, and prohibit wanton violence. The reason is that were there no such rules, there would be no human societies. Many rules that societies have in common are essential for cultural survival. They establish the necessary conditions that make social life possible. Thus, there could not be a human society that has ethical rules completely different from our own.

If this is correct, then the more radical claims made on behalf of ethical relativism are implausible. The main evidence cited in favor of ethical relativism – that different societies have different ethical practices – does not support the claim that there is a radical and unbridgeable gap between the ethics of different societies. For one thing, all functioning societies have rules intended to help preserve social order. The evidence suggests that these rules are similar in different societies, which is not surprising since people have the same basic needs regardless of where they live. Furthermore, for all the reasons listed earlier, a difference in practice need not amount to a difference in principle. In fact, we suggest that a genuine difference in ethical principles not attributable to a different understanding of facts, different circumstances, errors of logic and evidence, and so forth is likely to be rare.[3]

There still remains the possibility that different societies have different principles not attributable to any of the sources mentioned above. It may be very difficult to decide in any particular instance whether an apparent difference is a genuine one, but they might occur. What should we say about such differences, assuming one could be found?

Since such a difference would be a bedrock ethical difference not attributable to any nonethical source, it might seem as if a modified relativism must be true. Maybe not all rules can differ, a relativist might say, but some can, and about these rules and the practices they permit no rational intercultural discussion can take place, and no intercultural judgments can be made. Every society, at least potentially, differs ethically in some respect from other societies. This difference signifies a kind of ethical autonomy, an area of ethical freedom, into which it would be disrespectful for other societies to intrude.

Although there is some truth to the above argument, it is important to see what it does and does not establish. It does not show that there are genuine differences in ethical principles, but only that there might be. It does not show that apparent differences are genuine. And it does not show that different practices are grounded in different principles. Moreover, if genuine differences are to be found, rational discussion between societies must take place. Arguments must be evaluated, circumstances assessed, mistakes discovered and corrected, and agreements reached about what is and is not a real difference. But this, of course, is a paradigm of rational ethical debate and analysis. It is precisely the process by which we discuss and analyze ethical practices in our own culture as well as others. Thus, far from showing that ethical discussion between societies is impossible, ethical relativism, if true, would seem to require that it take place. Only in this way can genuine differences be found if they are present.

Finally, note that respect for the ethical autonomy of other cultures is proposed as a universal value, one that does not have merely local application. All of us, the relativist would say, should respect the views of other societies, and one way to do this is to be tolerant of differences when we find them. But there are other ways to be respectful of ethical autonomy. One of them, even more important than tolerance in our judgment, is to respect the rationality of others. We should not assume that apparent ethical differences are irrational or founded in reasons that we cannot comprehend. If we suppose that our society has good reasons for accepting certain ethical values, principles, and judgments, then it would be impertinent and contemptuous not to attribute the same to other societies. Tolerance, unless grounded in respect for rationality, is no more than a mean-spirited paternalism. It is an attitude taken toward those inferior in intellect and ability, those with whom it is fruitless to engage in meaningful debate. If relativists are to avoid this highly unattractive attitude, if they are to grant others the full measure of respect they are due, they cannot in good conscience advise us simply to be tolerant of diversity. They must instead concede that diversity marks the beginning of rational debate about ethics, not the end.

We hope by now to have shown that ethical relativism is a fairly innocuous ethical viewpoint. It cannot support the more radical claims sometimes made on its behalf. At best it shows that some diversity of ethical principles is possible. It does not show that differences are necessary, nor that they are extensive, nor even that when real diversity is found it cannot be rationally discussed. Relativism can serve as a reminder of the complexity of ethical views, and of how arduous it may be to understand and appreciate ethical differences. But beyond this its implications for ethical theory and practice are minimal.

The question of relevance

In our discussion thus far there is a question, or series of questions, that we have not addressed but that some readers may have wondered about. Suppose someone responded to our analysis of ethical relativism as follows: You may be right that ethical relativism does not imply that one should not make ethical judgments about practices in other cultures, nor does it imply that rational discussion about ethics cannot take place between different societies. But nothing in your argument shows that I should make such judgments. Why should I care about what happens in other cultures? Granted that brutality, corruption, aggression, and injustice are common in the world, what does that have to do with me? Why should I be concerned?

In one sense these questions are unanswerable. If someone has no concern about the fate of anyone other than themselves, if they resolutely refuse to consider the possibility that they have ethical obligations that extend beyond the circle of their immediate acquaintance, then little we can say will change their mind. Argument is futile with those who will not listen. In another sense, however, there is an answer. To see what it is, we need to suppose that the questions implicitly contain an argument of the following sort: I should be concerned only about those things that affect my self-interest. What happens to people in distant lands has little or no effect on my self-interest. Hence, I need not be concerned about them.

The second premise of this argument is highly questionable. It is no longer true, if it ever was, that what happens in the rest of the world is of little consequence to individuals in their home country. The global economy has effectively put an end to economic and political isolationism, and with it an end to the idea that distant events are irrelevant to individual self-interest. Thus, the argument as given does not justify lack of concern about those in distant lands.

A response to the objection is that one should be concerned about distant events only to the extent that one's self-interest is involved. If there is no reasonable connection between a particular individual's self-interest and the lives of those in other lands, then that individual need not be concerned with them.

This response brings us to the first premise, the thesis that self-interest is all that matters. As we will see in the next section, this view comes in several different guises. So that we can better respond to it, and better give our final answer to the argument that one need not be concerned with the fate of others, we will first place it in the context of what are usually called consequentialist ethical theories.

Consequentialism

Essentials of consequentialism

Consequentialism is a family of ethical viewpoints based on two central ideas. The first is a claim about what is of value for human beings. The second is that whether an act is ethically permissible is solely a matter of whether the act maximizes value. For example, suppose the value is happiness. Then an act is ethically permissible if and only if it maximizes happiness, i.e. if and only if it is a consequence of the act that it produces at least as much happiness as any other act. Acts that do not maximize happiness are not ethically permissible. For example, suppose the only acts available to Jones are *A*, *B*, and *C*, and that she can do exactly one of *A*, *B*, or *C*. And suppose *A* and *B* both maximize happiness, and *C* does not. Then it is ethically permissible for Jones to do *A* or to do *B*, and impermissible for her to do *C*. Since no acts are available to her except *A*, *B*, and *C*, and since no acts are ethically permissible for her except *A* and *B*, she is ethically obligated to do either *A* or *B*. No other ethically permissible choices are available to her.

Consequentialist theories can be subdivided according to (1) for whom the value is to be maximized, and (2) the kind of value to be maximized. For instance, the version of consequentialism called *ethical egoism* claims that an act is morally permissible for a person *P* if and only if the act maximizes the value for *P*. Nonegoistic versions of consequentialism say that an act is morally permissible for *P* if and only if the value is maximized for some larger group of people that includes *P*. To distinguish this theory from ethical egoism it is commonly called *utilitarianism*.

Values to be maximized include both intrinsic and instrumental goods. Intrinsic goods are valuable in themselves, and not valuable merely as a means to something else. Examples might be truth, beauty, love, friendship, pleasure, and happiness. Instrumental goods are not valuable in themselves, but are valuable because they are means to some other end. An example of an instrumental good is money. In this General Introduction we have space to discuss only one of these possible intrinsic goods. We will give examples of how egoism and utilitarianism propose that this good be maximized, and we will review some of the objections that have been raised against these versions of consequentialism. But before we do this there is another position that needs discussion. It is an empirical relation of ethical egoism called *psychological egoism*. Since modern business and economic theory rely heavily on psychological egoism, we will examine it in some detail.

Psychological egoism explained

There is an important difference between what *is* and what *ought to be*. For example, through no fault of their own many people suffer from hunger and malnutrition. This is a fact about the world, a report of what is. But this fact about the world does not imply that things ought to be this way. Were the world a more accommodating place there would be no hunger. No one would suffer from malnutrition. That is the way the world ought to be.

Psychological egoists make a claim about what is. It is a fact about human beings, they say, that individual humans act only to advance their self-interest. It is not merely that humans act from self-interest in limited but extreme circumstances, e.g. when their lives are at stake, or that humans act from self-interest in certain social conditions, e.g. in capitalist economies, but rather that each person acts from self-interest in every situation. Self-interest is and can be the only human motivation. That is the way humans are. Thus, it is useless to suggest that persons should be concerned about the welfare of others. People are incapable of concern for others except insofar as it enhances their own interests.

If psychological egoism is true, then ethics is pointless. Nothing is to be gained by exhorting people to do what they are incapable of doing, nor can they be blamed for failing to take the interests and welfare of others into account. So, for example, it would be pointless to argue that Ted Brown should consider the effects bribery would have on anyone other than himself, or to blame him for failing to do so. According to psychological egoists, it is a psychological fact that he cannot be concerned with the interests of others unless their interests are directly related to his.

Problems with psychological egoism

An immediate problem with psychological egoism is that apparent counterexamples are easy to find. We all know or have heard of cases in which people have sacrificed their fortunes or even their lives for the sake of others. And it is likely that many of us, when we reflect on our own experience, can recall occasions when we acted primarily from concern for others. Yet if psychological egoism is true, such acts are impossible. How do egoists explain this?[4]

One explanation egoists give is that acts apparently motivated by concern for others are, if examined closely, really motivated by self-interest. This explanation may be true in many cases. Acts that appear altruistic, i.e. motivated by concern for others, may be consciously or unconsciously self-interested. However, the fact that *some* apparently altruistic acts are self-interested does not show, as psychological egoism requires, that *all* apparently altruistic acts are really self-interested. To show that, egoists need to provide a lot more detail about why they think their view is true.

One argument egoists sometimes use is that people invariably do what they most want to do, assuming their action is voluntary.[5] The idea here is that people act to satisfy their desires. If they desire several things, they always pick the one that, *ceteris paribus*, they most desire. Furthermore, people always most desire to do what is in their self-interest. Thus, if one person intentionally acts in a way that benefits another person, it is because that act is what the person most wanted to do, and he or she most wanted to do it because benefitting the other person contributes to his or her self-interest.

There are three difficulties with this argument. We will mention the first two and discuss the third in more detail. The first is that it is not clear that people always do what they most desire. Sometimes they do things they would very much prefer not to, like pay taxes or keep a promise. Second, it certainly seems as if people often desire things and do things they know are not in their self-interest. For instance, many people smoke even though they acknowledge that smoking is not in their self-interest. Finally, it could be that what someone most desires to do is intended solely to benefit someone else. For instance, in war soldiers sometimes sacrifice their lives to save their comrades. Doesn't this show that psychological egoism is false?

Psychological egoists would claim it does not. People cannot most desire to act solely for the benefit of someone other than themselves. It is not psychologically possible. If *A* acts to benefit *B*, it must be because *A* believes, consciously or unconsciously, that the benefit to *B* helps *A* in some way. Otherwise *A* would not act to benefit *B*. Thus, when soldiers give their lives to save their comrades, they must (somehow) believe that it is to their benefit. For example, they might believe that to witness their friends die would be a worse fate than their own death.

However, this response begs the question – it assumes the very point at issue. The alleged reason that one person cannot act solely for the benefit of another is because psychological egoism is true. But the argument is supposed to show that psychological egoism is true, and nothing is accomplished if one must assume something is true to show that it is true. So we are still left with the question: Exactly why isn't it possible for one person to act solely for the benefit of another?

The argument from self-satisfaction

There are two kinds of benefits one person can derive from helping another. The first is what we might call an external benefit. For example, Jones saves Smith from the burning building to ensure that Smith is around to repay the considerable sum he owes Jones. But another kind of benefit is internal. People never act solely for the benefit of others, egoists argue, because they always get an internal feeling of self-satisfaction from helping others. Indeed, if the purpose of helping others is not to assure some external gain, then the only reason people try to benefit others is to get this feeling of self-satisfaction. And since feeling good about ourselves is pleasurable, and feeling pleasure is in a person's self-interest, psychological egoism is true after all.

This argument is not persuasive for two reasons. The first is that self-satisfaction is not the same as self-interest. Things in our self-interest may not give us self-satisfaction, and things that give us self-satisfaction may not be in our self-interest. For example, it might be very much in Smith's self-interest to pay his debt to his bookie even though he gets no self-satisfaction from it. And many people get self-satisfaction from donating supplies to victims of natural disasters even though it is not remotely in their self-interest to help. Self-interested behavior and behavior that gives self-satisfaction are just not the same.

The second problem with the argument is that it assumes that if, say, Jones helps another person, then her *reason* for helping must be to feel good about herself. Yet suppose Jones were to say, "Although it is true that I feel good as a result of helping others, that is not the reason I do it. I help others because I am ethically obligated to do so, and I would continue to help them even if I stopped getting self-satisfaction from it." How might psychological egoists respond?

The only response they could make is that Jones is mistaken about her motivation. She thinks she is motivated by ethical obligation, they would say, but were we to analyze her act carefully we would find that she is actually motivated by self-interest. The reason we can be assured she is so motivated is that psychological egoism is true. People are motivated only by self-interest. Moreover, despite what Jones says, if she were to stop getting satisfaction from helping others, she would stop helping them. The reason is the same – psychological egoism is true. But by now this type of response should be familiar. It assumes the point at issue and thus begs the question.

Psychological egoism: a proposal

At this point it might be helpful to review the discussion. We have posed a series of counterexamples to psychological egoism in which an individual reports that he or she performs an act for the benefit of someone else. Benefit to the other person is alleged to be the reason the act was performed, not external or internal benefit to the person performing the act. Psychological egoists then claim that the report must be mistaken because all behavior is self-interested. However, they offer no evidence that the act was self-interested other than appeal to the theory of psychological egoism. But this is unacceptable because it begs the question. Is there any way for egoists to avoid this problem?

The only way is for egoists to *show* that the acts are self-interested, and not *assert* that they are because psychological egoism is true. To do this they must insist that showing that an act has a certain *effect* does not automatically show that it has a certain *motivation*. Otherwise acts clearly detrimental to a person's self-interest would immediately prove that psychological egoism is false. But then by parity of reasoning egoists cannot claim that acts beneficial to the person performing them provide strong evidence for egoism, for such benefits could be incidental rather than intentional. Thus, the effect of acts is relatively weak evidence either for or against egoism. What egoists need is psychological evidence; that is, truthful reports of motivation from the person performing the act. And since many people report altruistic motivation, egoists must show that these reports are mistaken. Furthermore, egoists cannot take reports of self-interested motivation at face value. If they claim that reports of altruism can be mistaken, they must allow that reports of self-interest can be mistaken. If they do not, if they assert that reports of self-interested motivation cannot be wrong, they again run the risk of begging the question.

If all of this is correct, psychological egoists have an enormous research project ahead of them. To make a case for egoism they must conduct an in-depth psychological examination of individual persons to uncover or confirm the genuine motivation of particular acts done on specific occasions. Since the theoretical and practical obstacles to this project are immense, at best it will be difficult to complete, and it may be impossible. It is not surprising, then, that it remains largely undone, and that the evidence to date is not encouraging for egoism.[6]

The question remains of what to do until empirical research settles the issue. We suggest that in the meantime it is reasonable to believe that some acts are genuinely altruistic. There simply is no good evidence that psychological egoism is true, nor are there any convincing philosophical arguments in its favor. Moreover, there is a great deal of evidence, both anecdotal and experimental, in favor of altruism, and psychological egoists have given no compelling reason to think that this evidence is wrong. Until that happens, altruism remains a possibility, and, in our opinion, a strong probability. If this is right, then psychological egoism poses no significant threat for ethics.

Ethical egoism

Unlike psychological egoists, ethical egoists make a claim about what ought to be. They argue that each person ought to maximize his or her own self-interest. The principle they advocate is this:

> Ethical Egoism: An act *A* is ethically permissible for a person *P* if and only if *A* maximizes *P*'s self-interest. Acts that do not maximize *P*'s self interest are not ethically permissible for *P*.

Ethical egoism is the ethical principle Ted Brown tried to follow when deciding whether he should offer a bribe. In our discussion of Ted's dilemma we pointed out that his decision is not easy, because it is often difficult to anticipate the consequences of one's actions. But we said little about what Ted believes his self-interest to be, nor were we very precise about self-interest in our discussion of psychological egoism. However, to examine ethical egoism we need to be more precise about self-interest. Note that any analysis of self-interest we might give is constrained by ethical egoism's requirement that self-interest be maximized. Since to maximize something comparisons of more and less must be made, to apply the principle of ethical egoism it must be possible to make comparisons of self-interest. So what is this comparative concept of self-interest?

An answer favored by many people is to equate self-interest with happiness. Surely, they claim, it is in our self-interest to be happy. Furthermore, we often compare present states of happiness with those of the past and future: "I'm much happier now than I used to be and I expect to be happier still in the future." And there is a rough intuitive sense to the notion that happiness can be maximized. On the other hand, the concept of happiness may not be precise enough to give clear guidance for all choices that fall under the principle of ethical egoism. Consider, for example, an ethical egoist contemplating how he should lead his life. Assuming happiness is the same as self-interest, the principle of ethical egoism instructs him to do what will make him happiest. But we can imagine him asking, "Exactly what will make me happiest? Is it fame, fortune, knowledge, reputation? How can I know in advance what will maximize my happiness? And if I cannot know, how can I make an ethical choice?"

Hedonistic egoism

These are not easy questions. It looks as if the only way an individual could answer them is to have complete knowledge of his or her future. But this is impossible. And since individuals cannot be ethically required to do what is impossible, ethical egoism is unacceptable unless there is some way to show that it imposes no such requirement. But how might it be shown?

One method sometimes attempted is to further analyze the concept of happiness. Granted that we all want to be happy, just what is it to be happy anyway? A traditional answer is that people are happy when they experience pleasure, and unhappy when they experience pain. That is all there is to it. Happiness just is experiencing pleasure and avoiding pain. The nineteenth-century philosopher John Stuart Mill put it like this:

> [T]he ultimate end, with reference to and for the sake of which all other things are desirable (whether we are considering our own good or that of other people), is an existence exempt as far as possible from pain, and as rich as possible in enjoyments.

Mill is here advocating a view sometimes called *hedonism*, i.e. that the only thing of intrinsic value for humans is pleasure and the avoidance of pain. Everything else is and ought to be a means to that end.

Ethical egoists who accept Mill's outlook equate maximizing self-interest with maximizing pleasure and minimizing pain. This view, which we will call *hedonistic egoism*, requires that *all* acts available to a person be evaluated solely on their potential to cause pleasure or pain to that specific person. Acts that maximize pleasure or minimize pain are ethically permissible. Otherwise they are ethically impermissible. For example, suppose Jones can do only *A* or *B* but not both, and suppose both *A* and *B* are pleasurable for Jones but *A* is more pleasurable. Then, hedonistic egoists argue, Jones should do *A*. If *A* and *B* cause the same amount of pleasure, then it does not matter which Jones does. If *A* is pleasurable for Jones and *B* is not, then Jones should do *A*. Finally, if both *A* and *B* cause Jones pain but *A* causes less pain than *B*, then Jones should do *A*. If *A* and *B* cause the same amount of pain, then it does not matter which Jones does. Let us say that acts that conform to these examples "create the greatest balance of pleasure over pain." Now we can give a more exact statement of hedonistic egoism:

> Hedonistic Egoism: An act *A* is ethically permissible for a person *P* if and only if *A* creates the greatest balance of pleasure over pain for *P*. Acts that do not create the greatest balance of pleasure over pain for *P* are not ethically permissible for *P*.

The advantage of using pleasure and pain as a measure of self-interest instead of happiness is that pleasure and pain seem much more concrete and immediate than vague feelings of happiness. Moreover, it is easier to figure out what will cause pleasure and pain than what will lead to happiness, and easier to compare degrees of pain and pleasure than degrees of happiness. Perhaps the reason for this is that pleasure and pain have a basis in human physiology that happiness seems not to have, or not to have to the same degree. However, there are two misconceptions about hedonism that should be cleared up before we consider the arguments for hedonistic egoism. First, the hedonist's concept of pleasure should not be narrowly understood. In addition to ordinary physical pleasure, it can include a variety of other things such as intellectual and aesthetic pleasure, and the pleasures of friendship. Second, it is sometimes thought that hedonists care only about immediate pleasure and give no thought to the possibility that what causes them great pleasure now may lead to even greater pain in the future. But this need not be true. Rational hedonists will strive to create the greatest balance of pleasure over pain for themselves over the long term. Thus, they will forgo a short-term pleasure that leads to long-term pain, and will undergo short-term pain to gain long-term pleasure. A more serious objection to hedonism is this: Happiness is too complex an idea to be captured by something as one-dimensional as experiencing pleasure and avoiding pain, even if pleasure and pain are understood in the broadest sense. There is more to happiness than hedonists admit. It is possible that a life filled with little pleasure be happy for other reasons. Or that a life of great pleasure be ethically repugnant. Consider, for example, a powerful dictator who receives great pleasure from tormenting others. Consequently, it is a serious error to think that happiness can be understood solely in terms of pleasure and pain.

The case for hedonistic egoism

We will not speculate about how hedonistic egoists might respond to the above objection. Instead, we will suppose for the present that hedonism gives an adequate account of happiness, and that self-interest is best understood in terms of happiness. The next task is to examine the arguments for hedonistic egoism. It is important to see that hedonistic egoists believe that everyone should always follow the principle of hedonistic egoism. Thus, they are unlike ethical subjectivists and ethical relativists, and unlike those who believe that business or legal principles should sometimes take precedence over ethics. But since hedonistic egoists believe that everyone should accept their position, they need to give good reasons for it. Are there such reasons?

Here is one argument. Suppose there is a God who rewards each person with the pleasures of heaven or the pains of hell based on how well the person lives up to some set of God's commands while living on this earth. The pleasures of heaven and pains of hell are both intense and everlasting, so it maximizes long-term pleasure to attain heaven and avoid hell. Thus, it is in each person's interests to follow the commands while he or she is alive. And since persons are judged as individuals, each person is well advised to look after his or her own interests. Given the existence of such a God, ethical egoism is the only reasonable ethical viewpoint.

There are two main problems with this argument. First, it works only if there is a God who metes out rewards and punishments as described. Not everyone is convinced of this. However, granting there is such a God, say, the God of the New Testament, the second problem concerns the commands God issues. One of them is to "love thy neighbor as thyself." This in part implies that one should place the interests and welfare of one's neighbors on a par with one's own. And, furthermore, that one should be motivated by genuine altruism, and not see protecting the interests of one's neighbors merely as a means of gaining a reward in heaven. But this is inconsistent with hedonistic egoism since it dictates that persons be concerned only with their own interests. Thus, the argument does not give good reasons for everyone to be a hedonistic egoist. If anything, it shows that hedonistic egoism is an unacceptable ethical viewpoint.

A second argument is that individuals best know their own interests and are best able to look after their interests. Intervening in the lives of others usually causes more problems than it solves. In addition, many people do not want anyone meddling in their affairs, even when well intentioned. They think of it as an invasion of privacy. Thus, were we all to look out only for ourselves, it is likely we would all be better off in the long term.

The main idea in the second argument is that one should be a hedonistic egoist because it enhances the common good – everyone would be better off. But if so, then enhancing the common good is the ultimate goal of ethical action. Hedonistic egoism is no more than the (alleged) best means to that end. This puts hedonistic egoists in a very bad position for two reasons. The first is that if the generalization is false and hedonistic egoism is not in fact the best means to the common good, then hedonistic egoists would be obliged to abandon their position and search for a better means. And there are grounds for thinking it false. People are often helped rather than hurt by intervention in their lives. No doubt such intervention sometimes goes awry, but it does not follow from this that were it to cease entirely everyone would be better off. The second reason is that the notion of valuing the common good is quite foreign to hedonistic egoism. The main point of the theory is that, ethically speaking, it is the good of the individual that counts, not the good of the group. So for hedonistic egoists to appeal to the common good to justify their position is peculiar, to say the least. If hedonistic egoists are to persuade others to accept their view, they must find better reasons than the ones we have examined so far.

Hedonistic egoism reconsidered

So far the arguments for hedonistic egoism are not very convincing. And there are some reasons to reject it altogether. Here is one of them. Recall that if Jones has a choice of doing *A* or *B*, and if *A* and *B* cause her the same amount of pleasure (or pain), then from the point of view of hedonistic egoism it does not matter which she does. But suppose Jones knows that if she does *A*, then Smith will suffer a great deal of unprovoked and unnecessary harm. Yet if Jones does *B*, Smith will experience harmless pleasure. Can it be correct, as hedonistic egoism implies, that it is ethically indifferent which Jones does? It certainly seems not. Smith's well-being must count for something. If Jones's actions can either harm or benefit Smith at no cost to Jones, then it would seem an ethical imperative that she choose to benefit Jones. To be indifferent to Smith's well-being is ethically reprehensible. Since hedonistic egoism implies that it is not reprehensible but a matter of indifference, hedonistic egoism is unacceptable.

Another reason to reject hedonistic egoism is this. Suppose Jones and Smith are suffering from a disease that is rapidly fatal if left untreated. There is a pill that will cure the disease, but only one. According to hedonistic egoism, Jones is ethically required to take the pill, and so is Smith. Thus, if Jones tries to take it, Smith is ethically bound to prevent her. And if Smith tries to take it, Jones is ethically bound to prevent him. Thus Jones can act ethically only by preventing Smith from doing so, and vice versa. But can any ethical viewpoint be acceptable that implies that on some occasions one person can act ethically only by *preventing* another person from acting ethically?

Let us make the case a little more concrete. Suppose Jones and Smith are siblings, and Jones knows that even if she takes the pill she will die within a few months from some other painless but fatal ailment. If Smith takes the pill, however, he will be completely restored to health and will likely lead a long and happy life. Now suppose Jones decides to let Smith take the pill. How should Jones's action be evaluated? Most of us would probably think that she made the right decision, and that she should be praised and respected. At the very least she should not be condemned for acting unethically. But, if hedonistic egoism is true, it is possible that Jones acts unethically. It does not matter that she has only a few months to live as long as taking the pill will maximize benefit to her. If it does, hedonistic egoism requires that she take it. Not to do so is ethically impermissible.

In our judgment these consequences of hedonistic egoism show that it is an unacceptable ethical viewpoint. They illustrate two deep flaws. The first is that hedonistic egoism has no method of resolving ethical conflict. When it appears that one person can act ethically only by preventing another person from doing so, the conflict between them needs to be resolved in an ethically acceptable manner. But hedonistic egoism provides no such mechanism. The second flaw is that hedonistic egoism censures acts of self-sacrifice. Sometimes it is wrong to sacrifice one's interests for the sake of others, but it is not, as hedonistic egoism implies, *always* ethically impermissible. Were it so the world would be a poor place indeed.

Although the case for hedonistic egoism is weak and the reasons for rejecting it are compelling, we concede that it has an intuitive appeal that is hard to dismiss. We suggest that its appeal is grounded in two insights that any realistic ethical viewpoint needs to capture. The first is that mature and competent persons generally best know their own interests, and are best able to look out for them. The conviction that this is true is one reason most people find paternalism so unattractive. Moreover, there is no need to appeal to the common good to justify persons looking out for their own interests. The fact that something is beneficial to someone is prima facie justification enough for him or her to do it. The second reason is that as a practical matter it is extremely difficult or even impossible for most persons consistently to renounce their interests for the sake of others. But if ethics is to be relevant to our lives, it must be compatible with what it is possible for humans to do. It cannot constantly require of individuals that they heroically sacrifice their own interests.

Hedonistic egoism incorporates these insights, but it omits others that are equally important. The main one is that ethics is about relationships between people, relationships in which the interests of all parties must be considered. For hedonistic egoists only self-interest matters, and this is a fatal flaw.

Utilitarianism

In its traditional forms utilitarianism does not permit an individual to place special weight on his or her self-interest. Instead, the interests of all persons affected by an individual's action are given the same weight. So, for example, if Jones performs an action that affects the interests of Smith and Brown, then if she is a utilitarian she will give the interests of Smith and Brown the same weight she gives her own. For utilitarians, no one deserves or is granted special consideration. Everyone is treated alike.

But in what respect do utilitarians believe that everyone be treated alike? To understand this, we need to make some assumptions. The first is that self-interest is equivalent to experiencing pleasure and avoiding pain. In this utilitarians are like hedonistic egoists. The second is that the pleasures and pains of any one person are similar to those of any other person. Thus, Jones's pleasures and pains are like Smith's and Brown's. The third is that the duration and intensity of pleasure and pains can be quantified and measured. So, for example, it can be determined in any particular case whether Jones is experiencing more or less pleasure than Smith or Brown, and how much more or less. Finally, utilitarians assume that individuals are able to canvass the acts available to them and make reliable judgments about the amount of pleasure and pain distinct acts will cause each individual affected by the act. Given these assumptions, Jeremy Bentham, who founded modern utilitarianism in the eighteenth century, writes that we should:

> Sum up all the values of all the pleasures on the one side, and those of all the pains on the other. The balance, if it be on the side of pleasure, will give the *good* tendency of the act …, with respect to the interests of that *individual* person; if on the side of pain, the bad tendency … [then] Take an account of the *number* of persons whose interests appear to be concerned; and repeat the above process with respect to each … Take the *balance*; which, if on the side of *pleasure*, will give the general *good tendency* of the act, with respect to the total number of the community of individuals concerned; if on the side of pain, the general *evil tendency*, with respect to the same community.

Bentham's idea is to take the balance of pleasure over pain for each individual affected by an act and add them all up. Acts are then ranked according to how much total pleasure or pain they cause. Bentham then supposes that the act that causes the greatest total amount of pleasure, or the least amount of pain, is the morally best act. Let us say that an act that causes the greatest total amount of pleasure for everyone affected by the act, or the least amount of pain, *maximizes utility*. This gives us the following utilitarian principle:

> Hedonistic Utilitarianism: An act is ethically permissible if and only if it maximizes utility. Acts that do not maximize utility are not ethically permissible.

For example, suppose Jones can do either *A* or *B* but not both, and that Jones, Smith, and Brown are the only people affected by *A* and *B*. To make calculation of utility easier, also suppose pleasure is measured in positive units and pain in negative units. Now, to decide which act maximizes utility, Jones first estimates the units of pleasure *A* causes Smith and adds the units of pain. For instance, suppose *A* causes Smith six units of pleasure and two units of pain, for a sum of four units of pleasure. She does the same thing for Brown and finds that *A* causes her, say, five units of pleasure. Finally, she anticipates the amount of pleasure and pain *A* will cause her. Assume it is one unit of pain. Then she adds all three together and determines that *A* causes a total of eight units of pleasure. She repeats the same process for *B* and calculates that *B* causes a total of seven units of pleasure. Since the amount of total pleasure *A* causes is greater than the amount *B* causes, *A* maximizes utility.

Utilitarianism: for and against

All forms of consequentialism claim that the morally right thing to do is to promote the good of persons. This view has great appeal. Surely it is right to do good for people. No ethical view that denied this would be remotely plausible. In addition, consequentialism has the virtue of simplicity – all actions are ethically measured against the single standard of promoting good. And consequentialism is compatible with common-sense ideas about the kinds of acts that ought to be praised or condemned. Everyone agrees that promoting the good of persons deserves praise, and inhibiting it deserves condemnation. For these reasons consequentialism is a powerful ethical view, one that cannot be dismissed lightly.

Consequentialism begins to lose its attractions, however, when we start to think about how to implement it. For instance, particular versions of consequentialism, e.g. hedonistic utilitarianism, are only as plausible as the theory of human good that they advocate. So hedonistic utilitarianism is only as good as the hedonistic psychology on which it rests. And hedonism is not a very convincing theory of actual human motivation, nor of what human motivation ought to be.

But leaving that problem aside, there remain practical difficulties that may be insurmountable. For example, hedonistic utilitarianism supposes that individuals can compare their own pleasures and pains, e.g. Jones can say with certainty that this act causes her twice as much pleasure as that act, or that the pleasure of this is three times as much as the pain of that. But can we make such comparisons? You may like chocolate icecream more than vanilla, but can you say that it gives you exactly twice as much pleasure? Or that eating chocolate causes you three times more pleasure than getting a paper cut causes you pain? No doubt some pleasures are greater than others, as are some pains, but it seems unlikely that we can say exactly how much greater. And it is not clear that pleasures can at all be quantitatively compared with pains. Furthermore, how can the pleasures and pains of one individual be compared with those of another? How can one person determine that his pleasure from eating chocolate is more than, less than, or the same as another person's? The only way, it would seem, is for the first person to experience the pleasure of the second and compare it with his own. But this is impossible. One person cannot experience the pleasures and pains of another. And if a person cannot know exactly how much pleasure or pain an act will cause others, there is no way to calculate utility. So there is no way to decide which act is ethically permissible. And nothing could be more useless than an ethical view which exhorts one to act ethically and at the same time is so constructed as to assure that one never knows whether one is acting ethically or not.

To implement hedonistic utilitarianism persons must make calculations that cannot be made. Thus, as it stands, hedonistic egoism is not acceptable. Nor can it be made acceptable by substituting an alternative account of human good as long as the good for humans is tied to subjective experience. For example, one might try, as Mill did, to distinguish between the kinds of pleasures that persons experience. Some pleasures, Mill argued, are qualitatively better that others, e.g. intellectual pleasures are better than the pleasure one gets from food. He proposed that "competent judges," who had experienced a variety of pleasures, establish a hierarchy of different kinds of pleasure. Then, when making utilitarian calculations, "better" pleasures would count more heavily than "worse" pleasures. However, what standard of measurement do these judges use to decide that some pleasures are *better than* others instead of just *different from* others? Why should their standard be used instead of some other? And how do they know that what they experience as "better" is not experienced as "worse" by some other person? Mill has no convincing answer to these questions. Regardless of the kind or quality of the subjective experience said to constitute the good for persons, it seems impossible to establish an objective measure of that experience that can be used to calculate utility.[7]

Hedonistic utilitarians could respond to these objections by pointing out that, despite the difficulties mentioned, judgments about the relative amount of pain and pleasure an act will cause are often made. For example, think of the judgments made by parents, teachers, judges, and government officials. Making judgments about the subjective experience an act will cause is an inescapable part of the responsible exercise of legal and administrative power. And it is not as chancy an enterprise as the objection portrays. Mature and thoughtful people generally have a good idea of what will cause others pleasure and pain, and of how much it will cause. So there is no need to abandon hedonistic utilitarianism so quickly. Perhaps measurement of pains and pleasures cannot be precise, but it can be good enough to permit reliable judgments about the relative ethical worth of actions.

Hedonistic utilitarians who make this reply are advocating an important revision in the theory. They are abandoning the idea that *maximizing* utility is the sole criterion of the ethical worth of an action, and are substituting in its place the criterion of "*doing the best one can*" to maximize utility. For example, suppose Jones can do either *A* or *B* but not both. She estimates as best she can the amount of utility *A* will cause and the amount *B* will cause. She decides that *A* will cause more utility and so does *A*. As things turn out, her estimate is wrong and *A* causes less utility than *B* would have. According to the original principle of hedonistic utilitarianism, Jones's act is ethically impermissible. But since she did the best she could to estimate the utilities of *A* and *B*, on the revised theory it can no longer be said that what she did was wrong.

How can one judge whether an act is permissible or not according to the new criterion? Formerly it was alleged to be a relatively objective matter. If an act maximized utility it was ethically permissible; otherwise it was not. Judgments about the intentions and abilities of the person performing the act were not relevant. But now such judgments are relevant because one must decide whether a person really did his or her best. One must decide, for example, whether the person diligently looked for all the available data and made a rational judgment based on the data. The outcome of the act – the utility it causes – becomes less important than the effort and skill the person put into deciding what to do. Consequences become subordinate to good-faith effort by individuals. Thus, it is the ethical worth of individuals, not actions, that is of primary importance.

This change has far-reaching implications for hedonistic utilitarianism. So much so that it is questionable whether it is accurate to continue to classify the theory as consequentialist. But we will leave this issue and discuss another problem with implementing hedonistic utilitarianism.

Suppose Jones can do either *A* or *B* but not both, and that *A* and *B* affect only Jones, Smith, and Brown. Jones determines that *A* causes 12 units of pleasure for Smith, and 1 unit of pain each for Jones and Brown. Thus *A* causes a total of 10 units of pleasure. *B* causes three units of pleasure each for Jones, Smith and Brown, for a total of nine units of pleasure. The principle of hedonistic utilitarianism instructs Jones to maximize utility, so she should do *A*. But suppose she does *B* instead. Has she acted unethically?

Imagine Jones defends her action as follows: I know that *A* maximizes utility but I choose to do *B* because A *unfairly distributes* pain and pleasure. Smith gets all the pleasure and Brown and I get all the pain. *B*, on the other hand, gives each of us some pleasure and no one suffers pain. That seems much more fair. After all, why should Brown and I agree to suffer pain just so Smith can get all that pleasure? Why should we bear all the burdens and he get all the benefits?

Jones's defense highlights what many consider the most serious defect in hedonistic utilitarianism. It is completely insensitive to the distribution of pain and pleasure. It does not matter who gets how much pain or how much pleasure as long as utility is maximized. This makes it easy to construct examples in which hedonistic utilitarianism requires action that seems clearly wrong. For instance, suppose utility is maximized in the USA by ensuring that an ethnic minority gets all the pain and the white majority gets all the pleasure. That is unfair, but nothing in hedonistic utilitarianism prohibits it. Thus, if one believes that some distributions are more fair or just than others, and that being fair or just takes precedence over maximizing utility, then one will reject hedonistic utilitarianism.

One might suppose that utilitarianism can be repaired by adding some principle of distribution to the theory. And many attempts have been made to do this.[8] Some have argued, for instance, that individuals are justified in attaching greater weight to their own utility, thus enabling them to avoid sacrificing their personal good for the sake of the community except in rare circumstances. Others have argued that some distributions are unacceptable because they violate individual rights. These strategies assume that there is something about persons that insulates them from certain kinds of treatment, that makes it unfair or unjust to treat them in certain ways. We will discuss several of these views in the pages to come. But before we do so, we would like to emphasize again the importance and appeal of utilitarianism. Although many objections can be raised against it, in our opinion there is something undeniably right about utilitarianism. The basic idea – that it is morally right to contribute to the common welfare – is intuitively unassailable. The problem is to figure out exactly what one is obligated to contribute under different conditions. Sophisticated forms of utilitarianism make valiant efforts to address this problem, and not without success. Unfortunately we are unable to discuss these theories in this General Introduction, but we commend them to you. Some of them are listed in the suggested readings.

Deontological Ethics

Kant and the good will

The ethical view developed by the eighteenth-century philosopher Immanuel Kant stands in sharp contrast to consequentialism, relativism, and subjectivism. Kant's ethics does not depend on some prior concept of human good, it does not judge the ethical worth of actions based on their consequences, and it does not appeal to the desires of individuals or the common opinion of groups as a basis for ethical rules. Instead, Kant attempts to derive certain special ethical rules from the concept of reason. And because Kant believed that all mature persons have the capacity to reason, he thought that these rules applied to everyone. His arguments are subtle and complex. They are also among the most important and influential ethical arguments ever devised.

One place to begin thinking about Kant's ethics is to ask: What gives an action moral worth? What is it about a morally praiseworthy action that makes it praiseworthy? Consequentialists think that morally praiseworthy acts are those that have the best overall consequences. Results are what count; nothing else is relevant. Kant disagrees. He argues that we cannot judge the ethical worth of an action by its consequences because we cannot guarantee that what we intend to do actually occurs. Things can, and often do, go wrong. We may will to do good and inadvertently cause evil, or will to do evil and cause good. So the moral worth of an action cannot be defined by its consequences. Rather, Kant argues, it is defined by the act of willing itself. To see how this happens we need to make two preliminary points.

The first is that, according to Kant, the will is an internal faculty common to all persons. The will issues commands such as "let me now do *X*." But it only issues commands at the end of a process of reasoning. Hence, to will to do something is to rationally choose to do that thing. Kant says that the commands issued by the will can be formulated in statements he calls *maxims*. He believes that every act of will is associated with a maxim that expresses the intention of the agent. For example, if Jones wills to pay money she owes, the maxim which expresses her intention is "let me now pay my debt."

The second point is that Kant thinks of morality as the performance of duty. To perform a moral duty, for Kant, is to fulfill a requirement that is binding on all persons. We determine our duties by using a special rule of ethics which Kant calls the moral law. But there are at least two motivations for following a law. One is because we desire something, e.g. to gain the approval of our peers or to avoid a fine or other penalty. The other is respect for the law itself. One can choose to obey the law, not from desire or fear or calculated self-interest, but solely because one honors the law, because following the law is the right thing to do. When a person respects the moral law, and does what is right because it is right and for no other reason, Kant says that he or she is acting from a *good will*.

Kant believes that a good will is good without qualification. It is the only good thing that cannot be put to a bad use. When we act from a good will – when we do our duty out of respect for the moral law – then and only then do our actions have moral worth. Thus, we have Kant's answer to the question asked above – an action has moral worth just in case it is done from a good will. However, it leads naturally to another question, namely, what is the moral law?

Kant and the categorical imperative

To answer the second question it is helpful to understand Kant's ethical view as an attempt to find a rule for sorting maxims into those that are ethically acceptable and those that are not. For example, suppose Jones borrowed $5 from Smith and promised to pay it back the next day. When Jones sees Smith she could choose the maxim "let me now pay my debt" or "let me now avoid paying my debt." Kant believes that the former maxim is ethically correct and the latter is not. What he wants to do is find an ethical rule that always directs us to choose the former. It is this rule that he calls the moral law.

Kant argues that the rule, or moral law, will be expressed in the form of a command or imperative. He points out that there are two kinds of imperatives: hypothetical imperatives, which have the form "if you desire *A*, do *B*"; and categorical imperatives, which have the form "do *A*." However, the imperative Kant is looking for cannot be hypothetical. The reason is that the moral law is both *universal* and *necessary*. It is universal in that it applies to all persons, and necessary in that it does not depend on human sense experience, e.g. it does not refer to desires. But hypothetical imperatives make reference to our desires. Desires are discovered in sense experience; they are neither universal nor necessary. Thus, hypothetical imperatives are neither universal nor necessary. Thus, the rule for choosing maxims is a categorical imperative.

A categorical imperative, Kant argues, derives strictly from human reason. It makes no reference to consequences and is independent of desire. And since it arises from reason, it is acceptable to and binding upon all rational agents simply in virtue of their rationality.

It is important to see that a command like "shut the door!" is not a categorical imperative even though it seems to have the form "do *A*." The reason is that it makes implicit reference to desire, the desire to have the door shut. A true categorical imperative makes neither explicit nor implicit reference to desire. It applies to persons regardless of their desires.

To summarize thus far, Kant argues that the moral law is a categorical imperative. This imperative has the following characteristics: (1) it applies to all persons; (2) it makes no reference to desire; (3) it is a product of human reason; and (4) it can be used to sort maxims into those that are morally acceptable and those that are not. After many pages of complex argument, Kant proposes the following as the categorical imperative:

> First Categorical Imperative: Act only according to that maxim whereby you can at the same time will that it should become a universal law.

This is the moral law. It meets all of Kant's requirements. It is a categorical imperative. It is expressed in a universal form that applies to everyone. It makes no reference to desire or consequences. And, Kant tries to show, it arises from pure reason. This is why it is appropriate to call it a law. It is a law, not in the sense that it is passed by a legislature, but because it is a product of our own reason. Since each person has the faculty of reason, each person is (or could be) the author of the moral law. So in a sense we legislate the law to ourselves. We are not bound to obey it by some external force; rather, we are motivated to follow it by respect for ourselves and our own rationality. We follow the moral law because doing so expresses our nature as rational beings. To refuse to follow it is, therefore, irrational and against our nature.

How is one supposed to use the moral law to choose maxims? The idea is something like this. When a person is faced with a moral choice he or she formulates the maxim of his or her choice as a categorical "do this." Then the person asks whether the maxim can be *universalized*, i.e. whether it can be willed that everyone, in similar circumstances, choose the same maxim and follow it. If it can be willed as a universal law, one that everyone should always follow, let us say it is *compatible with* the moral law. Maxims that are compatible with the moral law are morally acceptable. If a maxim is not compatible with the moral law, it is not morally acceptable.

But why does compatibility matter? What difference does it make whether a maxim is compatible with the moral law or not? One reason it matters, Kant says, is because the moral law is a principle of reason, and maxims incompatible with the moral law are rationally inconsistent. They require us both to will a certain act at a certain time, and not to will the same act at the same time. But we cannot rationally consent both to do something and not to do it, and anything to which we cannot rationally consent cannot imply moral duties. Thus, maxims incompatible with the moral law are not ethically acceptable guides for action.

An example of how this is supposed to work might help. Recall Ted Brown's dilemma about whether to pay a bribe to get a big contract. To offer a bribe is to try to ensure that one secretly receives special treatment, treatment that puts others at a clear disadvantage. Can Ted consistently will that everyone in his circumstances pay the bribe? He cannot, for if it were to be a universal law that everyone offered a bribe to get a big contract, Ted would no longer be able to use bribery to get special treatment. Everyone would know about it, and his advantage would disappear. Thus, Ted cannot universalize his action. His maxim is not compatible with the moral law and so is not morally acceptable.

Here is another example. Suppose Jones promises Smith to do something although she has no intention of keeping her promise. The maxim of her act is "make promises when it is to your advantage even when you have no intention of keeping them." Can this be universalized? No, because if everyone were to do this the practice of promising would be undermined. No one would accept a promise at face value. As Kant says, "No one would believe what was promised to him but would only laugh at any such assertion as vain pretense." Since the maxim cannot be universalized, it is incompatible with the moral law and is not morally acceptable.

Criticisms of Kant

One of the main features of universalizable maxims is that they prevent persons who follow them from regarding themselves as special cases deserving of treatment that others are denied. That is one of the strengths of Kant's theory. It is not ethically acceptable to make exceptions for oneself. As it turns out, however, the feature of allowing no exceptions can be turned against Kant. Here is one of Kant's own examples.

Suppose Brown, who is innocent of any wrongdoing, is fleeing from someone who intends to murder him. Brown sees you and tells you where he is going to hide. Then the murderer comes along and asks you where Brown went. Should you tell the truth?

Since a general policy of lying is incompatible with the moral law, Kant argues that you should. As he puts it, "To be truthful in all deliberations, therefore, is a sacred and absolutely commanding decree of reason, limited by no expediency." Thus, Kant seems to believe there can be no exceptions to telling the truth.

But this cannot be the whole story. It cannot be right that one's only duty is to tell the truth. Surely one also has a duty to protect Brown. However, Kant permits no exceptions for Brown. What has gone wrong?

The main problem is that in the circumstances in which you find yourself it is unclear which maxim you should universalize. One possibility is "always lie when asked a question." This is obviously incompatible with the moral law and should be rejected. But Kant seems to assume that rejecting this maxim implies accepting "never lie when asked a question," which he believes is compatible with the moral law. However, there are other maxims one might follow, for example, "lie when no other alternative is available to protect the innocent from serious harm." This seems compatible with the moral law. If it were universalized murderers would no longer ask for directions, but that is no loss. Yet both maxims, the one Kant accepts and the one about protecting the innocent, apply in the present situation. How do you decide which to follow? And does it make a *moral* difference which decision you make?

The root of the difficulty is this. Any action can be described in a number of ways. These descriptions can be formulated into maxims, some of which will be universalizable and some not. However, Kant provides no method to decide which of the universalizable maxims should be chosen. Without this method his theory cannot be used to make an exact determination of our moral duty. Thus, Kant's theory is incomplete. It does not give clear-cut guidance in situations in which moral choices must be made.

Someone (not Kant) might respond that it makes no moral difference which maxim one chooses as long as it is universalizable and one acts from respect for the moral law. But this is wrong. It does make a difference. Based on the maxim you choose, Brown either lives or dies. And that is certainly a moral difference. Universalizability is not sufficient to tell us our moral duty. Something else is needed, something that tells us which universalizable maxim to follow.

If universalizability is not a sufficient test for moral duty, then perhaps universalizable maxims give us only prima facie duties, i.e. duties that hold unless overridden by other moral considerations. For example, the duty not to lie may be overridden by our obligation to protect the innocent. So to know our moral duty we need to know when one obligation is overridden by another. Since Kant believes that duties are absolute rather than prima facie, he has nothing to say about this. However, here is a suggestion that might work: a duty D_1 is overridden by another duty D_2 in circumstances C just in case there is a reason for doing D_2 rather than D_1 in C that every rational person would accept. The danger here is that there may be no such reason – no reason for doing one thing rather than another that everyone would accept. If so, then there will be cases of conflict of duty that cannot be resolved. No matter what one does, one acts immorally. That would be a moral tragedy.

The second version of the categorical imperative

Kant gives a second version of the categorical imperative which he (rather mysteriously) claims is equivalent to the first.

> Second Categorical Imperative: Act so that you treat humanity, whether in your own person or that of another, always as an end and never as a means only.

This imperative includes two of the main ideas of ethics in the Western tradition. The first is that persons should be treated as ends in themselves, i.e. as beings that are intrinsically valuable in themselves. The reason, for Kant, is that persons are centers of moral goodness. He believes moral goodness can exist in the world only in beings that can apprehend the moral law and freely choose to act from a sense of duty. The second idea is that persons are never to be treated merely as means to an end. Although we often use people as a means to gain something we want, we should at the same time acknowledge that they have value independent of their usefulness to us. They are not to be manipulated or exploited and then cast aside as one would a broken tool. For example, in relationships between teachers and students, doctors and patients, parents and children, and legislators and citizens, each party uses the other as a means to some end. But, Kant argues, each party should also regard the other as ends in themselves, and should treat them with the dignity and respect they deserve. Surely he is right about this.

Although the second imperative undeniably captures an important part of our ethical intuitions, it suffers from the same defect as the first. It does not give specific guidance in situations involving a moral choice. For example, suppose Ted Brown tries to follow the second imperative when deciding whether to offer a bribe. Does bribery treat others as ends in themselves or merely as means to an end? On one hand, it might be said that bribery does use others as mere means since it is a deceptive attempt to gain an unfair advantage. On the other, exactly which "others" are being so used? The other people who submitted a bid on the contract? But these people presumably did not submit the bid for themselves; rather, they were acting for a corporation. Corporations are not the sorts of things that apprehend the moral law and act from a sense of duty; that is something that only people can do. Thus, corporations are not intrinsically valuable in themselves. Thus, there is nothing wrong with using them as mere means.

In many business situations relations between persons, corporations, governments, unions, public interest groups, and so on are very complex. What does it mean, what could it mean, to treat persons as ends in themselves in these circumstances? Without doubt the sentiment is admirable, but sentiment is next to useless when one needs to know *precisely* what to do *now*. About this, the second imperative has nothing to say.

In response it could be argued that the objection raised against the second imperative is unfair. Kant never envisioned Ted Brown's dilemma, nor would he claim that the second imperative gives specific instructions in all circumstances. It is most useful in personal relationships in which people know each other and can judge more accurately when a specific behavior inappropriately uses others as means. That is its real application, and it is an important one.

We concede the point. The second imperative does not comfortably fit cases like Ted Brown's, so in a sense the objection is unfair. However, even in more personal relationships it does not do much better. For example, if you tell Brown's murderer where Brown is hidden, are you treating Brown with respect as an end in himself? Or if you lie to his murderer, are you treating the murderer as a mere means? The answers are not clear; arguments could be given either way. So the second imperative, like the first, needs something else, something that permits more precise answers to the questions raised.

One possible way to supplement Kant's theory is with the idea that people have moral rights that proscribe or compel certain behaviors. We will discuss rights in the next section. But before we do, recall that at the end of the section on relativism the question was posed: Why should I care about the interests of others as long as my interests are not involved? Kant's answer, and it is a good one, is that individuals should care about other people because they are centers of moral goodness and bearers of intrinsic value. Therefore, all people deserve to be treated with respect and dignity. To ignore the interests of other people, to shrug off the value they possess and pretend they do not matter, is to deny them what they are due. Furthermore, unless one is willing to be treated with disrespect and contempt oneself, it is to universalize a maxim that is plainly incompatible with the moral law. It is to say, "I need not consider the interests of others provided they cannot harm or help me, but when I cannot harm or help them, I want them to consider my interests nevertheless." In other words, one makes an exception for oneself for no good reason, indeed, for no reason at all other than "that is what I want."

Before we leave this section on Kant we should emphasize that we have given only the briefest introduction to many important facets of Kant's ethical philosophy, and we have left others out entirely. At best we have provided an interpretation of Kant's ethics, one that we think fairly represents some of the things he had to say, but no doubt one that some scholars will disagree with. We encourage everyone interested in ethical questions to read Kant and make up their own mind about what he has to say. Kant's works are sometimes difficult, but they are invariably rewarding.

Rights

The nature of rights

Over the last several centuries the language of rights has become commonplace in moral discourse. The conviction that people have rights has motivated the writing of documents from the US Declaration of Independence and the Bill of Rights to the United Nations' Universal Declaration of Human Rights. Everyone thinks they have rights, and everyone thinks rights are important. Among these rights are said to be rights to freedom of speech and assembly, property rights, rights to equal treatment, rights to equal pay for equal work, rights to education and basic medical care, rights to privacy, a right to know, and even a right to periodic vacation with pay. It is standard practice to invoke these and other rights in a throng of heated disputes about social and legal issues: abortion, affirmative action, workplace privacy, the treatment of children, and environmental protection, among others. But what are rights? Which rights do we have? And how important are they?

In many cases to say that someone has a right is to say that he or she has a justified claim against some person or group of persons. Rights of this kind are called *claim rights*. If a person has a claim right, then he or she is justly due something from others, something that can be demanded without appealing to their kindness, gratitude, pity, or good will. No favor, permission, or grant is needed to exact anything that one has as a matter of right. A person can insist that his or her rights be respected regardless of the wishes or inclinations of others, and, should those rights be denied without sufficient justification, properly raise indignant complaint. Thus, to have a claim right to something puts it beyond the reach of others to deny or withhold except in the most extreme circumstances. It is to have the most compelling and powerful claim of all.

One reason claim rights are so powerful is that they are correlative with duties – with what is due the holder of the right. If someone has a claim right of a certain kind, others have duties toward that person. These duties require either that other people not behave in certain ways toward the person, or that he or she be provided with certain goods or benefits. For example, if someone has a right not to be tortured, then others have a duty not to torture him or her; if he or she has a right to medical care, then others are required to provide him or her with medical care. Let us say that claim rights of the former kind are *barrier rights*. If someone has a barrier right, then others are barred from acting in certain ways toward that person. Claim rights of the latter kind are *welfare rights*. If someone has a welfare right, then others are required to provide the person with some good or make the good available to the person.

Although claim rights are an important class of rights, not all rights are claim rights, because not all rights imply that other people have specific duties. For example, in the USA a woman has a right to get an abortion, but no individual has a duty to perform abortions. In business, companies have a right to compete for market share, but no one has a duty to see to it that they succeed. We will not discuss these other rights here. However, several detailed analyses of rights are listed in the suggested readings.

Legal and moral rights

Claim rights ("rights" for brevity) can be further classified as either legal or moral rights. In the USA legal rights derive from the Constitution, laws passed by legislatures, and common law. Moral rights differ from legal rights in three important ways. First, they do not originate in nor are they justified by the actions of judges or legislative bodies. Second, they are held equally by all persons at all places and times. Third, unless they are codified in law, moral rights are not legally enforceable. To assert one's moral rights is to make a moral rather than a legal claim.[9] But all of this presents a puzzle. If moral rights are had by everyone but do not derive from legislative or judicial action, then evidently one does not have to do anything to possess them. Where, then, do they come from? In virtue of what do persons possess them? And if in many cases they cannot be legally enforced, why value them? In fact, why suppose there are moral rights at all?[10]

A case for rights

One reason to think there are moral rights is that they seem to be both the source of many legal rights and the ground or basis from which legitimate criticisms can be made of legal rights. For example, the authors of the Declaration of Independence appealed to "unalienable Rights" as a basis from which to criticize the rule of Great Britain and declare it invalid. These rights, for instance, the "Right of the People" to form a new government with new laws, were not legal rights. Indeed, they were used to justify actions that were decidedly illegal.

Moral rights can also be used to justify maintaining as well as changing law. For example, suppose that, using legal means provided for in the Constitution, an attempt is made to repeal the Bill of Rights. If you believe that this is not only a bad idea, but that persons would be wronged unless government is prevented from taking actions prohibited in the Bill of Rights, then you are assuming and appealing to moral rights that are independent of the law.[11]

There are many other examples of moral rights being used to criticize the law, or as a justification for passing laws. Social movements, such as the civil rights movement, have been organized to gain rights not codified in law. Wars have been fought to maintain them, and revolutions begun to achieve them. This reiterates a point made earlier: most people have the concept of a moral right and believe it has meaningful application in human affairs. Perhaps this pragmatic justification of moral rights is all that is needed. However, in our view there is another and more compelling justification. To see what it is, we need to return to Kant.

Kant argues that persons are intrinsically valuable. By this he means, in part, that they have value that is independent of their being valued. Thus, persons have value independent of their value as means to some end. As Kant says, they are ends in themselves. Moreover, all persons have value regardless of whether it is acknowledged or recognized. And all persons have the same degree of intrinsic value. Individuals differ in ability, achievement, and moral and personal virtue, but their intrinsic value is the same.

Now, to say that something is intrinsically valuable or valuable in itself sometimes implies that it is *worth seeking* for itself, and not only worth seeking because it is useful. Pleasure and happiness are intrinsically valuable in this sense. But pleasure and happiness are *psychological states*. They are experiences worth seeking for themselves, and seeking to experience such states is how humans acknowledge their value. But humans are not experiences; they are things that have experiences. Thus, they are not worth seeking in the sense that pleasure and happiness are worth seeking. Thus, to acknowledge the value of persons is not to seek a certain kind of experience. If we are to acknowledge the value of persons, if we are to see them as things that are worthwhile in themselves, something else must be done. But what?

To begin with, note that Kant and the utilitarians share an important belief, which is, roughly, that persons have a moral obligation to promote, protect, or enhance whatever is intrinsically valuable. For utilitarians intrinsic value is located, so to speak, in experience, e.g. the experience of pleasure. So utilitarians take it to be their moral obligation to maximize experiences of pleasure. Kant, on the other hand, locates intrinsic value in persons, and only derivatively in human experience. Thus, he believes there is a moral obligation to promote, protect, or enhance persons qua persons. This he proposes to do by treating persons as ends in themselves. But exactly how should we acknowledge the intrinsic value that all persons equally possess?

Here is a possibility. All normal persons have the capacity to exercise free choice in service of their interests. We suggest, then, that one way to promote, protect, and enhance the intrinsic value of persons is to grant that they have a valid claim, a *right*, to use this capacity. To respect this right is one way to acknowledge the value of persons. It is to grant that, in an important sense, to freely choose for oneself what one will do, believe, or become is part of what it means to be a human. It need not be the only way that human value is acknowledged, but is the only way that gives persons the "moral space" to fashion their own lives according to their own lights. It is one way to respect our common humanity, to grant us our due as beings who can apprehend the moral law and freely choose to follow it.

Barrier rights and welfare rights

So far we have argued that everyone has a right to exercise free choice in service of their interests. This right can be used to discover other rights. For example, if one has a right to free choice, then it seems reasonable that one has a right to whatever is needed to exercise free choice, for without these other rights the right to free choice would be empty. Among the things needed to exercise free choice is physical security. If the security of one's person or property can be denied or abridged without penalty by arbitrary government edicts or the caprice of individuals, then free choice means little. The right to physical security in turn implies that persons have a right not to be unjustifiably harmed, e.g. the right not to be murdered or tortured. These are what we earlier called barrier rights.

A number of other barrier rights have been proposed. Whether these can be derived from the right to free choice is controversial. However, it is generally supposed that barrier rights of all kinds protect vital human interests. Two important examples are the interests persons have in participating in the life of the community, and having a reasonable expectation of accomplishing personal goals. Barrier rights that protect the first interest might be, for example, rights to free speech and assembly, a right to equal treatment under law, and the right to vote and seek political office.

Barrier rights also protect the second interest. Without physical security, for example, no one could have reasonable expectations about the future. A number of people have argued, however, that barrier rights are not enough to protect the second interest. Welfare rights are needed as well. Rights to basic education, health care, and a guaranteed minimum standard of living are all needed, it has been argued, if one is to have any prospects for the future or any hope of undertaking a life plan. Whether there are welfare rights, and if there are, what specific obligations they impose, are issues we will not try to settle here. We note only that if persons have a vital interest in living a fulfilling life, then it is difficult to see how one could not claim, as a matter of right, the basic goods needed to make a fulfilling life possible.[12]

Conflict of rights

In political, social, and personal interactions there are many cases in which rights seem to conflict. For example, one person's right to free speech may conflict with another's right to privacy, or one person's right to nondiscriminatory treatment may conflict with another's right to associate with whomever he or she pleases. These cases can be handled in one of two ways. First, a conflict of rights is often only apparent and not actual. Frequently rights are stated in simple and unqualified language that encourages bold assertions based on modest reasons. Unless properly qualified, one person's "I have a right to say what I please" will inevitably conflict with another's "I have a right not to be offended by language I find distasteful." In these cases the specific content of the right and the circumstances under which it holds need to be carefully analyzed. Not all rights hold in all situations without exception. An assertion of right should always be given due consideration, but it does not entitle one to shout "Fire!" in a crowded theater, nor to censor works of art, literature, or political expression.

Sometimes, however, the conflict is real. It then should be recognized that rights, like duties, are prima facie: one right can be overridden by another in special cases. For example, the right to peaceful enjoyment of one's property may be overridden by concerns for public safety. The general rule is that, since rights protect interests, when one person's interests are stronger or more compelling than another's, then rights to the latter can be justifiably overridden by rights to the former. Some interests are so strong, however, that it is difficult to imagine cases in which rights protecting those interests can be justifiably overridden. An example is the right not to be tortured.

Although rights can be overridden, the reasons for doing so must be very strong. One person's rights cannot be overridden by the whims of others or by marginal gains for the good of the community. Recognizing rights demonstrates our belief in the value and dignity of persons. To override a right for less than overwhelming reasons belittles the value of persons and denies their dignity. It is not something to be undertaken lightly.

The Ethics of Virtue

The issue of character

At the beginning of this General Introduction we defined ethics as the study of what is good or right for persons, of the goals they ought to pursue, and the actions they ought to perform. We understood this definition to imply that the main task of ethics is to discover what responsible moral agents should do when confronted with decisions about right and wrong. One way to approach this task is to carefully formulate ethical or moral principles that distinguish between ethically permissible and ethically impermissible behavior. The principles are then used as guides for making ethical decisions. Utilitarianism and Kantianism are rival accounts of what those principles should be.

There is, however, quite a different way to understand the main task of ethics. Instead of focusing on moral principles, which are used to help answer the question "what should I do?", it focuses primarily on moral character, and asks "what kind of person should I be or become?" This approach to ethics is based on the concept of *virtue*. It emphasizes moral education and the development of moral character rather than a strict adherence to moral principles. The advantage of this approach, its proponents believe, is that it gives a much more complete and useful account of human life as it is actually lived by real persons in the historical and cultural circumstances in which they find themselves. It does not suppose that persons are, as one writer put it, "faceless ethical agents" striving to follow some abstract utilitarian or Kantian principle. Rather, it tries to describe and understand the traits that enable a person to lead a full and satisfying ethical life.

Virtues are traits of character that both help individuals achieve their goals and are beneficial to the larger community. Examples of virtues are courage, temperance, compassion, generosity, kindness, honesty, and concern for justice. Virtues should be distinguished from other personal traits, such as good health or innate intelligence, because virtues are components of one's character that engage the will. Virtuous acts do not happen by chance. They are chosen by someone who is fully aware of what he or she is doing. And they are chosen because they are virtuous, and not because they satisfy self-interest or are pleasurable. However, the Greek philosopher Aristotle, whose analysis of virtue is justly famous and influential, claimed that if one were trained or trained oneself to be, say, charitable, then charitable acts would become pleasurable and miserly acts painful. The charitable person does not begrudge giving money, nor does he or she resent those who receive it. For the charitable person, giving is enjoyable. But, once again, the reason one gives is not because it is enjoyable, but because it is virtuous.

The value of virtues for the individual and the community seems evident. Persons without some measure of the virtues mentioned above are not widely admired, nor, despite certain media images to the contrary, do they generally succeed in life. And a community composed of persons with few virtues is not likely to do well in the long run. Liars, cheats, cowards, and scofflaws are not valuable citizens. An important question, then, is how do persons become virtuous? According to Aristotle, it begins with moral education. Through education one learns the appropriate way to act in different circumstances. One acquires the virtue of honesty, for example, by being taught to act honestly and acting honestly in a variety of situations. Eventually these acts are chosen for their own sake, and honesty becomes a part of one's character. Other virtues are acquired in the same way.

Can one teach oneself to be virtuous? For example, can one teach oneself to be courageous? It would seem so, provided three conditions are met. First, one needs a model to follow, someone who actually is courageous. Second, one needs the willpower to act as that person would act if he or she were in a situation that calls for courage. Third, one needs real opportunities to act courageously. Courage (and all other virtues) is a behavior that is learned by doing. For instance, suppose you are a soldier about to enter a battle. You know you are not particularly courageous, but your friend Jones is. When you are in danger, you could ask yourself, "What would Jones do now?" Since Jones is courageous, she would act courageously as a matter of course. If you model your behavior after what she would do, then eventually you will become courageous as well.

If one becomes virtuous by being taught to be virtuous or modeling one's behavior after virtuous persons, then moral education is of the highest importance for a society that values virtuous people. To coin a phrase, virtuous people are made, not born. The social structure in which people live – family, religion, school, and other legal and social institutions – are of central importance in teaching virtue and making it possible for the virtues to be taught. If, through failure of will or lack of conviction, society does not ensure that people have the opportunity to learn to be virtuous, then it should come as no surprise when they are not. This does not imply that people should be brainwashed or indoctrinated with the beliefs of the cultural elite. But it does imply that stands must be taken about the kinds of behaviors that are and are not socially acceptable. Tolerance of the behavior of others is a virtue, but tolerance can be taken to extremes. To tolerate all behavior is to abandon any hope that personal and social relations can be useful, satisfying, or conducive to the general good.

Virtues and ethical principles

Philosophers have discussed many issues to do with virtues that we will be unable to cover in this General Introduction. They have wondered, for example, whether all virtues have something in common, whether one can have some but not all of the virtues, whether one can be virtuous some but not all of the time, and whether one can exemplify virtues in the service of evil goals. There is, however, one issue we will mention briefly. It is the issue of the relation between virtue ethics and ethical principles of the kind advocated by utilitarians and Kantians. Some virtue theorists claim that one can dispense with ethical principles altogether and construct a complete ethical viewpoint based solely on virtue. Is this possible?

We believe that ethical principles must play an important role in any ethical viewpoint. For example, consider the virtue of honesty in the context of Kant's example of the man fleeing the murderer. Suppose you are an honest person. When the murderer asks you where the man went, what is the honest thing to do? Do you tell the murderer or not?

In this case simply being honest is of no use unless you know which act is honest. And knowing which act is honest depends in part on which ethical principles you hold. For example, suppose you believe that the man fleeing the murderer has a right to life, and that this right cannot be overridden by the murderer's request. Then you would not tell the murderer where the man went. On the other hand, suppose you are a member of a slave-owning society, and that in your society a slave owner can do with his slaves as he will. And suppose that the man fleeing is a slave owned by the murderer. Do you tell the murderer where he went? Yes, because you believe that it is the honest thing to do. The rights of the slave are not a consideration, either because you believe that slaves have no rights or because you believe that property rights override the slave's right to life.[13]

The difference between these two societies is not that one has honest men and women and the other does not. The difference is that they hold very different principles about the rights of persons. The slave-owning society has the wrong ethical principles. They may be honest, but it is honesty tainted by service to a mistaken ethical viewpoint.

If our argument is correct, then a complete ethical viewpoint cannot be based solely on virtue. Ethical principles also have an important part to play. However, the role of the virtues should not be underestimated. If we were to ignore them in our account of ethics, then we would omit any understanding of what it means to be a person who actually leads an ethical life. And if we were to ignore them in our practice, then we would lack the continuity, coherence, and content that give our lives meaning. To modify one of Kant's famous phrases, virtuous people who lack ethical principles are ethically blind, but ethical principles without virtuous people are empty.

Conclusion

Those first beginning the study of ethics often find it confusing and even disheartening. There seem to be so many different ethical views, each apparently vulnerable to criticism, that it is very difficult to sort it all out and discover a reasonable ethical position that is applicable to everyday concerns. One might be tempted to throw up one's hands and say, "When they have it all figured out, then I will listen. Until then, I will just muddle through somehow."

But there is no need to give up so easily. Things are not as bad as they may seem. What follows is a suggestion about how one might proceed.

Suppose we try to combine some of the insights of utilitarianism and Kantianism. Suppose, for example, that we take as basic principles the two parts of Kant's second version of the categorical imperative. In other words, we adopt as a basic principle, first, that no one be treated as a means and, second, that as far as possible everyone be treated as an end in themselves. And suppose we take the first to imply that persons have, at a minimum, barrier rights that can justifiably be overridden only in extreme circumstances. And we take the second to imply that we should enhance the well-being of others – their happiness – to the extent we are able. Thus, by accepting barrier rights we ensure that persons are not treated as means, and by promoting happiness we treat them as ends in themselves.

This gives us two practical principles of ethics – respect the rights of others and promote their happiness. However, it is possible that enhancing the happiness of some unjustifiably violates the rights of others. So we need to state our "Kantian utilitarian" principle as follows:

> An act is ethically permissible if and only if (1) it does not unjustifiably violate any barrier rights, and (2) it

> brings about as much overall happiness as is consistent with (1). Acts that do not meet conditions (1) and (2) are not ethically permissible.

This principle clearly needs elaboration, analysis, and defense. For instance, it might be said that welfare rights should be included in addition to barrier rights. The number and strength of barrier rights needs to be discussed, as do the conditions under which those rights can be overridden. There remain problems about measuring the amount of happiness that one's actions bring about, and even about whether happiness is the appropriate value to use. And one could object that the principle is too stringent, that it requires too much of persons for them to use it in their ordinary lives. Still, it is, we suggest, a plausible and defensible step in the right direction. It attempts to combine the Kantian insight that it is ethically unacceptable to treat people in certain ways with the utilitarian insight that one should contribute to the general welfare. Whether it proves successful from both a philosophical and practical viewpoint is something that, for the present, we must leave for others to judge.[14]

In this General Introduction, lengthy though it is, we have omitted many topics in ethics and barely touched on others. This is not because they are unimportant or unworthy of extended comment, but only because choices had to be made. For good or ill, the choices we have made reflect what we believe to be the minimum necessary for understanding ethical issues in the world of business. We hope that we have given the reader some of the flavor of ethics, a taste of its richness and complexity. And we hope that the reader will be motivated to continue the study of ethics. Some things, we have tried to argue, are not only useful, they are worthwhile in themselves. We believe the study of ethics is one of them.

Notes

[1] In this General Introduction we will use the words *moral* and *ethical* interchangeably.

[2] See several meta-studies conducted, including: Moses L. Pava and Joshua Krausz, "The Association between Corporate Social-Responsibility and Financial Performance: The Paradox of Social Cost," *Journal of Business Ethics* 15(3) (1996), 321–358; J. Frooman, "Socially Irresponsible and Illegal Behaviour and Shareholder Wealth," *Business & Society* 36(3) (1997), 221–249; and Ronald M. Roman, Sefa Hayibor, and Bradley R. Agle, "The Relationship between Social and Financial Performance," *Business & Society* 38(1) (1999), 109–125.

[3] Someone might object here that even assuming that all societies have a common set of ethical rules does not show that those rules are ethically acceptable. It might be that all societies make a similar error about the rules, or that they simply follow a rule that is ethically unacceptable.

[4] We will sometimes use "egoist" as an abbreviation for "psychological egoist." It is important to see that an egoist, as we will use the term, is an advocate of a theory of human motivation, not someone who has the personality trait of being self-centered.

[5] By "act," we mean to include both acts and omissions.

[6] For an excellent discussion of this issue, see Amitai Etzioni, *The Moral Dimension: Toward a New Economics* (New York: Free Press, 1988), and Robert H. Frank, *Passions within Reason: The Strategic Role of the Emotions* (New York: Norton, 1988).

[7] Contemporary theories try to avoid this problem by using the notion of preference instead of pleasure. What is maximized is not pleasure, but the choices available to someone. Note that distribution problems could still occur. It might happen that total preferences for a group be maximized by severely restricting the choices available to a minority.

[8] Bentham made such an attempt by using the notion of "extent" in his analysis of pleasure.

[9] Many moral rights are codified in law. An example is the right to not be murdered. Other moral rights are not a part of law. For instance, a legal right that many people say is not a moral right is the right to an abortion. And an example of what some allege to be a moral right that is not a legal right in the United States is the right to be guaranteed a job.

[10] See Jeremy Bentham, "Anarchical Fallacies," in *Human Rights*, ed. A. I. Melden (Belmont, Calif.: Wadsworth, 1970), 28–39.

[11] This example is taken from David Lyons's Introduction to *Rights* (Belmont, Calif.: Wadsworth, 1979), 3–4.

[12] For a defense of welfare rights, see James Sterba, "The Welfare Rights of Distant Peoples and Future

Generations: Moral Side Constraints on Social Policy," *Social Theory and Practice* 7 (Spring 1981), 99–124.

13 For an excellent discussion of slave societies of this kind, and of many other issues concerning slavery, see Orlando Patterson, *Slavery and Social Death* (Cambridge, MA: Harvard University Press, 1982), 190–193.

14 This argument is taken from James W. Cornman and Keith Lehrer, *Philosophical Problems and Arguments: An Introduction* (New York: Macmillan, 1968), 432–434.

Suggested Readings

There are many fine books on ethics and ethical theory. We include only a very brief selection of those that the reader may find of use should he or she wish to continue the study of ethics. A very good secondary source for all the ethical viewpoints discussed in the Introduction is the *International Encyclopedia of Ethics*, ed. Hugh LaFollette (Oxford: Wiley-Blackwell, 2013).

Utilitarianism

The classic source for utilitarian ethics is John Stuart Mill's *Utilitarianism*, of which there are many editions. An excellent collection that includes Mill's work is *Mill: Utilitarianism*, ed. Samuel Gorovitz (Indianapolis: Bobbs-Merrill, 1971). Also see J. J. C. Smart and Bernard Williams, *Utilitarianism: For and Against* (Cambridge: Cambridge University Press, 1980); Samuel Scheffler, *The Rejection of Consequentialism* (Oxford: Oxford University Press, 1984); and Peter Singer, *Practical Ethics* (Cambridge: Cambridge University Press, 1993). A sophisticated utilitarian theory is developed by Richard B. Brandt in *A Theory of the Good and Right* (Oxford: Clarendon Press, 1979).

Deontological ethics

Immanuel Kant's writings about ethics extend over several volumes. Perhaps the best place to begin is his *Groundwork of the Metaphysic of Morals*, many editions. An excellent secondary source is Bruce Aune's *Kant's Theory of Morals* (Princeton: Princeton University Press, 1979). For contemporary interpretations of Kant's ethics see Christine M. Korsgaard, *Creating the Kingdom of Ends* (Cambridge: Cambridge University Press, 1996), and Francis Kamm, *Intricate Ethics: Rights, Responsibilities, and Permissible Harm* (Oxford: Oxford University Press, 2007).

Rights

Among the many books on rights are Ronald Dworkin, *Taking Rights Seriously* (Cambridge, MA: Harvard University Press, 1977); James W. Nickel, *Making Sense of Human Rights* (Berkeley: University of California Press, 1987); Henry Shue, *Basic Rights* (Princeton: Princeton University Press, 1980); and Judith J. Thomson, *In the Realm of Rights* (Cambridge, MA: Harvard University Press). For a view of rights that has consequentialist underpinnings, see L. W. Sumner, *The Moral Foundation of Rights* (Oxford: Clarendon Press, 1989).

Virtue

Any investigation of the virtues should probably begin with Aristotle's *Nicomachean Ethics*, many editions. For a contemporary view see Alasdair MacIntyre, *After Virtue* (Notre Dame: University of Notre Dame Press, 1981); Rosalind Hursthouse, *On Virtue Ethics* (Oxford: Oxford University Press, 1999); and Julia Annas, *Intelligent Virtue* (Oxford: Oxford University Press, 2011). An anthology that has many useful readings on virtue is *Vice and Virtue in Everyday Life*, ed. Christina Sommers and Fred Sommers (New York: Harcourt Brace, 1993).

Ethics and economics

In addition to the volumes by Etzioni and Frank listed in the endnotes to this General Introduction, an excellent book about ethics and its relation to economics is Allen Buchanan's *Ethics, Efficiency, and the Market* (Totowa, NJ: Rowman and Allanheld, 1985). Also see David Gauthier's *Morals by Agreement* (Oxford: Clarendon Press, 1986) for an insightful development of a theory of morals as a part of the theory of rational choice, as well as Amartya Sen, *On Ethics and Economics* (Malden, MA: Blackwell Publishers, 1987). A helpful secondary source is *The Oxford Handbook of the Philosophy of Economics*, ed. Harold Kincaid and Don Ross (Oxford: Oxford University Press, 2009).

Ethical skepticism

Finally, for a skeptical view of ethics, nothing is better than J. L. Mackie's *Ethics: Inventing Right and Wrong* (New York: Penguin Books, 1977), and Bernard Williams's *Ethics and the Limits of Philosophy* (Cambridge, MA: Harvard University Press, 1985). See also Walter Sinnot-Armstrong, *Moral Skepticisms* (Oxford: Oxford University Press, 2006). For an overview of recent empirical work on ethics that casts doubt on ethical theories, see Jonathan Haidt, *The Righteous Mind:Why Good People are Divided by Politics and Religion* (New York:Vintage Books, 2012).

Part 1

Ethics and Business
From Theory to Practice

Introduction

In exploring the ethical dimensions of business activity it is not always enough to focus attention on specific ethical problems. Issues such as the rights and duties of employees, product liability, and the responsibility of business to the environment arise in the context of a comprehensive economic system which deeply influences our values and structures the range of choices available to us. Often we will find that the most important ethical question is not "What is right or wrong in this particular situation?" but rather "What is the ethical status of a situation which forces such a choice on the agent?" or "How can the situation be restructured to provide a more satisfactory climate for ethical decision making?" Some ethical problems are not isolated but systemic; for this reason Chapter 1 examines the free-market system itself from an ethical and legal perspective. What we seek when we evaluate economic systems ethically, at least in part, is a framework for business transactions and decisions, as well as a set of procedures which, if followed, will generally bring about just results. Justice of this kind – called procedural justice – can be illustrated by the familiar method of dividing a piece of cake between two children: Assuming that the children should receive equal slices, if one child cuts the cake and the other chooses the first slice, justice should be served. Not all just procedures produce results as just as this one does. But in choosing an economic system we look for one which provides as much justice as possible. Traditionally, it has been held in America that capitalism is such a system; critics challenge this claim. An examination of this controversy requires a clear conception of what justice is, and the first three articles in Chapter 1 provide the groundwork for such a conception by presenting important theories of economic justice.

Even if the free-market system is just it may not mean that every event which occurs according to the rules of the system is just. Just procedures are not always sufficient to ensure just results. Suppose, for example, that a person owns one of the five waterholes on an island and that the other four unexpectedly dry up, leaving the owner with a monopoly over the water supply and the opportunity to charge exorbitantly high prices for water. It might be argued that even if the owner of the waterhole acquired it legally, did not conspire to monopolize, and allowed her prices to be determined by the fluctuations of the market, this situation is unjust. Although procedural justice may be necessary to bring about ethical outcomes, it may not be sufficient by itself to do so. Thus, although a just economic system is essential for an ethical business climate, we may also find it necessary to examine the relationships and transactions which take place within the system and to make ethical reasoning a part of business decision making at a more specific, less general level. Chapter 2 suggests some ways in which this might be done.

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Distributive Justice

Questions of economic justice arise when people find themselves in competition for scarce resources – wealth, income, jobs, food, or housing. If there are not enough of society's benefits – and too many of society's burdens – to satisfy everyone, we must ask how to distribute these benefits and burdens fairly. One of the most important problems of economic justice, then, is determining the fair distribution of limited resources.

What does it mean to distribute things justly or fairly? To do justice is to give each person what he or she deserves or is owed. If those who have the most in a society deserve the most and those who have the least deserve the least, that society is a just one. If not, it is unjust. But what makes one person more, another less, deserving?

Philosophers have offered a wide range of criteria for determining who deserves what. One suggestion is that everyone deserves an equal share. Others hold that benefits and burdens should be distributed on the basis of need, merit, effort or hard work, or contribution to society. John Rawls, Robert Nozick, and J. J. C. Smart each emphasize one or more of these criteria in constructing a theory of economic justice.

The theory of economic justice underlying American capitalism has tended to emphasize contribution to society, along with merit and hard work, as the basis of distribution. We do not expect everyone to end up with an equal share of benefits and burdens under a capitalist system. But supporters of capitalism hold that those who receive more do so because of their greater contribution, and that for this reason the inequalities are just. Recalling the Kantian ethical principles examined in the General Introduction to this book, however, it might be argued that rewarding people on the basis of what they contribute to the general welfare implies treating them as merely a means to an end rather than as ends in themselves and overlooks the intrinsic value of persons. Each person's contribution, furthermore, depends largely on inborn skills and qualities and circumstances which permit the development of these traits. Ought people to be rewarded in proportion to accidents of birth over which they have no control? Some philosophers, such as John Rawls in the first article, "Justice as Fairness," think not.

As an egalitarian, Rawls believes that there are no inborn characteristics which make one person more deserving than another; there are no differences between people which justify inequalities in the distribution of social benefits and burdens. Everyone deserves an equal share. That this is true does not mean that Rawls finds all inequalities unjust; but his theory permits only inequalities which benefit everyone and to which everyone has equal access.

Rawls argues that the principles of distribution he proposes are just because they are the principles which would be chosen by a group of rational and self-interested persons designing a society – assuming they are ignorant of their own abilities, preferences, and eventual social position. We ought to choose our principles of justice, Rawls claims, from behind a "veil of ignorance," a position strikingly similar to that of the child who cuts the cake, unsure of which piece he or she will eventually have. Although all those in Rawls's hypothetical situation seek to protect their own interest, they are prevented from choosing a principle of distribution which will benefit themselves at the expense of others. Thus they are likely to reject a utilitarian principle of justice under which the happiness of a few might be sacrificed to maximize total well-being, or a notion of justice in which distribution depends in part upon luck, skill, natural endowments, or social position. Rawls believes that they would select egalitarian principles.

Some critics have challenged Rawls's claim that rational persons acting from behind a veil of ignorance would choose egalitarian principles of justice. Rawls assumes that all people are self-interested, but he fails to take account of the gamblers and risk-seeking entrepreneurs among us. Others ask whether the choice of egalitarian principles by people essentially unaware of their own identity is really enough to justify them ethically. A possible defense of Rawls's argument involves an appeal to the Kantian ethical principle examined in this book's General Introduction. Kant held that one test of the ethical acceptability of a principle is whether it can be made into a universal law without contradiction. By placing us behind a hypothetical veil of ignorance, Rawls asks us to choose principles of justice which apply to ourselves and all others equally. As a universal law, Rawls seems to be saying, only an egalitarian theory of justice is fully consistent.

Because he gives everyone a voice in what the principles of justice are to be, and because equal treatment seems to recognize every person's intrinsic worth, Rawls's theory of justice also seems to satisfy the second Kantian test, the treatment of all people as ends in themselves. It is not clear, however, that the egalitarian way is the only way to treat people as ends in themselves. Robert Nozick's libertarianism, which emphasizes individual rights instead of equal distribution, might also be open to a Kantian defense.

Unlike Rawls, Nozick in his article "Distributive Justice" focuses his attention not on what each person ends up with, but on how each person acquired what he or she has. Justice for Nozick is historical and procedural; it resides in the process of acquisition. A theory of justice thus consists of setting forth rules for just acquisition. And something which has been justly acquired justly belongs to its owner even if this means that some people will receive a far greater share of benefits or burdens than others.

Nozick objects to the attempt to bring about justice by imposing a preconceived pattern of distribution, such as the egalitarian one, because he believes that no such pattern can be realized without violating people's rights. As the word "libertarian" suggests, the right most heavily emphasized by Nozick is a barrier right, the right of freedom, or noninterference. Interference, he holds, is permitted only when the rights of others are being violated. Second is the right to property which has been justly acquired. Under a libertarian theory of justice, taxation to redistribute and equalize wealth is a violation of human rights, an appropriation of the fruit of other people's freedom akin to forced labor. One might also look upon it as the treatment of others as means. The only way to treat people as ends in themselves, a libertarian might argue, is to guarantee them freedom from coercion. The only just pattern of distribution, libertarians claim, is not a pattern at all, but the product of a multitude of free, individual choices.

Critics of the libertarian theory generally attack what they view as its truncated conception of human rights. It may be true, they say, that persons have rights of noninterference. But surely there are other human rights more positive in nature. If persons have a right to life, for example, it could be argued that they also have welfare rights to the basic things they need in order to live: food, clothing, shelter, and so on. If this is true, their right to these things might sometimes override someone else's right to noninterference. For example, Nozick himself admits that it is unjust for one person to appropriate the entire supply of something necessary for life, as in the example of the waterhole mentioned above. If it is correct that there are welfare rights which supersede the right to noninterference, libertarianism needs re-examining.

J. J. C. Smart in his article "Distributive Justice and Utilitarianism" differs from both Nozick's and Rawls's theory of justice in that he neither attempts to make distribution conform to a specific pattern nor focuses on the process by which distribution takes place. As a utilitarian, Smart is concerned with the maximization of happiness or pleasure, and approves of any distribution of goods which accomplishes this goal. Thus, utilitarian justice could be compatible with either an equal or an unequal distribution of goods, depending on which of the two is shown to provide the greatest total happiness. Although in general Smart believes that an egalitarian distribution of benefits and burdens is most likely to maximize happiness, he is in no way committed to equality as a principle of distribution. On the contrary, if he were to find that extreme inequalities maximize happiness, he would be committed to these strategies. Utilitarianism, in short, is interested in the maximization of happiness and not in its distribution.

Some thinkers find utilitarianism's stress on the sum total of happiness to be incompatible with the very idea of justice, and Smart admits that justice is only a subordinate interest for utilitarians. Under utilitarianism, people may be denied what they deserve because that denial increases total happiness. On the other hand, and for the same reason, they may be given more than they deserve.

Justice and the Practice of Capitalism

Rawls, Nozick, and Smart offer different theories of economic justice. They say little, however, about how their principles apply in a capitalist economic system such as that in the USA. In articles by Jan Narveson entitled "The 'Invisible Hand'" and by Kent Greenfield entitled "Corporate Ethics in a Devilish System" we examine the implications for justice of a free-market system operating in the context of a complex system of laws. Narveson offers a defense of what he views as the morality of free-market capitalism; Greenfield places capitalism in the context of the laws under which it operates.

Perhaps the two most important characteristics of capitalism are (1) the private ownership of the means of production (as opposed to common or government ownership), and (2) a free-market system, in which prices and wages are not controlled by the government or by a small, powerful group, but are allowed to fluctuate based on supply and demand. The key word here is freedom. Essential to the system is free competition: Workers must be able to move freely from job to job as they choose, and everyone must be free to enter the market to buy and sell as they choose.

Clearly, a free-market system will not provide everyone with an equal share of income or wealth. Narveson argues, however, that the fact that capitalism is consistent with economic inequality does not make it unfair. He claims that the only way to achieve economic equality is through the redistribution of wealth by a government authority – a solution that violates individual liberty. Like Nozick, he defends the capitalist conception of justice because he believes that it best respects people's rights and maximizes freedom.

Moreover, Narveson argues, provided the market is constrained by rules prohibiting violations of the personal and property rights of others, i.e. force and fraud are illegal, a free-market system will benefit not only individuals who enter into market transactions, but society in general. This is true even though doing so is not the purpose of any individual market participant, and even though no one is compelled to provide social benefits to others, but because free markets generate positive externalities. Examples of positive externalities are the social benefits of entrepreneurial creativity, and the charity and philanthropy made possible by accumulated wealth. Thus, Narveson claims, absent force and fraud, free markets are the best available practical means we have for improving both individual and social welfare.

But does everyone, or nearly everyone, really benefit under a capitalist system? Some critics argue that the truth of this claim depends on the freedom of the market – a freedom, they hold, that is largely illusory. For instance, because of limitations due to lack of education, poverty, or social position, workers are not free to move from job to job and can thus become trapped in work that is hazardous or low-paying. And the influence of giant corporations skews the market. Individuals and small businesses are not able to compete on the same terms as large businesses, and hence competition is not truly free. Narveson's picture of capitalism, critics might say, fails to take account of the very real limitations experienced by people even in a free-market system. For this reason it is not clear that a capitalist economy is as generally beneficial as Narveson believes.

These objections do not challenge the concept of justice presented by Narveson. They suggest only that capitalist systems fail to achieve the justice they claim. But criticisms have also been leveled at the idea of justice that underlies capitalism. Capitalist justice as Narveson describes it ignores claims of need, for example. People are free to give to others in a capitalist economy, but the needy have no real right to demand that their needs be satisfied. For Narveson even a minimal social "safety net" is problematic. Thus, critics have concluded, capitalism sanctions poverty and extreme inequality, and pits human beings against one another in a fierce competitive struggle. Even if everyone does benefit from a capitalist economy, it might be argued, it is not clear that everyone receives what he or she deserves – the criterion we referred to earlier as the mark of justice.

While Narveson emphasizes the positive externalities of free markets, he recognizes that there are negative externalities as well. For instance, corporations may engage in behavior that imposes costs on society, such as dumping pollutants in water or air, if they think the benefits to the corporation outweigh the potential penalties. Or they may legally but unwisely focus on short-term profits at the expense of long-term returns. Such behaviors, Kent Greenfield argues, are not consequences of capitalism per se, but rather of capitalism as it operates in the context of laws and regulations that govern corporate activities. As he points out, corporations are subject neither to the constraints of conscience and social norms that govern the behavior of ordinary people, nor to many of the same social and legal penalties. One can't incarcerate a corporation. Nevertheless, one can use laws to change corporate behavior. Corporations are responsive to law, especially if it is strictly and fairly enforced. If the law permits or encourages unethical or socially detrimental behavior, then the remedy is to change the law. For example, if we want corporations to take the long view of their actions, to consider costs and benefits to society as well as the corporation, then we cannot rely solely on the market to enforce these norms. We must, Greenfield says, change the nature of the corporation and its management by changing the law to better reflect the ethical values we hold dear. As Greenfield reminds us, whether social institutions operate in a manner consistent with our understanding of justice is largely within our control. We have means at our disposal – the law – to ensure that they do.

From Theory to Practice

In Chapter 2 we turn from an examination of the justice of economic systems to an investigation of ethical business decision making within the system at a concrete, specific level. Some of the issues and difficulties businesspersons face when making ethical business decisions are illustrated in the cases at the end of Part 1. For example, in the case "The Ford Pinto," W. Michael Hoffman discusses the safety defects in the Pinto car, highlighting the importance of ethics in business decision making. Striking in Ford's decision to market a defective car is the lack of clarity concerning corporate values, the evasion of responsibility, and the refusal or inability of managers to engage in ethical reflection. Although Ford recognized that the Pinto was defective, they lacked the conceptual and analytic tools to state the ethical problem clearly and to make their concerns impact upon corporate policy in an effective way.

These tools are discussed in detail in the article by Michael Josephson, "Teaching Ethical Decision Making and Principled Reasoning". His article examines what is required for ethical decisions on a personal level, and describes a decision-making process managers can use when confronted with an ethical decision. He defines a series of essential terms which he uses in his discussion of ethical values and principles. He also analyzes some of the more common misconceptions about ethics, and goes over excuses and rationalizations for acting unethically. He concludes that using principled ethical decision-making procedures helps accomplish two important things. The first is to distinguish ethical from unethical responses. All too often businesspeople do not consider the ethical dimensions of their choices, or they assume that business or legal principles take precedence over ethics. This leads them to accept unethical choices, or even to fail to acknowledge that ethics is a factor in the decision. The second thing using principled ethical decision making accomplishes is to help rank acceptable ethical alternatives. For a variety of reasons, e.g. crucial facts about the consequences of a certain decision are unknown or ambiguous, some of the alternatives may be better than others.

Joseph Heath's "Business Ethics and Moral Motivation: A Criminological Perspective" takes a different approach to ethical decision making. Instead of discussing the components of good ethical decision making, he investigates the sources of bad ethical decisions, especially the decisions of "white-collar" criminals. Heath argues that commonly accepted explanations of illegal corporate behavior are mistaken. Extensive research shows that white-collar criminals do not break the law because their character is irremediably flawed, or because they are more greedy than normal, or because they have "bad" values. Instead, white-collar crime occurs when managers find themselves in specific situations where certain kinds of excuses can be used to rationalize their behavior, and these excuses are widely accepted by others as justifications for illegal or immoral behavior. Thus how individuals think about their circumstances, and what they expect others to think about them, play a major role in criminal business behavior. For instance, corporate managers sometimes attempt to deny responsibility for their actions by claiming that budget constraints, or competition, or orders from more senior managers put them in a position in which they have "no choice" but to violate the law. On other occasions managers may argue that their actions do no real harm, or that they are only retaliating against the actions of other firms, or that the laws themselves are unjust. In corporations where excuses and rationalizations like these are widely used, illegal and immoral behavior is more common. The way to prevent this, Heath argues, is to create an environment in which people are expected to behave ethically, and self-serving justifications are not accepted. In short, it is to create a corporate culture in which ethical behavior is the norm, and excuses are not tolerated.

Yet even if someone works in a corporate culture in which ethical behavior is expected, and even if managers attempt to follow the decision-making procedures suggested by Josephson, it still may be difficult to make the right decision. This is because, as David Messick and Max Bazerman point out in "Ethical Leadership and the Psychology of Decision Making," psychological tendencies we all have lead to systematic weaknesses in how we make decisions. For example, we have theories about the world around us that allow us to disregard the possible consequences of our decisions, to underestimate uncertainty and downplay the true risks, and to misjudge the true complexity of the causes of events. Further, our theories about other people, especially the tendency toward ethnocentrism and stereotyping, increase the risk that we create a gulf between "us" and "them" that enables us to downplay the interests of others. And finally our theories about ourselves – our tendencies to view ourselves in a positive light, to be overly optimistic about how much we know and our ability to control future events, and our willingness to excuse faults in ourselves that we would not excuse in others – tend to encourage us to see ourselves as people to whom normal rules and obligations do not apply, or do not apply as strictly.

Messick and Bazerman argue that while these psychological tendencies perhaps cannot be entirely eliminated, they can be minimized by bringing a variety of people into the decision-making process, and by honestly facing up to our limits as decision makers. Self-deception about our own psychological inclinations and deficiencies is something no responsible decision maker can afford.

In the final two articles in Chapter 2 a popular method of evaluating business decisions is discussed in "Cost-Benefit Analysis: An Ethical Critique" by Steven Kelman and in "Cost-Benefit Analysis Defended" by Herman B. Leonard and Richard J. Zeckhauser. Kelman sees in this widely used technique for business decision making – cost-benefit analysis – a close resemblance to the utilitarian principle examined in the General Introduction. He uses theoretical ethics to illuminate cost-benefit analysis and to argue for his claim that it should not be used as the primary tool in making ethical decisions. Commitment to cost-benefit analysis, as Kelman describes it, implies that costs and benefits should be totaled and weighed against each other in making a decision, that an act should not be undertaken unless its benefits exceed its costs, and that benefits and costs must be assigned dollar values so that they can be compared on a common scale.

We have already encountered the primary objections to utilitarianism in the General Introduction. Kelman reiterates some of these. Utilitarianism identifies what is right with what maximizes benefits and minimizes costs, Kelman explains. But he argues that there are instances – those which involve the breaking of a promise, for example, or the violation of a human right – in which an act may be wrong even if its benefits outweigh its costs. Kelman cites examples to illustrate his claim that the utilitarian principle permits or even requires some actions which we are inclined to feel are morally repugnant.

Kelman also challenges the possibility of placing dollar values on nonmarket items such as clean air, health and safety, and human life. And even if it were possible to determine prices for these goods which truly reflect their value to society, he holds, it would not be advisable to do so. Certain items like life and health are "priceless," and the very act of placing a price on them may distort their perceived value in society. Kelman fears that placing a price on these things declares that they are for sale; thus a worker's health may be traded because its dollar value is less than that of the equipment required to protect it. Cost-benefit analysis is particularly inappropriate, Kelman argues, when such "specially valued things" are at stake.

Leonard and Zeckhauser attempt to rebut several of the objections Kelman raises to cost-benefit analysis. They argue that cost-benefit analysis is an appropriate tool for making decisions affecting the public interest. They concede that not everything of value can be represented within the framework of cost-benefit analysis, but point out that this does not diminish its usefulness. It may be true that more is at stake than can be measured in terms of costs and benefits, but that does not mean that they are unimportant. Finally, they note that cost-benefit analysis is particularly valuable in decisions involving the imposition of risk. They say it is the most practical of the ethically defensible decision-making methods available. It is not without flaws, but it is better than the alternatives. The reader should keep cost-benefit analysis in mind when reading the cases in this part, such as "The Ford Pinto," "The Parable of the Sadhu," and "The Ok Tedi Copper Mine."

1

Theories of Economic Justice

Justice as Fairness

John Rawls

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The Main Idea of the Theory of Justice

My aim is to present a conception of justice which generalizes and carries to a higher level of abstraction the familiar theory of the social contract as found, say, in Locke, Rousseau, and Kant. In order to do this we are not to think of the original contract as one to enter a particular society or to set up a particular form of government. Rather, the guiding idea is that the principles of justice for the basic structure of society are the object of the original agreement. They are the principles that free and rational persons concerned to further their own interests would accept in an initial position of equality as defining the fundamental terms of their association. These principles are to regulate all further agreements: they specify the kinds of social cooperation that can be entered into and the forms of government that can be established. This way of regarding the principles of justice I shall call justice as fairness.

Thus we are to imagine that those who engage in social cooperation choose together, in one joint act, the principles which are to assign basic rights and duties and to determine the division of social benefits. Men are to decide in advance how they are to regulate their claims against one another and what is to be the foundation charter of their society. Just as each person must decide by rational reflection what constitutes his good, that is, the system of ends which it is rational for him to pursue, so a group of persons must decide once and for all what is to count among them as just and unjust. The choice which rational men would make in this hypothetical situation of equal liberty, assuming for the present that this choice problem has a solution, determines the principles of justice.

In justice as fairness the original position of equality corresponds to the state of nature in the traditional theory of the social contract. This original position is not, of course, thought of as an actual historical state of affairs, much less as a primitive condition of culture. It is understood as a purely hypothetical situation

John Rawls, "Justice as Fairness." Excerpted from *A Theory of Justice* by John Rawls (Cambridge, MA: Belknap Press of Harvard University Press, 1971), pp. 11–15, 60–64, 100–104, 136–137, 140–143, 144–145. © 1971 by the President and Fellows of Harvard College. Reprinted with permission of the publisher.

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characterized so as to lead to a certain conception of justice. Among the essential features of this situation is that no one knows his place in society, his class position or social status, nor does any one know his fortune in the distribution of natural assets and abilities, his intelligence, strength, and the like. I shall even assume that the parties do not know their conceptions of the good or their special psychological propensities. The principles of justice are chosen behind a veil of ignorance. This ensures that no one is advantaged or disadvantaged in the choice of principles by the outcome of natural chance or the contingency of social circumstances. Since all are similarly situated and no one is able to design principles to favor his particular condition, the principles of justice are the result of a fair agreement or bargain. For given the circumstances of the original position, the symmetry of everyone's relations to each other, this initial situation is fair between individuals as moral persons, that is, as rational beings with their own ends and capable, I shall assume, of a sense of justice. The original position is, one might say, the appropriate initial status quo, and thus the fundamental agreements reached in it are fair. This explains the propriety of the name "justice as fairness": it conveys the idea that the principles of justice are agreed to in an initial situation that is fair. The name does not mean that the concepts of justice and fairness are the same, any more than the phrase "poetry as metaphor" means that the concepts of poetry and metaphor are the same.

Justice as fairness begins, as I have said, with one of the most general of all choices which persons might make together, namely, with the choice of the first principles of a conception of justice which is to regulate all subsequent criticism and reform of institutions. Then, having chosen a conception of justice, we can suppose that they are to choose a constitution and a legislature to enact laws, and so on, all in accordance with the principles of justice initially agreed upon. Our social situation is just if it is such that by this sequence of hypothetical agreements we would have contracted into the general system of rules which defines it.

It may be observed that once the principles of justice are thought of as arising from an original agreement in a situation of equality, it is an open question whether the principle of utility would be acknowledged. Offhand it hardly seems likely that persons who view themselves as equals, entitled to press their claims upon one another, would agree to a principle which may require lesser life prospects for some simply for the sake of a greater sum of advantages enjoyed by others. Since each desires to protect his interests, his capacity to advance his conception of the good, no one has a reason to acquiesce in an enduring loss for himself in order to bring about a greater net balance of satisfaction. In the absence of strong and lasting benevolent impulses, a rational man would not accept a basic structure merely because it maximized the algebraic sum of advantages irrespective of its permanent effects on his own basic rights and interests. Thus it seems that the principle of utility is incompatible with the conception of social cooperation among equals for mutual advantage. It appears to be inconsistent with the idea of reciprocity implicit in the notion of a well-ordered society. Or, at any rate, so I shall argue.

I shall maintain instead that the persons in the initial situation would choose two rather different principles: the first requires equality in the assignment of basic rights and duties, while the second holds that social and economic inequalities, for example inequalities of wealth and authority, are just only if they result in compensating benefits for everyone, and in particular for the least advantaged members of society. These principles rule out justifying institutions on the grounds that the hardships of some are offset by a greater good in the aggregate. It may be expedient but it is not just that some should have less in order that others may prosper. But there is no injustice in the greater benefits earned by a few provided that the situation of persons not so fortunate is thereby improved. The intuitive idea is that since everyone's well-being depends upon a scheme of cooperation without which no one could have a satisfactory life, the division of advantages should be such as to draw forth the willing cooperation of everyone taking part in it, including those less well situated. Yet this can be expected only if reasonable terms are proposed. The two principles mentioned seem to be a fair agreement on the basis of which those better endowed, or more fortunate in their social position, neither of which we can be said to deserve, could expect the willing cooperation of others when some workable scheme is a necessary condition of the welfare of all.[1] Once we decide to look for a conception of justice that nullifies the accidents of natural endowment and the contingencies of social circumstance as counters in quest for political and economic advantage, we are led to these principles. They express the result of leaving aside those aspects of the social world that seem arbitrary from a moral point of view.

The idea of the original position is to set up a fair procedure so that any principles agreed to will be just. Somehow we must nullify the effects of specific contingencies which put men at odds and tempt them to exploit social and natural circumstances to their own advantage. Now in order to do this I assume that the parties are situated behind a veil of ignorance. They do not know how the various alternatives will affect their own particular case and they are obliged to evaluate principles solely on the basis of general considerations.[2] The veil of ignorance enables us to make vivid to ourselves the restrictions that it seems reasonable to impose on arguments for principles of justice, and therefore on these principles themselves. Thus it seems reasonable and generally acceptable that no one should be advantaged or disadvantaged by natural fortune or social circumstances in the choice of principles. It also seems widely agreed that it should be impossible to tailor principles to the circumstances of one's own case. We should insure further that particular inclinations and aspirations, and persons' conceptions of their good do not affect the principles adopted. The aim is to rule out those principles that it would be rational to propose for acceptance, however little the chance of success, only if one knew certain things that are irrelevant from the stand point of justice. For example, if a man knew that he was wealthy, he might find it rational to advance the principle that various taxes for welfare measures be counted unjust; if he knew that he was poor, he would most likely propose the contrary principle. To represent the desired restrictions one imagines a situation in which everyone is deprived of this sort of information. One excludes the knowledge of those contingencies which sets men at odds and allows them to be guided by their prejudices.

It is assumed, then, that the parties do not know certain kinds of particular facts. First of all, no one knows his place in society, his class position or social status; nor does he know his fortune in the distribution of natural assets and abilities, his intelligence and strength, and the like. Nor, again, does anyone know his conception of the good, the particulars of his rational plan of life, or even the special features of his psychology such as his aversion to risk or liability to optimism or pessimism. More than this, I assume that the parties do not know the particular circumstances of their own society. That is, they do not know its economic or political situation, or the level of civilization and culture it has been able to achieve. The persons in the original position have no information as to which generation they belong. These broader restrictions on knowledge are appropriate in part because questions of social justice arise between generations as well as within them, for example, the question of the appropriate rate of capital saving and of the conservation of natural resources and the environment of nature. There is also, theoretically anyway, the question of a reasonable genetic policy. In these cases too, in order to carry through the idea of the original position, the parties must not know the contingencies that set them in opposition. They must choose principles the consequences of which they are prepared to live with whatever generation they turn out to belong to. As far as possible, then, the only particular facts which the parties know is that their society is subject to the circumstances of justice and whatever this implies.

The restrictions on particular information in the original position are of fundamental importance. The veil of ignorance makes possible a unanimous choice of a particular conception of justice. Without these limitations on knowledge the bargaining problem of the original position would be hopelessly complicated. Even if theoretically a solution were to exist, we would not, at present anyway, be able to determine it.

The rationality of the parties

I have assumed throughout that the persons in the original position are rational. In choosing between principles each tries as best he can to advance his interests. But I have also assumed that the parties do not know their conception of the good. This means that while they know that they have some rational plan of life, they do not know the details of this plan, the particular ends and interests which it is calculated to promote. How, then, can they decide which conceptions of justice are most to their advantage? Or must we suppose that they are reduced to mere guessing? To meet this difficulty, I postulate that they would prefer more primary social goods rather than less (i.e., rights and liberties, powers and opportunities, income and wealth and self-respect). Of course, it may turn out, once the veil of ignorance is removed, that some of them for religious or other reasons may not, in fact, want more of these goods. But from the standpoint of the original position, it is rational for the parties to suppose that they do want a larger share, since in any case they are not compelled to accept more if they do not wish to nor does a person suffer from a greater liberty. Thus even though the parties are deprived of information about their particular ends, they have enough knowledge to rank the alternatives. They know that in general they must try to protect their liberties, widen their opportunities, and enlarge their means for promoting their aims whatever these are. Guided by the theory of the good and the general facts of moral psychology, their deliberations are no longer guesswork. They can make a rational decision in the ordinary sense.

The assumption of mutually disinterested rationality, then, comes to this: the persons in the original position try to acknowledge principles which advance their system of ends as far as possible. They do this by attempting to win for themselves the highest index of primary social goods, since this enables them to promote their conception of the good most effectively whatever it turns out to be. The parties do not seek to confer benefits or to impose injuries on one another; they are not moved by affection or rancor. Nor do they try to gain relative to each other; they are not envious or vain. Put in terms of a game, we might say: they strive for as high an absolute score as possible. They do not wish a high or a low score for their opponents, nor do they seek to maximize or minimize the difference between their successes and those of others. The idea of a game does not really apply, since the parties are not concerned to win but to get as many points as possible judged by their own system of ends.

I shall now state in a provisional form the two principles of justice that I believe would be chosen in the original position. The first statement of the two principles reads as follows.

- First: each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others.
- Second: social and economic inequalities are to be arranged so that they are both (a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all.

By way of general comment, these principles primarily apply, as I have said, to the basic structure of society. They are to govern the assignment of rights and duties and to regulate the distribution of social and economic advantages. As their formulation suggests, these principles presuppose that the social structure can be divided into two more or less distinct parts, the first principle applying to the one, the second to the other. They distinguish between those aspects of the social system that define and secure the equal liberties of citizenship and those that specify and establish social and economic inequalities. The basic liberties of citizens are, roughly speaking, political liberty (the right to vote and to be eligible for public office) together with freedom of speech and assembly; liberty of conscience and freedom of thought; freedom of the person along with the right to hold (personal) property; and freedom from arbitrary arrest and seizure as defined by the concept of the rule of law. These liberties are all required to be equal by the first principle, since citizens of a just society are to have the same basic rights.

The second principle applies, in the first approximation, to the distribution of income and wealth and to the design of organizations that make use of differences in authority and responsibility, or chains of command. While the distribution of wealth and income need not be equal, it must be to everyone's advantage, and at the same time, positions of authority and offices of command must be accessible to all. One applies the second principle by holding positions open, and then, subject to this constraint, arranges social and economic inequalities so that everyone benefits.

These principles are to be arranged in a serial order with the first principle prior to the second. This ordering means that a departure from the institutions of equal liberty required by the first principle cannot be justified by, or compensated for, by greater social and economic advantages. The distribution of wealth and income, and the hierarchies of authority, must be consistent with both the liberties of equal citizenship and equality of opportunity.

It is clear that these principles are rather specific in their content, and their acceptance rests on certain assumptions that I must eventually try to explain and justify. For the present, it should be observed that the two principles (and this holds for all formulations) are a special case of a more general conception of justice that can be expressed as follows.

> All social values – liberty and opportunity, income and wealth, and the bases of self-respect – are to be distributed equally unless an unequal distribution of any, or all, of these values is to everyone's advantage.

Injustice, then, is simply inequalities that are not to the benefit of all. Of course, this conception is extremely vague and requires interpretation.

As a first step, suppose that the basic structure of society distributes certain primary goods, that is, things that every rational man is presumed to want. These goods normally have a use whatever a person's rational plan of life. For simplicity, assume that the chief primary goods at the disposition of society are rights and liberties, powers and opportunities, income and wealth. These are the social primary goods. Other primary goods such as health and vigor, intelligence and imagination, are natural goods; although their possession is influenced by the basic structure, they are not so directly under its control. Imagine, then, a hypothetical initial arrangement in which all the social primary goods are equally distributed: everyone has similar rights and duties, and income and wealth are evenly shared. This state of affairs provides a benchmark for judging improvements. If certain inequalities of wealth and organizational powers would make everyone better off than in this hypothetical starting situation, then they accord with the general conception.

Now it is possible, at least theoretically, that by giving up some of their fundamental liberties men are sufficiently compensated by the resulting social and economic gains. The general conception of justice imposes no restrictions on what sort of inequalities are permissible; it only requires that everyone's position be improved.

The second principle insists that each person benefit from permissible inequalities in the basic structure. This means that it must be reasonable for each relevant representative man defined by this structure, when he views it as a going concern, to prefer his prospects with the inequality to his prospects without it. One is not allowed to justify differences in income or organizational powers on the ground that the disadvantages of those in one position are outweighed by the greater advantages of those in another. Much less can infringements of liberty be counterbalanced in this way. Applied to the basic structure, the principle of utility would have us maximize the sum of expectations of representative men (weighted by the number of persons they represent, on the classical view); and this would permit us to compensate for the losses of some by the gains of others. Instead, the two principles require that everyone benefit from economic and social inequalities.

The tendency to equality

I wish to conclude this discussion of the two principles by explaining the sense in which they express an egalitarian conception of justice. Also I should like to forestall the objection to the principle of fair opportunity that it leads to a callous meritocratic society. In order to prepare the way for doing this, I note several aspects of the conception of justice that I have set out.

First we may observe that the difference principle gives some weight to the considerations singled out by the principle of redress. This is the principle that undeserved inequalities call for redress; and since inequalities of birth and natural endowment are undeserved, these inequalities are to be somehow compensated for.[3] Thus the principle holds that in order to treat all persons equally, to provide genuine equality of opportunity, society must give more attention to those with fewer native assets and to those born into the less favorable social positions. The idea is to redress the bias of contingencies in the direction of equality. In pursuit of this principle greater resources might be spent on the education of the less rather than the more intelligent, at least over a certain time of life, say the earlier years of school.

Now the principle of redress has not to my knowledge been proposed as the sole criterion of justice, as the single aim of the social order. It is plausible as most such principles are only as a *prima facie* principle, one that is to be weighed in the balance with others. For example, we are to weigh it against the principle to improve the average standard of life, or to advance the common good. But whatever other principles we hold, the claims of redress are to be taken into account. It is thought to represent one of the elements in our conception of justice. Now the difference principle is not of course the principle of redress. It does not require society to try to even out handicaps as if all were expected to compete on a fair basis in the same race. But the difference principle would allocate resources in education, say, so as to improve the long-term expectation of the least favored. If this end is attained by giving more attention to the better endowed, it is permissible; otherwise not. And in making this decision, the value of education should not be assessed only in terms of economic efficiency and social welfare. Equally if not more important is the role of education in enabling a person to enjoy the culture of his society and to take part in its affairs, and in this way to provide for each individual a secure sense of his own worth.

Thus although the difference principle is not the same as that of redress, it does achieve some of the intent of the latter principle. It transforms the aims of the basic structure so that the total scheme of institutions no longer emphasizes social efficiency and technocratic values. We see then that the difference principle represents, in effect, an agreement to regard the distribution of natural talents as a common asset and to share in the benefits of this distribution whatever it turns out to be. Those who have been favored by nature, whoever they are, may gain from their good fortune only on terms that improve the situation of those who have lost out. The naturally advantaged are not to gain merely because they are more gifted, but only to cover the costs of training and education and for using their endowments in ways that help the less fortunate as well. No one deserves his greater natural capacity nor merits a more favorable starting place in society. But it does not follow that one should eliminate these distinctions. There is another way to deal with them. The basic structure can be arranged so that these contingencies work for the good of the least fortunate. Thus we are led to the difference principle if we wish to set up the social system so that no one gains or loses from his arbitrary place in the distribution of natural assets or his initial position in society without giving or receiving compensating advantages in return.

The natural distribution of talents is neither just nor unjust; nor is it unjust that men are born into society at some particular position. These are simply natural facts. What is just and unjust is the way that institutions deal with these facts. Aristocratic and caste societies are unjust because they make these contingencies the ascriptive basis for belonging to more or less enclosed and privileged social classes. The basic structure of these societies incorporates the arbitrariness found in nature. But there is no necessity for men to resign themselves to these contingencies. The social system is not an unchangeable order beyond human control but a pattern of human action. In justice as fairness men agree to share one another's fate. In designing institutions they undertake to avail themselves of the accidents of nature and social circumstance only when doing so is for the common benefit. The two principles are a fair way of meeting the arbitrariness of fortune; and while no doubt imperfect in other ways, the institutions which satisfy these principles are just.

There is a natural inclination to object that those better situated deserve their greater advantages whether or not they are to the benefit of others. At this point it is necessary to be clear about the notion of desert. It is perfectly true that given a just system of cooperation as a scheme of public rules and the expectations set up by it, those who, with the prospect of improving their condition, have done what the system announces that it will reward are entitled to their advantages. In this sense the more fortunate have a claim to their better situation; their claims are legitimate expectations established by social institutions, and the community is obligated to meet them. But this sense of desert presupposes the existence of the cooperative scheme; it is irrelevant to the question whether in the first place the scheme is to be designed in accordance with the difference principle or some other criterion.

Perhaps some will think that the person with greater natural endowments deserves those assets and the superior character that made their development possible. Because he is more worthy in this sense, he deserves the greater advantages that he could achieve with them. This view, however, is surely incorrect. It seems to be one of the fixed points of our considered judgments that no one deserves his place in the distribution of native endowments, any more than one deserves one's initial starting place in society. The assertion that a man deserves the superior character that enables him to make the effort to cultivate his abilities is equally problematic; for his character depends in large part upon fortunate family and social circumstances for which he can claim no credit. The notion of desert seems not to apply to these cases. Thus the more advantaged representative man cannot say that he deserves and therefore has a right to a scheme of cooperation in which he is permitted to acquire benefits in ways that do not contribute to the welfare of others. There is no basis for his making this claim. From the standpoint of common sense, then, the difference principle appears to be acceptable both to the more advantaged and to the less advantaged individual.

Notes

[1] For the formulation of this intuitive idea I am indebted to Allan Gibbard.

[2] The veil of ignorance is so natural a condition that something like it must have occurred to many. The closest express statement of it known to me is found in J. C. Harsanyi, "Cardinal Utility in Welfare Economics and in the Theory of Risk-Taking." *Journal of Political Economy*, vol. 61 (1953). Harsanyi uses it to develop a utilitarian theory.

[3] See Herbert Spiegelberg, "A Defense of Human Equality," *Philosophical Review*, vol. 53 (1944), pp. 101, 113–123; and D. D. Raphael, "Justice and Liberty," *Proceedings of the Aristotelian Society*, vol. 51 (1950–1951), p. 187f.

Distributive Justice

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The minimal state is the most extensive state that can be justified. Any state more extensive violates people's rights. Yet many persons have put forth reasons purporting to justify a more extensive state. It is impossible within the compass of this book to examine all the reasons that have been put forth. Therefore, I shall focus upon those generally acknowledged to be most weighty and influential, to see precisely wherein they fail. In this paper we consider the claim that a more extensive state is justified, because necessary (or the best instrument) to achieve distributive justice.

Robert Nozick, "Distributive Justice." Excerpted from *Anarchy, State and Utopia* by Robert Nozick (New York: Basic Books, Inc.,1974). © 1974 Robert Nozick. Reprinted with permission of Perseus Books Group.

The term "distributive justice" is not a neutral one. Hearing the term "distribution," most people presume that some thing or mechanism uses some principle or criterion to give out a supply of things. Into this process of distributing shares some error may have crept. So it is an open question, at least, whether *re*distribution should take place; whether we should do again what has already been done once, though poorly. However, we are not in the position of children who have been given portions of pie by someone who now makes last minute adjustments to rectify careless cutting. There is no *central* distribution, no person or group entitled to control all the resources, jointly deciding how they are to be doled out. What each person gets, he gets from others who give to him in exchange for something, or as a gift. In a free society, diverse persons control different resources, and new holdings arise out of the voluntary exchanges and actions of persons. There is no more a distributing or distribution of shares than there is a distributing of mates in a society in which persons choose whom they shall marry. The total result is the product of many individual decisions which the different individuals involved are entitled to make.

The Entitlement Theory

The subject of justice in holdings consists of three major topics. The first is the *original acquisition of holdings*, the appropriation of unheld things. This includes the issues of how unheld things may come to be held, the process, or processes, by which unheld things may come to be held, the things that may come to be held by these processes, the extent of what comes to be held by a particular process, and so on. We shall refer to the complicated truth about this topic, which we shall not formulate here, as the principle of justice in acquisition. The second topic concerns the *transfer of holdings* from one person to another. By what processes may a person transfer holdings to another? How may a person acquire a holding from another who holds it? Under this topic come general descriptions of voluntary exchange, and gift and (on the other hand) fraud, as well as reference to particular conventional details fixed upon in a given society. The complicated truth about this subject (with placeholders for conventional details) we shall call the principle of justice in transfer. (And we shall suppose it also includes principles governing how a person may divest himself of a holding, passing it into an unheld state.)

If the world were wholly just, the following inductive definition would exhaustively cover the subject of justice in holdings.

1. A person who acquires a holding in accordance with the principle of justice in acquisition is entitled to that holding.
2. A person who acquires a holding in accordance with the principle of justice in transfer, from someone else entitled to the holding, is entitled to the holding.
3. No one is entitled to a holding except by (repeated) applications of 1 and 2.

The complete principle of distributive justice would say simply that a distribution is just if everyone is entitled to the holdings they possess under the distribution.

A distribution is just if it arises from another just distribution by legitimate means. The legitimate means of moving from one distribution to another are specified by the principle of justice in transfer. The legitimate first "moves" are specified by the principle of justice in acquisition. Whatever arises from a just situation by just steps is itself just. The means of change specified by the principle of justice is transfer preserve justice. As correct rules of inference are truth-preserving, and any conclusion deduced via repeated application of such rules from only true premises is itself true, so the means of transition from one situation to another specified by the principle of justice in transfer are justice-preserving, and any situation actually arising from repeated transitions in accordance with the principle from a just situation is itself just. The parallel between justice-preserving transformations and truth-preserving transformations illuminates where it fails as well as where it holds. That a conclusion could have been deduced by truth-preserving means from premises that are true suffices to show its truth. That from a just situation a situation *could* have arisen via justice-preserving means does *not* suffice to show its justice. The fact that a thief's victims voluntarily *could* have presented him with gifts does not entitle the thief to his ill-gotten gains. Justice in holdings is historical; it depends upon what actually has happened. We shall return to this point later.

Not all actual situations are generated in accordance with the two principles of justice in holdings: the principle of justice in acquisition and the principle of justice in transfer. Some people steal from others, or defraud them, or enslave them, seizing their product and preventing them from living as they choose, or forcibly exclude others from competing in exchanges. None of these are permissible modes of transition from one situation to another. And some persons acquire holdings by means not sanctioned by the principle of justice in acquisition. The existence of past injustice (previous violations of the first two principles of justice in holdings) raises the third major topic under justice in holdings: the rectification of injustice in holdings. If past injustice has shaped present holdings in various ways, some identifiable and some not, what now, if anything, ought to be done to rectify these injustices? What obligations do the performers of injustice have toward those whose position is worse than it would have been had the injustice not been done? Or, that it would have been had compensation been paid promptly? How, if at all, do things change if the beneficiaries and those made worse off are not the direct parties in the act of injustice, but, for example, their descendants? Is an injustice done to someone whose holding was itself based upon an unrectified injustice? How far back must one go in wiping clean the historical slate of injustices? What may victims of injustice permissibly do in order to rectify the injustices being done to them, including the many injustices done by persons acting through their government? I do not know of a thorough or theoretically sophisticated treatment of such issues. Idealizing greatly, let us suppose theoretical investigation will produce a principle of rectification. This principle uses historical information about previous situations and injustices done in them (as defined by the first two principles of justice and rights against interference), and information about the actual course of events that flowed from these injustices, until the present, and it yields a description (or descriptions) of holdings in the society. The principle of rectification presumably will make use of its best estimate of subjunctive information about what would have occurred (or a probability distribution over what might have occurred, using the expected value) if the injustice had not taken place. If the actual description of holdings turns out not to be one of the descriptions yielded by the principle, then one of the descriptions yielded must be realized.

The general outlines of the theory of justice in holdings are that the holdings of a person are just if he is entitled to them by the principles of justice in acquisition and transfer, or by the principle of rectification of injustice (as specified by the first two principles). If each person's holdings are just, then the total set (distribution) of holdings is just. To turn these general outlines into a specific theory we would have to specify the details of each of the three principles of justice in holdings: the principle of acquisition of holdings, the principle of transfer of holdings, and the principle of rectification of violations of the first two principles. I shall not attempt that task here. (Locke's principle of justice in acquisition is discussed below.)

Historical Principles and End-Result Principles

The general outlines of the entitlement theory illuminate the nature and defects of other conceptions of distributive justice. The entitlement theory of justice in distribution is *historical*; whether a distribution is just depends upon how it came about. In contrast, *current time-slice principles* of justice hold that the justice of a distribution is determined by how things are distributed (who has what) as judged by some *structural* principle(s) of just distribution. A utilitarian who judges between any two distributions by seeing which has the greater sum of utility and, if the sums tie, applies some fixed equality criterion to choose the more equal distribution, would hold a current time-slice principle of justice. As would someone who had a fixed schedule of trade-offs between the sum of happiness and equality. According to a current time-slice principle, all that needs to be looked at, in judging the justice of a distribution, is who ends up with what; in comparing any two distributions one need look only at the matrix presenting the distributions. No further information need be fed into a principle of justice. It is a consequence of such principles of justice that any two structurally identical distributions are equally just. (Two distributions are structurally identical if they present the same profile, but perhaps have different persons occupying the particular slots. My having ten and your having five, and my having five and your having ten are structurally identical distributions.) Welfare economics is the theory of current time-slice principles of justice. The subject is conceived as operating on matrices representing only current information about distribution. This, as well as some of the usual conditions (for example, the choice of distribution is invariant under relabeling of columns), guarantees that welfare economics will be a current time-slice theory, with all of its inadequacies.

Most persons do not accept current time-slice principles as constituting the whole story about distributive shares. They think it relevant in assessing the justice of a situation to consider not only the distribution it embodies, but also how that distribution came about. If some persons are in prison for murder or war crimes, we do not say that to assess the justice of the distribution in the society we must look only at what this person has, and that person has, and that person has, . . . at the current time. We think it relevant to ask whether someone did something so that he *deserved* to be punished, deserved to have a lower share.

Patterning

The entitlement principles of justice in holdings that we have sketched are historical principles of justice. To better understand their precise character, we shall distinguish them from another subclass of the historical principles. Consider, as an example, the principle of distribution according to moral merit. This principle requires that total distributive shares vary directly with moral merit; no person should have a greater share than anyone whose moral merit is greater. Or consider the principle that results by substituting "usefulness to society" for "moral merit" in the previous principle. Or instead of "distribute according to moral merit," or "distribute according to usefulness to society," we might consider "distribute according to the weighted sum of moral merit, usefulness to society, and need," with the weights of the different dimensions equal. Let us call a principle of distribution *patterned* if it specifies that a distribution is to vary along with some natural dimension, weighted sum of natural dimensions, or lexicographic ordering of natural dimensions. And let us say a distribution is patterned if it accords with some patterned principle. The principle of distribution in accordance with moral merit is a patterned historical principle, which specifies a patterned distribution. "Distribute according to I.Q." is a patterned principle that looks to information not contained in distributional matrices. It is not historical, however, in that it does not look to any past actions creating differential entitlements to evaluate a distribution; it requires only distributional matrices whose columns are labeled by I.Q. scores. The distribution in a society, however, may be composed of such simple patterned distributions, without itself being simply patterned. Different sectors may operate different patterns, or some combination of patterns may operate in different proportions across a society. A distribution composed in this manner, from a small number of patterned distributions, we also shall term "patterned." And we extend the use of "pattern" to include the overall designs put forth by combinations of end-state principles.

Almost every suggested principle of distributive justice is patterned: to each according to his moral merit, or needs, or marginal product, or how hard he tries, or the weighted sum of the foregoing, and so on. The principle of entitlement we have sketched is *not* patterned. There is no one natural dimension or weighted sum or combination of a small number of natural dimensions that yields the distributions generated in accordance with the principle of entitlement. The set of holdings that results when some persons receive their marginal products, others win at gambling, others receive a share of their mate's income, others receive gifts from foundations, others receive interest on loans, others receive gifts from admirers, others receive returns on investment, others make for themselves much of what they have, others find things, and so on, will not be patterned.

To think that the task of a theory of distributive justice is to fill in the blank in "to each according to his ___" is to be predisposed to search for a pattern; and the separate treatment of "from each according to his __" treats production and distribution as two separate and independent issues. On an entitlement view these are *not* two separate questions. Whoever makes something, having bought or contracted for all other held resources used in the process (transferring some of his holdings for these cooperating factors), is entitled to it. The situation is *not* one of something's getting made, and there being an open question of who is to get it. Things come into the world already attached to people having entitlements over them. From the point of view of the historical entitlement conception of justice in holdings, those who start afresh to complete "to each according to his __" treat objects as if they appeared from nowhere, out of nothing. A complete theory of justice might cover this limited case as well; perhaps here is a use for the usual conceptions of distributive justice.

So entrenched are maxims of the usual form that perhaps we should present the entitlement conception as a competitor. Ignoring acquisition and rectification, we might say:

> From each according to what he chooses to do, to each according to what he makes for himself (perhaps with

> the contracted aid of others) and what others choose to do for him and choose to give him of what they've been given previously (under this maxim) and haven't yet expended or transferred.

This, the discerning reader will have noticed, has its defects as a slogan. So as a summary and great simplification (and not as a maxim with any independent meaning) we have:

> From each as they choose, to each as they are chosen.

How Liberty Upsets Patterns

It is not clear how those holding alternative conceptions of distributive justice can reject the entitlement conception of justice in holdings. For suppose a distribution favored by one of these non-entitlement conceptions is realized. Let us suppose it is your favorite one and let us call this distribution D_1; perhaps everyone has an equal share, perhaps shares vary in accordance with some dimension you treasure. Now suppose that Wilt Chamberlain is greatly in demand by basketball teams, being a great gate attraction. (Also suppose contracts run only for a year, with players being free agents.) He signs the following sort of contract with a team: In each home game, twenty-five cents from the price of each ticket of admission goes to him. (We ignore the question of whether he is "gouging" the owners, letting them look out for themselves.) The season starts, and people cheerfully attend his team's games; they buy their tickets, each time dropping a separate twenty-five cents of their admission price into a special box with Chamberlain's name on it. They are excited about seeing him play; it is worth the total admission price to them. Let us suppose that in one season one million persons attend his home games, and Wilt Chamberlain winds up with $250,000, a much larger sum than the average income and larger even than anyone else has. Is he entitled to this income? Is this new distribution D_2 unjust? If so, why? There is *no* question about whether each of the people was entitled to the control over the resources they held in D_1 because that was the distribution (your favorite) that (for the purposes of argument) we assumed was acceptable. Each of these persons *chose* to give twenty-five cents of their money to Chamberlain. They could have spent it on going to the movies, or on candy bars, or on copies of *Dissent* magazine, or of *Monthly Review*. But they all, at least one million of them, converged on giving it to Wilt Chamberlain in exchange for watching him play basketball. If D_1 was a just distribution, and people voluntarily moved from it to D_2, transferring parts of their shares they were given under D_1 (what was it for if not to do something with?), isn't D_2 also just? If the people were entitled to dispose of the resources to which they were entitled (under D_1), didn't this include their being entitled to give it to, or exchange it with, Wilt Chamberlain? Can anyone else complain on grounds of justice? Each other person already has his legitimate share under D_1. Under D_1, there is nothing that anyone has that anyone else has a claim of justice against. After someone transfers something to Wilt Chamberlain, third parties *still* have their legitimate shares; *their* shares are not changed. By what process could such a transfer among two persons give rise to a legitimate claim of distributive justice on a portion of what was transferred, by a third party who had no claim of justice on any holding of the others *before* the transfer? To cut off objections irrelevant here, we might imagine the exchanges occurring in a socialist society, after hours. After playing whatever basketball he does in his daily work, or doing whatever other daily work he does, Wilt Chamberlain decides to put in *overtime* to earn additional money. (First his work quota is set; he works time over that.) Or imagine it is a skilled juggler people like to see, who puts on shows after hours.

The general point illustrated by the Wilt Chamberlain example and the example of the entrepreneur in a socialist society is that no end-state principle or distributional patterned principle of justice can be continuously realized without continuous interference with people's lives. Any favored pattern would be transformed into one unfavored by the principle, by people choosing to act in various ways; for example, by people exchanging goods and services with other people, or giving things to other people, things the transferrers are entitled to under the favored distributional pattern. To maintain a pattern one must either continually interfere to stop people from transferring resources as they wish to, or continually (or periodically) interfere to take from some persons resources that others for some reason chose to transfer to them.

Patterned principles of distributive justice necessitate *re*distributive activities. The likelihood is small that any actual freely-arrived-at set of holdings fit a given pattern; and the likelihood is nil that it will continue to fit the pattern as people exchange and give. From the point of view of an entitlement theory, redistribution is a serious matter indeed, involving, as it does, the violation of people's rights. (An exception is those takings that fall under the principle of the rectification of injustices.) From other points of view, also, it is serious.

Taxation of earnings from labor is on a par with forced labor. Some persons find this claim obviously true: taking the earnings of *n* hours labor is like taking *n* hours from the person; it is like forcing the person to work *n* hours for another's purpose. Others find the claim absurd. But even these, if they object to forced labor, would oppose forcing unemployed hippies to work for the benefit of the needy. And they would also object to forcing each person to work five extra hours each week for the benefit of the needy. But a system that takes five hours' wages in taxes does not seem to them like one that forces someone to work five hours, since it offers the person forced a wider range of choice in activities than does taxation in kind with the particular labor specified.

Whether it is done through taxation on wages or on wages over a certain amount, or through seizure of profits, or through there being a big *social pot* so that it's not clear what's coming from where and what's going where, patterned principles of distributive justice involve appropriating the actions of other persons. Seizing the results of someone's labor is equivalent to seizing hours from him and directing him to carry on various activities. If people force you to do certain work, or unrewarded work, for a certain period of time, they decide what you are to do and what purposes your work is to serve apart from your decisions.This process whereby they take this decision from you makes them a *part-owner* of you; it gives them a property right in you. Just as having such partial control and power of decision, by right, over an animal or inanimate object would be to have a property right in it.

Locke's Theory of Acquisition

We must introduce an additional bit of complexity into the structure of the entitlement theory. This is best approached by considering Locke's attempt to specify a principle of justice in acquisition. Locke views property rights in an unowned object as originating through someone's mixing his labor with it. This gives rise to many questions. What are the boundaries of what labor is mixed with? If a private astronaut clears a place on Mars, has he mixed his labor with (so that he comes to own) the whole planet, the whole uninhabited universe, or just a particular plot? Which plot does an act bring under ownership?

Locke's proviso that there be "enough and as good left in common for others" is meant to ensure that the situation of others is not worsened. I assume that any adequate theory of justice in acquisition will contain a proviso similar to Locke's. A process normally giving rise to a permanent bequeathable property right in a previously unowned thing will not do so if the position of others no longer at liberty to use the thing is thereby worsened. It is important to specify *this* particular mode of worsening the situation of others, for the proviso does not encompass other modes. It does not include the worsening due to more limited opportunities to appropriate, and it does not include how I "worsen" a seller's position if I appropriate materials to make some of what he is selling, and then enter into competition with him. Someone whose appropriation otherwise would violate the proviso still may appropriate provided he compensates the others so that their situation is not thereby worsened; unless he does compensate these others, his appropriation will violate the proviso of the principle of justice in acquisition and will be an illegitimate one. A theory of appropriation incorporating this Lockean proviso will handle correctly the cases (objections to the theory lacking the proviso) where someone appropriates the total supply of something necessary for life.

A theory which includes this proviso in its principle of justice in acquisition must also contain a more complex principle of justice in transfer. Some reflection of the proviso about appropriation constrains later actions. If my appropriating all of a certain substance violates the Lockean proviso, then so does my appropriating some and purchasing all the rest from others who obtained it without otherwise violating the Lockean proviso. If the proviso excludes someone's appropriating all the drinkable water in the world, it also excludes his purchasing it all. (More weakly, and messily, it may exclude his charging certain prices for some of his supply.) This proviso (almost?) never will come into effect; the more someone acquires of a scarce substance which others want, the higher the price of the rest will go, and the more difficult it will become for him to acquire it all. But still, we can imagine, at least, that something like this occurs: someone makes simultaneous secret bids to the separate owners of a substance, each of whom sells assuming he can easily purchase more from the other owners; or some natural catastrophe destroys all of the supply of something except that in one person's possession. The total supply could not be permissibly appropriated by one person at the beginning. His later acquisition of it all does not show that the original appropriation violated the proviso. Rather, it is the combination of the original appropriation *plus* all the later transfers and actions that violates the Lockean proviso.

Each owner's title to his holding includes the historical shadow of the Lockean proviso on appropriation. This excludes his transferring it into an agglomeration that does violate the Lockean proviso and excludes his using it in a way, in coordination with others or independently of them, so as to violate the proviso by making the situation of others worse than their baseline situation. Once it is known that someone's ownership runs afoul of the Lockean proviso, there are stringent limits on what he may do with (what it is difficult any longer unreservedly to call) "his property." Thus a person may not appropriate the only water hole in a desert and charge what he will. Nor may he charge what he will if he possesses one, and unfortunately it happens that all the water holes in the desert dry up, except for his. This unfortunate circumstance, admittedly no fault of his, brings into operation the Lockean proviso and limits his property rights. Similarly, an owner's property right in the only island in an area does not allow him to order a castaway from a shipwreck off his island as a trespasser, for this would violate the Lockean proviso.

Notice that the theory does not say that owners do not have these rights, but that the rights are overridden to avoid some catastrophe. (Overridden rights do not disappear; they leave a trace of a sort absent in the cases under discussion.) There is no such external (and *ad hoc*?) overriding. Considerations internal to the theory of property itself, to its theory of acquisition and appropriation, provide the means for handling such cases.

I believe that the free operation of a market system will not actually run afoul of the Lockean proviso. If this is correct, the proviso will not provide a significant opportunity for future state action.

Distributive Justice and Utilitarianism

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Introduction

In this paper I shall not be concerned with the defense of utilitarianism against other types of ethical theory. Indeed I hold that questions of ultimate ethical principle are not susceptible of proof, though something can be done to render them more acceptable by presenting them in a clear light and by clearing up certain confusions which (for some people) may get in the way of their acceptance. Ultimately the utilitarian appeals to the sentiment of generalized benevolence, and speaks to others who feel this sentiment too and for whom it is an over-riding feeling.[1] (This does not mean that he will always act from this over-riding

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feeling. There can be backsliding and action may result from more particular feelings, just as an egoist may go against his own interests, and may regret this.) I shall be concerned here merely to investigate certain consequences of utilitarianism, as they relate to questions of distributive justice. The type of utilitarianism with which I am concerned is act utilitarianism.

The Place of Justice in Utilitarian Theory

The concept of justice as a fundamental ethical concept is really quite foreign to utilitarianism. A utilitarian would compromise his utilitarianism if he allowed principles of justice which might conflict with the maximization of happiness (or more generally of goodness, should he be an "ideal" utilitarian). He is concerned with the maximization of happiness[2] and not with the distribution of it. Nevertheless he may well deduce from his ethical principle that certain ways of distributing the means to happiness (e.g., money, food, housing) are more conducive to the general good than are others. He will be interested in justice in so far as it is a political or legal or quasi-legal concept. He will consider whether the legal institutions and customary sanctions which operate in particular societies are more or less conducive to the utilitarian end than are other possible institutions and customs. Even if the society consisted entirely of utilitarians (and of course no actual societies have thus consisted) it might still be important to have legal and customary sanctions relating to distribution of goods, because utilitarians might be tempted to backslide and favour non-optimistic distributions, perhaps because of bias in their own favour. They might be helped to act in a more nearly utilitarian way because of the presence of these sanctions.

As a utilitarian, therefore, I do not allow the concept of justice as a fundamental moral concept, but I am nevertheless interested in justice in a subordinate way, as a means to the utilitarian end. Thus even though I hold that it does not matter in what way happiness is distributed among different persons, provided that the total amount of happiness is maximized, I do of course hold that it can be of vital importance that the means to happiness should be distributed in some ways and not in others. Suppose that I have the choice of two alternative actions as follows: I can either give $500 to each of two needy men, Smith and Campbell, or else give $1000 to Smith and nothing to Campbell. It is of course likely to produce the greatest happiness if I divide the money equally. For this reason utilitarianism can often emerge as a theory with egalitarian consequences. If it does so this is because of the empirical situation, and not because of any moral commitment to egalitarianism as such. Consider, for example, another empirical situation in which the $500 was replaced by a half-dose of a life saving drug, in which case the utilitarian would advocate giving two half-doses to Smith or Campbell and none to the other. Indeed if Smith and Campbell each possessed a half-dose it would be right to take one of the half-doses and give it to the other. (I am assuming that a whole dose would preserve life and that a half-dose would not. I am also assuming a simplified situation: in some possible situations, especially in a society of nonutilitarians, the wide social ramifications of taking a half-dose from Smith and giving it to Campbell might conceivably outweigh the good results of saving Campbell's life.) However, it is probable that in most situations the equal distribution of the means to happiness will be the right utilitarian action, even though the utilitarian has no ultimate moral commitment to egalitarianism. If a utilitarian is given the choice of two actions, one of which will give 2 units of happiness to Smith and 2 to Campbell, and the other of which will give 1 unit of happiness to Smith and 9 to Campbell, he will choose the latter course.[3] It may also be that I have the choice between two alternative actions, one of which gives −1 unit of happiness to Smith and +9 units to Campbell, and the other of which gives +2 to Smith and +2 to Campbell. As a utilitarian I will choose the former course, and here I will be in conflict with John Rawls' theory, whose maximin principle would rule out making Smith worse off.

Utilitarianism and Rawls' Theory

Rawls deduces his ethical principles from the contract which would be made by a group of rational egoists in an 'original position' in which they thought behind a 'veil of ignorance,' so that they would not know who they were or even what generation they belonged to.[4] Reasoning behind this veil of ignorance, they would apply the maximin principle. John Harsanyi earlier used the notion of a contract in such a position of ignorance, but used not the maximin principle but the principle of maximizing expected utility.[5] Harsanyi's method leads to a form of rule utilitarianism. I see no great merit in this roundabout approach to ethics *via* a contrary to fact supposition, which involves the tricky notion of a social contract and which thus appears already to presuppose a moral position. The approach seems also too Hobbesian: it is anthropologically incorrect to suppose that we are all originally little egoists. I prefer to base ethics on a principle of generalized benevolence, to which some of those with whom I discuss ethics may immediately respond. Possibly it might show something interesting about our common moral notions if it could be proved that they follow from what would be contracted by rational egoists in an 'original position,' but as a utilitarian I am more concerned to advocate a normative theory which might replace our common moral notions than I am to explain these notions. Though some form of utilitarianism might be deducible (as by Harsanyi) from a contract or original position theory, I do not think that it either ought to be or need be defended in this sort of way.

Be that as it may, it is clear that utilitarian views about distribution of happiness do differ from Rawls' view. I have made a distinction between justice as a moral concept and justice as a legal or quasi-legal concept. The utilitarian has no room for the former, but he can have strong views about the latter, though *what* these views are will depend on empirical considerations. Thus whether he will prefer a political theory which advocates a completely socialist state, or whether he will prefer one which advocates a minimal state (as Robert Nozick's book does[6]), or whether again he will advocate something between the two, is something which depends on the facts of economics, sociology, and so on. As someone not expert in these fields I have no desire to dogmatize on these empirical matters. (My own private non-expert opinion is that probably neither extreme leads to maximization of happiness, though I have a liking for rather more socialism than exists in Australia or U.S.A. at present.) As a utilitarian my approach to political theory has to be tentative and empirical. Not believing in moral rights as such I can not deduce theories about the best political arrangements by making deductions (as Nozick does) from propositions which purport to be about such basic rights.

Rawls deduces two principles of justice.[7] The first of these is that 'each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others,' and the second one is that 'social and economic inequalities are to be arranged so that they are both (a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all.' Though a utilitarian could (on empirical grounds) be very much in sympathy with both of these principles, he could not accept them as universal rules. Suppose that a society which had no danger of nuclear war could be achieved only by reducing the liberty of one percent of the world's population. Might it not be right to bring about such a state of affairs if it were in one's power? Indeed might it not be right greatly to reduce the liberty of 100% of the world's population if such a desirable outcome could be achieved? Perhaps the present generation would be pretty miserable and would hanker for their lost liberties. However we must also think about the countless future generations which might exist and be happy provided that mankind can avoid exterminating itself, and we must also think of all the pain, misery and genetic damage which would be brought about by nuclear war even if this did not lead to the total extermination of mankind.

Suppose that this loss of freedom prevented a war so devastating that the whole process of evolution on this planet would come to an end. At the cost of the loss of freedom, instead of the war and the end of evolution there might occur an evolutionary process which was not only long lived but also beneficial: in millions of years there might be creatures descended from *Homo sapiens* which had vastly increased talents and capacity for happiness. At least such considerations show that Rawls' first principle is far from obvious to the utilitarian, though in certain mundane contexts he might accede to it as a useful approximation. Indeed I do not believe that restriction of liberty, in our present society, could have beneficial results in helping to prevent nuclear war, though a case could be made for certain restrictions on the liberty of all present members of society so as to enable the government to prevent nuclear blackmail by gangs of terrorists.

Perhaps in the past considerable restrictions on the personal liberties of a large proportion of citizens may have been justifiable on utilitarian grounds. In view of the glories of Athens and its contributions to civilization it is possible that the Athenian slave society was justifiable. In one part of his paper, 'Nature and Soundness of the Contract and Coherence Arguments,'[8] David Lyons has judiciously discussed the question of whether in certain circumstances a utilitarian would condone slavery. He says that it would be unlikely that a utilitarian could condone slavery as it has existed in modern times. However, he considers the possibility that less objectionable forms of slavery or near slavery have existed. The less objectionable these may have been, the more likely it is that utilitarianism would have condoned them. Lyons remarks that our judgments about the relative advantages of different societies must be very tentative because we do not know enough about human history to say what were the social alternatives at any juncture.[9]

Similar reflections naturally occur in connection with Rawls' second principle. Oligarchic societies, such as that of eighteenth century Britain, may well have been in fact better governed than they would have been if posts of responsibility had been available to all. Certainly to resolve this question we should have to go deeply into empirical investigations of the historical facts. (To prevent misunderstanding, I do think that in our present society utilitarianism would imply adherence to Rawls' second principle as a general rule.)

A utilitarian is concerned with maximizing total happiness (or goodness, if he is an ideal utilitarian). Rawls largely concerns himself with certain 'primary goods,' as he calls them. These include 'rights and liberties, powers and opportunities, income and wealth.'[10] A utilitarian would regard these as mere means to the ultimate good. Nevertheless if he is proposing new laws or changes to social institutions the utilitarian will have to concern himself in practice with the distribution of these 'primary goods' (as Bentham did).[11] But if as an approximation we neglect this distinction, which may be justifiable to the extent that there is a correlation between happiness and the level of these 'primary goods,' we may say that according to Rawls an action is right only if it is to the benefit of the least advantaged person. A utilitarian will hold that a redistribution of the means to happiness is right if it maximizes the general happiness, even though some persons, even the least advantaged ones, are made worse off. A position which is intermediate between the utilitarian position and Rawls' position would be one which held that one ought to maximize some sort of trade-off between total happiness and distribution of happiness. Such a position would imply that sometimes we should redistribute in such a way as to make some persons, even the least advantaged ones, worse off, but this would happen less often than it would according to the classical utilitarian theory.

Utilitarianism and Nozick's Theory

General adherence to Robert Nozick's theory (in his *Anarchy, State and Utopia*)[12] would be compatible with the existence of very great inequality indeed. This is because the whole theory is based quite explicitly on the notion of *rights*: in the very first sentence of the preface of his book we read 'Individuals have rights. . . .' The utilitarian would demur here. A utilitarian legislator might tax the rich in order to give aid to the poor, but a Nozickian legislator would not do so. A utilitarian legislator might impose a heavy tax on inherited wealth, whereas Nozick would allow the relatively fortunate to become even more fortunate, provided that they did not infringe the *rights* of the less fortunate. The utilitarian legislator would hope to increase the total happiness by equalizing things a bit. How far he should go in this direction would depend on empirical considerations. He would not want to equalize things too much if this led to too much weakening of the incentive to work, for example. Of course according to Nozick's system there would be no reason why members of society should not set up a utilitarian Utopia, and voluntarily equalize their wealth, and also give wealth to poorer communities outside. However, it is questionable whether such isolated Utopias could survive in a modern environment, but if they did survive, the conformity of the behaviour of their members to utilitarian theory, rather than the conformity to Nozick's theory, would be what would commend their societies to me.

Summary

In this article I have explained that the notion of justice is not a fundamental notion in utilitarianism, but that utilitarians will characteristically have certain views about such things as the distribution of wealth, savings for the benefit of future generations and for the third world countries and other practical matters. Utilitarianism differs from John Rawls' theory in that it is ready to contemplate some sacrifice to certain individuals (or classes of individuals) for the sake of the greater good of all, and in particular may allow certain limitations of personal freedom which would be ruled out by Rawls' theory. *In practice*, however, the general tendency of utilitarianism may well be towards an egalitarian form of society.

Notes

[1] In hoping that utilitarianism can be rendered acceptable to some people by presenting it in a clear light, I do not deny the possibility of the reverse happening. Thus I confess to a bit of a pull the other way when I consider Nozick's example of an 'experience machine.' See Robert Nozick, *Anarchy, State and Utopia* (Oxford: Blackwell, 1975), pp. 42–45, though I am at least partially reassured by Peter Singer's remarks towards the end of his review of Nozick, *New York Review of Books*, March 6, 1975. Nozick's example of an experience machine is more worrying than the more familiar one of a pleasure inducing machine, because it seems to apply to ideal as well as to hedonistic utilitarianism.

[2] In this paper I shall assume a hedonistic utilitarianism, though most of what I have to say will be applicable to ideal utilitarianism too.

[3] There are of course difficult problems about the assignment of cardinal utilities to states of mind, but for the purposes of this paper I am assuming that we can intelligibly talk, as utilitarians do, about units of happiness.

[4] John Rawls, *A Theory of Justice* (Cambridge, Mass: Harvard University Press, 1971).

[5] John C. Harsanyi, 'Cardinal Utility in Welfare Economics and the Theory of Risk-Taking,' *Journal of Political Economy*, 61 (1953), 434–435, and 'Cardinal Welfare, Individualistic Ethics, and Interpersonal Comparisons of Utility,' *ibid.*, 63 (1955), 309–321. Harsanyi has discussed Rawls' use of the maximin principle and has defended the principle of maximizing expected utility instead, in a paper 'Can the Maximin Principle Serve as a Basis for Morality? A Critique of John Rawls' Theory.' *The American Political Science Review*, 69 (1975), 594–606. These articles have been reprinted in John C. Harsanyi, *Essays on Ethics, Social Behavior, and Scientific Explanation* (Dordrecht, Holland: D. Reidel, 1976).

[6] Robert Nozick, *Anarchy, State and Utopia*. (See note 1 above.)

[7] Rawls, *A Theory of Justice*, p. 60.

[8] In Norman Daniels (ed.), *Reading Rawls* (Oxford: Blackwell, 1975), pp. 141–167. See pp. 148–149.

[9] Lyons, *op. cit.*, p. 149, near top.

[10] Rawls, *op. cit.*, p. 62.

[11] On this point see Brian Barry, *The Liberal Theory of Justice* (London: Oxford University Press, 1973), p. 55.

[12] See note 1.

The "Invisible Hand"

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Why should we be enthusiastic about the market? The most famous argument supporting its social usefulness is the "Invisible Hand" idea, found in a single paragraph in Adam Smith's *Wealth of Nations*. Such arguments propose that desirable social outcomes will be promoted by people who are not acting intentionally to promote what they would describe as "social outcomes" at all. Reflection suggests that the argument, despite its one-liner status in Smith, is not quite so simple. To fill in such an argument, we need, I take it, to specify or explain 5 things:

1. the proposed outcome that is claimed to be desirable,
2. the assumed motivations of those whose actions are held to promote them in this way;
3. the institutional conditions necessary for this to take place;
4. the mechanism or feature of these nonintentional processes by which the promotion of these ends is made likely; and finally,
5. why people should care whether it is brought about or not.[1]

At the outset, let me explain that the moral correctness of the principles on which the market is founded is not derived from the invisible hand. But the claim that it is the most desirable general social arrangement for economic affairs is not quite the same thing as the claim that the morality of the market is sound on basic moral grounds. The Invisible Hand argument offers frosting on what is already a cake. But I think it a good argument, and the frosting is a very rich affair.

Here is my sketch of how this works. In very brief:

1. The proposed outcome is that people do better.
2. The motivation imputed to the actors is simple self-interest, primarily.
3. The institutional conditions required are whatever it takes to enable people to rely on continued ownership of property and income got by free exchange with willing others.
4. The primary mechanism is what are now called Positive Externalities.
5. People should care because they stand to gain – individually, as well as collectively, and to gain almost no matter what their particular interests are.

The rest of this essay will flesh out these claims.

1. The Desired Outcome

The "desired social outcome" is that people are better off. The more people who are better off, and the better off they are, the better.

My apologies if this sounds trite. But then, if it does strike people as trite, that presumably is because everyone regards it as obvious. We would then have the highly desirable feature that we are agreed about the fundamental aim of all this, and if we differ, it is regarding how to bring it about. But two important notes have to be made here.

First, and essential: the criteria for better-offness, on the view assumed here, are set by *them* – by the very people whose benefit is in question, *not* by the theorist. People have a range of values, of preferences, which can be more or less fulfilled. The object in question is that they be more rather than less fulfilled. The object, in short, is the best life for everyone, so far as each one is concerned.

It is easy to invoke extra criteria here. If you look at society from the perspective of some special religious or idealistic viewpoint, of course, arguments of the kind discussed here may be of little avail. The free market will not impose your favorite religion, or way of life, on everyone, and if you regard that as an objection to it, then it will be an irrefutable one. Of course, the upholders of the innumerable different views with which you disagree will not regard your option as the best one, or even as a good one – and then what? When you bear in mind the multiplicity of people we find in society, and try to produce an analysis that takes each of *them* into account, the rationale of using the liberal criterion is fairly obvious.

Second: We do need to ask, "best" relative to what? This, being ambiguous, calls for two answers. First, it could be better compared to *the status quo for each person*. Second, it could be better than *any alternatives*. Both are being claimed here.

But a third idea is definitely *not* fundamentally relevant: *better than others are doing*. It is, of course, logically impossible for everyone to do better than everyone else.

A much thornier related issue will be thought to be this: suppose P_1 makes one subset of people better off relative to the status quo, P_0, whereas P_2 renders a different subset better off, so that some who are better off in P_1 are worse off than they would be in P_2, and vice versa. What are we to say about this?

Here I provide an answer that will bother some people and not others: namely, that questions of this kind, by and large, do not, so far as social philosophy is concerned, matter. What does matter is that none are made better off *by* making others worse off, *than* *they were in the status quo* – not worse off *than the others*, of course, but worse off *than they were before*.

The people whom this will "bother," as I put it, are many and probably include most readers of this journal. The specific and intended implication of the above is that we are not to make someone better off by compelling someone else to help make him so. Helpfulness to others is a major virtue. Indeed, we should agree with Hume that benevolence is at the top of the list of virtues. But it is no longer a virtue when it is compelled, and compulsion is precisely what such interventions as state welfare systems substitute for benevolence. The person who professes such concern for the poor that she is all for compelling the rest to "contribute" to their betterment speaks from both sides of her mouth. And of course she will have great difficulty, should she address the matter, in explaining why it is only her fellow poor Americans or Canadians or Xians who are to be helped in this way, rather than the billions of far needier persons in other parts of the world. She will have even greater difficulty explaining how it is that compulsion for this purpose is morally legitimate in the first place. Most people object to theft, even though it too has the structure of compelling some people (the victims) to contribute to the welfare of some others (the thieves). Few actually try to explain this disparity between what they think about the behavior of their fellow men as privately acting people, and what they think about the behavior of governments which appear to do exactly the same thing. They seem to think it a fundamental moral postulate that we are to exercise compulsion over an arbitrarily selected group of people (fellow nationals of the same state) in order to provide certain goods for another arbitrarily selected group of persons (needy fellow residents of the same state). These "fundamental postulates," we may well suspect, are a refuge of the dialectically bereft, and, in the process, a cloak to cover aspirations to power over one's fellows.

In the previous paragraph, to be sure, I go out on a limb, and no doubt unnecessarily. For one can, and we in practice do, combine – if uneasily – a partially free enterprise system with a "safety net" of publicly supported welfare services. Probably few readers object to the mixed system we actually have, even if none of them can produce much of a justification for it. So let us suppose that we have this safety net, at a fairly low level, with free enterprise prevailing above it. The virtues of the Invisible Hand will still be very much in evidence, and that is what is being argued for here. And probably not too many readers will even complain about the market's indifference to "distribution" once you get above the "safety level."

For various reasons, only some of which are developed below, I am quite willing to regard Gross Domestic Product *per capita*, with some qualifications, as a reasonably good measure of the general good we are interested in here, and I presume that most readers would accept this, on reflection – for there isn't much else that we have to go by, at least at present. GDP is by no means perfect, however, partly for reasons that will be mentioned below. It is merely an available and fairly decent measure of what we are looking for.

One serious shortcoming of GDP, however, needs mention right away: it doesn't tell us about the incomes of recipients of charity and other voluntary but noncommercial transfers. The income from which the charitable person makes the transfer is included, as it should be; but what he does with it may well not get registered as the income of the someone else who benefits, as it would when there is actual exchange of money for services or goods. One critic complains, "GDP only functions for those with something to exchange."[2] But that is true only of the measuring device, not of the thing measured. Gross Domestic Product is a measure of production, as the name implies; but it is not a direct measure of distribution, in the sense of tracking what happens to the products in question. As a major relevant example: until at least the late 20th century, *most* personal income went to expenditures on persons other than the earner. Husbands, in particular, spent most of their money on their families. A wife not receiving income outside the home is not regarded as having an "income," and yet, she typically commanded an array of goods and services for self and family. in most cases a quite substantial one, and usually more than half her husband's reported income. Nowadays, when most women are employed outside as well as inside the home, the joint incomes of the parents go considerably, if not mostly, to their children, whose "incomes" in this respect are in turn not measured by GDP. Not measured by it, indeed: but it happens all the same, and all the time – exemplifying, in fact, one of the respects in which the Invisible Hand is at work. Likewise the recipients of the immense amount of charitable and other noncommercial expenditure in a modern economy (notably the U.S., which is by far the most generous country in terms of personal charitable giving). The effect of this, of course, is to make the actual income in terms of command of goods and services of the people in a free market society very much more equal than it may appear if we confine ourselves to income-earners only. There is no easy way to keep track of all that in a measure such as GDP, but to ignore it would be to distort reality. It is *not* true that the only people who *receive* in a free market society are people who *earn* what they get (and in the case of "housewives", as they used to be called, they also earn it, but it goes unrecorded as personal income.)

2. Motivations

What is assumed about motivations? A fundamental virtue of the market is that the answer to this question is – very little! People are assumed merely to be interested in various goals, personal or otherwise: which is virtually to say, that they have interests – which in turn is basically just to recognize that they are people. It is presumed – and there is overwhelming empirical evidence for this, if one supposes it to be a matter of "evidence" – that typical and prominent among those goals are ones that do *not* include broad-scale social ideals. Rather, they include things like a better house for oneself & one's family, vacations, nice furniture, trips to the opera, the odd bottle of scotch, as well as support of churches, charities, and clubs – things like that. To say that they are interested in promoting their personal "wealth" is fair enough, though it is by no means necessary that this motive be either the *exclusive* motive or even the *predominant* motive of everybody or even anybody. All that is required is that an interest in expanding one's real income be quite strong in by far the majority of normal people. What we assume most people are motivated by, in short, is, as the saying goes, that it is better to be healthy, happy, and rich than sick, miserable, and poor. Other things being equal, the richer the better – and other things are, very often, close enough to "equal" to do.

Is the pursuit of those goals *constrained* in some way? Of course it is. In market relations, it is constrained by the property and personal rights of others: each person's pursuits are to be constrained against pursuing them *by* imposing costs, losses, harms to other persons. Thus, the Lockean version of the Law of Nature is operative: nobody is allowed to better himself by making others worse off than they would be absent the intervention. Note, however, two important points.

First: such pursuit is *not* constrained by any strictly *distributional* requirements, in particular. There is no insistence that the pattern of benefits issuing from any particular exchange show any particular configuration – equality with some reference group, for instance – so long as each party to it is acting under no misinformation supplied by the other as regards the activities and conditions under which the agreement is made. In a way, that is what is most distinctive about the market, and likely what most who object to it object to.

Second: note too – a matter of enormous importance – that we are not, of course, to be protected against "loss of market share" or loss of benefits that others have no duty to give us in the first place. If you stand to lose a job, you are protected only insofar as your contract protects you. Society doesn't owe you a living, nor does your employer's competition. And your employer owes you only what is specified in the employment agreement. Each, in general, must make his or her own way; none is to make it by theft or extortion or coercion of others.

If this seems a downside of the market, consider the alternative: a stagnant economy in which some few are fixed in high places and others in low, with no way to go forward. The free market, if genuinely free, doesn't protect those who do badly, but on the other hand, by that very fact, it creates opportunities. The person who doesn't make it at job x is likely to find another situation, y, and in the longer run it will be a better one than he had before.

Third: this motivational restriction is not taken to be a part of human nature. If it were, this whole question would look very different. The market constraint, to respect the persons and properties of others, is not a necessary part of the actors' basic motivations themselves: it is not assumed that people are just naturally born with these constraints operative. How people come to be constrained in these ways is an important question, and I take it be obvious that moral training by parents and peers has a great deal to do with it. However, in discussing how the market works in principle, what we are talking about is what would happen *if* the rule, and the only basic rule, of economic activity is that they are thus constrained, and not how they come to be so. Nor is it assumed that everyone is in fact always perfectly respectful of these rights of others – obviously they are not. We need not make any particular assumptions about which extra sources of reinforcement of such constraints would be most effective, or necessary. (And this will be discussed in the next section, on institutional conditions.) The point is only that to have a market situation rather than some other sort, we must have individuals in possession of various goods and services that can be transferred to others at will, and their possession must be secure enough so that individuals can deal with each other today regarding what they will do tomorrow and the next. Strictly speaking, we can only *trade* what we *have*, and when instead we steal, or cheat, or murder in order to get it, we no longer have a market, but rather a situation of something like war. The market, *as such*, is a peaceful institution, based on mutual recognition of rights over the goods and services the exchange of which is its purpose.

Many will have doubts about this, claiming that "it's a jungle out there!" But the jungle consists of competitors, trying to make an even better offer to potential customers, with wares competitive to the ones that you are selling, and motivating you to respond by making your own better yet. The morality of the market does not, of course, allow dealing with the competition by shooting them, or by cheating. It allows only that you make a better pitch to the consumer, offering better goods or services or at a lower price.

There is, however – as Adam Smith was well aware even in his day, and we are even more so now – very much a question of you or your competitors resorting to the device of making the other guys' activities *illegal*. See your local congressman or MP for details about government subsidies, restrictions, regulations, taxes, and other "benefits" designed to reduce the "threat" of the "jungle" – and thereby to reduce or eliminate the benefits of the free market. But again, this is the antithesis of the market, not its instantiation.

3. Institutional Conditions

As to the question of what "institutional conditions" are necessary, the short answer is – conceivably *none*. But that does depend on what you count: as an "institution," and even more on what you mean by "necessary." If it is government institutions that the questioner has in mind, then the point is that they are at least not *logically* necessary to the market. What is necessary, in any practical sense, is that the rules recognizing each others' rightful possessions be adopted by the participants, and this in turn most likely will require that they be reinforced by the familiar methods of moral training and social reinforcement. Specifically, what is needed is the constraint mentioned above: people are to respect others' persons and property. No force may be employed against others merely to enhance one's own ends; it may be employed only in defense of persons and legitimately acquired property – that is, of the things people have acquired by finding, making, or being voluntarily given them by someone else, or, most essentially so far as the market is concerned, by trading with others on agreed terms. That, in brief, is the Morality of the Market. (Perhaps it is just Morality, period, or rather, that major part of Morality that treats of our enforceable duties toward others. There is nothing *special* about a morality telling you to refrain from getting your way by killing, assaulting, injuring, maiming, lying, or stealing.)

There is, of course, the matter of currency systems, roads and communications – "infrastructure." It is not very surprising that all of these useful assists to market exchange should have fallen into the hands of governments, and indeed, most readers will never even have considered the possibility that they should be provided in any other way – even though every one of those things, and many more, such as education – were, in various places and for ages, privately provided. But we will, for present purposes, suppose that these items are provided somehow, whether by government (typically, nowadays) or not (frequent, especially in the past); and if by government, that they will be funded by taxation (likely much less efficiently than they could be).

At this point, it is perhaps worth mentioning a misunderstanding that has been more than a little promoted by David Gauthier's important discussion in his influential book, *Morals by Agreement*.[3] Gauthier there argues that the market is a "morally free zone," an area within which nothing is morally right or wrong. What makes his discussion misleading is that there is an assumption used to *define* the market in the sense he intends there, namely, that there are no *externalities*. Externalities include things like force and fraud – the very things that the morality of the market prohibits. More generally, negative externalities are the flipside of the invisible hand: unintended harms and evils inflicted on others in the course of intendedly innocent transactions. (There can also be positive externalities – unintended benefits to others. We'll discuss those in the next section, however.) In a market as stipulated by Gauthier's definition, each person gets exactly what he produces or what he agrees to receive for it, by exchange, and nothing else. But this is simply to define an abstract model. The claim that what goes on in what we call the market in the real world is "morally free" is not true; insofar as the condition is realized purely by stipulation, the question of what would have to go on in real life in order that such a model can be approximated is simply put to one side. But in the real world, people have to be somehow induced not to violate these constraints on occasions when it is possible to do so – as it very often is, obviously. It is those constraints that define the market, in real-world terms. Insofar as people are observing them, we have a market, and to the extent that they don't, we don't, strictly speaking, but something less, or something quite other.

Typically when people speak of "market society" they have in mind various real-world communities such as Switzerland or the United States. But to do so is to lump too much together. All contemporary states have very substantial "public sectors" in which economic activity is to some considerable extent controlled by a central government, deciding generally what is to be done with people's money, and the government's income is got by taxation. But that is not market activity as such, even though governments often, and wisely, proceed by putting out contracts for bidding by private companies, and of course always negotiate their wage contracts with individuals seeking their best employment option just as they would when dealing with a private company. Still, insofar as a nation has public-sector activity, with the possible exception of the provision of a monetary system and of such legal apparatus as may be necessary to define property rights, it is to that extent not fully a market society. Moreover, insofar as activity in the society is prompted by criminal activity, we also have deviations from our market model.

It might be argued that the philosophy of market society actually *induces* people to commit crime – just as it might plausibly be argued that the very success of market society in providing so much wealth, ready to be stolen by energetic criminals, is what induces such crime. But obviously that is no part of the definition of market society, and it can only promote confusion to insist on building such deviations into the very heart of the notion. And as to the presence of potential for deviating, one does have to point out that all societies, inherently offer such potential. No society can make it literally impossible for people to kill, cheat, injure, and delude other people in pursuit of their various ends. Whether it is "more possible" in a market society is a fair, but difficult question – difficult because it is hard to see just how this would be measured. Pointing to fairly high crime rates in the U.K. and the U.S., for example, encounters the problem that those rates are extremely low in Hong Kong, Japan, and Switzerland, which are about as capitalist as, or perhaps more so than, the first set. It is clear that other cultural factors besides the functioning of markets are responsible for high crime rates. In the U.S., additionally; the crime rate is at least doubled, according to all responsible sources, by the prohibition of drugs – which is an anti-market measure, not a market feature. How much of the crime we find around us is due to the irresponsible laws that such crime builds on is a nice question, but certainly much of it is. And that is a point that cannot be laid to the door of the market, but rather, to the door of the politics of particular cultures such as our own.

Insofar as there are police forces, guards, and so on, market participants will be spending money on the sort of "overhead" that the existence of crime will create. If we want to call those measures "institutions," and if we assume that a certain amount of criminality is only to be expected, then we may accept that some institutional framework is necessary for real-world, functioning markets. In the ensuing discussion, this will be assumed without further comment, except to remind the reader that what makes it necessary is deviation from the market idea, rather than instantiation of it.

4. What Makes it Work?

What reason is there to think that the envisaged actions of individuals will in fact redound to the advancement of the objective mentioned in (1), despite the fact that nobody is presumed to be aiming at it, as such? The answers to this most fundamental question for present purposes are, I think clear. I shall divide them into two parts. The first part is remarkably obvious; but in part it is, perhaps, something that could escape notice and apparently sometimes does – indeed, it must have done so, considering the ill repute into which the market has fallen among most of today's intellectuals and academics. The second part is both subtler and more important.

First, the easy part. The moral (and, usually, legal) constraints that frame the market require us to refrain from force, theft, and fraud.[4] No one, then, is to visit harms upon others, whether they are directly in one's line of vision or not. That constraint is pretty easy to meet, generally speaking. We must, to be sure, allow that it is possible to visit inadvertent or unforeseen damages on persons well out of one's "line of vision." However, those persons have an interest in not having such harms visited upon them, and there is some reason to think that they would typically be aware of substantial ones, and ready to do something about them. Supposing this to be so, now consider the effects of transactions, dealings with other people who *are* "in one's line of vision": face-to-face dealings, as with friends or customers and employees. In all these cases, we may expect these relations to be, by and large, mutually advantageous. I deal with you because I suppose that my situation, on the whole, will be improved by doing so; and vice versa. And for the most part, that is a reasonable supposition and actually works out. There is no need to tot up sums and see how much one of us gains *as compared with* the other, that being a factor that is rarely relevant. Each of us does his or her homework, sizing up the opportunities before him, comparing their likely benefits with those of known alternatives, and perhaps sometimes being motivated to look for further alternatives, which are then added to the list and duly appraised as well. When we act, we each suppose we are doing our best. Nobody forces us to choose the alternative we do, and yet we take it. There is a reasonable presumption that, by and large, we take that one because we have done our homework tolerably competently, and each of us will do reasonably well – better, almost always, than if we do nothing.

Here again, we must bear in mind that the measure of value is the individual's own estimates of it, not the theorist's or someone else's. Of course some people think that almost all of our behavior is wrong: we should be spending all our time contemplating Allah, or our navels, or writing poetry. It cannot be too strongly emphasized that such judgments are not relevant here. Society consists of a large number of people, all different from each other, and they pursue their own ends, not ours or the Pope's.

Now multiply that obvious point – that voluntary exchanges are made for mutual benefit – by some very huge number, and take into account that there is no special reason to expect significant negative side effects of our dealings with each other in most cases, and the result is that we can expect things to go generally fairly well. By and large, we will all enjoy a general improvement in our lots, barring calamities. Yet each need only intend to benefit himself, or (more usually) himself and some few others – family, friends, acquaintances, coworkers. Very often, to be sure, people *do* intend to benefit many others, but the point is that it doesn't matter whether that is so, nor to what extent it is so, since the result emerges even if they have no such benevolent intentions. As Adam Smith notes in the famous quotation, the public good will be advanced in that way even if no one directly intends to advance it.

Second: this brings us to the less obvious but more important feature – the answer that is really the main one, the primary reason why we should agree with Adam Smith's dictum. This answer stems from the fact that in our dealings with others, there are frequently, indeed typically, side effects of those dealings, viz., effects other than or in addition to the ones we are as such pursuing in the dealing in question, which can generally be expected to be for the good – effects that make somebody or other better off than he or she might otherwise have been, and make nobody worse off than he or she might otherwise have been. These are what is known, accordingly, as "positive externalities". It is the particular way in which these come about, and the overwhelming likelihood that they will do so in a free enterprise, market society – but not in anti-market societies – that attests to the plausibility of the Invisible Hand thesis.

When Jones builds a fine house on the corner, he brings pleasure to the eye of passersby even though that was likely not his main, and probably not any part of, his object in building the house, Moreover, the house keeps him healthier, enabling him to work more years, to the benefit of those with whom he works. When Linda buys a new clock from Sam's hardware, a visitor later contemplates it during tea and realizes that she must leave now to make an urgent appointment; tinker Robinson buys tools or books, and ends up making a major invention that ultimately saves much labor for millions of people. The merchant who sells Mr. Robinson those items does not do so for the purpose of promoting those inventions (though Robinson's investors, if he presses his invention to the point of commercial exploitation, of course do.) As usual, the merchant is simply trying to make a living. There is no end of unintended byproducts of exchanges which weren't made for the purpose of promoting those particular objectives, but nevertheless, and unsurprisingly, do in fact promote them. As a result, all we need is to block, if we can, the intended and unintended *negative* externalities, the tendencies toward doing harm, toward making life worse for others, and then the several million flowers will bloom, variously, but very often, indeed overwhelmingly typically, to the benefit of others.

More generally, then: free exchanges are for mutual benefit, and usually achieve that; but the benefits thus obtained enable people, in turn, to do more good for more people. Merchants in pursuing profits make useful things that people are willing to buy – and the more money the merchant makes, the more people he must have benefited, provided that it is derived from honest trade rather than violence, fraud, or politically-extorted impositions. And each of these benefits provides a base for further ones down the line. Thus the utility of society is enhanced *over and above the sum of the good results which were aimed at* in the various interactions permitted by the market system. **That is the essence of the invisible hand**. *Market transactions as defined above can be expected to produce not only direct benefits for those party to them, but predominantly positive externalities, thus leaving people better off than they are made strictly as a result of their own engaging in such activities.*

Of course, it may be agreed that these results *are* the intended, or at least the expected and certainly hoped-for results of the market *system*: What's intended by adopting and promoting the market system is that people do well. People intend to do well anyway, of course, but they often enough resort to methods whose side effects – or even whose central effects – are quite inconsistent with the promotion, or even the maintenance, of the good of others. What we who advance the market cause say is that those are the wrongful means, the means which are to be blocked – prohibited in many cases, discouraged in others. And we say that provided this is done, the overall results will be even better than the sum of the particular expected or intended goods stemming from each individual interaction, insofar as we can reasonably talk about anything as fancy as a "sum."

A further word should be added about the effects of competition. The consumer benefits whenever he buys anything voluntarily – he's better off, in his view, for buying it than not buying it. But of course he'd like to get it cheaper, or get a better one for the same price. The free market system does not require anyone to do anything about this – indeed, there is no *requirement* that anyone go into business at all. But then, we do have millions of people interested in promoting their own well-being, and a prominent way of doing this is to have, hence to make, more money. You make more if you sell more at a profit, or in the case of one's services, for a higher wage or salary. A higher profit per unit is fine, or more units, or any blend of the two. Accepting a lower profit per unit but selling a lot more units is one of the classic methods, and more likely to succeed than the alternative of seeking a higher profit per unit – the latter is done more often by way of politics than of market activity, seeing that competition awaits those who try to put up prices on their own. No one is required to compete, except in the sense that those who don't take account of the competition are unlikely to survive in the business world. And again, the result of this continual request for higher net profits is continued improvement for the consumer. And "the consumer," don't forget, is *everybody*.

At this point, we must take note of a prominent tendency among critics nowadays, to raise questions such as this: The world is awash in huge negative externalities, typically calling for massive doses of government deviance control to manage. Think of all the environmental legislation, the food and drug acts, counterfeiting laws, auto safety, toy safety. The history of capitalism is a history of firms and individuals passing costs on to someone else wherever it is possible."[5] Now, there's no denying much of what the critic says. But notice that there are two claims here, not just one.

First, there is an implicit claim that it is part of the *very structure of the market* that negative externalities can be safely imposed on people with no recourse. And that is exactly false. In fact, the real-world problem is that the legal structure that would enable these people to respond to the problem are suppressed by their governments. Individuals cannot sue for redress from pollution – not because they have no case, but because their government has arrogated to itself the sole right of dealing with the problem. Thus the courts in the area of Sudbury ruled against local farmers seeking redress against large companies for defoliating their farms, holding that it was the "public interest" that the big companies be able to carry on, pollution and all.[6]

And second, it is assumed that government regulation, environmental restrictions (such as the notorious Kyoto Accords recently passed by the Canadian parliament), and innumerable interventions in the market are in fact both necessary and effective for their purpose. There is every reason to deny both. Much environmental regulation is not in the interests of the public, but rather of vested interests. Compulsory or public-supported "blue boxes," for example, are anti-economic – a boon to the companies whose uneconomic services are thus subsidized by the taxpayer, but a nuisance and a detriment to the consumer and of no use whatever to the environment. Thus, for example, there simply is no case for requiring paper in Ontario to be recycled – no point in "saving trees," which are grown at a faster rate than they are cut down. The requirement is by the government via ill-considered ideology, not by private individuals wanting to do better.[7]

So one must agree with the questioner that we see a great deal of passing of bucks to governmental agencies, and a great deal of mishandling of the bucks thus passed – but it is a mistake to blame this on the market as such. It is not part of the philosophy of the market that people be able to injure their fellows with impunity: for that we must lay the blame on governments. Redressing the effects of, say, pollution is a tricky matter, but it is not one that is denied by the market philosophy – precisely the reverse. What's wrong with pollution is, precisely, that it invades persons and their property.

5. Why Cheer?

Why could individuals be expected to applaud the goal in question – promotion of the public good, and specifically wealth – even while not as such aiming at it? This may sound like a self-answering question: *of course* – so one might say – the public is interested in the public well-being. But while the answer is remarkably easy, it is not actually pleonastic. One can be expected to applaud because one can expect to gain, no matter who one is, and so long as one has any capacity to produce results that are desirable in one's own view. But why applaud when *others* prosper? To this there is a good answer: *you* are sure to be among those "others." Looking down the road, as we must always do in moral matters, we can see that the tendency of people to confine themselves to activities that benefit some while harming none is one that will in innumerable ways redound to one's own well-being as well.

It might of course be argued – to understate the case rather markedly, for it not only "might be" but certainly will be, and is, vociferously and typically asserted that *non*producers are in a very different boat from producers. The market system, after all, does not, *just as such*, supply anything to paraplegics, incompetents, or those with a very strong aversion to work and investment. And this is true, of course. The question is whether that fact provides any reason to deplore the market, *even from the point of view of those persons themselves*. The critic will turn this into a barb aimed at the market: "a market morality provides no motive for anyone to help the needy and in fact, provides a motive to do the reverse,"[8] So it is said. But wrongly.

The answer to such critics is clear. First, it is of course true that the market does not "provide" the *motive* to help those needing help – in this respect being identical with all other systems, no system "supplies" motivation – motives must come from within. Those who simply do not care about their fellows will not, of course, contribute to charity – though they will, by their profit-seeking activity, be de facto contributing to the means for assisting them utilized by others. (A friend suggests that Bill Gates has done far more for humanity, even apart from his extremely generous charitable activities, than Mother Theresa. He has a point.) But those, like the critic envisaged in the quotation, who talk of "providing motivation" mean *compulsion*. Their claim is that people won't help other people unless *forced* to do so, by law – by the Taxman. It is interesting that they talk so, which suggests that supporters of welfare states and more are themselves devoid of human sympathy, as well as very short on perception of ordinary human behavior. For it is a matter of common observation that most of us are indeed disposed to help our fellows out, in innumerable ways.

What I want to urge is that, paradoxical though it may seem, paraplegics will benefit far *more* from a system *in which no one is compelled to help paraplegics* – just as able persons will gain much more from employment with profit-seekers than from welfare cheques. The same goes for countless other such cases. This is all, again, the result of the invisible hand, though it is also a direct function of the central features of the system. The first and most basic point here is that in a wealthy society, there is more for the non-producers to be able to acquire. The fact that it is much cheaper, as a result of the innumerable transactions between self-interested parties, helps a lot, for the charitable but less wealthy are then enabled to do more to help.

As an example: a few blocks from my house is a charming store called "Generations," in which the castoff goods of many people are sold for ridiculous prices. No one, however poor, need go without decent clothing, assorted personal belongings, even furniture, in Waterloo, Ontario, when a serviceable sofa is available for $15, suit coats for $3, sweaters for $1. But this is in no way a government institution. It is run entirely by volunteers and one paid employee, and runs at a profit, the profits going to overseas charity. This is but one of many, many establishments of a similar kind in this modest-sized and typical city. Meanwhile, the Canadian Government by its program of restrictions and licenses on milk production, ensures that the poor pay more than twice what the market would entail for a litre of milk.

What the paraplegic needs is, of course, motivation on the part of those who own the resources they desire. But since those resources are much greater and much cheaper than they would be in any other form of human society, those who do have such motivation are more likely to be able to do something about it. Wealthy parents see to the care of their children, for example, and characteristically to many others as well, including, often enough, the poor as a class. Indeed, I propose that it is wholly reasonable to expect that *virtually every single person in this category* will be better off in a strongly market society than he or she would be in any other sort of society, given a reasonable period of time. Nor need the time be very long – a few years was all it took for free-enterprising Germany to rise from the ruins of World War II under the leadership of the economically savvy Ludwig Erhardt. And I would even venture to assert that, antecedently viewed, literally *every* person would expect to do so. (This does not mean that if you ask them, that's what they'll *say*. It means that if you look at his prospects objectively, in the light of what is known, those prospects are, in his own terms, better.)

Of course the argument of the welfare-state supporter presupposes that we all have a duty of justice to cater to the poor and the sick. It is not obvious where such a duty would come from, and those who employ the arguments never bother to provide them. (Nor do they explain why they do not think we should all be taxed to within an inch of our lives to support impoverished persons in Bangladesh, central China, and so on.) But there is only one source of support for those who cannot support themselves: human sympathy, which is indeed very widespread. Sympathy however, is a feeling, a sentiment, and the question is how such a thing can be a rational basis for imposing *compulsory* duties on the rest. Again, the most reasonable thing to say about that is that it cannot, and accordingly that charity should be voluntary, not compelled. It should be, because it must be. Nevertheless, in a free society, we can expect the previous result: the level of wealth available to sympathetic persons will be so great that the results for the unfortunate can be expected to be better than they would be under a compulsory regime anyway. You *can* have it both ways. (And the history of wealthy societies makes this clear. Even in the 19th century, when we were far less wealthy than we are now, and when there were no laws compelling all to contribute, the very sick were cared for, starvation was rare to the point of nonexistence, and in general the consequences which contemporary pundits assert for free societies simply did not happen. Sweatshop labor, of course, did happen – but by the usual method of voluntary arrangements between worker and employer, not by the whip and the lash.)[9]

The general conclusion, then, is that the effects of the Invisible Hand reach very far and very deep. People doing the things that interest them, because they interest them, can be expected to do them better than people acting under compulsion. In the course of their pursuit of their various interests, they make free exchanges with others, whether like-minded or not, and the result is that society is continually improved. Even though I have no interest, myself, in most of the particular services that other people render each other, yet the indirect effect of their doing so is that I benefit anyway. As Bastiat pointed out, the work of thousands goes into the supplying of my ten-cent pencil, as well as my two-thousand-dollar computer; yet none of those concerned need have been acting with a view to my benefit, as such.[10] Yet we can expect that many will benefit from the use I make of that pencil or computer, and in general that we all benefit from the best use that everyone makes of their various talents and resources, And all of this comes from people who do not, by and large, intend to benefit society as such, Smith's view, then, is amply confirmed upon analysis. The right way to organize society is to prohibit evil, not to inflict evils on some in order to compel them to do good to others. The promotion of good for others happens whether it is directly or indirectly intended by economic agents.

Probably the principal obstacle to the understanding of the free market is the contemporary inability to understand freedom itself. Freedom does not mean that you are compelled to seek your own benefit exclusively. The free market is the situation in which people are not compelled, rather than one in which they are: they are not compelled to maximize their incomes, any more than to contribute to worthy causes. Freedom means, rather, that you can do *what you want*, within the limits imposed by the like freedom of others. But what *do* you want? The multimillionaires of the late 19th and early 20th centuries, besides organizing highly productive factories and retail stores and the like, endowed museums, symphony orchestras, libraries, and universities as well as churches, hospitals, and assorted other amenities to their and others' communities. Nowadays government undercuts such efforts, pocketing their profits before they can accumulate to the point where people can afford such things – and we have, everywhere, underfunded hospitals and symphony orchestras, homeless people on the streets who prefer the streets to the public welfare services extended to them (and much prefer the services of churches and other charities), and innumerable other byproducts of the system in which we prefer compelling others to allowing them to act as they see fit.

Business is the fundamental wealth-producer in the "advanced" nations of the world. The point of this essay has been that it is no surprise that the societies in which business has flourished have also been, by and large, the ones in which more people are better off than in the dictatorships, would-be communes, or caste-bound societies of former times. The wealth comes largely from the efforts of ordinary people to do better for themselves. It is that which enables all to thrive – and would do so even more, if only we would continue to let them do so.[11]

Notes

[1] I am indebted to Alistair MacLeod's work for being motivated to work up this list. Professor MacLeod only lists three, however.

[2] The thought was formed by Alex Michelos, editor of this Journal.

[3] David Gauthier, *Morals by Agreement* (New York; Oxford University Press, 1986), Ch. IV, 83–112.

[4] While I would argue that those all come to the same thing, I'll be content here with a list. I would argue, but not here, that all these are species of the same

genus: the unilateral imposition of costs or harms on others.

5 The question is framed by Alex Michalos.

6 See Elizabeth Brubaker, *Property Rights in the Defence of Nature* (1995, Earthscan, Toronto). The case began when Justice Middleton denied injunctive relief to farmers who had brought suit against the Sudbury smelters for damages to their crops. His reasoning was that the economic benefit from the smelters was worth more to the region than was the product of the farms. Donald Dewees and Michael Halewood (*U of T Law Journal*, 42 (1992): 1–21) demonstrated that the smelters were more than profitable enough to compensate the farmers for damages and still be viable. The next year, the Ontario legislature passed legislation that absolved Sudbury smelters from liability for trespass or nuisance from emissions. Part of the rationale, by the way, was that the smelters were needed for the war effort of that noblest of conflicts, World War I. [My thanks to Glenn Fox of the University of Guelph for this reference.]

7 The literature on such matters is immense. I refer the reader, for a brief treatment, to chapter 10, "Morals and the Environment," in my own *Moral Matters* (Peterborough, Ont.: Broadview Press, 2nd edition, 1999). See the reading list in it for much more.

8 Again, this formulation is supplied by Michalos.

9 A useful recent source regarding voluntary institutional support of the needy is found in David T. Beito, *From Mutual Aid to the Welfare State* (Chapel Hill, N.C.: University of North Carolina Press, 2000). There is an immense literature on this and on the distortions of economic history in the U.S., England, and elsewhere that are commonly accepted by the unwary.

10 Frederick Bastiat, "Natural and Artificial Social Order," in *Economic Harmonies* (Irvington-on-Hudson, NY, Foundation for Economic Education, 1996), p. 3.

11 I am greatly indebted to the editor of the JOBE for lucidly expounding his extensive and clear disagreements with the first draft of this paper. Several alterations in this paper are due to that source, and hopefully make the position herein expressed clearer and perhaps more persuasive.

Corporate Ethics in a Devilish System

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When participating in discussions of corporate ethics, I am often struck by the narrowness of the discussion. Frequently, what many consider corporate ethics is an insistence on compliance with law and a focus on various mechanisms for keeping companies within the straight and narrow of legal boundaries.[1] I believe this fixation on compliance with law is a constrained view of corporate ethics, and this Essay will set out some reasons why.

Legal compliance is important, of course. Corporations are immensely powerful economic entities, and management's respect for law is essential if companies are to be operated in a way that is consistent with social welfare.[2] Moreover, as artificial entities, corporations are not subject to the constraints of conscience and social norm that limit the behavior of natural persons[3] As I have written before, "it is widely believed that corporate illegality and crime are 'imperfectly regulated by social controls' because corporations cannot be incarcerated, have no conscience, are typically very complex institutions, and are not subject to the same social controls and reputational constraints as individuals."[4]

The emphasis on legal compliance is even more crucial because of the fact that a small but significant portion of the corporate law academy does not appear

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to deem it important as a goal in and of itself. Judge Frank Easterbrook and Professor Daniel Fischel, for example, two of the leading scholars of the "nexus of contracts" movement within corporate law, made a splash a number of years ago when they suggested that the duty to obey the law is simply a constituent part of the duty to maximize the firm's value,[5] They argued, "if illegality will profit the company more than it will cost the company, the corporation should break the law."[6] Additionally, they wrote that "[m]anagers have no general obligation to avoid violating regulatory laws, when violations are profitable to the firm. . . ."[7] They also argued that when a corporation determines whether illegality is likely to be profitable, the cost that should be considered is not the actual penalty or fine; rather, it is the *expected* penalty, fine, or other costs.[8] In essence, a corporation should consider the cost of illegality as the penalty, fine, or other costs discounted by the chance of the exposure of the corporation's illegality.[9] The law, in other words, merely imposes a price for illegal behavior.[10] If the corporation is willing to pay, then no problem with illegality exists.[11]

Critics disapprove of this belief in the non-distinctiveness of illegal behavior, which is, thankfully, not the majority view within the academy[12] or in the courts.[13] Without doubt, compliance with law is crucial, and those who make it their life's work to ensure that corporations comply with the law deserve congratulations and support.

But a dedication to legality standing alone is hardly a robust sense of ethics, corporate or otherwise. If I were to teach my son that being ethical means simply to obey the rules, then I would be offering impoverished and limited guidance.[14] Ethics means more than obeying the law.[15] If that is so, why do so many discussions of corporate ethics begin and end in consideration of the law and how to ensure that corporations obey it? The reason is that it is difficult to expect businesses and the people within them to do more, given the legal framework we impose on them.

I should pause to admit an underlying assumption here: that situation more than disposition drives the behavior of most people.[16] An individual's motivations occur within a framework of incentives and disincentives, and individuals are affected by their surroundings and by myriad influences.[17] Despite our best intentions, and despite what many of us assume about our own behavior and by those around us, we make decisions less because of some inner compass than by the pushes and pulls of situation.

This is especially true of corporate executives (not to mention the corporations themselves). The "role morality" of executives, created by law and norm, creates for them the overarching and urgent goal of producing financial returns for shareholders, focused in the short term.[18] That goal subordinates other matters.[19] If executives wanted to act beyond that role in a way they thought their ethical system required, they might be able to on the edges.[20] For the most part, however, their obligations to their company and their shareholders, enforced by law and the market, keep them acting within narrow bounds.[21]

In this view, failures of corporate ethics are not matters of bad people acting within and through business. Rather they are failures of the system itself. Let me explain.

There are many views of what constitutes the substance of ethical or moral behavior.[22] Whether one takes guidance from religious norms or from Rawls, Kant, Aristotle or other philosophical thinkers, there are significant areas of agreement as to what amounts to ethical behavior. If my son asked me what ethics really means (and I try to tell him these things even when he does not ask), I would encourage him to think about the obligations of acting with due care for others, of taking responsibility for the effect of one's actions, of being honest, of considering broadly one's impacts, and of taking a long-term view, especially with regard to resource use.

Corporate law and financial markets operate to make these ethical obligations difficult to satisfy in a business setting. Limited liability, for example, the very cornerstone of corporate law,[23] is inconsistent with the ethical norm of taking responsibility for one's own actions since it shields people from liability that arises from their wrongful conduct.[24] Limited liability is fundamental and indeed is a principal reason that businesses choose to incorporate.[25] Moreover, corporations create subsidiaries through which they can perform risky operations, in part because the parent can shield assets from any potential liability.[26] There may be strong reasons to support limited liability in order to incentivize business creation and capital formation. Certainly, however, this has ethical implications and should be subject to an ethical critique, especially if it allows companies to shield themselves from taking financial responsibility for harms they cause.[27]

The expectations for corporate executives also contradict the ethical obligation of honesty. To be sure, there is a massive legal framework built up to protect shareholders from fraud, and consumer and creditor protections also exist.[28] But employees are not protected by anti-fraud law on the federal or state level.[29] If the CEO goes to a shareholder meeting and lies about financial projections, it can be a federal crime.[30] If she then appears in the employee lunchroom and utters the same lie, not only is it *not* a violation of law, it may in fact be consistent with (or required by) her fiduciary duty to maximize shareholder value.[31]

The imperative that corporate managers take a narrow and short-term view of their obligations is also ethically problematic. Those executives who think broadly about their obligations or want to offer fair and proportionate "returns" to stakeholders other than equity investors are routinely punished by the market – they suffer criticism by Wall Street, sometimes suits by the plaintiffs bar, and sometimes takeover.[32] An executive that causes the company to act in the long term, to take into consideration the interests of stakeholders other than shareholders, or willingly to accept lower profit in order to avoid imposing costly externalities on society at large will appear, from the viewpoint of shareholders and their Wall Street protectors, to be under-performing.[33] To the extent that ethics imposes costs or lengthens the time horizon – something that ethics by its own terms is bound to do – it is unsustainable unless we change the system in which we ask corporate executives to work. We would need to adjust the obligations of their roles to include, at least, the possibility and, more appropriately, the obligation to act in an ethically robust way.

I recognize that short-termism is an evil that many have started to speak out against, including representatives of corporate management such as the Chamber of Commerce and the Business Roundtable.[34] Sarbanes-Oxley plays into this opposition, in fact, since it is now more difficult for managers to use accounting manipulation to hide efforts on their part to manage for the long term.[35] In other words, to satisfy short-term Wall Street expectations, managers were formerly able to manipulate more easily the financial disclosures from quarter to quarter without actually managing for the short term.[36] It is a very real possibility that one of the unintended consequences of Sarbanes-Oxley's stricter reporting standards is that now in order to *appear* to manage in the short term, one must *actually* manage for the short term.

Many have argued that the responsibilities of Sarbanes-Oxley should be relaxed.[37] There may be some merit to this argument with regard to specific provisions, but a general trend toward fewer responsibilities is not one that I would applaud. On the contrary, I believe we ought to impose more rather than fewer responsibilities on management and use the law to make our ethical norms real and impactful. If the corporations, as institutions, are indeed without consciences – the prototypical Holmesian "Bad Man"[38] – and corporate managers are limited by their role morality, then the way to make corporate ethics more than a public relations gimmick is to embody them in law.

What would such an ethical system of corporate law look like? If ethics is taking responsibility for one's actions, considering broadly one's actions, being honest, and taking the long-term view, then we could change corporate law in realistic and meaningful ways to make those norms more realizable in the corporate context. We could change corporate governance to give those contributors to the firm who do not own stock – employees, communities, other stakeholders – some ability to have their views heard and considered within the governance of the firm. Bringing the views of non-shareholder stakeholders into the governance of the firm would not only make it more likely that the corporation will consider broadly the impacts of its decisions, it also will – because shareholders tend to have a very short time horizon[39] – necessarily cause the firm to take a longer-term view of its decisions and strategies. Such inclusion will also cause corporations to internalize more of the costs of their decisions. In addition, the law should require corporations to tell the truth not only to shareholders and consumers, but to employees as well.

The market, by itself, will not cause companies to act this way. Of course, some companies do try to take into account the long-term interests of a broader group of stakeholders, to beneficial effect.[40] But most do not for several reasons. The long-term benefits are either not recognized, not deemed important, or not internalized into the decision-making of the firm.[41] Shareholders elect boards, and the law makes shareholders supreme.[42] Few directors or managers have the incentive to push their firms to take what must seem a huge short-term risk – reallocating more decision-making power to non-equity investors – for gains that seem abstract or beyond the time horizon for shareholders.[43] The law must overcome this "stickiness" of the status quo.

One concern often expressed is that a more robust system of stakeholder governance will impose large and unsustainable costs on the United States economy, especially in an increasingly globalized world economy.[44] The answer to this concern begins with the notion that employee (and stakeholder) involvement in management is compatible with business success. As I have discussed at length elsewhere, as employees feel more "ownership" in their firm, they will work harder, contribute more ideas, improve their productivity, malinger less, and obey company rules more.[45] This will tend to improve company profitability over time. The more difficult competitiveness critique to answer is not that individual firms will fail if they take into account the interests of stakeholders, but that capital (i.e., shareholders) will flee U.S. markets if a stakeholder governance framework is established.[46] It is true that recognizing a stakeholder framework might bring about a reallocation of the corporate surplus away from shareholders and toward other stakeholders. That is part of the objective of such a framework. But as the stakeholder model creates gains for the corporation as a whole, then the slice of the pie going to shareholders may grow in an absolute sense, even if it is not as large in a comparative sense.

The judgment of capital is always a relative one – "will I make more if I invest here or elsewhere?" – so a stakeholder corporate governance regime will only cause capital to flee if it can find a better risk/return mix elsewhere. Given the power and stability of U.S. markets, there are very few places likely to offer a better risk/return ratio. Europe's current corporate governance framework is more protective of stakeholders than any regime the U.S. is likely to enact, making it unlikely that capital will flee to Europe.[47] Indeed, the fact that Europe has such a robust system of stakeholder protection while maintaining healthy and competitive capital markets is an indication that there is little reason to worry that capital will abandon ship if the U.S. adopts a similar model.[48]

All of this is to say that if we, collectively, desire corporations and their management to behave more ethically in any genuine sense, we have the tools at our disposal to bring that about. Those tools are *legal* tools, changing the nature of the obligations of the firm and of its management. The current corporate governance framework constrains management to act in ways that we would deem unethical if conducted in other areas of life. We cannot expect people to act as Saints in a devilish system.

Notes

[1] *See* Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. Rey. 1265, 1375 (1998) (noting that with regard to corporate social responsibility, prominent scholars and practitioners have emphasized the duty of corporate directors and officers to ensure legal compliance).

[2] Patrick J. Ryan, *Strange Bedfellows: Corporate Fiduciaries and the General Law Compliance Obligation in Section 201(a) of the American Law Institute's Principles of Corporate Governance*, 66 WASH. L. Rev. 413, 417, 430–31 (1991).

[3] *Id*. at 423–29 (arguing that corporations are complex organizations of various individuals whose specialization and incomplete knowledge make it more likely that the organization will behave unlawfully); *see also* WILLIAM S. LAUFER, CORPORATE BODIES AND GUILTY MINDS: THE FAILURE OF CORPORATE CRIMINAL LIABILITY (2006).

[4] Kent Greenfield, *Ultra Viess Lives! A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce lnternational Law* Norms*)*, 87 VA. L. REV. 1279,1289–90 (2001) (quoting Ryan, *supra* note 2, at 417).

[5] *See* Frank H, Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155,

1177 (1982) ("Corporations are not privileges; a corporation is no more than a convenient name for a nexus of contractual relationships among people.... When the corporation is properly seen as a summary of a set of contractual relationships, it becomes difficult, probably impossible, to say that the agents (managers) may take it on themselves to define the responsibility of the firm.")

[6] *Id.* at 1168 n.36.

[7] *Id.* at 1168 n.36, 1177 n.57 ("[M]anagers not only may but also should violate the rules when it is profitable to do so.").

[8] *See id.* at 1158.

[9] *See id.* For an excellent discussion, see Williams, *supra* note 1, at 1279–80.

[10] *See* Easterbrook & Fischel, *supra* note 5, at 1158.

[11] *See id.*

[12] For a review of the literature on point and an extensive critique of the Easterbrook & Fischel view, see Greenfield, *Ultra Vires Lives!, supra* note 4; Williams, *supra* note 1. For a more recent discussion of mechanisms to control corporate illegality, see Adam Sulkowski & Kent Greenfield, *A Bridle, a Prod, and a Big Stick: An Evaluation of Class Actions, Shareholder Proposals, and the Ultra Vires Doctrine as Methods for Controlling Corporate Behavior*, 79 St. John's L. Rev. 929 (2005).

[13] *See* Stone v. Ritter, 911 A.2d 362, 369 (Del, 2006) (citing *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006)) (discussing the obligation to obey the law as a component of the duty of good faith); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 968 (Del. Ch. 1996) (discussing the obligation of management to erect an internal reporting system to aid management in ensuring that the company is complying with applicable laws).

[14] And even this guidance occasionally would be wrong because some rules should be disobeyed, as a matter of ethics. *See* Martin Luther King, Jr., Letter from a Birmingham Jail (Apr. 16, 1963), *available at* http://www.stanford.edu/group/King/frequentdoes/birmingham.pdf ("[O]ne has a moral responsibility to disobey unjust laws.").

[15] Merriam-Webster defines "ethics" as "the discipline dealing with what is good and bad and with moral duty and obligation." Merriam-Webster Online Dictionary, http//www.merriam-webster.com/dictianary/ethics (last visited Feb. 15, 2008); *see also* Note, *Finding Strategic Corporate Citizenship: A New Game Theoretic View,* 117 Harv. L. Rev. 1957, 1958 (2004) ("The words 'ethics' and 'responsibility' connote selflessness and altruism, internalizing a concept of charity without expectation of payback.")

[16] For accessible and persuasive treatments of the dispositionalist-situationist debate, see Adam Benforado et al., *Broken Scales: Obesity and Justice in America*, 53 Emory L.J. 1645 (2004); Jon Hanson & Kathleen Hanson, *The Blame Frame Justifying (Racial) Injustice in America*, 41 Harv. C. R.–C-L. L. Rev. 413 (2006); Jon Hanson & David Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, 152 U. Pa, L. Rev. 129 (2003) [hereinafter Hanson & Yosifon, *The Situation*]; Jon Hanson & David Yosifon, *The Situational Character: A Critical Realist Perspective on the Human Animal*, 93 Geo. L.J. 1 (2004). Also very helpful is the blog The Situationist, http://thesituationist.wordpress.com/ (last visited Mar. 10, 2008) (created by Jon Hanson and Michael MeCann).

[17] *See* Hanson & Yosifon, *The Situation, supra* note 16, at 136–38.

[18] *See* Lawrence E. Mitchell, *Cooperation and Constraint in the Modern Corporation: An Inquiry into the Causes of Corporate Immorality,* 73 Tex. L. Rev. 477, 501 (1995) (discussing the role morality of corporate executives).

[19] *ld.*

[20] *ld.* at 522. The business judgment rule provides deference to the decisions of company directors. This deference offers flexibility to the executives to make decisions in a more ethically robust way, as long as they rationally can claim that their actions are in the long-term interests of the company. *See*, e.g., Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (giving deference to management's decision not to install lights at the Chicago Cubs park, even though every other Major League Baseball franchise had done so, for the putative reason that neighborhood decay brought about by nighttime games would hurt the team in the long run). John Nilson and I have argued that the business judgment rule is a necessary ameliorative to the single-minded demand to maximize profit. *See* Kent Greenfield & John E. Nilson, *Gradgrind's Education: Using Dickens and Aristotle* to *Understand (and Replace?) the Business Judgment Rule*, 63 Brook. L Rev. 799, 842 (1997).

[21] Mitchell, *supra* note 18, at 522. For an analysis of the limitations of the business judgment rule in offering freedom to corporate executives, see Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age,* 2 Harv. L. & Pol'y Rev. 1 (2008) [hereinafter Greenfield, *Gilded Age*].

22 For a sampling of the many views on the substance of ethical or moral behavior, consult religious writings such as the Bible, the Qu'ran, the Talmud, and the Veda. *See also* Aristotle, The Nicomachean Ethics of Aristotle (Sir David Ross trans., Oxford Univ. Press 1975) (1925) (focusing on the development of a balanced moral character and one's affirmative choice to engage in consistent virtuous conduct); Immanuel Kant, Groundwork for the Metaphysics of Morals (Allen W. Wood ed. and trans., Yale Univ. Press 2002) (reasoning that moral behavior is such only if it is motivated exclusively by good will); John Rawls, A Theory of Justice (1971) (invoking social contract theory to argue that moral behavior on the societal level is achieved through a recognition of inviolable basic liberties and equality of opportunity).

23 Nina A. Mendelson, *A Controller-Based Approach to Shareholder Liability for Corporate Torts*, 102 Colum. L. Rev. 1203, 1208–09 (2002).

24 *See id.* at 1204.

25 *Id.* at 1208–09.

26 Lynn M. LoPucki, *Virtual Judgment Proofing: A Rejoinder*, 107 Yale L. J. 1413,1427 (1998) ("Limiting liability is widely understood to be the principal reason for the separate incorporation of subsidiaries.").

27 The scholarship on limited liability and its implications is extensive. For a taste, see Lawrence E. Mitchell, Corporate Irresponsibility; America's Newest Export (2001) (describing the moral hazards arising from limited liability); Theresa Gabaldon, *Experiencing Limited Liability: On Insularity and Inbreeding on Corporate Law,* in Progressive Corporate Law 111–37 (Lawrence E. Mitchell ed., 1995); Mendelson, *supra* note 23. But *see* Steven Bainbridge, *Abolishing Veil Piercing* 26 J. Corp. L. 479 (2001) (providing an argument to justify limited liability regimes while suggesting that corporate veil piercing should be constrained); Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 Yale L. J. 1879 (1991).

28 *See generally* Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204,116 Stat. 745 (codified as amended in scattered sections of 11,15, 18, 28, and 29 U.S.C.) the purpose of the Sarbanes-Oxley Act is to protect shareholders by improving corporate disclosure regulations. For a more substantive discussion of the Sarbanes-Oxley Act's protective provisions, see J. Brent Wilkins, *The Sarbanes-Oxley Act of 2002: The Ripple Effects of Restoring Shareholder Confidence*, 29 S. Ill. U. L.J. 339 (2005).

29 *See generally* Kent Greenfield, The Failure of Corporate Law: Fundamental Flaws & Progressive Possibilities (2006) [hereinafter Greenfield, Failure] (arguing for federal fraud protection for employees); Kent Greenfield, *The Unjustified Absence of Federal Fraud Protection in the Labor Market*, 107 Yale L.J. 715 (1997) (suggesting a potential federal statutory scheme to protect the labor market in the same way that federal anti-fraud regulation protects the capital markets).

30 Various cases have been brought against corporate directors alleging violations of federal securities laws when the corporation lies or conceals financial projections to shareholders. *See,* e.g., Grossman v. Novell, Inc., 120 F. 3d 1112 (10th Cir. 1997); Provenz v. Miller, 102 F.3d 1478, 1487 (9th Cir. 1996) ("A [financial] projection is a 'factual' misstatement [actionable under securities law] 'if (1) the statement is not actually believed, (2) there is no reasonable basis for the belief, or (3) the speaker is aware of undisclosed facts tending seriously to undermine the statement's accuracy.'"); Plaine v. McCabe, 797 F.2d 713, 723 (9th Cir. 1986) (noting that allegations of misrepresentation or failure to disclose specific items, including, financial projections, from tender offer documents sufficiently stated a claim for violations of federal law).

31 *See* Robert C. Clark, *Major Changes Lead Us Back* to *Basics (A Response to the Symposium on My Treatise)*, 31 J. Corp. L. 591, 596–97 (2006) (explaining the fiduciary duty to maximize shareholder value).

32 *See* Shimko v. E. States Corp., 146 A.2d 851, 892 (Md. 1958) (addressing suit by shareholders to compel the corporation to pay dividends when there was a two million dollar surplus, and the corporation claimed it would use it as part of a long-term recapitalization plan). *See generally* Dodge v. Ford Motor Co., 170 N.W. 668, 685 (Mich. 1919) (awarding payment of dividends to shareholders on the grounds that withholding payment to increase the welfare of the general public was not in the best interests of the corporation and shareholders).

33 *See* Dodge, 170 N.W. at 679, 683, 685 (explaining how Ford Motor Co.'s non-payment policy was viewed to be under-performing).

34 *See* Lee Drutman, *The Long-Term Value Moment*, Am. Prospect, July 9, 2007, http://www.prospect.org/cs/articles?article = the_longterm_value_moment (cataloging various studies pointing out the pathologies of short-termism in the business strategy).

35 Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, §§ 101–09, 116 Stat. 745, 750–71 (codified as amended at 15 U.S.C. $$ 7201–19 (Supp.V 2006)).

36 *See* Drutman, *supra* note 34.

37 *See* Peter K.M. Chan, *Breaking the Market's Dependence on Independence: An Alternative to the "Independent"*

Outside Auditor, 9 Fordham J. Corp. & Fin. L. 347, 349 (2004) (arguing that the auditing restrictions in Sarbanes-Oxley should he relaxed); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 Yale L.J. 1521, 1602 (2005) (arguing that because of the haste under which Sarbanes-Oxley was enacted, the Act does not appropriately serve the corporate world's needs and should be relaxed); Stephen Labaton, *Investors' Suits Face Higher Bar, Justices Rule*, N.Y. Times, June 22, 2007, at A1 (reporting that industry groups and allies in academia have urged the Bush Administration and Congress to make it more difficult for investors to bring lawsuits against corporations and to relax some of the provisions of the Sarbanes-Oxley Act of 2002).

[38] Oliver W. Holmes, Jr., Justice, Supreme Judicial Court of Mass., The Path of the Law, Remarks at the Dedication of the new hall of the Boston University School of Law (Jan. 8, 1897), *in* 10 Harv. L. Rev. 457, 459 (1897) ("If you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences.").

[39] The average stock turnover for Fortune 500 companies is over 100% a year, and is even greater for smaller companies. Lawrence E. Mitchell, The Speculation Economy: How Finance Triumphed Over Industry 277–78 (2007).

[40] *See generally* Rajendra S. Sisodia et al., Firms of Endearment: How World Class Companies Profit From Passion and Purpose (2007) (arguing that stakeholder management results in market successes).

[41] *But see* Ronald Chen & Jon Hanson, *The Illusion of Law: The Legitimating Schemas of Modern Policy and Corporate Law*, 103 Mich. L. Rev. 1, 46–48 (2004) (discussing the "shareholder primacy" theory of the corporation where if one takes a long-term view of shareholders' interests, advancing the concerns of other corporate constituents may serve to enhance shareholder value); David Locasio, Comment, *The Dilemma of the Double Derivative Suit*, 83 Nw. U. L. Rev. 729, 758 (1989) (explaining that, under Delaware law, the business judgment rule affords corporate directors broad discretion in their decision-making that enables them to consider the long-term interests of shareholders (citing Auerbach v. Bennett, 393 N.E.2d 994, 1000 (N.Y. 1979)).

[42] *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) (discussing the benefits of a corporate model where the shareholders elect the members of the board: "If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out").

[43] There are many factors that have led companies to focus on equity-driven investors and short-term gains instead of allocating decisions based on long-term growth and giving power to non-equity investors. *See*, e.g., Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. Chi. L. Rev. 187, 205–13 (1991) (discussing how competition among institutional investors can lead corporations to focus on short-term gains which can threaten the long-term health of a company). Because of this, the long-term interests of the shareholders might actually be weakened. Thomas Lee Hazen, *The Short-Term/long-term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law*, 70 N.C. L. Rev. 137, 179 (1991) ("Although not all observers agree, many have suggested that corporate managers' obsession with short-term shareholder wealth maximization has, in many cases, diverted their attention away from the efficient operation of their companies.").

[44] *See* Ethan S. Burger, *Who Is the Corporation's Lawyer?*, 107 W. Va. L. Rev. 711, 741–42 (2005) (explaining the two common theories of stakeholder governance and noting that the stakeholder model results in difficulty in sustaining competitiveness because of the increasing globalization of the economy).

[45] *See* Greenfield, Failure, *supra* note 29, For a broad overview of the debate on the effectiveness of employee ownership, see generally Henry Hansmann, *When Does Worker Ownership Work? ESOPS, Law Firms, Codetermination, and Economic Dependency*, 99 Yale L.J. 1749 (1990) (describing employee ownership in various employment contexts and its benefits and costs).

[46] *See* John C. Coffee, Jr., *The Future As History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 Nw. U. L. Rev. 641 (1999) (examining the various types of stakeholder governance both in the United States and abroad, and discussing the implications of each, the reasons for the disparity between countries in governance standards, and how adopting various forms of stakeholder governance specifically could impact the United States).

[47] *See* Luca Enriques, *Bad Apples, Bad Oranges: A Comment From Old Europe on Post-Enron Corporate Governance Reforms*, 38 Wake Forest L. Rev. 911 (2003) (discussing European corporate governance and stakeholder protection in the context of the Enron collapse).

[48] For a more extensive answer to this critique, *see* Greenfield, *Gilded Age, supra* note 21.

Questions for Discussion

1. Rawls argues that just principles would be chosen by rational, self-interested people behind a "veil of ignorance." What is the purpose of the "veil of ignorance"? Do you think that people placed behind such a veil would choose the principles Rawls proposes? Can you imagine another set of principles they might choose instead?
2. Nozick rejects any system that tries to ensure a particular distribution of income or wealth, e.g. an equal distribution, because he believes such a system would interfere with people's liberty. However, he grants that under some circumstances forced redistribution might be permissible. What are those circumstances? What principle of redistribution might he agree to?
3. Why does Smart believe that the general tendency of utilitarianism is toward equality? Under what conditions might there be an exception to this tendency? What would Rawls and Nozick have to say about Smart's theory of justice?
4. Narveson argues that free-market capitalism has "positive externalities," i.e. social benefits such as entrepreneurial creativity, even though such benefits are not intended by individual market participants. But he notes that there are negative externalities as well, industrial pollution, for example. Might there be circumstances in which the costs of negative externalities outweigh the benefits of positive externalities? What would Narveson advise in this situation?
5. Greenfield believes that the way to reform corporate ethical behavior is to pass laws that encourage good corporate ethics and discourage bad corporate ethics. But is it really possible to capture anything more than the bare essentials of ethical behavior in legal terms? Is that good enough? And what if business conditions change too fast for the law to keep pace?

2

Ethics and Business Decision Making

Teaching Ethical Decision Making and Principled Reasoning

Michael Josephson

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The ethical quality of our society is determined by the separate actions of public officials and their staffs, employers and their employees, parents and their children, teachers and their students, professionals and their clients, individuals and their friends. Each of us is almost always in one or more of these roles and our decisions are important. They are important on an individual level because they establish and define our ethical character. They are important on a social level because they produce significant direct consequences and, indirectly, help to set the moral tone of all social interactions.

Michael Josephson, "Teaching Ethical Decision Making and Principled Reasoning." Excerpted from *Ethics: Easier Said Than Done* (Winter 1988). Reprinted with permission of the Josephson Institute for the Advancement of Ethics.

Every day we face situations which test our ethical consciousness and commitment. Sometimes, the ethical implications of our decisions are apparent. Our consciences are awake and active, warning us to be good. In such cases, we know we will be held accountable for our conduct and we do not tell big lies, steal or break important promises.

Most of our decisions, however, are more mundane. They deal with our basic personal and occupational relationships and activities and there are no sirens causing us to view the choice as an ethical one. We rely heavily on habits, common sense and our perceptions of custom (i.e., what we think is generally considered acceptable by those engaged in similar activities). The dominant consideration is expediency – accomplishing our tasks, getting what we want, with as little hassle as possible.

Most of us do pretty well in dealing with the big and obvious ethical decisions. We tend to judge ourselves, and would like others to judge us by, these self-conscious choices which usually display our virtue. Unfortunately, we are more likely to be judged, and tripped up, by the way we handle the hundreds of ethical "sleepers" that cumulatively shape our reputations.

In recent years we have witnessed a growing concern about the way people are behaving. In fact, the proliferation of well-publicized examples of dishonesty, hypocrisy, cheating and greed has created some

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alarm about the state of personal ethics. If these incidents are indicative of a trend, there is much reason for concern because they reflect a level of selfishness, shortsightedness and insensitivity that could undermine the moral fabric of our society.

Ethics Education

In response to this new awareness, there has been a revived interest in ethics education. The pendulum of social conscience seems to be swinging the other way and there is a call for a return to traditional moral values and value-centered education. It has become clear to many that "value clarification," "situational ethics," and "ethical relativism" do not provide the inspiration, motivation or training to generate either the good will or discipline that are essential to moral conduct. Moreover, most academic courses which teach *about* ethics do not seem to engage students on a level that is likely to affect their behavior. The goal of the reformers is to find a way to increase ethical conduct.

We know that ethics are "learned" or "developed," yet many are not sure if ethics can be "taught." We do know that attitudes and character traits are not conveyed in the same way we convey other forms of knowledge (i.e., ethics is not something that can be taught like history or geography). Basic moral education occurs during the process of growing up. We learn from parents, teachers, religious leaders, coaches, employers, friends and others and, as a result, most of us reach adulthood with our character essentially formed and with a basic understanding of, and fundamental respect for, ethical values.

But, the presumptive values adopted in our youth are not immutably etched in our character. We know that values are constantly shuffled and prioritized, for better and for worse, in response to life experiences. Thus, youthful idealism is tested as we are emancipated into a world where important and binding decisions must be made. Only then do we discover what we are really willing to do to get and hold a job and be successful in a competitive society. By the same process, the blind competitiveness and materialism of young adulthood will later be challenged by life-changing experiences (e.g., illness, parenthood, divorce, death of a loved one) or the simple fact of maturation, causing one to reflect on the meaning of life (sometimes inducing a "mid-life crisis").

The point, and it has enormous significance for ethics educators, is that the formation, refinement and modification of a person's operational value system – the attitudes and beliefs that motivate conduct – are an ongoing process which continues throughout one's adult life. It is never too late.

Approaches to Ethics Education

One approach to conduct-oriented ethics education deals directly with the development of character and the inculcation and reinforcement of basic moral values such as honesty, caring, fairness and accountability. This approach has potential in the education of children and adolescents, but it is not likely to be effective in dealing with young adults and mature professionals.

The second approach focuses on the development of qualities beyond character – qualities that can be developed or enhanced even in adults. Ethical behavior is the result of ethical decisions, and ethical decision making requires: (1) *ethical commitment* – the personal resolve to act ethically, to do the right thing; (2) *ethical consciousness* – the ability to perceive the ethical implications of a situation; (3) *ethical competency* – the ability to engage in sound moral reasoning and develop practical problem solving strategies.

The purpose of this article is to present a theory of ethics education and to describe a framework for analyzing ethical problems which can be taught in college, postgraduate professional courses, and ethical decision-making workshops.

Setting Reasonable Goals

> I am only one, but still I am one. I cannot do everything, but I can do something. And, because I cannot do everything, I will not refuse to do what I can.
>
> —Edwin Hale

> Those who believe they can do something are probably right, and so are those who believe they can't.
>
> —*Unknown*

It is important to recognize the limitations of ethics education. Many people will simply not respond to appeals to conscience or moral principle. Many people are unwilling, or at a particular point in their lives, unready, to examine the ethical quality of their conduct and change their priorities. Thus, the most appropriate target for ethics programs is not bad and selfish people who knowingly do wrong, but the vast majority of decent people who are already disposed to act with propriety but who, because of lack of insight, rigorous moral reasoning or practical problem solving ability, lose sight of their ethical aspirations and make wrong decisions.

The importance and value of ethics education does not depend on the eradication of all misconduct. If just some of the people act more ethically just some of the time, the effort is worthwhile.

Defining Terms

In order to avoid the semantic quicksand that often engulfs discussions about ethics, it is necessary to define the essential terms and concepts involved.

Ethics refers to a system or code of conduct based on moral duties and obligations which indicate how we should behave; it deals with the ability to distinguish right from wrong and the commitment to do what is right.

Morals refers to what is good and right in character and conduct. The term is essentially interchangeable with ethics, though in common usage, "morality" often implies particular dogmatic views of propriety, especially as to sexual and religious matters. Since the term "ethics" does not carry these same connotations, it is more neutral.

Personal ethics refers to an individual's operational code of ethics based on personal values and beliefs as to what is right or good.

Values are core beliefs which guide or motivate attitudes and actions. Many values have nothing to do with ethics.

Ethical values are beliefs (e.g., honesty and fairness) which are inherently concerned with what is intrinsically good or right and the way one should act.

Nonethical values are ethically neutral values (e.g., wealth, security, comfort, prestige and approval). They are not necessarily inconsistent with ethical values, but often there is a conflict.

Ethical principles are standards or rules describing the kind of behavior an ethical person should and should not engage in. For example, the value of honesty translates into principles demanding truthfulness and candor and forbidding deception and cheating.

Ethical Norms

> What is morality in any given time or place? It is what the majority then and there happen to like and immorality is what they dislike
>
> —Alfred North Whitehead

> The so-called new morality is too often the old immorality condoned.
>
> —Lord Shawcross

> In matters of principle stand like a rock; in matters of taste swim with the current.
>
> —Thomas Jefferson

It is critical to effective ethics education to overcome the cynicism of ethical relativism – the view that ethics is just a matter of opinion and personal belief as in politics or religion. Though debatable beliefs regarding sexual matters and religion often do travel under the passport of morality, there are ethical norms that transcend cultures and time.

While ethics educators must be aware that sermonizing and moralizing about particular ethical principles are not generally effective – after all, "No one likes to be 'should' upon" (a wonderful phrase from *How Can I Help?* by Ram Dass and Paul Gorman, Knopf 1985) – it is not constructive to be so value neutral that everyone is allowed to think that ethics is simply a matter of personal opinion and that one person's answer is necessarily as good as that of another's.

In fact, the study of history, philosophy and religion reveal a strong consensus as to certain universal and timeless values essential to the ethical life: (1) *Honesty*, (2) *Integrity*, (3) *Promise-keeping*, (4) *Fidelity*, (5) *Fairness*, (6) *Caring for Others*, (7) *Respect for Others*, (8) *Responsible Citizenship*, (9) *Pursuit of Excellence*, and (10) *Accountability*.

These ten core values yield a series *of principles*, do's and don'ts, which delineate right and wrong in general terms and, therefore provide a guide to behavior. Individuals may want to edit or augment the list, but we have found it to be a valuable tool in examining the ethical implications of a situation and providing solid reference points for ethical problem solving.

Ethical principles

Honesty Be truthful, sincere, forthright, straightforward, frank, candid; do not cheat, steal, lie, deceive, or act deviously.

Integrity Be principled, honorable, upright, courageous and act on convictions; do not be two-faced, or unscrupulous or adopt an end-justifies-the-means philosophy that ignores principle.

Promise-keeping Be worthy of trust, keep promises, fulfill commitments, abide by the spirit as well as the letter of an agreement; do not interpret agreements in a technical or legalistic manner in order to rationalize noncompliance or create excuses for breaking commitments.

Fidelity Be faithful and loyal to family, friends, employers, and country; do not use or disclose information learned in confidence; in a professional context, safeguard the ability to make independent professional judgments by scrupulously avoiding undue influences and conflicts of interest.

Fairness Be fair and open-minded, be willing to admit error and, where appropriate, change positions and beliefs, demonstrate a commitment to justice, the equal treatment of individuals, and tolerance for diversity; do not overreach or take undue advantage of another's mistakes or adversities.

Caring for others Be caring, kind and compassionate; share, be giving, serve others; help those in need and avoid harming others.

Respect for others Demonstrate respect for human dignity, privacy, and the right to self-determination of all people; be courteous, prompt, and decent; provide others with the information they need to make informed decisions about their own lives; do not patronize, embarrass or demean.

Responsible citizenship Obey just laws (if a law is unjust, openly protest it); exercise all democratic rights and privileges responsibly by participation (voting and expressing informed views), social consciousness and public service; when in a position of leadership or authority, openly respect and honor democratic processes of decision making, avoid unnecessary secrecy or concealment of information, and assure that others have the information needed to make intelligent choices and exercise their rights.

Pursuit of excellence Pursue excellence in all matters; in meeting personal and professional responsibilities, be diligent, reliable, industrious, and committed; perform all tasks to the best of your ability, develop and maintain a high degree of competence, be well informed and well prepared; do not be content with mediocrity but do not seek to win "at any cost."

Accountability Be accountable, accept responsibility for decisions and the foreseeable consequences of actions and inactions, and for setting an example for others. Parents, teachers, employers, many professionals and public officials have a special obligation to lead by example, to safeguard and advance the integrity and reputation of their families, companies, professions and the government; avoid even the appearance of impropriety and take whatever actions are necessary to correct or prevent inappropriate conduct of others.

The first question in ethical decision making is: "Which ethical principles are involved in the decision?" Considering the above list is an excellent way to isolate the relevant issues involved.

Ethical Theories

Though we run the risk of alienating many philosophy-oriented ethicists, in the Institute's programs we have not found it particularly useful to dwell on ethical theories. Our time with audiences is limited and most want to get immediately to the heart of ethical problem solving.

In fact, we present a variation of philosopher W. D. Ross' notion that there are certain *prima facie obligations* which impose ethical duties that can be avoided only in order to perform superior ethical duties – a kind of compromise between Kant's strict duty theory and John Stuart Mill's utilitarianism. Thus, implicit in our analysis of practical decision making situations is the principle that ethical duties are real, important and binding, and that they can be overborne only by other ethical duties.

The Golden Rule On the other hand, we have found it helpful to emphasize the Golden Rule: "Do unto others as you would have them do unto you; and love thy neighbor as thyself." Most of the ethical principles listed above can be derived from these simple statements.

This approach to ethical decision making is surprisingly effective. In many cases, simply by asking, "How would I want to be treated in this situation?" the ethical response becomes clear. We do not want to be lied to or deceived, so we should not lie to or deceive others. We want people to keep their promises and treat us fairly, so we should keep our promises and treat others fairly.

The major problem with the Golden Rule is that in complex cases, where a decision is likely to affect different people in different ways, a more sophisticated method of sorting out ethical responsibilities is necessary.

Stakeholder analysis To deal with these complex situations, we advocate an analytical tool developed in the corporate responsibility literature. Since the decision is often likely to affect an entire network of people with differing interests, it is necessary to carefully sort out the interests by determining, in a systematic way, which people have a stake in the decision. Thus, a threshold question in analyzing a problem is: "Who are the stakeholders and how is the decision likely to affect them?" This method does not solve the problem, but it helps the decision maker see all the ethical implications of conduct and reduces the likelihood of inadvertent harm.

Ethical Behavior

> Would the boy you were be proud of the man you are?
> —Laurence Peter

> The trouble with the rat race is that even if you win, you're still a rat.
> —Lily Tomlin

Ethics education works best when it builds upon our positive inclinations. Most people want to be ethical; they want to be worthy of the respect and admiration of others and they want to be proud of themselves and what they do for a living. Self-esteem and self-respect depend on the private assessment of our own character. Very few people can accept the fact that they are less ethical than others. In fact, most people believe that they are more ethical.

Because of the importance of this positive self-image, many people will alter their conduct if they discover it is inconsistent with their espoused values. Thus, it is important to discuss candidly the common misconceptions and normal excuses, rationalization, and temptations which impede ethical conduct. Although some level of confrontation may be necessary to cut through natural defenses, it is critical to avoid an adversarial atmosphere which will merely produce resistance. The most successful methods present participants with the opportunity to discuss pertinent and specific problems with peers and help them to clarify their ethical aspirations, engage in moral reflection, and enhance their ethical issue-spotting, reasoning and problem-solving abilities.

Common misconceptions

Ethics are only concerned with misconduct Most discussions about ethics focus on misconduct and improprieties – the negative dimension of ethics. But, as is apparent from our list of ethical principles, an equally important dimension of ethics focuses on positive actions, doing the right thing, on producing good, helping and caring, rather than on avoiding wrongdoing. Under this affirmative perspective, ethical principles are not merely burdens and limitations; they are also guidelines for the constructive role a person of virtue can play in society.

If it's legal, it's ethical Law abidingness is an aspect of responsible citizenship and an ethical principle especially important in a democracy. We should not, however, confuse ethics with legality. Laws and written codes of ethics are minimalist in nature – they only establish the lines of consensus impropriety.

Ethics requires more of a person than technical compliance with rules. Everything that is lawful is not, *ipso facto*, ethical. Thus, the fact that certain conduct escapes the label of illegality, including the fact that a person has been formally acquitted of a criminal charge, does not, in itself, provide moral exoneration.

People we regard as ethical do not measure their conduct in terms of minimal standards of virtue. They do not walk the line, nor consistently resort to legalistic rationales to circumvent legitimate standards of behavior or the spirit of their agreements. Ethical persons consciously advance ethical principles by choosing to do more than they have to and less than they have a right to do.

The ethical person may, however, occasionally choose to openly violate a law believed to be unjust. The ethical value of lawfulness can be overborne by other conscience driven values. Thus, civil disobedience, the open and deliberate refusal to abide by certain laws, has a long and honorable history. The thing that makes such lawbreaking ethically justifiable is the integrity of the violator and the courage of convictions shown by the willingness to publicly challenge the law and bear the consequences. On the other hand, it is not ethical to break a law one disagrees with in the hope of not being found out. The kind of covert lawlessness that characterized the darker side of the Iran-Contra scandal does not qualify as civil disobedience.

There is a single right answer An ethical decision maker does not proceed on the assumption that there is a single "right" answer to all ethical dilemmas. In most situations, there are a number of ethical responses. The first task is to distinguish ethical from unethical responses; the second, is to choose the best response from the ethically appropriate ones. Although there may be several ethical responses to a situation, all are not equal. Some are more ethical than others, and some are more consistent with an individual's personal goals and value system than others.

Excuses, rationalizations and temptations

It is important to try to understand why people tend to act unethically. An easy answer is that they are just plain bad. This is simply not so. The truth is that a great deal of improper conduct is committed by fundamentally decent people who believe in and are committed to ethical values. There are three major reasons that ethically concerned persons fail to conform to their own moral principles: (1) *unawareness and insensitivity*, (2) *selfishness*, consisting of self-indulgence, self-protection, and self-righteousness, and (3) *defective reasoning*.

> **Unawareness and Insensitivity** At the turn of the century, a Russian noblewoman attended an opera and wept out of compassion at the death of a poor peasant. She was still weeping when she left the opera house and found that her footman had frozen to death while waiting for her as he was instructed to do. She became angry, cursing his ignorance and her inconvenience, making no connection between her compassion and her conduct.

Moral blindness, the failure to perceive all the ethical implications of conduct, is a major source of impropriety. In some cases, this blindness results from the operation of subconscious defense mechanisms which protect the psyche from having to cope with the fact that many of the things we do and want to do are not consistent with our ethical beliefs. Elaborate and internally persuasive excuses and rationalizations are used to fool our consciences. Among the most potent are:

- Everyone does it.
- To get along, go along.
- They don't understand.
- I can't do anyone any good if I lose my job.
- I have no time for ethical subtleties.
- Ethics is a luxury I can't afford right now.
- Its not my job/worry/problem.

> You can't learn too soon that the most useful thing about principle is that it can always be sacrificed to expediency.
>
> —Somerset Maugham

> Senators who go down in defeat in defense of a single principle will not be on hand to fight for that or any other principle in the future.
>
> —John F. Kennedy

A common context for this ethical self-deception is occupational behavior. Most occupations develop the "insider syndrome" which rationalizes ethically dubious conduct and immunizes the occupation from the criticism of outsiders on the grounds that the critics simply don't understand the necessities and values that insiders take for granted.

Insider rationales are particularly effective at making expediency a new ethical principle which overrides integrity, honesty and accountability in order to achieve the "greater good" (i.e., the end justifies the means). For example, politicians are viewed as frequently relying on insider rationales to justify various forms of deception, the leaking of confidential information, and cynical manipulation of campaign financing and outside income rules. Journalists are thought to justify the use of stolen documents, invasions of privacy, and arrogant and offensive interviewing behavior – all based upon vague notions of the public's right to know, though the public regularly denounces such press tactics.

Selfishness Implicit in all ethical theories is the notion of caring for and respecting others. In many cases, this requires us to forego personal benefits or bear personal burdens; some level of self-sacrifice is essential to consistent ethical conduct.Thus, selfishness continually assaults the conscience with temptations and rationalizations.

The natural inclination to selfishness has been amplified by certain self-actualizing philosophies coming out of the 1960s and 1970s which either advocated or were misinterpreted to condone selfishness. In the 1980s these philosophies seemed to spawn a generation of greedy people whose dominant values stress materialism.

Although there are many who proudly proclaim their individualistic "everyone for himself/herself" creed, most do not. Most still believe in the primacy of traditional values such as integrity, loyalty, giving, and sharing, but they are influenced by their environment and the ample supply of excuses and justifications developed to defend the new faith. Selfishness comes in three major forms: (1) self-indulgence, (2) self-protection, and (3) self-righteousness.

Self-indulgence Perhaps the most common and easily identifiable source of unethical conduct is self-indulgence. Although few people are as open as Ivan Boesky was when he publicly asserted that "greed is good," many people lie, break commitments, violate or evade laws, and fail to demonstrate caring, compassion and charity in order to advance narrow personal interests. They often cover-up the selfish motive with noble sounding sentiments, e.g., "I'm doing it for my family";"I'm creating (or protecting) jobs";"If the business doesn't survive it will be worse for everyone"; "It's in the interests of all the shareholders (or the public)"; and,"My constituency needs me."

Self-protection The instinct for self-protection often generates lying, deception and cover-ups, including big and little lies (e.g., "I knew nothing about this";"The check is in the mail";"Tell him I'm not in"), concealment, blameshifting, and even document destruction.These actions frequently result from a fear of, or unwillingness to accept, the consequences of prior behavior. The temptation to sacrifice ethical principles is particularly great when it is believed that the consequences will be unfair or disproportionate – an easy thing to believe when you are the one to suffer the consequences.

Self-righteousness A particularly troublesome type of selfishness results from a form of arrogance arising from self-righteousness. For example, Colonel Oliver North demonstrated a type of integrity when he decided to "go above the law" by shredding documents, lying and deceiving, and withholding vital information to advance his strong personal convictions.The ethical problem arises, however, from the fact that he knew that his beliefs were at variance with honest good faith beliefs of others who had at least an equal right to participate in the decision making process. His conduct denied these people the ability to exercise personal autonomy and deprived them of the ability to carry out their constitutional responsibilities. He did not openly disagree with the Congressional mandates and statutes; instead, he sought to privately nullify them by ignoring them.To accomplish his goals he violated ethical principles of honesty, promise-keeping, respect for others, and responsible democratic citizenship.

Defective reasoning In addition to sorting out the various values involved and those stakeholders affected, a substantial amount of factual analysis and prediction of consequences is necessary to ethical decision making. This requires sophisticated reasoning skills; defects in reasoning or mistakes in evaluation can result in decisions which are inconsistent with ethical principles. We find two common errors: people consistently overestimate the costs of doing the right thing, and underestimate the cost of failing to do the right thing.

Principled reasoning directs the decision maker to recognize where information is incomplete, uncertain or ambiguous, and to make reasonable efforts to get additional information and clarify the ambiguities! After evaluating the facts, the next step is to predict, with as much certainty as is reasonably possible, the likely consequences of contemplated conduct on all those affected by a decision (i.e., stakeholders).

Another defective reasoning problem, related to the selfishness issues, emanates from the fact that unethical conduct normally yields short-run benefits which, when looked at through the distorted lens of self-interest, seem to outweigh the *possibility* of long-range harms which may flow from unethical conduct. Often, it is easier to lie, deceive, conceal or disregard commitments than to confront a problem head on and accept the costs inherent in honesty and integrity.

The fact is that an ethical person must often sacrifice short-term benefits to achieve long-term advantages. He or she must also be prepared to sacrifice physical or material gains for abstract intangibles such as self-esteem, the respect of others, reputation and a clear conscience. An ethical person must be able to distinguish between short-term and long-term benefits and costs.

Ethical Decision Making

Ethical decision making refers to a process of choosing (i.e., principled reasoning) which systematically considers and evaluates alternate courses of conduct in terms of the list of ethical principles. It does not proceed on the assumption that there is a single "right" answer to most problems. To the contrary, it recognizes that though some responses would be unethical, in most situations there are a number of ethical ways of dealing with a situation.

The first task of ethical decision making is to distinguish ethical from unethical responses; the second is to choose the best response from the ethically appropriate ones. Although there may be several ethical responses to a situation, all are not equal.

Making the distinctions necessary is much more difficult and complex than is normally thought because, in so many real world situations, there are a multitude of competing interests and values, and crucial facts are unknown or ambiguous. Since our actions are likely to benefit some at the expense of others, ethical decision makers also attempt to foresee the likely consequences of their actions.

We cannot solve all problems by resorting to some mechanistic formula, but we can be more effective if we have a structure. A process which systematically takes into account the ethical principles involved in a decision tends to prevent inadvertent unethical conduct and allows us to consciously choose which values to advance – to determine whom to aid and whom to harm.

When one is in the trenches, it is difficult, if not impossible, to analyze problems fully and objectively. While most people do not want more rules telling them what to do, they do want assistance in perceiving the ethical implications of their decisions and in developing realistic, morally-centered approaches for resolving ethical dilemmas. . . .

In the "real world" there are many shades of gray, even in routine decision making. Most of these decisions are made in the context of economic, professional, and social pressures which compete with ethical goals and conceal or confuse the moral issues. We must, therefore, be ever vigilant to use principled reasoning in the pursuit of ethical decision making. The essential skills *can* be taught to adults; their subsequent behavior *can* be more ethical. It may not always be simple to do, but, then again, ethics truly are "easier said than done."

Business Ethics and Moral Motivation
A Criminological Perspective

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One of the peculiar features of business ethics, as compared to other domains of applied ethics, is that it deals with a domain of human affairs that is afflicted by serious criminality, and an institutional environment that is in many cases demonstrably criminogenic (Braithwaite, 1989, pp. 128–129; Coleman, 1989, pp. 6–8; Leonard and Weber, 1970; Sutherland, 1968, p. 59). The oddity of this state of affairs is sometimes lost on practitioners in the field. It is common, for instance, at business ethics conferences for the majority of presentations to be concerned, not with ethical issues in the narrow sense of the term (where there is often some question as to where the correct course of action lies), but with straightforward criminality. In this respect, all the talk of "ethics scandals" in the early years of the twenty-first century has been very misleading, since what really took place at corporations like Enron, Worldcom, Parmalat and elsewhere was, first and foremost, an outbreak of high-level, large-scale white-collar crime. Each illegal act was no doubt surrounded by a broad penumbral region of unethical conduct, yet in each case the core actions all involved a failure to respect the law.

The high incidence of crime in the corporate environment is, in itself, something of a mysterious phenomenon. Most well-adjusted adults would never consider shoplifting from their local grocery store, or stealing from their neighbor's backyard, despite having ample opportunity to do so. Yet according to a United States Chamber of Commerce Study, 75% of individuals steal from their employer at some time or other (McGurn, 1988). Studies of supermarket and restaurant employees found that 42 and 60% (respectively) admitted to stealing from their employer in the past six months (Boye and Jones, 1997; Hollinger et al., 1992). The losses suffered as a result of this sort of "occupational crime" – crime committed by individuals *against* the corporation – greatly exceed the total economic losses suffered from all street crime combined (Snyder and Blair, 1989). Yet this does not even begin to take into consideration the losses suffered from "corporate crime" – crimes committed by individuals on *behalf of* the corporation. During the 1990s the list of firms that were convicted of serious criminal offenses in the United States included (either the parent, a division or a subsidiary of) BASF, Exxon, Pfizer, Banker's Trust, Teledyne, IBM, Hyundai, Sears, Eastman Kodak, Royal Caribbean Cruises, Litton, General Electric, Chevron, Unisys, ALCOA, Tyson Foods, Bristol-Meyers Squibb, and Mitsubishi (Mokhiber, 2006).

The phenomenon of white-collar crime clearly casts a long shadow over discussions in business ethics. One of the most important effects has been the development of a strong emphasis upon questions of *moral motivation* within the field. In many domains of applied ethics, such as bioethics, it is often not clear what the right thing to do is. In business ethics, on the other hand, there is often no real dispute about the content of our moral obligations (i.e., *what* we should be doing), the question is rather how to *motivate* people to do it. The moral rules, in other words, are often quite platitudinous (e.g., don't lie, don't cheat, don't steal …) and, within a given culture or society, typically coincide with legal rules. The tough questions arise at the level of compliance: what to do when a rival firm gains competitive advantage through deception, or when a supervisor orders sensitive documents to be destroyed, or even when ethical behavior simply conflicts with the bottom line (Stark, 1993). As a result, business ethicists have exhibited considerable concern over the relationship between moral obligation and self-interest, whether it be in discussions of agency theory (Bowie and Freeman, 1992), the question of whether "ethics pays" (Vogel, 2005; Webley

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and More, 2003), or even debates over how (or whether) business ethics should be taught (Williams and Dewett, 2005).

Criminologists also have a longstanding preoccupation with motivational questions, in part because crime prevention is such a major component of their professional mandate. Considerable resources have been dedicated to the task of studying the causes of crime, and a sophisticated body of research has emerged. Given that business ethicists have cognate interests, one might expect that this research would serve as an important source of information and inspiration. Unfortunately, this resource has barely begun to be tapped. For example, instead of speculating about the motives of those who steal from their employers, business ethicists could consult Cressey's (1953) classic study *Other People's Money*, which featured extensive interviews with incarcerated embezzlers. Yet Cressey's study, a staple of the criminology literature, has been cited exactly once in the 25-year history of the *Journal of Business Ethics* (less often than the 1991 Danny DeVito film of the same name).[1] This is unfortunate, since criminologists are practically unanimous in rejecting several of the more popular "folk" theories about what motivates people to commit crimes. Yet many of these same theories continue to thrive in the business ethics literature as explanations for unethical behavior.

In this article, I will attempt to lead by example, by showing how a criminological perspective can help to illuminate some of the questions about moral motivation that have often troubled business ethicists. I will begin by explaining why criminologists almost unanimously *reject* three of the folk theories often proposed as explanations for white-collar crime: first, that criminals suffer some defect of character; second, that they suffer from an excess of greed; or third, that they "don't know right from wrong." I will then go on to discuss a theory that is widely accepted among criminologists, involving what are referred to as "techniques of neutralization." One of the most noteworthy features of this theory is that it is far more cognitivist than any of the folk theories – it suggests that the way people *think* about their actions and the situation has an enormous amount to do with their propensity to commit various crimes. I conclude by considering some of the positive conclusions that business ethicists can draw from this (including some important implications for the way that business ethics is taught).

Folk Theories of Motivation

I have spoken so far as though there were a single, unified, "criminological perspective" on the subject of white-collar crime. This is, of course, an exaggeration. Criminologists disagree with one another just as heartily as specialists in any other academic discipline, and the field of study is divided into a number of rival schools of thought (e.g., see Jones, 2005). Nevertheless, there are also a number of very broad presuppositions that are widely shared within the discipline, but which may be counterintuitive to outsiders. They constitute a set of very general ideas and approaches that are mastered during early education in the field and are subsequently taken for granted. It is these general ideas that are largely uncontroversial among criminologists, and make up what I am referring to as the "criminological perspective."

The first feature of the criminological perspective is that it takes as its point of departure an inversion of the everyday question that people tend to ask about crime. Picking up the morning newspaper, reading about some egregious offense, we naturally ask ourselves, "Why do people do such things?" Yet what the criminologist regards as mysterious is not the fact that some people commit crimes, but rather the fact that more people do not commit more crimes more often. This is because, when looked at from the standpoint of individual incentives, only a tiny percentage of those who could advance their interests through criminal activity actually choose to do so. Even though illegal activity is punished, the legal system typically fails to supply adequate external incentives for compliance – the chances of apprehension are remote, and the threat of punishment is highly attenuated. Thus, what the criminologist needs to ask first is "Why do people *not* commit crimes?" Only once this question has been answered can one go on to deal with the exceptions.

The standard solution to this problem is to point out some type of socialization process that individuals undergo, in the passage from childhood to membership in adult society, which aligns individual preferences with social expectations in such a way that individuals acquire a desire to comply with institutional norms. According to Talcott Parsons, this coincidence of self-interest and role expectations is "the hallmark of institutionalization" (Parsons et al., 1961, p. 76). Parsons used the term *deviance* in a technical sense to refer to "a process of motivated action, on the part of the actor who has unquestionably had a full opportunity to learn the requisite orientations, tending to deviate from the complementary expectations of conformity with common standards so far as these are relevant to the definition of his role" (Parsons, 1951, p. 206). Deviance in turn evokes various "mechanisms of social control" aimed at "motivating actors to abandon their deviance and resume conformity" (i.e., restoring full institutionalization). The most significant mechanism is the imposition of external sanctions. These work to bring about a greater alignment of self-interest and social expectations, not only by realigning external incentives in such a way as to encourage conformity, but also, when "internalized" by the subject, by socializing the individual in such a way that his preferences become less anti-social.

This analysis, which was enormously influential in early American sociology (and by extension, criminology), has a number of noteworthy consequences. The first is that it defines crime as a type of deviance (Parsons et al., 1961, pp. 869–871), rather than as a simple failure of mechanism design. Thus the attempt to understand the sources of crime focuses upon failures of socialization and failures of social control – failures that are, of course, interdependent, since the primary mechanism of social control (external sanctions) also has a socializing function. This perspective also suggests that "moral" and "legal" norms within a particular society be viewed on a continuum, with the primary difference being merely that the former are enforced through what are, to varying degrees, informal social sanctions, whereas the latter are enforced using the power of the state.

This is the very general theoretical framework presupposed by the overwhelming majority of criminologists. Even so-called "rational choice" approaches to criminology are based upon variants of this view (Akers, 1990). Beyond this, however, things get complicated. Applying this framework to the explanation of crime turns out to be more difficult than initially imagined, and a lot of early speculation about the causes of crime turned out to be false. Crime is widely understood to represent *some* form of deviance, but it is not entirely clear in many cases where the deviance lies. Naturally, before inquiring into the causes of crime, the first step must be to determine what precise form of deviance is involved. Here, it turns out that many of the traditional folk theories of criminal motivation are unsupported by the evidence. Three in particular have been debunked:

Character

It is widely believed among members of the public that criminal deviance is due to some failure of primary socialization. According to this folk view, criminals "lack conscience," are "sociopathic," or else possess some other character flaw that leaves them lacking the disposition to "do the right thing." Thus criminal conduct is explained as a consequence of some defect in the individual criminal's personality structure.

The problem with this theory is that it overgeneralizes in a way that is unsupported by the evidence (Coleman, 1989, pp. 202–204). Failures of socialization do, of course, occur, and sociopathy is a genuine phenomenon. However, the overwhelming majority of criminals suffer from neither. Indeed, it is precisely the *ordinariness* of white-collar criminals that led to a serious rethinking among criminologists in the first half of the twentieth century of the Victorian view of criminality, which regarded offenders as either genetically or psychologically inferior. As Edwin Sutherland noted, "businessmen are generally not poor, are not feebleminded, do not lack organized recreational facilities, and do not suffer from the other social and personal pathologies" (1968, p. 58). A certain percentage of white-collar criminals may be more egocentric and reckless than the norm, but almost all fall within the range of what is considered psychological normal. Furthermore, an equally large number are simply "muddled" or "incompetent" (Spencer, 1965, p. 261). There is no particular psychological trait that they all share, nor is there any trait or set of traits that set them apart in any significant way from the general population.

Indeed, the tendency to overestimate the effect of "character" upon action is an extremely pervasive error, which afflicts many of our folk theories of social interaction (Ross and Nisbet, 1991; Wilson, 2002, p. 207). The evidence of this is quite powerful. Consider, for example, the "Panalba" case, involving the pharmaceutical company Upjohn. After strong medical evidence emerged that the drug was causing a number of serious side-effects (including unnecessary deaths) and that it offered no medical benefits beyond those that could be obtained from other products on the market, the board of directors of the firm decided not only to continue marketing and selling the drug, but also arranged to have a judge issue an injunction to stop the FDA from taking regulatory action (Mintz, 1969). When the FDA finally succeeded in having the drug banned in the United States, the firm continued to sell it in foreign markets. When this story is presented as a case history, respondents are almost unanimous in their conviction that the actions of the Upjohn board were "socially irresponsible" (Armstrong, 1977). Attitude surveys also show that respondents in the United States regard executives who allow their firm to sell a drug with undisclosed harmful side-effects as having committed a serious criminal offense, second only to murder and rape in severity (Scott and Al-Thakeb, 1997). However, when management and executive training students were put in a role-playing scenario (as members of a corporate board, faced with the same decision that confronted Upjohn), 79% chose the "highly irresponsible" option, of not only continuing with sales of the drug, but also taking action to prevent government regulation. The other 21% chose to continue selling the drug for as long as possible, only without trying to interfere with the regulatory process. Thus the range of behavior extended from "highly" to "moderately" irresponsible. Not one group chose the "socially responsible" action of voluntarily withdrawing the drug from the market (Armstrong, 1977, p. 200). These results were obtained from 91 different trials of the experiment in 10 different countries (Armstrong, 1977, p. 197).

It is worth noting that Scott Armstrong, the investigator who conducted these studies, initiated them because he was puzzled by the Upjohn case, and believed that his own students at the Wharton School of Management could not possibly do such a thing (Hilts, 2003). Unfortunately, it was his own students who became the first group to disprove this hypothesis. Anyone familiar with Stanley Milgram's (1974) experiments would be unlikely to find this surprising. What Milgram had shown, and what subsequent studies have shown again and again, is that perfectly ordinary people are able to commit very serious crimes or moral offenses when put in the right situation. The celebrated Stanford prison camp experiment (Haney et al., 1973) taught very much the same lesson.

This is not a finding that is specific to criminology. Social psychologists have accumulated considerable evidence to show that our folk theories of character have little or no predictive value when it comes to determining the probability of "moral" versus "immoral" conduct, whereas situational factors are extremely important. In one particularly noteworthy experiment, students at the Princeton Theological Seminary were told that they needed to report to a building across campus in order to do a presentation. Some were told that they were running late, others that they were just on time, and some that they were a bit early. The experiment was designed, so that, on the way, they would pass a stranger in need of assistance. Of those who were told that they were late, only 10% stopped to help, versus 45% of those who were on time, and 63% of those who were early (Darley and Batson, 1973, p. 105). Other studies in a similar vein have shown quite clearly that situational factors far outweigh the effects of character when it comes to determining behavior (Doris, 2002, pp. 30–60).

Yet despite the absence of evidence, the belief that criminals possess a deviant psychology or personality structure is remarkably persistent. Some have suggested that this is because the belief serves as a source of reassurance to the non-criminal segment of the population. As James William Coleman writes:

> The public tends to see criminals as a breed apart from "normal" men and women. The deviants among us are commonly branded as insane, inadequate, immoral, impulsive, egocentric, or with any one of a hundred other epithets. In seeing the deviant as a wholly different kind of person from ourselves, we bolster our self-esteem and help repress the fear that under the right circumstances we, too, might violate the same taboos. But this system of facile psychological determinism collapses when applied to white collar criminals. The embezzling

> accountant or the corporate functionary serving in an employer's illegal schemes conforms too closely to the middle-class ideals of American culture to be so easily dismissed (Coleman, 1989, pp. 200–201).

The idea that criminals suffer from some sort of character defect also serves the important function of absolving many institutions of any responsibility for the conduct of their members. According to the popular view, respect for social expectations, whether legal or moral, is something that is taught primarily in the home, cultivated through appropriate child-rearing techniques. As philosopher Michael Levin put it, "Moral behavior is the product of training, not reflection. As Aristotle stressed thousands of years ago, you get a good adult by habituating a good child to do the right thing" (Levin, 1989). He goes on to conclude that ethics courses in law schools, medical schools, business schools, and even high schools, are an "utterly pointless exercise," simply because students are fully socialized by the time they get to these institutions, and so it is too late for educators to do anything about their character.

It follows from this analysis that institutions of higher learning cannot be blamed for the conduct of their students. While Dean of the Sloan School of Management, Lester Thurow argued that business schools should be absolved of any responsibility for the unethical or illegal actions of their graduates. His argument was based upon a variation of the "garbage-in garbage-out" principle. "Business students come to us from society. If they haven't been taught ethics by their families, their clergymen, and their elementary and secondary schools … there is very little we can do. Injunctions to 'be good' don't sway young men and women in their mid- to late 20s. In the final analysis, what we produce is no worse than what we get" (Thurow, 1987). The assumption is that the way people *think* about their decisions is unimportant, and thus students have nothing to be taught about the moral or legal challenges that may arise in a business context. Students are programmed during early childhood to be either "good boys and girls" or bad ones. What they are subsequently taught about the ways of the world, over the course of their education, is taken to be irrelevant. Yet, this moral psychology is false (as thoroughly discredited as Aristotle's views on physics and biology). The fact that such ideas continue to circulate in the public sphere – the fact that they exercise influence in a various public policy debates – should be a source of considerable consternation.

Greed

There is no doubt that the vast majority of white-collar crime is motivated by what might broadly be referred to as pecuniary incentives. Typically, individuals who commit occupational crimes are seeking to enrich themselves personally, just as firms engaged in corporate crime aspire to improve their financial performance. In addition, of course, since most people prefer more money to less, there is a temptation to assume that this basic incentive is what underpins criminal conduct. Naturally, the mere presence of a pecuniary incentive is not sufficient to explain criminal conduct, since the vast majority of individuals confront such incentives on a regular basis and yet do not avail themselves of the opportunity to commit crimes. This is where greed comes in. While everyone likes money, some people seem to like it more intensely than others. Thus it may be tempting to conclude that, in the case of white-collar criminals, the intensity of their passion for money simply outweighs the various incentives that encourage respect for the law.[2]

There are many problems with this explanation. First of all, it should be noted that it does very little to explain corporate crime. Employees often break the law in ways that enhance the profits of the firm, but which generate very little personal benefit for themselves. There is an important difference, for instance, between the crimes committed at Enron by Andrew Fastow, who secretly enriched himself at the expense of the firm, and those committed by Kenneth Lay and Jeffrey Skilling, who for the most part acted in ways that enriched the firm, and themselves only indirectly (via the high stock price). Loose talk about "greed" in the corporate setting often obscures the crucial distinction between enhancing one's own compensation and enhancing the earnings of the firm. In the latter case, most of the money goes to other people, not to the law-breaker, and thus greed – at least of the conventional sort – cannot be the primary explanation.

Greed offers a more plausible explanation for occupational crime, but even here the picture is quite complicated. Often it is not the desire for gain that motivates white-collar criminals, but rather a strong aversion to losses (there is a well-documented asymmetry in behavioral psychology between the way that individuals treat losses and gains [Tversky and Kahneman, 1991]). This is reflected in the fact that crime seems to be more prevalent in firms that are doing poorly than in firms that are doing well (Coleman, 1989, pp. 230–231; Lane, 1953). Many white-collar criminals are certainly individuals who find themselves financially "squeezed" in some way (Cressey, 1950, pp. 742–743). In such cases, it appears to be fear or anxiety rather than greed that is the dominant motive.Yet another fair proportion of crime appears to be related to "rising expectations," when actual gains fall somewhat short of anticipated ones. In this case again, it is not exactly greed that is doing the work, but rather a sense of entitlement that develops and is subsequently disappointed.

These incentives are all very commonplace – indeed, they are *too* commonplace to serve as a useful explanation for criminal behavior. As Sutherland and Cressey argue,"though criminal behavior is an expression of general needs and values, it is not explained by those general needs and values, since non-criminal behavior is an expression of the same needs and values" (1978, p. 82). In other words, if greed combined with opportunity really *caused* crime in any significant sense, then there would be a lot more crime, simply because greed is ubiquitous as a human motive and the world is rife with opportunity.

Finally, it is worth noting that the "bigger" occupational crimes tend to be committed by individuals who are further up the chain of command in the firm (Weisburd et al., 1991). In part this is due to the structure of opportunities – low-level employees tend to commit less serious crimes, simply because they are not trusted with large sums of money, their work is more closely supervised, etc. Yet, if money is subject to diminishing returns, as economists typically suppose, then it is often unclear what motivates managers, many of whom are already quite wealthy, to risk everything just to gain a relatively marginal increase in income. As Coleman has observed, "Criminal activities are surprisingly common among elite groups that might be thought to have little to gain from such behavior" (Coleman, 1989, p. 243). It is also unclear, why greed motivates them to commit crimes in this one particular domain of life, but does not impel them toward crime in other areas (e.g., ordinary street crime).

Indeed, one of the reasons that we ascribe an excess of greed to white-collar criminals is that we often find their motives to be inscrutable. Large numbers of offenses are clearly committed by individuals who are wealthy beyond the dreams of avarice. To the average person, the reasons these people have for stealing seem as obscure as, say, the motive that Hugh Grant had for marital infidelity. The ascription of "greed," in such cases, far from constituting an *explanation* for their conduct, signals rather the *absence* of any plausible explanatory hypothesis.

Values

One of the characteristics shared by the previous two folk theories of criminality is that they focus entirely upon the propensity of individuals, acting as individuals, to commit crimes.Yet, white-collar crime, just like street crime, has an important social dimension. If the individualistic approach were correct, then one would expect to find a fairly random distribution of white-collar crime throughout various sectors of the economy, depending upon where individuals suffering from poor character or an excess of greed wound up working. Yet, what one finds instead are very high concentrations of criminal activity in particular sectors of the economy. Furthermore, these pockets of crime often persist quite stubbornly over time, despite a complete change-over in the personnel involved. For example, the petrochemical, automobile, and pharmaceutical industries have been plagued by corporate crime for years, in a way that, for example, the farm equipment or the beverage industries have not (Clinard and Yeager, 1980, pp. 340–341). Of course, some of this can be explained by the structure of opportunities in certain occupations (as with theft by dockworkers, or corruption among police officers), but much of it also has to do with the formation of deviant or criminal subcultures, often with their own internal rules and normative expectations, which in turn get reproduced over time (Mars, 1982).

It is precisely this observation that led Sutherland (who coined the term "white-collar crime" and did the pioneering research on the subject), to posit his "associational" theory of white-collar crime (1949). He basically treated crime as a form of learned behavior, acquired through contact and observation of the activities of other criminals. This theory has a number of defects, including the fact that, stated baldly, the explanation is regressive (who did those other criminals learn from?), but what matters for our purposes are not the merits of the theory but rather the motive that Sutherland had for proposing it. His goal was to account for the contagion-like pattern exhibited by these criminal offenses. It is precisely this pattern that overly individualistic explanations fail to account for.

One popular strategy for attempting to explain the social dimension of criminal activity is to imagine that these deviant subcultures have essentially the same internal structure as the dominant society, but that their members adhere to a different set of values, one that is not shared by those outside the group (Braithwaite, 1989, pp. 21–24; Cohen, 1955). According to this view, the mechanism that produces 'criminal' conduct within the subculture is the same as the mechanism that produces 'law-abiding' conduct in the broader culture, viz. conformity to some set of shared expectations. The reason that the former is 'criminal' while the latter is not is simply that the two groups have different values – what one calls "good" the other calls "bad," and *vice versa*. (So-called "labeling theory," which argues that crime is essentially an artifact of the power that dominant groups have to define certain forms of conduct as deviant, is a variation on this view.)

This sort of thinking is quite widespread. For example, after the Haditha massacre in Iraq, the United States Marine Corps ordered new "core values" training for all soldiers. The senior officer in Iraq explained that although most soldiers "perform their jobs magnificently every day … there are a few individuals who sometimes choose the wrong path." In order to correct the problem, he said, "it is important that we take time to reflect on the values that separate us from our enemies" (Stout, 2006).

The problem of soldiers "choosing the wrong path," by attacking unarmed civilians is a good example of criminal deviance. The way that the Marine Corps chose to render this choice intelligible was by interpreting it as the adoption, on the part of these soldiers, of a deviant set of values, viz. those of the "enemy." Thus the way to solve the problem, in their view, was to reaffirm amongst all a commitment to the official "values" of the organization. Yet, one need only think about this analysis for a moment to see that it constitutes a highly dubious explanation for the conduct in question. How plausible is it to suppose that a group of American soldiers got together and decided that there was in fact nothing wrong with terrorism (i.e., the intentional targeting of civilians), and that this change in value-commitment caused their subsequent conduct?

Criminologists give very little credence to such explanations. Research on juvenile delinquents, in particular, has shown that young offenders typically do not reject the values of mainstream society, nor do they endorse any rival system of group-specific values. "Even serious repeat delinquents mostly place higher value on conventional accomplishments than on success at breaking the law" (Braithwaite, 1989, p. 23). They tend to partake of the same normative consensus as every other member of mainstream society: they share the same role models (e.g., "a humble, pious mother or a forgiving, upright priest" [Sykes and Matza, 1957, p. 665]), they approve of the same standards of behavior, and so on. In other words, there is no *fundamental* disagreement about what is right and wrong between the majority of those who do and those who do not commit crimes. It is precisely because delinquents recognize the "wrongness" of their behavior, at some level, that they usually draw a distinction between those who are legitimate targets of crime ("fair game") and those who are not (Sykes and Matza, 1957, p. 665).

Techniques of Neutralization

There is no question that crime involves some form of social deviance. The question that has preoccupied criminologists is "What sort of deviance?" – or more specifically, "Where exactly does the breakdown in social order occur?" While there is still considerable controversy over the correct answer to these questions, several incorrect answers have been rejected with near-unanimity. As we have seen (and contrary to popular wisdom), crime does not primarily involve a defect of character, it is not simply a matter of incentive or opportunity, and it does not reflect a rejection of society's basic moral principles. Indeed, the central question that has preoccupied criminologists for the past century, especially with regard to white-collar crime, has been "Why do psychologically normal individuals, who share the conventional value-consensus of the society in which they live, sometimes take advantage of opportunities to engage in criminal conduct?"

One way to find out why people commit crimes is to ask them. Of course, criminals can hardly be expected to have the last word on the subject, but it does seem reasonable to give them at least the first word. When criminologists did begin talking to criminals about their crimes, some interesting things turned up. One of the most noteworthy was the extent to which criminals rationalize their actions. Cressey (1953), for instance, was struck by the number of convicted embezzlers who claimed to be merely "borrowing" the money, with every intention of repaying it. Sutherland noted that one of the things criminals pick up through "differential association" are "definitions favorable to the violation of law" (Sutherland and Cressey, 1978, p. 81), in other words, ways of describing their actions that made them seem less wrong. Gilbert Geis, studying the major antitrust case brought against heavy electrical equipment manufacturers in 1961, drew particular attention to the number of defendants who "took the line that their behavior, while technically criminal, had really served a worthwhile purpose by 'stabilizing prices'" (1968, p. 108).

Cressey referred to such euphemisms as "vocabularies of adjustment," which allowed the criminal to minimize the apparent conflict between his or her behavior and the prevailing normative consensus. Criminologists had traditionally described these as rationalizations, used after the fact to protect the individual from blame. Sykes and Matza (1957), however, suggested that this sort of reasoning often preceded the action as well, constituting a mechanism through the criminal, in effect, gave himself permission to violate the law. Thus, they claimed that much of delinquency involved, not deviancy with respect to primary values, but rather a deviant use of what were, in principle, legitimate excuses for crime.[3] Through these excuses, "social controls that serve to check or inhibit deviant motivational patterns are rendered inoperative, and the individual is freed to engage in delinquency without serious damage to his self image" (Sykes and Matza, 1957). Thus they referred to them as "techniques of neutralization." Thus according to Sykes and Matza,

> much delinquency is based on what is essentially an unrecognized extension of defense to crimes, in the form of justifications for deviance that are seen as valid by the delinquent but not by the legal system or society at large (1957, p. 666).

Sykes and Matza draw attention to five categories of neutralization techniques, used by offenders to deny the criminality of their actions. It is important to note that each appeals to a consideration that, in some cases, provides the basis for a legitimate excuse. What distinguishes the criminal is the tendency to make overly generous or self-serving use of them.[4]

Denial of responsibility

The offender here claims that one or more of the conditions of responsible agency were not met: that the action or its consequences were unintentional; that he was drunk, insane, provoked, or otherwise unable to think clearly while performing it; that he had "no choice" but to do it, and thus acted out of necessity; that it was all an accident, etc.

Denial of injury

The offender seeks to minimize or deny the harm done, e.g., by claiming that an assault was merely intended to frighten, that stolen money was merely borrowed (or the victim too rich to notice it missing). Overly generous applications of the *volenti non fit iniuria* principle also fall into this category (the claim that the victim's consent negates the injury).

Denial of the victim

The offender acknowledges the injury, but claims that the victim is unworthy of concern because, in some sense, he deserved it. Thus the crime is portrayed as retaliation for some offense committed by the victim (or a preemptive strike, to stave off an attack), e.g., vandalism is portrayed as "revenge on an unfair teacher," thefts are excused on the grounds that the storekeeper is "crooked" (Sykes and Matza, 1957, p. 668). Attacks on stigmatized minorities are also often justified in this way.

Condemnation of the condemners

The offender attempts to "turn back" the charges by impugning the motives of those who condemn his actions. Thus the police are criticized for being corrupt, singling him out unfairly, prosecuting him out of malice, racism, stupidity, etc. It is sometimes suggested that it is morally unacceptable for one individual to be punished for an offense, when not everyone who has committed the same offense is punished.

Appeal to higher loyalties

The offender denies that the act was motivated by self-interest, claiming that it was instead done out of obedience to some moral obligation (that conflicted with the law). These obligations often have a highly particularistic character, such as loyalty to friends, family, or fellow gang-members. Offenders might also claim to have been acting for political motives, and thus characterize their behavior as a form of dissent or civil disobedience.

I have interpreted the above categories quite broadly, in order to subsume some subsequent proposals for addition to the list (e.g., Minor, 1981). However, two additional techniques proposed by other authors are sufficiently different that they deserve categories of their own.

Everyone else is doing it

This is to be distinguished from cases in which the offender uses the fact that others violate the law, and yet escape prosecution, in order to condemn the condemners, or uses the fact that others break the law to show that he had "no choice" but to follow suit, and thus was acting out of necessity. In some cases, the mere fact that others are breaking the law is used to suggest that it is unreasonable for society to expect compliance. An appeal to the fact of widespread violation may also be used to remove the moral stigma associated with an offense. In either case, the goal is to show that the law is out of touch with social expectations, and therefore that enforcement is illegitimate.

Claim to entitlement

The offender may claim an entitlement to act as he did, either because he was subject to a moral obligation, or because of some misdeed perpetrated by the victim. He may, however, grant that his motive was self-interested, and yet still claim an entitlement to the act, simply by denying the authority of the law (Coleman, 1989, p. 213). An offender may argue, for instance, that he was acting "within his rights," and that the legal prohibition of his conduct constituted unjust or unnecessary interference. Certain offenders also appeal to a more "karmic" version of this argument, claiming that their good behavior on past occasions gives them an entitlement to act badly in this one respect (Klockars, 1974).

The important thing about the use of excuses is that they allow the delinquent to "have his cake and eat it too," by retaining allegiance to the dominant system of norms and values, while at the same time exempting his own actions from its imperatives, thereby freeing him to pursue his self-interest in a relatively unconstrained fashion (Sykes and Matza, 1957, p. 667). In many cases, a *cognitive* norm will be violated (e.g., "stealing" is described as "borrowing"), in such a way as to allow the offender to claim that he was in compliance with a more heavily weighted moral or legal norm (e.g., "don't steal").

Consider, for example, the following letter, which was sent to two researchers investigating the use of neutralization techniques by hunters cited for illegal possession of game in the state of Colorado. In a cover letter accompanying the survey, the researchers used the term "poaching" to describe the offense. Although this is in fact the correct term, the description was vehemently resisted by many of those who responded to the survey. One of them wrote:

> I almost didn't answer this, I had to leave it lay for several days in order to calm down some. I am very proud of my almost 40 years of hunting and fishing in Colorado. For someone to put me in the same category with poachers,

> as far as I am concerned that puts them in the same category with antihunting groups. If that's an injustice it can't be a bigger injustice than what you did [to] me. I made a mistake once, and a young hothead game warden tried to take advantage of it to boost his arrest record point system. I misread some very complicated regulations. They write them more complicated every year to try to boost their "fine" income (Eliason and Dodder, 1999, p. 239).

Apart from the writer's success in squeezing perhaps four different categories of neutralizing excuse into one short paragraph, what is noteworthy about the letter is the writer's strong endorsement of the dominant social attitudes toward "poaching." Indeed, it is precisely because he abhors poachers that he is driven to adopt the rather untenable position that while he may (by his own admission) have illegally hunted game, he is nevertheless not a poacher. One can find similar attempts to defeat analyticity in the claim, often made by those convicted of white-collar offenses, that though they may have broken the law, they are not really criminals (Geis, 1968, p. 104).

As one can see from this example, there is an element of genuine self-deception in the use that offenders make of these neutralizing excuses. Furthermore, it is still in many respects a mystery why certain people, in certain situations, seem to be more vulnerable to these sorts of self-deceptions. Thus the discussion of techniques of neutralization does not solve the problem of explaining criminal motivation. The significance of the theory lies in the way that it redirects our attention, away from the issue of compliance with primary moral norms, toward compliance with the secondary norms that govern excusing conditions. It suggests that what many criminals are doing, when they break the law, is not violating shared moral principles, but rather *circumventing them* – violating nonmoral rules in such a way as to persuade themselves that their criminal actions remain compliant with the prevailing set of moral rules.

Hence, this theory puts considerable emphasis upon the way that individuals *think* about their actions, it is not a fully cognitivist account of criminal motivation. There is still a core element of deviance in the criminal will that remains somewhat mysterious – not entirely though. It is here that the social dimension of criminal behavior is clearly important. The offender will find it much easier to regard his own excuses as plausible (and thus to maintain the self-deception) if he is in a social environment in which such claims tend to be given credence, or where he is unlikely to encounter critical or dismissive voices. Thus "differential association" and the formation of deviant "subcultures" remain an important part of the story about crime. Neutralization theory, however, regards the function of these subcultures differently. Rather than sustaining an independent system of values and moral principles, different from those of the mainstream, the function of the subculture is to create a social context in which certain types of excuses are given a sympathetic hearing, or perhaps even encouraged.[5] In this way, the offender finds it easier to live with the (otherwise glaring) contradiction between his own commitment to the moral standards of society and the criminality of his actions.

There is some debate about how much this theory explains, since the use of such techniques of neutralization is not universal (e.g., Kraut, 1976, pp. 363–364). It is also not clear to what extent these techniques are used merely to provide excuses, or whether they in fact supply full-blown justifications (Hindelang, 1970, 1974). It seems clear, for instance, that an appeal to higher loyalties suggests that the action was not merely excusable, but actually the right thing to do under the circumstances. In that case, the extent to which the criminal shares in the broader normative consensus of the society becomes subject to dispute. Nevertheless, the basic empirical phenomenon of neutralization is clearly an important one (see Agnew, 1994; Agnew and Peters, 1986; Akers et al., 1979; Buffalo and Rodgers, 1971; Landsheer et al., 1994). In contemporary criminological research, it is typically embedded within a multifactorial theory of deviance, as one of several "social" factors that generate a propensity toward crime (Akers, 1998, pp. 77–87). It is worth singling out for special attention in this context, however, because it is a factor that should be of particular interest to business ethicists.

Neutralizations in Business

When crime is analyzed from the perspective of techniques of neutralization – rather than, say, faulty socialization or deviant values – it immediately becomes apparent why bureaucratic organizations such as large corporations, as well as the "market" more generally, might constitute peculiarly criminogenic environments. These are institutional contexts that generate a very steady stream of rather plausible (or plausible-sounding) excuses for misconduct. This is the result of a confluence of factors: first, corporations are typically large, impersonal bureaucracies; second, the market allows individuals to act only on the basis of local information (Hayek, 1945), leaving them in many cases unaware of the full consequences of their actions; third, widespread ideological hostility to government, and to regulation of the market in particular, results in diminished respect for the law; and finally, the fact that firms are engaged in adversarial (or competitive) interactions gives them broader license to adopt what would otherwise be regarded as anti-social strategies (Heath, 2007). The other major feature of the corporation, and of the business world more generally, is that it constitutes a subculture that in many cases isolates individuals from the broader community, and thus may serve to insulate deviant ideas and arguments from critical scrutiny.

It may be helpful to consider these factors from the perspective of the seven different categories of neutralization technique. Sykes and Matza's original work was done in the context of juvenile delinquency and street gangs. However, it is easy to see that there are very familiar "business" versions of each pattern of excuse that was encountered there.

Denial of responsibility

Hannah Arendt once described bureaucracy as "rule by nobody" (1969, p. 81). With corporate crime in particular, it is seldom the case that any one individual is clearly responsible for a particular action. Thus when a crime is committed, everyone can, with some degree of plausibility, point the finger at someone else. The person who carried out the action can blame the person who made the decision, the person who made the decision can blame the person who vetted the decision, etc. (e.g., see Vandivier, 1996, p. 128). Due to the organizational hierarchy of the firm, individuals can always try to pass the blame up to their superiors. These superiors can, in turn, try to pass the blame back down, by insisting that their subordinates acted independently (Clinard and Yeager, 1980, p. 45). (In this context, it is worth noting that the "ethics codes" adopted by some firms clearly facilitate the latter. By imposing upon each employee the obligation to resist any "unethical" orders, they in turn make it more difficult for these employees to shift the blame up.)

The competitive structure of the marketplace, not to mention the "hard budget constraint" (Kornai, 1992, pp. 143–144) imposed by investors, also generate the perception, among many people, that they have "no choice" but to violate the law. This is, of course, predicated upon the assumption that the bankruptcy of the firm (or personal bankruptcy, or even just losing one's job) is an evil to be avoided at all cost. For example, Geis quotes one defendant in the heavy electrical antitrust case excusing his actions in the following terms: "I thought that we were more or less working on a survival basis in order to try to make enough to keep our plant and our employees" (1968, p. 108). Here one can see the vocabulary of "survival" being used to blend the "necessity" defense into an appeal to higher loyalties (in this case, an altruistic concern for the plant's employees).

The competitiveness of the marketplace, and the workplace, also means that if one individual refuses to perform an illegal act, he may simply be replaced by someone else who is (or if one firm refuses to pay a bribe, the business will simply go to some other firm that is, etc.).[6] This suggests that the illegal act is going to occur regardless of what any one individual chooses, and is thus subject to some sort of metaphysical "necessity." As a result, the particular individual who happens to perform the act cannot be said to have "caused" the harm that results, since one of the central counterfactuals associated with causal relations is false (it is not the case that, had he not performed the act, the harm would not have occurred).

Denial of injury

One of the most important features of white-collar crime is its often "faceless" character. In general, people have more permissive attitudes toward crime when the victim is unknown, or else an institution (Landsheer et al., 1994, p. 51). Most white-collar criminals never meet or interact with those who are harmed by their actions (and in many cases they wouldn't even know how to find their victims should they choose to). This makes it more plausible to claim that no injury has occurred. In antitrust cases, in particular, many offenders simply refuse to believe that they have caused any harm. Geis quotes a Westinghouse executive, for instance, acknowledging that price-fixing arrangements were illegal, but denying that they were criminal: "I assumed that criminal action meant damaging someone, and we did not do that" (1968, p. 108). One can find the same steadfast refusal to acknowledge any harm by Microsoft executives, despite having been found in violation of the law in both the United States and the European Union. The problem stems from an ignorance of, or perhaps an unwillingness to grasp, a rather subtle point of economic theory, viz. that the social cost of monopoly is borne, not by those who purchase the firm's products, but rather by those who do *not* purchase them due to monopolistic pricing. Typically, however, monopolists point to the satisfaction of the firm's own customers as evidence that their conduct caused no harm. This defense is based upon an economic fallacy, but it is hardly one that they have an incentive to sort their way out of.

In these cases, there is potential confusion as to the *identity* of the individuals who are harmed by the criminal's actions. In other cases, the mere fact that there is *diffusion* of the harm over a very large number of persons is appealed to as grounds for denial that anyone was injured by the person's actions. This is presumably what underlies the widespread conviction that crimes committed against large corporations are more acceptable than those committed against small ones. It may also be a major factor in the extraordinarily permissive public attitudes toward tax evasion, insurance fraud or crimes resulting in losses that are covered by insurance. Finally, because shareholders are not entitled to any fixed rate of profit, actions that merely produce a lower rate of profit are sometimes excused on the grounds that they did not result in actual losses.

One of the most general grounds for denying injury stems from overly generous use of the *volenti non fit iniuria* principle. This is often tied to a form of market utopianism, which suggests market outcomes are to be presumed efficient until proven otherwise. Since market transactions typically involve consent, it is relatively easy for people to convince themselves that shareholders who are exploited by management could have invested their money elsewhere, consumers who purchase inferior goods ignored the "buyer beware" rule, workers who are injured "knew the risks when they took the job," and so on. One can find highly sophisticated variants of these arguments. Certain proponents of the so-called "efficient markets" hypothesis, for example, claim that the stock market fully anticipates managerial graft when determining the price at which shares trade. Since the shares of firms where managers abuse their perqs will trade at a discount, this sort of 'abuse' does not actually harm shareholders – indeed some theorists claim that it is merely "implicit compensation" for the managers. Many "economically" minded theorists defend insider trading using more-or-less the same rationale (Easterbrook and Fischel, 1991, pp. 257–258).

Denial of the victim

The essence of this neutralization technique is the claim that, rather than merely acting opportunistically toward the victim, the offender is in fact playing tit-for-tat, and thus responding in kind to past opportunistic conduct on the part of the supposed victim. The least sophisticated version of this argument involves simply pointing at the other and saying "he started it." The more sophisticated version involves presenting the offender as exacting righteous vengeance, perhaps even sacrificing his own interests in order to ensure that the crimes of others do not go unpunished.

This category of neutralization technique is especially important when it comes to occupational crime. It is very difficult to find an employee who believes that an enhancement of the overall level of distributive justice in society would require a reduction of his or her current compensation package. Such perceptions of "underpayment inequity" can be an important source of occupational crime (Greenberg, 1990). Among less skilled workers, people often confuse the fact that their *role* is invaluable to the organization with the belief that *they* are essential to the organization. Thus they feel undercompensated, ignoring the fact that it is the ease with which they can be replaced that determines their wage rate, not the value that they contribute to the firm on a day-to-day basis.

The basic structural problem comes from the difference between the adversarial orientation associated with the competitive labor market and the more cooperative orientation required for work within the firm. Labor is, as Karl Polanyi wrote, a "fictitious commodity" (1944, pp. 72–73). When a firm hires an employee on salary, what they are doing is essentially paying to secure that person's cooperation. Yet when it comes to negotiating compensation, it is the adversarial norms of the marketplace that prevail (see Heath, 2007). It can be very difficult for employees to "switch hats" so quickly, to put what are often very bitter wage negotiations behind them, and return to being "team players," devoting themselves selflessly to the interests of the firm.

All of this creates an environment in which it is relatively easy for people to convince themselves that, rather than stealing, what they are really doing is taking what they are owed, or perhaps punishing their employer tor treating employees poorly (Green, 1990, pp. 81–83; Greenberg, 1990). In one large-scale survey, Richard Hollinger and John Clark found that "when employees felt exploited by the company… these workers were more involved in acts against the organization as a mechanism to correct perceptions of inequity or injustice" (1983, p. 142). Furthermore, if the corporation is engaged in unethical or illegal practices, employees may regard their own theft as nothing but the seizure of "ill-gotten gains." More generally, few people in the public at large regard corporations as absolutely innocent (in the way that a person walking down the street, singled out at random and mugged, is absolutely innocent). This contributes to a general propensity to regard occupational white-collar crime as merely "just deserts" (and hence as victimless).

Condemnation of the condemners

One of the most prominent features of corporate crime is the frequency with which business executives dispute the legitimacy of the law under which they are charged, or impugn the motives of the prosecutors who enforce them. Consider, for instance, the abuse that was heaped upon New York State Governor Eliot Spitzer during his tenure as Attorney General (particularly in the *Wall Street journal*) for exposing a wide range of dubious practices in the insurance, mutual fund, and securities industry. His major prosecutorial work was almost never discussed, in the popular press, without some mention of his "political ambitions."

More generally, corporate criminals will often contest the very legitimacy of regulation, by suggesting that the government, when it imposes constraints upon the marketplace, is actually beholden to "special interests," while the corporation represents the broader interests of the public. Since the latter is taken to be a larger constituency than the former, the suggestion is that the corporation enjoys stronger democratic legitimacy than the government. Another common strategy is to pick out one overzealous or odd regulation and use it as grounds for dismissing the need for all regulation (Clinard and Yeager, 1980, pp. 70–71), or to impugn the competence of government in general. Raymond de Sousa, for instance, argued for jury-nullification in the Hollinger International case on this basis: "I have very little confidence that the same vast bureaucratic apparatus that manages our health care, our post office or our roads somehow becomes more competent and fair when it comes to criminal justice" (De Sousa, 2007).

The other major strategy is to suggest that the government is motivated by some type of ideological agenda (as opposed to the corporation, which for structural reasons can have no interest other than to "give the people what they want"). Thus prosecution of white-collar offenses is seen as stemming, not from considerations of justice, but rather from some sectarian political ideology.[7] The very concept of "white-collar crime" is often dismissed as a socialist plot, despite the fact that the primary beneficiaries of such prosecutions are usually capitalists (i.e., investors). For example, when Robert Lane interviewed a group of business executives in the early 1950s, asking them how to reduce the level of corporate crime, the most common recommendation was to "stop the drift to socialism and the restriction of freedom." (Lane, 1953, p. 164). All of the other proposals made by these executives focused upon either increasing the quality or integrity of *government*, or else decriminalizing the relevant activities. Not one made any suggestion that would have enhanced compliance with the existing body of law.

Appeal to higher loyalties

"I did it for my family," remains one of the most popular excuses for occupational crime, especially among female offenders (Daly, 1989). These sorts of excuses are no different in kind from the ones employed by street criminals. What is different in the business context, and what outsiders sometimes have difficulty comprehending, is the extent to which the *corporation itself* can serve as an object of higher loyalty. This is especially the case in more knowledge-intensive industries, which are subject to greater "information impactedness," and so rely much more heavily upon the loyalty of their employees in order to overcome internal agency problems. Considerable effort on the part of management is aimed toward cultivation of these loyalties, from dramatic initiation rituals for new employees, on-site recreational and sports facilities, personal counseling services, to the ubiquitous "team building" seminars and weekend retreats (Arnott, 2000).

An unintended consequence of the intense loyalties that are developed through such techniques is that employees may sometimes feel that they are excused from any accusation of criminality, so long as their actions were undertaken for the sake of the firm rather than for reasons of self-interest. (For example, it is quite plausible to suppose that neither Kenneth Lay nor Jeffrey Skilling were motivated by any personal pecuniary incentive when they misled investors about Enron's financial condition. They did it for the sake of Enron – an organization that they both continued to insist was a "great company" even after its collapse [McLean and Elkind, 2004, p. 419].) One study of retired Fortune 500 company managers by Marshall Clinard (1983) showed a widespread condemnation of whistleblowing, on the grounds that it conflicted with the "loyalty" owed by employees to the firm. Many believed that (with certain exceptions, such as safety violations) individuals who were unwilling to participate in illegal activities should simply quit their jobs and keep quiet, rather than "go to the government" (1983, p. 116).

It should also be noted that managers will sometimes appeal to the fiduciary relationship that they hold toward shareholders as an excuse for misconduct (Clinard and Yeager, 1980, p. 72). (Depending upon the audience being appealed to, offenders will also sometimes appeal to stakeholder interests as well. Corporate crime, for instance, can be excused as an action taken to stave off bankruptcy, in order to protect workers from losing their jobs, etc.) The "we did it for the shareholders" excuse had a ring of plausibility to it, because agents are obliged to advance the interests of their principal as best they can, and this sometimes does require violations of conventional morality. Lawyers, for instance, are generally thought to be under a professional obligation to conceal information on behalf of their clients in many circumstances. Yet the loyalty argument is spurious as a defense against crime, of course, because agency relationships cannot be used to "launder" impermissible actions in this way.

Everyone else is doing it

This is an excuse for all kinds of crime, but it should be noted that it has greater plausibility in a business context than in many other cases. This is because the competitiveness of the marketplace creates certain pressures that are absent in other domains. If one doctor is performing unnecessary procedures, this does not necessarily create any pressure on other doctors to do the same, simply because it doesn't affect them in any material way. In business, however, illegal conduct can give a firm an unfair competitive advantage that threatens rival firms with significant losses. For example, a minor safety infraction may save a firm only a small amount of money, but if it gives them an advantage over their competitors, which allows them to land several contracts that might otherwise have gone to them, then these slight gains will be significantly amplified. This will, in turn, create pressures on their rivals to follow suit. (It may also make the violation seem trivial, relative to what is at stake.)

The best analogy here is to the dilemma that many athletes face when confronted with the problem of doping in sport (Heath, 2007). In some cases, the individual faces a situation in which the consequence of acting ethically is certain defeat. Similarly, corporations are sometimes put in situations where they must offer a bribe, or arrange a kickback scheme, if they want to do business with a particular client. Thus there are clearly cases in which "everyone else is doing it" can serve as a reasonable excuse (although never, it should be noted, as a justification). This having been said, however, one must be on guard against the tendency toward overuse of this excuse. In particular, one must be suspicious of the version that treats it as a general result of microeconomic theory that the misbehavior of one firm "forces" all others to follow suit. In Clinard's study of middle managers, for instance, most ranked the "unethical competitive practices" on the part of rival firms quite low in their assessment of the causes of unethical or criminal conduct (1983, pp. 62–63), while only one in nine felt that it was a significant factor. Primarily, this is because they felt ethical firms had a variety of different ways of protecting themselves from these sorts of tactics – including, most significantly, bringing adverse publicity or regulatory attention to bear upon the firm that was acting unethically or illegally.

Entitlement

One of the major differences between corporate crime and street crime is the frequency with which white-collar criminals simply deny the authority of the laws that they have broken. Often this is based on some variant of *laissez-faire* ideology (e.g., Clinard andYeager, 1980, p. 69), which either contests the legitimacy, or denies the efficacy, of any government interference in the market. More sophisticated apologists appeal to the "business judgment" rule, in order to condemn government interference in mere "governance" issues. Both arguments suggest that the state simply does not have the right to regulate certain forms of private transactions. Thus individual businesspeople need not appeal to any "higher good" in defense of their actions, they need only insist upon their rights. Civil rights legislation and various aspects of labor law were for a long time very publicly resisted on these grounds – shouldn't employers be free to choose who they want to employ, or which customers they want to serve? What business is it of the government's?

These sorts of ideological challenges can have very powerful effects. In the United States, for instance, where these ideas enjoy much greater public acceptance, "the problem of business resisting law enforcement by forming oppositional and criminogenic business subcultures would seem to be more widespread" (Braithwaite, 1989, p. 129). Braithwaite draws particular attention to the Occupational Safety and Health Administration in the United States, which has encountered what he calls "an organized subculture of resistance that advocates contesting all enforcement actions, that is consistently challenging and litigating the legitimacy of the government to enforce the law" (1989, p. 129). It is worth pausing for a moment to emphasize how extraordinarily uncommon it is in advanced Western democracies to encounter such large-scale, organized attempts to undermine the authority of the law. The rather uncompromising tradition of individual rights in the United States, combined with the fact that the American Supreme Court for many years (during the so-called "Lochner" era) interpreted these rights in such a way as to prohibit many of the forms of government intervention in the marketplace that we see today, presumably accounts for much of this phenomenon.

It is also quite easy to find "karmic" versions of the entitlement argument, where people point to how much "good" a company does (e.g., the number of satisfied customers, happy employees, etc.) as an excusing condition for violations of law.

The power of these techniques of neutralization is amplified by the social environment created within many corporations. As Gerald Mars has emphasized, illegal conduct creates considerable cognitive dissonance for the typical perpetrator. Membership in a deviant subgroup plays an important role in "normalizing" this otherwise proscribed conduct. Without the supportive group, "the 'sinning' self threatens to overwhelm the working self." (1982, p. 170).

For most people, work is the center of their lives. Not only do they spend more waking hours at work than anywhere else, but they do most of their socializing there as well. Their entire circle of social interaction is often limited to family and coworkers. This is encouraged by many modern management techniques, which take a lot of the interactions that would traditionally have occurred outside the workplace and transfer them to inside the organization – creating what Dave Arnott (2000) refers to as "all-consuming organizations." One can see this trend at work in the creation of company "campuses" or "compounds," which include banking services, medical clinics, dry cleaners, daycares, and convenience stores (Arnott, 2000, pp. 72–73). A (largely) unintended consequences of this trend is that it leaves employees increasingly cut off from any contact with the broader community, and in many cases, even from their own families. Such arrangements are troublesome, from the standpoint of white-collar crime, simply because they also leave individuals quite isolated from any contact with those who might challenge the "company line" on illegal practices, or reject the excuses that are conventionally offered within the firm.

Implications for Business Ethics

There is an enormous benefit to be derived for business ethicists from this sort of foray into the criminology literature. I would like to draw attention to some of the implications that the focus on techniques of neutralization has for the way that business ethics is taught. This is an issue that is close to the heart of many in the field, since most people who do research in business ethics also teach it. Of those who teach business ethics, very few do so out of purely "academic" interest, most are also hoping, in one way or another, to improve the chances that their students will act ethically, when and if they continue on to careers in business. There is nothing wrong with such aspirations. Suppose though that we change the focus slightly, in order to bring the criminological perspective to bear. Instead of asking how an ethics course should be taught, in order to reduce the chances that students will behave unethically, let us ask how a course should be taught, in order to reduce the chances that students will go on to commit major felonies. We can then ask what advice a criminologist would have to offer. By paying careful attention to this advice, we can perhaps learn some more effective strategies for the design of ethics courses as well.

The first thing that one notices, when turning to the issue of ethics education, is that the debate over the efficacy of business ethics programs is almost entirely dominated by the folk theories of moral motivation that have been so thoroughly discredited in the field of criminology. Critics of business ethics typically argue that morality is matter of character, or of values, and that "by the time students enroll in college-level business courses their values have already been formed, rendering ethics education a waste of time" (Williams and Dewett, 2005). Defenders of business ethics education, unfortunately, have been far too willing to accept the theory of moral motivation that is implicit in this critique. Thus they have responded by trying to show that it is still possible to improve the character (Hartman, 1998), or influence the values (Williams and Dewett, 2005, pp. 112–113), of students. A more appropriate response would be to dismiss the entire frame of reference.

It is worth recalling, in this context, that the motivation most people have for obeying the law is often the same as the motivation that they have for acting ethically. This is especially true with regard to white-collar crime, where enforcement is exceedingly difficult, and the threat of legal penalties in many cases slim to non-existent (Coleman, 1989, pp. 177–180). Insofar as most people respect the law, they do so because they feel morally bound to do so. What the criminology literature tells us about this moral motivation is that it is not about character, and it is not about values. On the contrary, it is various aspects of the *situation* that individuals find themselves in, what they *think* about this situation, and what they *expect others* to think about the situation, that plays the major role in determining how they conduct themselves.

Too many business ethicists, unfortunately, have maintained a stubborn adherence to a discredited folk theory of character traits (e.g., Hartman, 1998; Solomon, 1992, pp. 3–4). The fact that institutional context is far more important than character should be a source of encouragement for business ethicists. After all, thinking in a disciplined manner about the sort of institutional arrangements that employees find themselves working in is one of the central functions of management. One of the interesting results turned up by Armstrong, in his study of how management students would behave when confronted with the Panalba case, is that the outcome was highly sensitive to the way that he described the role that students would be playing. When told that "a resolution was passed in 1950 which stated that the Board's duty was to represent the stockholders," 79% of groups chose the "highly irresponsible" course of action. However, when told that a resolution was passed stating that "the Board's duty was to represent the interests of each and every one of its 'interest groups' or 'stakeholders'" the level of highly irresponsible conduct dropped to 22% (Armstrong, 1979, p. 203). Setting aside the more complicated question of whether this sort of "stakeholder" orientation represents either a feasible or desirable way of achieving more ethical conduct in business (see Heath, 2006), what this result does show quite clearly is that the way individuals conceive of their obligations – and the neutralizations that are made available to them by aspects of their situation – is an enormously important factor in the decisions that they ultimately make.

This has important implications for business ethicists. On the one hand, it means the business schools – and business managers more generally – cannot simply throw up their hands and claim that it is "too late" to do anything about ethics. The best way to get people to behave ethically is to put them in a situation in which ethical conduct is expected of them and self-serving excuses are not tolerated. This is a matter of effective institutional design. Thus business ethics courses need not do anything particularly profound, such as forcing students to rethink their fundamental values, or promoting their moral development (Williams and Dewett, 2005, p. 112). They need only teach managers how to create institutional environments that will promote ethical conduct. One way of doing this, suggested by the criminology literature, is to create an environment in which the standard techniques of neutralization used to excuse criminal and unethical behavior are not accepted.

If one takes this perspective seriously, then there is no particular reason for business ethics courses to focus on moral dilemmas, or to teach fundamental meta-ethical perspectives (Kantian, utilitarian, etc.) Students do not commit crimes because they lack expertise in the application of the categorical imperative or the felicific calculus. They are more likely to commit crimes because they have talked themselves into believing some type of excuse for their actions, and they have found a social environment is which this sort of excuse is accepted or encouraged. Thus a more useful intervention, in an ethics course, would be to attack the techniques of neutralization that students are likely to encounter, and may be tempted to employ, when they go on to their future careers. As we have seen, white-collar criminals are typically conflicted about their own actions. They know what morality and the law require of them. The problem is that they have convinced themselves that no one is really injured by their actions, or that they had no choice in the matter, or that it's permissible because everyone else is doing it, etc. Typically, the arguments they have used to convince themselves are sufficiently fragile that they can only be sustained in a supportive environment, among peers who are also inclined to view these claims as legitimate. One way to tackle this problem, "preemptively" so to speak, is to demonstrate the inadequacy of these rationalizations, e.g., by tracing out the harm caused by embezzlement, or expense account abuse; by articulating the logic of government regulation and the basis for its legitimacy; by explaining the concept of market failure and why unconstrained competition sometimes produces inferior results; and by exploring the tendency toward dissipation of responsibility in bureaucracies. One can imagine an ethics curriculum structured around these themes. The goal would be to bring to conscious awareness certain patterns of self-exculpatory reasoning, and to flag them as suspicious, so that students will be less likely to accept them at face value when they encounter them later in life. The goal, in other words, would be to neutralize the neutralizations.

Notes

[1] The one article that cites it is Chan (2003), although Cressey's name is misspelled.

[2] This might be thought of as a defect of character, and thus merely a special case of the previous folk theory. Yet there are ways of construing the underlying moral psychology that are not committed to a "virtue ethics" framework. This, combined with the frequency of appeal to this motive, justifies giving it a separate treatment.

[3] I am tacitly introducing the distinction between excuses and justifications into this discussion (see Baron, 2005). To justify an action is to show that it is, in some sense, the "right" thing to do. To excuse an action, on the other hand, is to grant that it is, in some sense,

the "wrong" thing to do, but to claim that the individual cannot be blamed for performing it under the circumstances (Ripstein, 1998). Sykes and Matza use only the vocabulary of "justification," but most of the patterns of reasoning they discuss are better understood as excuses.

4 I use masculine pronouns throughout, in reflection of the fact that the overwhelming majority of criminals – both white collar and blue collar – are men.

5 In this context, one might read with interest the lyrics of Ice Cube's "Why We Thugs."

6 My father, while serving in the Royal Canadian Air Force, once threatened to resign if a particular practice, which he considered unethical, was not stopped. His commanding officer stuck his fist into a pail of water that happened to be on his desk, pulled it out, and said "You see that Heath? That's the hole you'll leave in this organization when you're gone."

7 Writing for the Heritage Foundation, Baker Jr. (2004) argues, "The origin of the 'white-collar crime' concept derives from a socialist, anti-business viewpoint that defines the term by the class of those it stigmatizes."

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Ethical Leadership and the Psychology of Decision Making

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Changes in today's business environment pose vexing ethical challenges to executives. We propose that unethical business decisions may stem not from the traditionally assumed trade-off between ethics and profits or from a callous disregard of other people's interests or welfare, but from psychological tendencies that foster poor decision making, both from an ethical and a rational perspective. Identifying and confronting these tendencies, we suggest, will increase both the ethicality and success of executive decision making.

Executives today work in a moral mine field. At any moment, a seemingly innocuous decision can explode and harm not only the decision maker but also everyone in the neighborhood. We cannot forecast the ethical landscape in coming years, nor do we think that it is our role to provide moral guidance to executives. Rather, we offer advice, based on contemporary research on the psychology of decision making, to help executives identify morally hazardous situations and improve the ethical quality of their decisions.

Psychologists have discovered systematic weaknesses in how people make decisions and process information; these new discoveries and theories are the foundation for this paper. These discoveries involve insights into errors that people make when they estimate risks and likelihoods, as well as biases in the way they seek information to improve their estimates. There are new theories about how easily our preferences can be influenced by the consequences we consider and the manner in which we consider them. Social psychologists have new information about how people divide the world into "us" and "them" that sheds new light on how discrimination operates. Finally, there has been important new research into the dimensions along which people think that they are different from other people, which helps explain why people might engage in practices that they would condemn in others.[1]

We focus on three types of theories that executives use in making decisions – theories about the world, theories about other people, and theories about ourselves. Theories about the world refer to the beliefs we hold about how the world works, the nature of the causal network in which we live, and the ways in which our decisions influence the world. Important

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aspects of our theories about the world involve our beliefs about the probabilistic (or deterministic) texture of the world and our perceptions of causation.

Theories about other people are our organized beliefs about how "we" are different from "they." Interestingly, "they" may be competitors, employees, regulators, or foreigners, and whoever is "we" today may be "them" tomorrow. Our beliefs about others influence the ways in which we make judgments and decisions about other people, and these influences are often unconscious.

Finally, we all correctly believe that we are unique individuals. However, theories about ourselves lead us to unrealistic beliefs about ourselves that may cause us to underestimate our exposure to risk, take more than our fair share of the credit for success (or too little for failure), or be too confident that our theory of the world is the correct one. If most of the executives in an organization think that they are in the upper 10 percent of the talent distribution, there is the potential for pervasive disappointment.

Our discussion of these three theories focuses on the ways they are likely to be incorrect. Our message, however, is not that executives are poor decision makers. We focus on problem areas because they are the danger zones where errors may arise. They are the places where improvements may be achieved, areas in which executives would like to change their decision making if only they better understood their existing decision processes.

Theories about the World

Successful executives must have accurate knowledge of their world. If they lack this knowledge, they must know how to obtain it. One typical challenge is how to assess the risk of a proposed strategy or policy, which involves delineating the policy's consequences and assessing the likelihood of various possibilities. If an executive does a poor assessment of a policy's consequences, the policy may backfire and cause financial as well as moral embarrassment to the firm and the decision maker. There are three components to our theories of the world: the consideration of possible consequences, the judgment of risk, and the perception of causes.

The cascade of consequences

A principle in ecology that Hardin has called the First Law of Ecology is, simply stated, "You can never do just one thing."[2] Major decisions have a spectrum of consequences, not just one, and especially not just the intended consequence. Everyday experience as well as psychological research suggests that, in making complex choices, people often simplify the decision by ignoring possible outcomes or consequences that would otherwise complicate the choice. In other words, there is a tendency to reduce the set of possible consequences or outcomes to make the decision manageable. In extreme cases, all but one aspect of a decision will be suppressed, and the choice will be made solely on the basis of the one privileged feature. The folly of ignoring a decision's possible consequences should be obvious to experienced decision makers, but there are several less obvious ways in which decision errors can create moral hazards. The tendency to ignore the full set of consequences in decision making leads to the following five biases: ignoring low-probability events, limiting the search for stakeholders, ignoring the possibility that the public will "find out," discounting the future, and undervaluing collective outcomes.

Ignoring low-probability events If a new product has the potential for great acceptance but a possible drawback, perhaps for only a few people, there is a tendency to underestimate the importance of the risk. In the case of DES (diethylstilbestrol), a synthetic estrogen prescribed for women with problem pregnancies, there was some early indication that the drug was associated with a higher than normal rate of problems not only in pregnant women but also in their daughters.The importance of this information was insufficiently appreciated. Worrisome risks may be ignored if they threaten to impede large gains.

Limiting the search for stakeholders DES's most disastrous effects did not befall the consumers of the drug, namely, the women who took it; the catastrophe struck their daughters. When there is a tendency to restrict the analysis of a policy's consequences to one or two groups of visible stakeholders, the decision may be blind-sided by unanticipated consequences to an altogether different group. A careful analysis of the interests of the stakeholders (those persons or groups whose welfare may be affected by the decision under consideration) is essential to reasonably anticipating potential problems. A basic tenet of moral theories is to treat people with respect, which can be done only if the interests of all concerned people are honestly considered. Assessing others' interests would have required research, for instance, on the long-term effects of DES.

Ignoring the possibility that the public will "find out" The stakeholder who should always be considered is the public in general. Executives should ask, "What would the reaction be if this decision and the reasons for it were made public?" If they fear this reaction, they should reconsider the decision. One reason for the test is to alert executives that if the decision is made, they will have to conceal it to avoid adverse public response. The need to hide the decision, and the risk that the decision and its concealment might be disclosed, become other consequences to face. The outrage provoked by the revelation that a crippling disease, asbestosis, was caused by asbestos exposure was partly due to the fact that Johns Manville had known about and hidden this relationship for years while employees and customers were continuously exposed to this hazard. A decision or policy that must be hidden from public view has the additional risk that the secret might be revealed. Damage to self-respect and institutional respect of those who must implement and maintain the concealment should also be considered a consequence.

Discounting the future The consequences that we face tomorrow are more compelling than those we must address next week or next year. The consequences of decisions cascade not only over people and groups, but also over time. Figuring out how to address the entire temporal stream of outcomes is one of the most challenging tasks executives face. Policy A will earn more money this year than Policy B, but a year from now, if we get there, Policy B will probably leave us stronger than Policy A. Theories of the world that fail to cope with the temporal distribution of consequences will not only leave executives puzzled about why they are not doing better; they will also expose executives to accusations that they squandered the future to exploit the present. The tendency to discount the future partly explains the decaying urban infrastructure, the U.S. budget deficit, the collapse of fisheries, global warming, and environmental destruction. While there is much debate about the destructiveness of these issues, in each instance, the key decision makers have clearly underweighted the future in making the appropriate balanced decisions.

Undervaluing collective outcomes Accurate theories of the world must also be sensitive to the collective consequences of decisions. When E.F. Hutton's managers decided to earn money by kiting checks, not only did they put the reputation of their own firm in jeopardy, they also endangered the reputation of the entire securities industry. When a chemical firm decides to discharge waste into a public lake, it pollutes two collective resources, the lake and the reputation of the chemical industry in general. There is a tendency to treat these collective costs as externalities and to ignore them in decision making. To do so, however, is to ignore a broad class of stakeholders whose response could be, "If they voluntarily ignore the collective interests, then it is in the collective interest to regulate their activity."

Ethical decisions must be based on accurate theories about the world. That means, at a minimum, examining the full spectrum of a decisions consequences. Our perspective suggests that a set of biases reduces the effectiveness of the search for all possible consequences. It is interesting to evaluate the infamous Pinto decision from this consequential perspective. Ford executives knew that the car had a fire risk, but the cost they associated with it was small. Their deliberations gave no consideration to their customers' interests. They made no effort to ask car buyers if they were willing to pay an extra $10 to shield the gas tank. The Pinto decision proved a colossal embarrassment to Ford; when the documents were released, the effort to conceal the decision failed, and public opinion, fueled by Ralph Nader's book *Unsafe at Any Speed*, ran deeply and strongly against Ford.[3] The public felt that there was a collective interest in automobile safety and that Ford and, by association, the other auto manufacturers, were indifferent to that concern. From the public's perspective, it would be stupid to permit unethical firms to police themselves.

Judgment of risk

Theories of the world will be inaccurate if they systematically fail to account for the full spectrum of consequences associated with decisions. And they will be inaccurate if they systematically err in assessing the probabilities associated with the consequences. Let's first consider these two scenarios:

- A tough-minded executive wants to know if the company's current promotion practices have caused any specific case of demonstrated discrimination against a minority employee. He explains that he is not interested in vague possibilities of discrimination but is concerned that the firm not do anything that "really" causes discrimination.
- Edmund Muskie, a candidate in the 1972 U.S. presidential election, borrowed the words of President Harry Truman when he stated that what this country needed was a "one-armed" economist. When asked why, he responded that he was tired of economists who said "on the one hand ..., but on the other hand...."

Denying uncertainty These decision makers are grasping for certainty in an uncertain world. They want to know what *will or did* happen, not what *may or might have* happen(ed). They illustrate the general principle that people find it easier to act as if the world were certain and deterministic rather than uncertain and often unpredictable. The executive in the first scenario wants to know about "real" discrimination, not the possibility of discrimination. Muskie expressed frustration with incessantly hearing about "the other hand." What people want to hear is not what *might* happen, but what *will* happen, When executives act as if the world is more certain than it is, they expose themselves to poor outcomes, for both themselves and others. It is simply foolish to ignore risk on one's own behalf, but it is unethical to do so on behalf of others.

There are some good reasons why people underestimate the importance of chance. One is that they misperceive chance events. When the market goes up on five consecutive days, people find a reason or cause that makes the world seem deterministic (for example, a favorable economic report was published). If the market goes up four days and then down on the fifth, people say a "correction" was due. Statistical market analyses suggest that changes in indices such as the Dow Jones index are basically random. Yet each morning, we are offered an "explanation" in the financial pages of why the market went up or down.

One implication of the belief in a deterministic world is the view that evidence should and can be perfect. The fact that there is a strong statistical relationship between smoking and bad health, for instance, is insufficient to convince tobacco company executives that cigarettes are harmful, because the standard of proof they want the evidence to meet is that of perfection. Any deviation from this standard is used strategically as evidence that smoking is not harmful.

We believe in a deterministic world in some cases because we exaggerate the extent to which we can control it. This illusion of control shows up in many contexts, but it seems maximal in complex situations that play out in the future. The tendency appears in experimental contexts in which people prefer to bet on the outcome of a flip of a coin that has not yet been tossed rather than on one that has already been thrown but whose outcome is unknown to the bettor.[4] The illusory sense that a bet may influence the outcome is more acute for future than for past events.

The illusion of control undoubtedly plays a large role in many business decisions. Janis has suggested that President Kennedy's disastrous decision to invade Cuba at the Bay of Pigs was flawed by, among other things, an erroneous belief that the invasion forces, with U.S. support, could control the battle's outcome.[5] Evidently, the Russian military offered similar assurances to support their attack on Grozny.

One common response to the assertion that executives underestimate the importance of random events is that they have learned through experience how to process information about uncertainty. However, experience may not be a good teacher. In situations in which our expectations or predictions were wrong, we often misremember what our expectations, in fact, were. We commonly tend to adjust our memories of what we thought would happen to what we later came to know did happen. This phenomenon, called the "hindsight bias," insulates us from our errors.[6]

We fail to appreciate the role of chance if we assume that every event that occurred was, in principle, predictable.The response "I should have known ..." implies the belief that some future outcome was inherently knowable, a belief incompatible with the fact that essentially random events determine many outcomes. If every effort has been made to forecast the result of a future event, and the result is very different from predictions, it may be ill-advised to blame ourselves or our employees for the failure.This, of course, assumes that we made every effort to collect and appropriately process all the information relevant to the prediction.

Risk trade-offs Uncertainty and risk are facts of executive life. Many risky decisions concern ethical dilemmas involving jobs, safety, environmental risks, and organizational existence. How risky is it to build one more nuclear power plant? How risky is it to expose assembly-line employees to the chemicals for making animal flea collars? At some point, our decisions are reduced to basic questions like: What level of risk is acceptable? How much is safety worth?

One unhelpful answer to the second question is "any price." That answer implies that we should devote all our efforts to highway improvement, cures for cancer, reducing product risks, and so on, to the exclusion of productivity. Throughout our lives, dealing with risk requires trading off benefits and costs; however, this is not a process that people find easy. It is much simpler, but completely unrealistic, to say "any price." The illusion that a riskless world can be created is a myth that is consistent with a theory of the world that minimizes the role of chance.

If we deal irrationally or superficially with risk, costly inconsistencies can occur in the ways we make risk tradeoffs. Experts point out that U.S. laws are less tolerant of carcinogens in food than in drinking water or air. In the United Kingdom, 2,500 times more money per life saved is spent on safety measures in the pharmaceutical industry than in agriculture. Similarly, U.S. society spends about $140,000 in highway construction to save one life and $5 million to save a person from death due to radiation exposure.

A special premium seems to get attached to situations in which all risk can be eliminated. Consider the following two scenarios:

Scenario A. There is a 20 percent chance that the chemicals in your company's plant might be causing ten cancer-related illnesses per year. Your company must decide whether to purchase a multimillion-dollar filtration system that would reduce this probability to a 10 percent chance.

Scenario B. There is a 10 percent chance that the chemicals in your company's plant might be causing ten cancer-related illnesses per year. Your company must decide whether to purchase a multimillion-dollar filtration system that would entirely eliminate this risk.

Evidence suggests that executives would be more likely to purchase the filtration system in scenario B than in scenario A.[7] It appears to be more valuable to eliminate the entire risk than to make an equivalent reduction from one uncertain level to another. Rationally, all reductions in a risk of 10 percent should have the same value for the decision maker. The "preference for certainty" suggests that a firm might be willing to spend more money to achieve a smaller risk reduction if that smaller reduction totally eliminated the risk. Were this the case, not only would the firm's decision be wasteful, it would be unethical because it failed to accomplish the greatest good with the budget allocated for it.

Perceptions of risk are often faulty, frequently resulting in public and private decision makers' misdirected risk-reduction efforts. Is it not a breech of ethics if incoherent policies save fewer lives at greater costs than other possible policies? Failure to explicitly deal with risk tradeoffs may have created precisely such a situation.

Risk framing Whether a glass is half-full or half-empty is a matter of risk framing. When the glass is described as half-full, it appears more attractive than when described as half-empty. Similarly, a medical therapy seems more desirable when described in terms of its cure rate than its failure rate. This finding probably occurs because the cure rate induces people to think of the cure (a good thing), whereas an equivalent description in terms of failures induces people to think of failures (not a good thing).

A less obvious effect has been found with regard to the framing of risks. Consider this example:

- A large car manufacturer has recently been hit with a number of economic difficulties. It appears that it needs to close three plants and lay off 6,000 employees. The vice president of production, who has been exploring alternative ways to avoid the crisis, has developed two plans.

  Plan A will save one of the three plants and 2,000 jobs.

  Plan B has a one-third probability of saving all three plants and all 6,000 jobs, but has a two-thirds probability of saving no plants and no jobs.

Which plan would you select? There are a number of things to consider in evaluating these options. For example, how will each action affect the union? How will each plan influence the motivation and morale of the retained employees? What is the firm's obligation to its shareholders? While all these questions are important, another important factor influences how executives respond to them. Reconsider the problem, replacing the choices provided above with the following choices.

*Pla*n C will result in the loss of two of the three plants and 4,000 jobs.

Plan D has a two-thirds probability of resulting in the loss of all three plants and all 6,000 jobs, but has a one-third probability of losing no plants and no jobs.

Now which plan would you select? Close examination of the two sets of alternative plans finds the two sets of options to be *objectively* the same. For example, saving one of three plants and 2,000 of 6,000 jobs (plan A) offers the same objective outcome as losing two of three plants and 4,000 of 6,000 jobs (plan C). Likewise, plans B and D are objectively identical. Informal empirical investigation, however, demonstrates that *most* individuals choose plan A in the first set (more than 80 percent) and plan D in the second set (more than 80 percent).[8] While the two sets of choices are objectively the same, changing the description of the outcomes from jobs and plants *saved* to jobs and plants *lost* is sufficient to shift the prototypic choice from risk-averse to risk-seeking behavior.

This shift is consistent with research showing that individuals treat risks concerning perceived gains (e.g., saving jobs and plants – plans A and B) differently from risks concerning perceived losses (e.g., losing jobs and plants – plans C and D). The way in which the problem is "framed" or presented can dramatically change how executives respond. If the problem is framed in terms of losing jobs and plants, executives tend to take the risk to avoid any loss. The negative value placed on the loss of three plants and 6,000 jobs is usually perceived as not being three times as bad as losing one plant and 2,000 jobs. In contrast, if the problem is framed in terms of saving jobs and plants (plans A and B), executives tend to avoid the risk and take the sure "gain." They typically view the gain placed on saving three plants and 6,000 jobs as not being three times as great as saving one plant and 2,000 jobs.

This typical pattern of responses is consistent with a general tendency to be risk averse with gains and risk seeking with losses.[9] This tendency has the potential for creating ethical havoc. When thinking about layoffs, for instance, most employees surely focus on their potential job loss. If executives adopt a risk-prone attitude in such situations – that is, if they are willing to risk all to attempt to avoid any losses – they may be seen as reckless and immoral by the very people whose jobs they are trying to preserve. If different stakeholders have different frames, the potential for moral disagreement is great.

Perception of causes

The final aspect of executives' theories of the world, perhaps the most important, is the beliefs that executives and other people cherish about the causal texture of the world, about *why* things happen or don't happen. Everyone holds beliefs about business successes and failures. As we mentioned earlier, every morning we're given a reason for why the stock market rose, fell, or stayed the same, thus reinforcing the theory that the world is deterministic. Moreover, judging causal responsibility is often a precursor to judging moral accountability and to blaming or praising a person, organization, or policy for an outcome. However, even under the best of circumstances, causation is usually complex, and ambiguity about causation is often at the heart of disputes about responsibility, blame, and punishment.

Consider, for example, the *Herald of Free Enterprise*, a ferry that carried automobiles from the Belgian port of Zeebrugge to Dover, England. Several years ago, it sank in a placid sea a few minutes after leaving Zeebrugge; 180 persons drowned. An investigation determined that the boat sank because the bow doors, through which the cars enter, had been left open, allowing water to pour into the vessel. The assistant bosun, who was responsible for closing the bow doors, had, tragically, taken a nap.

There were no alarm lights to warn the captain that the doors were open. The captain had requested such lights, but the company had denied his request; it felt warning lights were unnecessary because the first mate monitored the closing. On this occasion, the first mate failed to monitor the bow-door closing because he was needed elsewhere on board due to a chronic manpower shortage. Furthermore, the monitoring system was a "negative" check system, which means that signals were sent only if problems were detected. The lack of a signal was construed as an indication that all was well; the captain did not have to wait for a "positive" signal from the boat deck. Finally, there was the question of why water entered the ship since the bow doors are normally several meters above sea level. The answer was that the ship had taken on ballast to enable it to take cars onto the upper car deck. The captain had not pumped out the ballast before departing because he needed to make up twenty minutes to get back on schedule. Thus the ship left harbor at full throttle, creating a bow wave, with the ship's bow unusually low in the water.

What caused the *Herald of Free Enterprise* to capsize? Who is to blame? We have many candidates for blame: the assistant bosun, the first mate, the captain, the person who refused to provide warning lights, the person who instituted the negative check system, and the owners of the line for failing to provide adequate crew for the boat.

Focus on people A central issue in this case is the tendency of most people to *blame a person*. This principle is at the heart of the slogan of the National Rifle Association, a U.S. lobbying organization for gun manufacturers and users: "Guns don't kill people, people do." "Human error" becomes the cause assigned to many accidents involving complex technologies (such as ferries). We tend to blame people because it is easy to imagine them having done something to "undo" or prevent the accident. If the assistant bosun had not fallen asleep, if the first mate had stayed on the car deck to supervise the bow-door closing, if the captain had not left the harbor at full speed before pumping the ballast, and so on.

It is less easy to imagine changing the ship's equipment and procedures, and these appear less salient as a cause of the disaster. The absence of warning lights allowed the ship to depart with the bow doors open. The negative check system invited a nonmessage to be misconstrued as an "all clear" signal. The point is that human "errors" occur within systems that may vary widely in the degree to which they are "error proof." Our theories about the world usually involve people as the causal agents, rather than environments either that influence people for good or bad or that can compensate for human weaknesses such as drowsiness. From an engineering viewpoint, what is easier to change – warning lights or periodic drowsiness?

Different events Theories about causes often lead people to disagree, because, as McGill has pointed out, they are explaining different events.[10] When Sears introduced a commission-based sales system at its automotive repair shops, there was an increase in consumer complaints, usually accusing the shop of performing unnecessary, expensive work. Sears acknowledged that there had been some "isolated abuses" but denied that the problem was widespread. In subsequent public discussions, some of the controversy confused two phenomena. The first is why a particular employee would recommend and perform unnecessary work. The question, "Why did Jack do this?" may lead to determining how Jack is different from Bill and other employees who did not recommend unnecessary work. These causes answer the question, "Why did Jack do this, while others did not?" Are there changes in Jack's situation that can explain his misconduct? "Why did Jack do this now, when he did not do it earlier?" is another way to construe this question.

The second question is why Sears had more complaints in the new system. The fact that there was a change raises an important issue: different systems may produce different levels of unethical conduct. If we focus only on Jack, or if we never change the system, we fail to see that the system itself can be a cause of problems. In many cases, something like the method of compensation appears in the background. If an employee behaves dishonestly, we tend to contrast him or her with honest workers, rather than ask if there is something encouraging dishonesty. When we change situations, we can sometimes see that an organization's features can have a causal impact on human actions, analogous to what happens when a community is exposed to a carcinogenic agent.The overall cancer rate in the community will increase, but it may be difficult ever to determine whether any specific individual's cancer was caused by the toxin. There may be convincing proof that the agent is a cause of cancer in the community generally, but not of any particular cancer.

Sins of omission We have no problem judging that the assistant bosun bears some responsibility for the passenger deaths on the *Herald of Free Enterprise*, even though his contribution to the disaster was a failure to act. In many other situations, in which expectations and duties are not as well defined as they were with the *Herald*, a failure to take an action is used to shield persons from causal and, hence, moral responsibility. Is a public health official who decides not to authorize mandatory vaccinations responsible for the deaths of those who succumb to the disease?[11] Is the executive who fails to disclose his knowledge of a colleague's incompetence responsible for the harm that the colleague causes the firm? Many people would answer these questions in the negative, largely because they perceive that the immediate cause of the deaths or harm is the virus or incompetence. But since the actions of the public health official and the executive could have prevented the harm, their actions are *logically* in the same category as those of the assistant bosun. It is an old adage that evil prevails when good people fail to act, but we rarely hold the "good" people responsible for the evil.

Theories about Other People

An executive's social world is changing at least as fast as his or her physical world. The internationalization of manufacturing and marketing exposes executives to very different cultures and people, and they need to be tolerant of different customs, practices, and styles. More women are entering the work force. In the United States, both the African American and Latino populations are growing faster than the Anglo population, a demographic fact reflected in labor markers. Also, the United States, like many other nations, prohibits employment discrimination on the basis of religion, race, gender, age, and other types of social or personal information. This combination of factors – the increasing social diversity of the business world and the inappropriateness of using such social information in making decisions – creates many ethical hazards that executives must avoid. Incorrect theories about social groups – about women, ethnic minorities, or other nationalities – increase executives' danger markedly. In this section, we discuss how executives, like other people, are likely to harbor erroneous theories about other groups.[12]

Ethnocentrism

The characteristics of our nation, group, or culture appear to us to be normal and ordinary, while others appear foreign, strange, and curious. Implicit in this perception is the assumption that what is normal is good and what is foreign, different, and unusual is less good. This perception that "our" way is normal and preferred and that other ways are somehow inferior has been called ethnocentrism. In the ethnocentric view, the world revolves around our group, and our values and beliefs become the standard against which to judge the rest of the world.

Everyone is ethnocentric to some degree.We probably cannot escape the sense that our native tongue is "natural" while other languages are artificial, that our food is normal while others are exotic, or that our religion is the true one while others are misguided. The fact that ethnocentrism is basic and automatic also makes it dangerous. We do not have to harbor hostile views of members of other groups in order to subtly discriminate. We must merely believe that our own group is superior, a belief that is often actively and officially encouraged by the groups in question and that most of us find all too easy to maintain.

The consequences of ethnocentrism are pervasive. We may describe the same actions of "us" and "them" in words that are descriptively equivalent but evaluatively biased. We are loyal, hard-working, and proud; they are clannish, driven, and arrogant. We are fun loving; they are childish.

Furthermore, "we" tend to be like each other and quite different from "them." "We" come in all shapes and sizes, while "they" tend to be all alike. We take pleasure in "our" successes and grieve over "our" failures, while we are relatively uncaring about "their" outcomes. We expect aid and support from others of "us" and are more willing to support "us" than "them." We may not wish "them" harm but would not go out of our way to help "them." What is curious about this phenomenon is that today "we" may be residents of Chicago and "they" may be rural residents of Illinois, and tomorrow "we" may be Americans and "they" may be Europeans, or "we" may be men and "they" may be women.

Ethnocentric thinking exaggerates the differences between "us" and "them" in ways that can expose leaders to the risk of making ethically unsound decisions. Intensely competitive situations, such as military contexts, illustrate this type of distortion. Military strategists have often made different assumptions about how "we" and "they" will react to intensive attack. They seem to believe that the enemy's spirit can be broken by a prolonged artillery or bombing attack and associated deprivations. Their belief does not seem to have been weakened by the evidence of Leningrad, London, Dresden, Vietnam, or, more recently, Sarajevo. In all these cases, civilian populations were subjected to intensive, prolonged attack, the main consequence of which seems to have been to strengthen the afflicted people's resolve to resist the aggressors. U.S. leaders did not share the Japanese belief that a swift and decisive victory over the U.S. Pacific fleet at Pearl Harbor would destroy the American will to wage a Pacific war. These instances reflect the belief that "they" will be more discouraged by extreme hardship than "we" would be. These incorrect theories about "them" turned out to be seriously wrong and immeasurably costly.

It is an error to think that the effects of ethnocentrism are always as momentous or conspicuous as in these examples. Consider the charge of pervasive racial discrimination in mortgage lending. There is evidence that a higher proportion of minority applicants than white applicants are rejected. This difference in rejection rates remains after accounting for the effects of differences in income, employment stability, credit history, and other indicators of creditworthiness. Yet mortgage bankers vigorously deny that they are harder on minority applicants than on white ones.

Much research indicates that the way ethnocentrism often works is not by denigrating "them" but by rendering special aid to "us." This has been called the "in-group favoritism" hypothesis.[13] In mortgage lending, this hypothesis suggests that the difference in approval rates for whites and minorities may not reflect the fact that qualified minority applicants are denied, but that unqualified white applicants are given loans. This difference has important implications for banks that want to understand and correct the disparity. Establishing a review procedure for rejected minority loans would not be an advisable policy if the in-group favoritism hypothesis is correct, because there may be few, if any, qualified minorities who are rejected. Looking only at rejected minority loans would uncover no evidence of racial discrimination. To find where the discriminatory action lies, the bank needs to examine the marginally unqualified applicants. The in-group favoritism hypothesis predicts that, of this group, more white than minority applicants will be approved.

Stereotypes

In addition to the "theory" that "our" group is better than others, we often have specific beliefs about particular groups, which constitute implicit theories about people in these groups. We have stereotypes about different nationalities, sexes, racial groups, and occupations. To the extent that we rely on stereotypes rather than information about individuals, we risk making unfair, incorrect, and possibly illegal judgments. The issue here is not the extent to which stereotypes are accurate; the issue is whether people will be judged and evaluated on the basis of their individual qualities or on the basis of their group membership. The fact that women are generally smaller and weaker than men is irrelevant to the question of whether a particular woman is strong enough to perform a physically demanding job.

Like ethnocentrism, stereotypes are dangerous because we are often unaware of their influence. We tend to think that our beliefs about groups are accurate, and we can often draw on experience to support these beliefs. Experience, however, can be a misleading guide. Think about the people whom you consider to be the most effective leaders in your company. What qualities do they have that make them effective? For a purely historical reason, there is a good chance that the people who come to mind as effective leaders are men. For that reason, many of the qualities you associate with effective leadership may be masculine. Consequently, you may find it difficult to imagine a woman who could be an effective leader.

It is instructive to review the origins of the common belief that business leaders are masculine. First, there is the fact that twenty to thirty years ago, almost all businesspeople were men. Thus *successful* businesspeople today – those who have been in business twenty or thirty years – are also men. If we form our impressions of what it takes to succeed by abstracting the qualities of the successful people we know, a perfectly reasonable process, our impressions will have a distinctly masculine aura. It is not that we have evidence that women do not succeed; rather, we have little evidence about women at all. If you are asked to imagine people in your company who are notorious failures, the people you conjure up would probably also be men. The stereotypical failure is probably also a man.

How can we guard against the dangers of ethnocentric and stereotypical theories? Starting with ethnocentrism, we should question arguments based on the belief that "they" are different from "us." The safest assumption to make, in the absence of contrary evidence, is that "they" are essentially the same as "us" and that if we want to know how "they" will react to a situation, a wise first step is to ask how "we" would react. Historically, far more harm has been incurred by believing that different groups are basically different than by assuming that all people are essentially the same.

Many decisions that executives make involve promotion, hiring, firing, or other types of personnel allocations. These decisions are stereotypical when they use considerations about the group rather than information about the person. "Women can't handle this kind of stress" is a stereotypical statement about women, not an assessment of a particular individual. Executives should be especially alert for inappropriate theories about others when the criteria for evaluation and the qualifications under discussion are vague. Ethnocentric or stereotypical theories are unlikely to have a large impact if rules state that the person with the best sales record will be promoted. The criteria and qualifications are clear and quantified. However, vague criteria such as sociability, leadership skill, or insight make evaluation susceptible to stereotyping.

One of the most effective strategies for combating ethnocentrism and stereotypes is to have explicit corporate policies that discourage them, such as adopting and publishing equal opportunity principles and constantly reminding employees that group-based judgments and comments are unacceptable. Executives must be the ethical leaders of their organizations.

Theories about Ourselves

Low self-esteem is not generally associated with successful executives. Executives need confidence, intelligence, and moral strength to make difficult, possibly unpopular decisions. However, when these traits are not tempered with modesty, openness, and an accurate appraisal of talents, ethical problems can arise. In other words, if executives' theories about themselves are seriously flawed, they are courting disaster. Research has identified several ways in which peoples' theories of themselves tend to be flawed."[14] We discuss three: the illusion of superiority, self-serving fairness biases, and overconfidence.

Illusion of superiority

People tend to view themselves positively. When this tendency becomes extreme, it can lead to illusions that, while gratifying, distort reality and bias decision making. Scholars have identified three such illusions: favorability, optimism, and control.[15]

Illusion of favorability This illusion is based on an unrealistically positive view of the self, in both absolute and relative terms. For instance, people highlight their positive characteristics and discount their negatives. In relative terms, they believe that they are more honest, ethical, capable, intelligent, courteous, insightful, and fair than others. People give themselves more responsibility for their successes and take less responsibility for their failures than they extend to others. People edit and filter information about themselves to maintain a positive image, just as totalitarian governments control information about themselves.

Illusion of optimism This illusion suggests that people are unrealistically optimistic about their future relative to others. People overestimate the likelihood that they will experience "good" future events and underestimate the likelihood of"bad" future events. In particular, people believe that they are less susceptible than others to risks ranging from the possibility of divorce or alcoholism to injury in traffic accidents. To the extent that executives believe themselves relatively immune from such risks, they may be willing to expose themselves and their organizations to hazards.

Illusion of control The illusion of optimism is supported by the illusion of control that we referred to earlier. One reason we think we are relatively immune to common risks is that we exaggerate the extent to which we can control random events. Experiments have demonstrated the illusion of control with MBA students from some top U.S. business schools, so there is no reason to think that executives who have attended these schools will be immune to them.[16] (Indeed, the belief that one is exempt from these illusions, while others are not, is an excellent illustration of the illusion of optimism.)

These illusions may also characterize peoples' attitudes about the organizations to which they belong. The result is a kind of organizational ethnocentrism, as we discussed earlier. Managers may feel that their company's contributions to society are more important than those of other companies, even when a neutral observer sees comparability. Similarly, executives may feel that the damage their firms cause society is not as harmful as that created by other organizations. Such a pattern of beliefs can create a barrier to societal improvement when each organization underestimates the damages that it causes. Often, however, firms and their executives genuinely believe that they are being fair and just in their positions (and that others are biased, an illustration of the illusion of favorability).

Self-serving fairness biases

Most executives want to act in a just manner and believe they are fair people. Since they are also interested in performance and success, they often face a conflict between fairness and the desired outcome. They may want a spacious office, a large share of a bonus pool, or the lion's share of the market. Furthermore, they may believe that achieving these outcomes is fair because they deserve them. Different parties, when judging a fair allocation among them, will often make different judgments about what is fair, and those judgments will usually serve the party's interest. These judgments often reflect disagreements about deservedness based on contributions to the collective effort. It is likely that if you asked each division in your organization to estimate the percentage of the company's worth that is created by the division, the sum of the estimates would greatly exceed 100 percent. (Research has been shown this to be true with married couples. The researchers who did the study reported that they had to ask the questions carefully because spouses would often be amazed, and then angry, about the estimates that their mates gave to questions like, "What percentage of the time do you clean up the kitchen?"[17])

One important reason for these self-serving views about fairness is that people are more aware of their contributions to collective activities than others are likely to be; they have more information about their own efforts than others have or than they have about others. Executives may recall disproportionately more instances of *their* division helping the corporation, of *their* corporation helping the community, and of *their* industry helping society.

Furthermore, executives, like other people, credit themselves for their efforts, whereas they are more likely to credit others only for their achievements. They also credit themselves for the temptations that they resisted but judge others strictly by their actions, not by their lack of action. An executive who is offered a substantial bonus to misrepresent the financial well-being of her firm may feel proud of her honesty when she declines, but others may either not know of the temptation or, if they do, believe that she merely followed the rules. While she may feel that the firm owes her gratitude, the firm may not share that feeling.

These fairness biases are particularly problematic during negotiations, when costly delays and impasses result. Egocentric interpretations of fairness hinder conflict resolution because each party believes that its own demands are fair and thus is unwilling to agree to what it perceives as inequitable settlements. It is not just a matter of different interests, it is a matter of what is fair and proper. The difference in perspectives can lead parties to question each others' ethics and morality. The temptation to view the other side as immoral when they fail to agree with us is especially pronounced in situations in which ethnocentric impulses may be aroused – for instance, international negotiations, labor management negotiations, or negotiations that involve issues of race or gender. For example, Price Waterhouse, a major accounting firm, was surprised when it lost a sexual discrimination suit. The firm's view of its procedures' fairness was at odds with the plaintiff's and judge's views.

Overconfidence

Most people are erroneously confident in their knowledge. In situations in which people are asked factual questions and then asked to judge the probability that their answers are true, the probability judgments far exceed the actual accuracy measures of the proportion of correct answers.[18] For instance, when asked, "Which city is farther north, Rome or New York?," most respondents choose New York and indicate a probability of about 90 percent that it is true. In fact, it is not true; Rome is slightly north of New York. Research has indicated that when people (including executives) respond to a large group of two-option questions for which they claim to be 75 percent certain, their answers tend to be correct only 60 percent of the time.[19] For confidence judgments of 100 percent, it is not uncommon for subjects to be correct only 85 percent of the time. Other research found that subjects who assign odds of 1,000:1 to their answers are correct only 90 to 96 percent of the time.[20] Overconfidence has been identified among members of the armed forces, executives, business students, and C.I.A. agents.[21]

The danger of overconfidence is, of course, that policies based on erroneous information may fail and harm others as well as the executive who established the policy. Overconfidence, as part of our theories about ourselves, coupled with flawed theories about the world or about other people, poses serious threats to rational and ethical decision making.

To the degree to which people are overconfident in their (conservative) risk assessments – in their beliefs about the availability of scarce resources or the character of people unlike themselves – they will fail to seek additional information to update their knowledge. One cost of overconfidence is a reluctance to learn more about a situation or problem before acting.

Even if people acknowledge the need for additional information, research has shown that their process for gaining that information may be biased to confirm prior beliefs and hypotheses.[22] This tendency was initially demonstrated in a series of studies in which the subjects were given a three-number sequence, 2-4-6. Their task was to discover the numeric rule to which the three numbers conformed. To determine the rule, they were allowed to generate other sets of three numbers that the experimenter would classify as either conforming or not conforming to the rule. At any point, subjects could stop when they thought that they had discovered the rule.

The rule is "any three ascending numbers." Suppose you thought the rule was "the difference between the first two numbers equals the difference between the last two numbers" (a common expectation). Testing confirming sequences, like 1-2-3, 10-15-20, or 122-126-130, will provide positive feedback and increase confidence in the original, but incorrect, hypothesis. To discover how the true rule differs from this rule, you must try sequences that do not conform to the hypothesized rule. You need to ask questions that, if answered positively, would disconfirm your rule. This is a less comfortable mode of acquiring information, partly because it may appear that you are not confident in your belief.

Transpose this idea to an executive questioning an engineer about the safety of a tool grip. The executive wants to and does believe that the grip is safe. If the executive asks questions like, "This really is a safe grip, isn't it?" or "Does this grip meet all the standards that have been set for this type of tool?," he is doing two things that may distort the information that he will receive. First, he is displaying the confirmation bias by asking questions he expects to be answered "yes."

Second, he is unconsciously exploiting social politeness, because people are more likely to agree than disagree. So by asking these types of questions, the executive is less likely to learn if the engineer has misgivings about any design features than if he asked questions such as, "What are the advantages and disadvantages of the grip?" or "What are the things we have most to worry about with this design?"

These processes suggest that executives may be favorably biased toward themselves and their firms. Will feedback help to eliminate or reduce these biases? We believe that feedback may provide only limited help because of the tendency to seek and notice confirming information, which forms an additional barrier to learning through experience.

When we consider the combined impact of the three processes described in this section – the illusion of superiority, self-centered perceptions of fairness, and overconfidence – we can see the peril associated with erroneous theories of the self. The major peril is that we will come to see ourselves as people for whom the normal rules, norms, and obligations do not apply. The danger is that an executive, especially a successful executive, will hold himself above conventional ethical principles and subject himself only to self-imposed rules that others might judge to be self-serving. He might justify telling a lie on the ground that it permits him to achieve important benefits for others (such as shareholders or employees) even though the shareholders or employees are being duped. He might feel that inflating an expense account or using company property for personal ends is not "really" wrong because of the value that he contributes to the company. Finally, he may undertake an immoral or illegal act, convinced that he will never be caught. The tendencies to feel superior, to generate self-serving, on-the-spot moral rules, and to be overconfident about beliefs create the potential for moral shallowness and callowness.

Improving Ethical Decision Making

Our position is that the causes of poor ethical decisions are often the same as the causes of poor decisions generally; decisions may be based on inaccurate theories about the world, about other people, or about ourselves. We suggest that ethical decision making may be improved in the same way that general decision making is improved. In this final section, we outline three broad criteria that executives can focus on: quality, breadth, and honesty.

Quality

Executives who make higher-quality decisions will tend to avoid ethical mistakes. Improving the quality of decision making means ensuring that all the consequences of actions are considered. It implies having accurate assessments of the risks associated with possible strategies and being attuned to the pitfalls of egocentric biases.

A general principle is that the types of flaws and biases we have discussed are likely to influence decision making more when decisions are intuitive, impulsive, or subjective rather than concrete, systematic, and objective. Stereotypes, for instance, have less influence on personnel decisions or performance appraisals if the evaluation criteria are quantitative rather than subjective and vague. Managers often resist this suggestion because they feel that using quantitative procedures makes their judgment "mechanical" or superfluous. The argument in favor of such procedures is that they reduce, or at least identify, opportunities for inappropriate information to influence decisions. Using a quantitative process allows a manager to identify precisely the source of such inappropriate information. Often, systematic procedures result in the same decision as more subjective ones, but the results are more acceptable because the process is viewed as objective, fair, and less subject to bias.

Whenever possible, executives should base decisions on data rather than hunches. In uncertain situations, the best guide comes from close attention to the real world (e.g., data), not from memory and intuition. People worry more about death by murder than death by automobile accident, even though the latter is, statistically, a much greater threat than the former. Reasoning by anecdote – for example, "My engineering chief says he is convinced the product is safe, regardless of what the test results say" – not only wastes resources expended to gather the data but also irresponsibly exposes others to avoidable risks.

A corollary is that getting high-quality data is obligatory. In business, as in science, passing off poor, unreliable data as good is fraudulent and inexcusable.

Sometimes executives cannot escape making decisions and judgments on subjective, intuitive bases. But they can take steps to prevent some of the biases from distorting judgment. To combat overconfidence, for instance, it is effective to say to yourself, "Stop and think of the ways in which you could be wrong." Similarly, to avoid minimizing risk, you can ask, "What are the relevant things that I don't know?" Often, a devil's advocate, who is given the role of scrutinizing a decision for false assumptions and optimistic projections, can play this role. A major difference between President Kennedy's Bay of Pigs fiasco and his skillful handling of the Cuban missile crisis was his encouragement of dissenting opinions and inclusion of people whose political orientations disagreed with his own.[23]

One threat to rational and ethical decision making that we noted earlier stems from the untrustworthiness of human memory. The first step in managing this threat is to acknowledge it. The second is to compensate for it with improved, detailed record keeping. This recommendation corresponds to a tenet of the total quality management movement – record keeping and benchmarking are central to measuring objectively how well a process is performing. Quality management and ethical management are close companions; what promotes one generally promotes the other. Erroneous theories threaten both.

Breadth

By breadth, we mean assessment of the full range of consequences that policies may entail. An ethical audit of a decision must take into account the outcomes for all stakeholders. The first task is to compile a list of the stakeholders. The second is to evaluate a decision's likely outcomes from the stakeholders' perspective.

One approach to identifying stakeholders is to make the decision process as open as possible and invite input from interested parties. However, different groups may have different access to public information, so this technique risks overlooking important constituencies. A potential solution is to include representatives of the important groups on the decision-making team. Broad consultation, which requires an active search to enlist all affected parties into the decision-making process, is important. Openness itself is often a signal to potential opponents that nothing is being hidden and there is nothing to fear. For example, a few years ago, two relatively similar construction projects in Arizona differed greatly in the care they took to involve the active environmental groups in their communities. The project that worked continually with citizens gained their trust and support for the project, while the one that ignored environmentalists faced expensive legal challenges in court.

Socially responsible executive decision making recognizes that a company is part of a broader community that has an interest in its actions. A full accounting for decisions must include a community-impact assessment. If there is community opposition to a policy, it is far better to address it early on rather than risk being ambushed by it later.

Finally, executives' decisions affect those not only in the present but also in the future. Executives' responsibility is to manage so that the world's social and physical environments are not spoiled for future generations. The continual squandering of nonrenewable resources or overuse of renewable ones gives privileges to the current generation at the expense of later ones. Likewise, postponing the payment for what we enjoy today saddles future generations with paying for current consumption. None of us would intentionally make our own children worse off than we are, and we would not want others to do so either.

Breadth is an important quality of ethical decision making because it is both ethically proper *and* strategically sound. It means doing the right thing and doing the smart thing. Intentional decisions to exclude stakeholders' interests or input may not only violate their rights, which is an ethical infraction, but also invite opposition, resentment, and hostility, which is stupid.

Honesty

In discussing breadth, we urged openness. But executives can rarely divulge all the information involved in a decision. Much information is proprietary, gives competitors an unfair advantage, and is legally confidential. A policy of openness does not require executives to tell all. It is perfectly ethical and appropriate to withhold some types of information. It is inappropriate to withhold information about a project or policy merely because an executive is ashamed to make it public. We propose that, if an executive feels so embarrassed about some aspect of a project that she wants to hide the information, she probably should not undertake the project. Conscience, in short, is a good litmus test for a decision's ethicality. If an idea cannot stand the light of day or the scrutiny of public opinion, then it is probably a bad idea. A variant of this "sunshine test" is to imagine how you would feel if you saw the idea or decision on the front page of the *New York Times*.

As we pointed out earlier, you cannot always trust your reaction to a hypothetical test. It's easy to say, "I wouldn't mind it if my family knew that I misstated the firm's income by $20 million," when this is, in fact, completely untrue. As one scholar points out, we ourselves are the easiest audience that we have to play to and the easiest to fool.[24] Consequently, we should imagine whether our audience would accept the idea or decision. In particular, we should ask whether the people with the most to lose would accept the reasons for our actions. If not, we are probably on moral thin ice.

One risk often overlooked when practicing deceit is the continual need to maintain deception. Not only are original facts hidden, but the fact of hiding must also be hidden. In the notorious Watergate scandal, President Nixon was forced from office not for what occurred in the Watergate complex, but for the efforts the White House made to hide the offense.

While it is important to be honest with others, it is just as important to be honest with yourself. Self-deception – being unaware of the processes that lead us to form our opinions and judgments – is unavoidable. We think we remember things accurately, but careful studies show that we do not. We think we know why we make judgments about other people, but research shows us other reasons.

If we can accept the fact that the human mind has an infinite, creative capacity to trick itself, we can guard against irrational, unethical decisions. To deny this reality is to practice self-deception. We can learn to suspect our naive judgments. We can learn to calibrate ourselves to judge risk. We can examine our motives in judging others; are we using hard, reliable information to evaluate subordinates, or are we using stereotypes?

The topic of executive ethics has been dominated by the assumption that executives are constantly faced with an explicit trade-off between ethics and profits. We argue, in contrast, that unethical behavior in organizations is more commonly affected by psychological tendencies that create undesirable behavior from both ethical and rational perspectives. Identifying and confronting these psychological tendencies will increase the success of executives and organizations.

Notes

[1] For the research on which we based this article, see: M. H. Bazerman, *Judgment in Managerial Decision Making* (New York: John Wiley, 1994); R.M. Dawes, *Rational Choice in an Uncertain World* (San Diego, California: Harcourt Brace Jovanovich, 1988); T. Gilovich, *How We Know What Isn't So* (New York: Free Press, 1991); and S. Plous, *The Psychology of Judgment and Decision Making* (New York: McGraw Hill, 1993). A forthcoming book will explore these and other topics in greater detail. See: D.M. Messick and A. Tenbrunsel, *Behavioral Research and Business Ethics* (New York: Russell Sage Foundation, forthcoming).

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Cost-Benefit Analysis
An Ethical Critique

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At the broadest and vaguest level, cost-benefit analysis may be regarded simply as systematic thinking about decision-making. Who can oppose, economists sometimes ask, efforts to think in a systematic way about the consequences of different courses of action? The alternative, it would appear, is unexamined decision-making. But defining cost-benefit analysis so simply leaves it with few implications for actual regulatory decision-making. Presumably, therefore, those who urge regulators to make greater use of the technique have a more extensive prescription in mind. I assume here that their prescription includes the following views:

1. There exists a strong presumption that an act should not be undertaken unless its benefits outweigh its costs.
2. In order to determine whether benefits outweigh costs, it is desirable to attempt to express all benefits and costs in a common scale or denominator, so that they can be compared with each other, even when some benefits and costs are not traded on markets and hence have no established dollar values.
3. Getting decision-makers to make more use of cost-benefit techniques is important enough to

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warrant both the expense required to gather the data for improved cost-benefit estimation and the political efforts needed to give the activity higher priority compared to other activities, also valuable in and of themselves.

My focus is on cost-benefit analysis as applied to environmental, safety, and health regulation. In that context, I examine each of the above propositions from the perspective of formal ethical theory, that is, the study of what actions it is morally right to undertake. My conclusions are:

1. In areas of environmental, safety, and health regulation, there may be many instances where a certain decision might be right even though its benefits do not outweigh its costs.
2. There are good reasons to oppose efforts to put dollar values on non-marketed benefits and costs.
3. Given the relative frequency of occasions in the areas of environmental, safety, and health regulation where one would not wish to use a benefits-outweigh-costs test as a decision rule, and given the reasons to oppose the monetizing of non-marketed benefits or costs that is a prerequisite for cost-benefit analysis, it is not justifiable to devote major resources to the generation of data for cost-benefit calculations or to undertake efforts to "spread the gospel" of cost-benefit analysis further.

I

How do we decide whether a given action is morally right or wrong and hence, assuming the desire to act morally, why it should be undertaken or refrained from? Like the Molière character who spoke prose without knowing it, economists who advocate use of cost-benefit analysis for public decisions are philosophers without knowing it: the answer given by cost-benefit analysis, that actions should be undertaken so as to maximize net benefits, represents one of the classic answers given by moral philosophers – that given by utilitarians. To determine whether an action is right or wrong, utilitarians tote up all the positive consequences of the action in terms of human satisfaction. The act that maximizes attainment of satisfaction under the circumstances is the right act. That the economists' answer is also the answer of one school of philosophers should not be surprising. Early on, economics was a branch of moral philosophy, and only later did it become an independent discipline.

Before proceeding further, the subtlety of the utilitarian position should be noted. The positive and negative consequences of an act for satisfaction may go beyond the act's immediate consequences. A facile version of utilitarianism would give moral sanction to a lie, for instance, if the satisfaction of an individual attained by telling the lie was greater than the suffering imposed on the lie's victim. Few utilitarians would agree. Most of them would add to the list of negative consequences the effect of the one lie on the tendency of the person who lies to tell other lies, even in instances when the lying produced less satisfaction for him than dissatisfaction for others. They would also add the negative effects of the lie on the general level of social regard for truth-telling, which has many consequences for future utility. A further consequence may be added as well. It is sometimes said that we should include in a utilitarian calculation the feelings of dissatisfaction produced in the liar (and perhaps in others) because, by telling a lie, one has "done the wrong thing." Correspondingly, in this view, among the positive consequences to be weighed into a utilitarian calculation of truth-telling is satisfaction arising from "doing the right thing." This view rests on an error, however, because it *assumes* what it is the purpose of the calculation to *determine* – that telling the truth in the instance in question is indeed the right thing to do. Economists are likely to object to this point, arguing that no feeling ought "arbitrarily" to be excluded from a complete cost-benefit calculation, including a feeling of dissatisfaction at doing the wrong thing. Indeed, the economists' cost-benefit calculations would, at least ideally, include such feelings. Note the difference between the economist's and the philosopher's cost-benefit calculations, however. The economist may choose to include feelings of dissatisfaction in his cost-benefit calculation, but what happens if somebody asks the economist, "Why is it right to evaluate an action on the basis of a cost-benefit test?" If an answer is to be given to that question (which does not normally preoccupy economists but which does concern both philosophers and the rest of us who need to be persuaded that cost-benefit analysis is right), then the circularity problem reemerges. And there is also another difficulty with counting feelings of dissatisfaction at doing the wrong thing in a cost-benefit calculation. It leads to the perverse result that under certain circumstances a lie, for example, might be morally right if the individual contemplating the lie felt no compunction about lying and morally wrong only if the individual felt such a compunction!

This error is revealing, however, because it begins to suggest a critique of utilitarianism. Utilitarianism is an important and powerful moral doctrine. But it is probably a minority position among contemporary moral philosophers. It is amazing that economists can proceed in unanimous endorsement of cost-benefit analysis as if unaware that their conceptual framework is highly controversial in the discipline from which it arose – moral philosophy.

Let us explore the critique of utilitarianism. The logical error discussed before appears to suggest that we have a notion of certain things being right or wrong that *predates* our calculation of costs and benefits. Imagine the case of an old man in Nazi Germany who is hostile to the regime. He is wondering whether he should speak out against Hitler. If he speaks out, he will lose his pension. And his action will have done nothing to increase the chances that the Nazi regime will be overthrown: he is regarded as somewhat eccentric by those around him, and nobody has ever consulted his views on political questions. Recall that one cannot add to the benefits of speaking out any satisfaction from doing "the right thing," because the purpose of the exercise is to determine whether speaking out *is* the right thing. How would the utilitarian calculation go? The benefits of the old man's speaking out would, as the example is presented, be nil, while the costs would be his loss of his pension. So the costs of the action would outweigh the benefits. By the utilitarians' cost-benefit calculation, it would be *morally wrong* for the man to speak out.

To those who believe that it would not be morally wrong for the old man to speak out in Nazi Germany, utilitarianism is insufficient as a moral view. We believe that some acts whose costs are greater than their benefits may be morally right and, contrariwise, some acts whose benefits are greater than their costs may be morally wrong.

This does not mean that the question whether benefits are greater than costs is morally irrelevant. Few would claim such. Indeed, for a broad range of individual and social decisions, whether an act's benefits outweigh its costs is a sufficient question to ask. But not for all such decisions. These may involve situations where certain duties – duties not to lie, break promises, or kill, for example – make an act wrong, even if it would result in an excess of benefits over costs. Or they may involve instances where people's rights are at stake. We would not permit rape even if it could be demonstrated that the rapist derived enormous happiness from his act, while the victim experienced only minor displeasure. We do not do cost-benefit analyses of freedom of speech or trial by jury. The Bill of Rights was not RARGed.[1]

As the United Steelworkers noted in a comment on the Occupational Safety and Health Administration's economic analysis of its proposed rule to reduce worker exposure to carcinogenic coke-oven emissions, the Emancipation Proclamation was not subjected to an inflationary impact statement. The notion of human rights involves the idea that people may make certain claims to be allowed to act in certain ways or to be treated in certain ways, even if the sum of benefits achieved thereby does not outweigh the sum of costs. It is this view that underlies the statement that "workers have a right to a safe and healthy work place" and the expectation that OSHA's decisions will reflect that judgment.

In the most convincing versions of non-utilitarian ethics, various duties or rights are not absolute. But each has *a prima facie* moral validity so that, if duties or rights do not conflict, the morally right act is the act that reflects a duty or respects a right. If duties or rights do conflict, a moral judgment, based on conscious deliberation, must be made. Since one of the duties non-utilitarian philosophers enumerate is the duty of beneficence (the duty to maximize happiness), which in effect incorporates all of utilitarianism by reference, a non-utilitarian who is faced with conflicts between the results of cost-benefit analysis and non-utility-based considerations will need to undertake such deliberation. But in that deliberation, additional elements, which cannot be reduced to a question of whether benefits outweigh costs, have been introduced. Indeed, depending on the moral importance we attach to the right or duty involved, cost-benefit questions may, within wide ranges, become irrelevant to the outcome of the moral judgment.

In addition to questions involving duties and rights, there is a final sort of question where, in my view, the issue of whether benefits outweigh costs should not govern moral judgment. I noted earlier that, for the common run of questions facing individuals and societies, it is possible to begin and end our judgment simply by finding out if the benefits of the contemplated act outweigh the costs. This very fact means that one way to show the great importance, or value, attached to an area is to say that decisions involving the area should not be determined by cost-benefit calculations. This applies, I think, to the view many environmentalists have of decisions involving our natural environment. When officials are deciding what level of pollution will harm certain vulnerable people – such as asthmatics or the elderly – while not harming others, one issue involved may be the right of those people not to be sacrificed on the altar of somewhat higher living standards for the rest of us. But more broadly than this, many environmentalists fear that subjecting decisions about clean air or water to the cost-benefit tests that determine the general run of decisions removes those matters from the realm of specially valued things.

II

In order for cost-benefit calculations to be performed the way they are supposed to be, all costs and benefits must be expressed in a common measure, typically dollars, including things not normally bought and sold on markets, and to which dollar prices are therefore not attached. The most dramatic example of such things is human life itself; but many of the other benefits achieved or preserved by environmental policy – such as peace and quiet, fresh-smelling air, swimmable rivers, spectacular vistas – are not traded on markets either.

Economists who do cost-benefit analysis regard the quest after dollar values for non-market things as a difficult challenge – but one to be met with relish. They have tried to develop methods for imputing a person's "willingness to pay" for such things, their approach generally involving a search for bundled goods that *are* traded on markets and that vary as to whether they include a feature that is, *by itself*, not marketed. Thus, fresh air is not marketed, but houses in different parts of Los Angeles that are similar except for the degree of smog are. Peace and quiet is not marketed, but similar houses inside and outside airport flight paths are. The risk of death is not marketed, but similar jobs that have different levels of risk are. Economists have produced many often ingenious efforts to impute dollar prices to non-marketed things by observing the premiums accorded homes in clean air areas over similar homes in dirty areas or the premiums paid for risky jobs over similar non-risky jobs.

These ingenious efforts are subject to criticism on a number of technical grounds. It may be difficult to control for all the dimensions of quality other than the presence or absence of the non-marketed thing. More important, in a world where people have different preferences and are subject to different constraints as they make their choices, the dollar value imputed to the non-market things that most people would wish to avoid will be lower than otherwise, because people with unusually weak aversion to those things or unusually strong constraints on their choices will be willing to take the bundled good in question at less of a discount than the average person. Thus, to use the property value discount of homes near airports as a measure of people's willingness to pay for quiet means to accept as a proxy for the rest of us the behavior of those least sensitive to noise, of airport employees (who value the convenience of a near-airport location) or of others who are susceptible to an agent's assurances that "it's not so bad." To use the wage premiums accorded hazardous work as a measure of the value of life means to accept as proxies for the rest of us the choices of people who do not have many choices or who are exceptional risk-seekers.

A second problem is that the attempts of economists to measure people's willingness to pay for non-marketed things assume that there is no difference between the price a person would require for *giving up* something to which he has a preexisting right and the price he would pay to *gain* something to which he enjoys no right. Thus, the analysis assumes no difference between how much a home-owner would need to be paid in order to give up an unobstructed mountain view that he already enjoys and how much he would be willing to pay to get an obstruction moved once it is already in place. Available evidence suggests that most people would insist on being paid far more to assent to a worsening of their situation than they would be willing to pay to improve their situation. The difference arises from such factors as being accustomed to and psychologically attached to that which one believes one enjoys by right. But this creates a circularity problem for any attempt to use cost-benefit analysis to determine *whether* to assign to, say, the homeowner the right to an unobstructed mountain view. For willingness to pay will be different depending on whether the right is assigned initially or not. The value judgment about whether to assign the right must thus be made first. (In order to set an upper bound on the value of the benefit, one might hypothetically assign the right to the person and determine how much he would need to be paid to give it up.)

Third, the efforts of economists to impute willingness to pay invariably involve bundled goods exchanged in *private* transactions. Those who use figures garnered from such analysis to provide guidance for *public* decisions assume no difference between how people value certain things in private individual transactions and how they would wish those same things to be valued in public collective decisions. In making such assumptions, economists insidiously slip into their analysis an important and controversial value judgment, growing naturally out of the highly individualistic microeconomic tradition – namely, the view that there should be no difference between private behavior and the behavior we display in public social life. An alternative view – one that enjoys, I would suggest, wide resonance among citizens – would be that public, social decisions provide an opportunity to give certain things a higher valuation than we choose, for one reason or another, to give them in our private activities.

Thus, opponents of stricter regulation of health risks often argue that we show by our daily risk-taking behavior that we do not value life infinitely, and therefore our public decisions should not reflect the high value of life that proponents of strict regulation propose. However, an alternative view is equally plausible. Precisely because we fail, for whatever reasons, to give lifesaving the value in everyday personal decisions that we in some general terms believe we should give it, we may wish our social decisions to provide us the occasion to display the reverence for life that we espouse but do not always show. By this view, people do not have fixed unambiguous "preferences" to which they give expression through private activities and which therefore should be given expression in public decisions. Rather, they may have what they themselves regard as "higher" and "lower" preferences. The latter may come to the fore in private decisions, but people may want the former to come to the fore in public decisions. They may sometimes display racial prejudice, but support anti-discrimination laws. They may buy a certain product after seeing a seductive ad, but be skeptical enough of advertising to want the government to keep a close eye on it. In such cases, the use of private behavior to impute the values that should be entered for public decisions, as is done by using willingness to pay in private transactions, commits grievous offense against a view of the behavior of the citizen that is deeply engrained in our democratic tradition. It is a view that denudes politics of any independent role in society, reducing it to a mechanistic, mimicking recalculation based on private behavior.

Finally, one may oppose the effort to place prices on a non-market thing and hence in effect incorporate it into the market system out of a fear that the very act of doing so will reduce the thing's perceived value. To place a price on the benefit may, in other words, reduce the value of that benefit. Cost-benefit analysis thus may be like the thermometer that, when placed in a liquid to be measured, itself changes the liquid's temperature.

Examples of the perceived cheapening of a thing's value by the very act of buying and selling it abound in everyday life and language. The disgust that accompanies the idea of buying and selling human beings is based on the sense that this would dramatically diminish human worth. Epithets such as "he prostituted himself," applied as linguistic analogies to people who have sold something, reflect the view that certain things should not be sold because doing so diminishes their value. Praise that is bought is worth little, even to the person buying it. A true anecdote is told of an economist who retired to another university community and complained that he was having difficulty making friends. The laconic response of a critical colleague – "If you want a friend why don't you buy yourself one" – illustrates in a pithy way the intuition that, for some things, the very act of placing a price on them reduces their perceived value.

The first reason that pricing something decreases its perceived value is that, in many circumstances, non-market exchange is associated with the production of certain values not associated with market exchange. These may include spontaneity and various other feelings that come from personal relationships. If a good becomes less associated with the production of positively valued feelings because of market exchange, the perceived value of the good declines to the extent that those feelings are valued. This can be seen clearly in instances where a thing may be transferred both by market and by non-market mechanisms. The willingness to pay for sex bought from a prostitute is less than the perceived value of the sex consummating love. (Imagine the reaction if a practitioner of cost-benefit analysis computed the benefits of sex based on the price of prostitute services.)

Furthermore, if one values in a general sense the existence of a non-market sector because of its connection with the production of certain valued feelings, then one ascribes added value to any non-marketed good simply as a repository of values represented by the non-sector one wishes to preserve. This seems certainly to be the case for things in nature, such as pristine streams or undisturbed forests: for many people who value them, part of their value comes from their position as repositories of values the non-market sector represents.

The second way in which placing a market price on a thing decreases its perceived value is by removing the possibility of proclaiming that the thing is "not for sale," since things on the market by definition are for sale. The very statement that something is not for sale affirms, enhances, and protects a thing's value in a number of ways. To begin with, the statement is a way of showing that a thing is valued for its own sake, whereas selling a thing for money demonstrates that it was valued only instrumentally. Furthermore, to say that something cannot be transferred in that way places it in the exceptional category – which requires the person interested in obtaining that thing to be able to offer something else that is exceptional, rather than allowing him the easier alternative of obtaining the thing for money that could have been obtained in an infinity of ways. This enhances its value. If I am willing to say "You're a really kind person" to whoever pays me to do so, my praise loses the value that attaches to it from being exchangeable only for an act of kindness.

In addition, if we have already decided we value something highly, one way of stamping it with a cachet affirming its high value is to announce that it is "not for sale." Such an announcement does more, however, than just reflect a preexisting high valuation. It signals a thing's distinctive value to others and helps us persuade them to value the thing more highly than they otherwise might. It also expresses our resolution to safeguard that distinctive value. To state that something is not for sale is thus also a source of value for that thing, since if a thing's value is easy to affirm or protect, it will be worth more than an otherwise similar thing without such attributes.

If we proclaim that something is not for sale, we make a once-and-for-all-judgment of its special value. When something is priced, the issue of its perceived value is constantly coming up, as a standing invitation to reconsider that original judgment. Were people constantly faced with questions such as "how much money could get you to give up your freedom of speech?" or "how much would you sell your vote for if you could?", the perceived value of the freedom to speak or the right to vote would soon become devastated as, in moments of weakness, people started saying "maybe it's not worth *so much* after all." Better not to be faced with the constant questioning in the first place. Something similar did in fact occur when the slogan "better red than dead" was launched by some pacifists during the Cold War. Critics pointed out that the very posing of this stark choice – in effect, "would you *really* be willing to give up your life in exchange for not living under communism?" – reduced the value people attached to freedom and thus diminished resistance to attacks on freedom.

Finally, of some things valued very highly it is stated that they are "priceless" or that they have "infinite value." Such expressions are reserved for a subset of things not for sale, such as life or health. Economists tend to scoff at talk of pricelessness. For them, saying that something is priceless is to state a willingness to trade off an infinite quantity of all other goods for one unit of the priceless good, a situation that empirically appears highly unlikely. For most people, however, the word priceless is pregnant with meaning. Its value-affirming and value-protecting functions cannot be bestowed on expressions that merely denote a determinate, albeit high, valuation. John Kennedy in his inaugural address proclaimed that the nation was ready to "pay any price [and] bear any burden … to assure the survival and the success of liberty." Had he said instead that we were willing to "pay a high price" or "bear a large burden" for liberty, the statement would have rung hollow.

III

An objection that advocates of cost-benefit analysis might well make to the preceding argument should be considered. I noted earlier that, in cases where various non-utility-based duties or rights conflict with the maximization of utility, it is necessary to make a deliberative judgment about what act is finally right. I also argued earlier that the search for commensurability might not always be a desirable one, that the attempt to go beyond expressing benefits in terms of (say) lives saved and costs in terms of dollars is not something devoutly to be wished.

In situations involving things that are not expressed in a common measure, advocates of cost-benefit analysis argue that people making judgments "in effect" perform cost-benefit calculations anyway. If government regulators promulgate a regulation that saves 100 lives at a cost of $1 billion, they are "in effect" valuing a life at (a minimum of) $10 million, whether or not they say that they are willing to place a dollar value on a human life. Since, in this view, cost-analysis "in effect" is inevitable, it might as well be made specific.

This argument misconstrues the real difference in the reasoning processes involved. In cost-benefit analysis, equivalencies are established *in advance* as one of the raw materials for the calculation. One determines costs and benefits, one determines equivalencies (to be able to put various costs and benefits into a common measure), and then one sets to toting things up – waiting, as it were, with bated breath for the results of the calculation to come out. The outcome is determined by the arithmetic; if the outcome is a close call or if one is not good at long division, one does not know how it will turn out until the calculation is finished. In the kind of deliberative judgment that is performed without a common measure, no establishment of equivalencies occurs in advance. Equivalencies are not aids to the decision process. In fact, the decision-maker might not even be aware of what the "in effect" equivalencies were, at least before they are revealed to him afterwards by someone pointing out what he had "in effect" done. The decision-maker would see himself as simply having made a deliberative judgment; the "in effect" equivalency number did not play a causal role in the decision but at most merely reflects it. Given this, the argument against making the process explicit is the one discussed earlier in the discussion of problems with putting specific values on things that are not normally quantified – that the very act of doing so may serve to reduce the value of those things.

My own judgment is that modest efforts to assess levels of benefits and costs are justified, although I do not believe that government agencies ought to sponsor efforts to put dollar prices on non-market things. I also do not believe that the cry for more cost-benefit analysis in regulation is, on the whole, justified. If regulatory officials were so insensitive about regulatory costs that they did not provide acceptable raw material for deliberative judgments (even if not of a strictly cost-benefit nature), my conclusion might be different. But a good deal of research into costs and benefits already occurs – actually, far more in the U.S. regulatory process than in that of any other industrial society. The danger now would seem to come more from the other side.

Note

[1] *Editor's note*: The Regulatory Analysis Review Group (RARG) was created by President Carter to improve the cost-benefit analysis of regulatory policy. It was subsequently disbanded by President Reagan.

Cost-Benefit Analysis Defended

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Cost-benefit analysis, particularly as applied to public decisions involving risks to life and health, has not been notably popular. A number of setbacks – Three Mile Island is perhaps the most memorable – have called into question the reliability of analytic approaches to risk issues. We believe that the current low reputation of cost-analysis is unjustified, and that a close examination of the objections most frequently raised against the method will show that it deserves wider public support.

Society does not and indeed could not require the explicit consent of every affected individual in order to implement public decisions that impose costs or risks. The transactions costs of assembling unanimous consent would be prohibitive, leading to paralysis in the status quo. Moreover, any system that required unanimous consent would create incentives for individuals to misrepresent their beliefs so as to secure compensation or to prevent the imposition of relatively small costs on them even if the benefits to others might be great.

If actual individual consent is an impractically strong standard to require of centralized decisions, how should such decisions be made? Our test for a proposed public decision is whether the net benefits of the action are positive. The same criterion is frequently phrased: Will those favored by the decision gain enough that they would have a net benefit even if they fully compensated those hurt by the decision? Applying this criterion to all possible actions, we discover that the chosen alternative should be the one for which benefits most exceed costs. We believe that the benefit-cost criterion is a useful way of defining "hypothetical consent" for centralized decisions affecting individuals with widely divergent interests: hypothetically, if compensation could be paid, all would agree to the decision offering the highest net benefits. We turn now to objections commonly raised against this approach.

Compensation and Hypothetical Consent

An immediate problem with the pure cost-benefit criterion is that it does not require the actual payment of compensation to those on whom a given decision imposes net costs. Our standard for public decision-making does not require that losers be compensated, but only that they *could* be if a perfect system of transfers existed. But unless those harmed by a decision are *actually* compensated, they will get little solace from the fact that someone is reaping a surplus in which they could have shared.

To this we make two replies. First, it is typically infeasible to design a compensation system that ensures that all individuals will be net winners. The transactions costs involved in such a system would often be so high as to make the project as a whole a net loss. But it may not even be desirable to construct full compensation systems, since losers will generally have an incentive under such systems to overstate their anticipated losses in order to secure greater compensation.

Second, the problem of compensation is probably smaller in practice than in principle. Society tends to compensate large losses where possible or to avoid imposing large losses when adequate compensation is not practical. Moreover, compensation is sometimes overpaid; having made allowances *ex ante* for imposing risks, society still chooses sometimes to pay

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additional compensation *ex post* to those who actually suffer losses.

Libertarians raise one additional argument about the ethical basis of a system that does not require full compensation to losers. They argue that a public decision process that imposes uncompensated losses constitutes an illegal taking of property by the state and should not be tolerated. This objection, however strongly grounded ethically, would lead to an untenable position for society by unduly constraining public decisions to rest with the status quo.

Attention to Distribution

Two distinct types of distributional issue are relevant in cost-benefit analysis. First, we can be concerned about the losers in a particular decision, whoever they may be. Second, we can be concerned with the transfers between income classes (or other defined groups) engendered by a given project. If costs are imposed differentially on groups that are generally disadvantaged, should the decision criterion include special consideration of their interests? This question is closely intertwined with the issue of compensation, because it is often alleged that the uncompensated costs of projects evaluated by cost-benefit criteria frequently fall on those who are disadvantaged to start with.

These objections have little to do with cost-benefit analysis as a method. We see no reason why any widely agreed upon notion of equity, or weighting of different individual's interests, cannot in principle be built into the cost-benefit decision framework. It is merely a matter of defining carefully what is meant by a benefit or a cost. If, in society's view, benefits (or costs) to some individuals are more valuable (costly) than those to others, this can be reflected in the construction of the decision criterion.

But although distribution concerns could be systematically included in cost-benefit analyses, it is not always – or even generally – a good idea to do so. Taxes and direct expenditures represent a far more efficient means of effecting redistribution than virtually any other public program; we would strongly prefer to rely on one consistent comprehensive tax and expenditure package for redistribution than on attempts to redistribute within every project.

First, if distributional issues are considered everywhere, they will probably not be adequately, carefully, and correctly treated anywhere. Many critics of cost-benefit analysis believe that project-based distributional analysis would create a net addition to society's total redistributive effort; we suggest that is likely, instead, to be only an inefficient substitution.

Second, treating distributional concerns within each project can only lead to transfers within the group affected by a project, often only a small subset of the community. For example, unisex rating of auto insurance redistributes only among drivers. Cross-subsidization of medical costs affects only those who need medical services. Why should not the larger society share the burden of redistribution?

Third, the view that distributional considerations should be treated project-by-project reflects a presumption that on average they do not balance out – that is, that some groups systematically lose more often than others. If it were found that some groups were severely and systematically disadvantaged by the application of cost-benefit analyses that ignore distributional concerns, we would favor redressing the balance. We do not believe this is generally the case.

Sensitive Social Values

Cost-benefit analysis, it is frequently alleged, does a disservice to society because it cannot treat important social values with appropriate sensitivity. We believe that this view does a disservice to society by unduly constraining the use of a reasonable and helpful method for organizing the debate about public decisions. We are not claiming that every important social value can be represented effectively within the confines of cost-benefit analysis. Some values will never fit in a cost-benefit framework and will have to be treated as "additional considerations" in coming to a final decision. Some, such as the inviolability of human life, may simply be binding constraints that cannot be traded off to obtain other gains. Nor can we carry out a cost-benefit analysis to decide which values should be included and which treated separately – this decision will always have to be made in some other manner.

These considerations do not invalidate cost-benefit analysis, but merely illustrate that more is at stake than just dollar measures of costs and benefits. We would, however, make two observations. First, we must be very careful that only genuinely important and relevant social values be permitted to outweigh the findings of an analysis. Second, social values that frequently stand in the way of important efficiency gains have a way of breaking down and being replaced over time, so that in the long run society manages to accommodate itself to some form of cost-benefit criterion. If nuclear power were 1000 times more dangerous for its employees but 10 times less expensive than it is, we might feel that ethical considerations were respected and the national interest well served if we had rotating cadres of nuclear power employees serving short terms in high-risk positions, much as members of the armed services do. In like fashion, we have fire-fighters risk their lives; universal sprinkler systems would be less dangerous, but more costly. Such policies reflect an accommodation to the costs as a recognition of the benefits.

Measurability

Another objection frequently raised against cost-benefit analysis is that some costs and benefits tend to be ignored because they are much more difficult to measure than others. The long-term environmental impacts of large projects are frequently cited as an example. Cost-benefit analysis is charged with being systematically biased toward consideration of the quantifiable aspects of decisions.

This is unquestionably true: cost-benefit analysis is *designed* as a method of quantification, so it surely is better able to deal with more quantifiable aspects of the issues it confronts. But this limitation is in itself ethically neutral unless it can be shown that the quantifiable considerations systematically push decisions in a particular direction. Its detractors must show that the errors of cost-benefit analysis are systematically unjust or inefficient – for example, that it frequently helps the rich at the expense of the poor, or despoils the environment to the benefit of industry, or vice versa. We have not seen any carefully researched evidence to support such assertions.

We take some comfort in the fact that cost-benefit analysis is sometimes accused of being biased toward development projects and sometimes of being biased against them. Cost-benefit analyses have foiled conservation efforts in national forests – perhaps they systematically weight the future too little. But they have also squelched clearly silly projects designed to bring "economic development" to Alaska – and the developers argued that the analysis gave insufficient weight to the "unquantifiable" value of future industrialization.

In our experience, cost-benefit analysis is often a tool of the "outs" – those not currently in control of the political process. Those who have the political power to back the projects they support often have little need of analyses. By contrast, analysis can be an effective tool for those who are otherwise not strongly empowered politically.

Analyzing Risks

Even those who accept the ethical propriety of cost-benefit analysis of decisions involving transfers of money or other tangible economic costs and benefits sometimes feel that the principles do not extend to analyzing decisions involving the imposition of risks. We believe that such applications constitute a *particularly* important area in which cost-benefit analysis can be of value. The very difficulties of reaching appropriate decisions where risks are involved make it all the more vital to employ the soundest methods available, both ethically and practically.

Historically, cost-benefit analysis has been applied widely to the imposition and regulation of risks, in particular to risks of health loss or bodily harm. The cost-benefit approach is particularly valuable here, for several reasons. Few health risks can be exchanged on a voluntary basis. Their magnitude is difficult to measure. Even if they could be accurately measured, individuals have difficulty interpreting probabilities or gauging how they would feel should the harm eventuate. Compounding these problems of valuation are difficulties in contract, since risks are rarely conveyed singly between one individual and another.

The problem of risks conveyed in the absence of contractual approval has been addressed for centuries through the law of torts, which is designed to provide compensation after a harm has been received. If only a low-probability risk is involved, it is often efficient to wait to see whether a harm occurs, for in the overwhelming majority of circumstances transactions costs will be avoided. This approach also limits debate over the magnitude of a potential harm that has not yet eventuated. The creator of the risk has the incentive to gauge accurately, for he is the one who must pay if harm does occur.

While in principle it provides efficient results, the torts approach encounters at least four difficulties when applied to many of the risks that are encountered in a modern technological society. The option of declaring bankruptcy allows the responsible party to avoid paying and so to impose risks that it should not impose. Causality is often difficult to assign for misfortunes that may have alternative or multiple (and synergistically related) causes. Did the individual contract lung cancer from air pollution or from his own smoking, or both? Furthermore, the traditional torts requirement that individuals be made whole cannot be met in many instances (death, loss of a limb). Finally, paying compensation after the fact may also produce inappropriate incentives, and hence be inefficient. Workers who can be more or less careful around dangerous machinery, for example, are likely to be more careful if they will not be compensated for losing an appendage.

Our normal market and legal system tends to break down when substantial health risks are imposed on a relatively large population. These are, therefore, precisely the situations in which the cost-benefit approach is and should be called into play. Cost-benefit analysis is typically used in just those situations where our normal risk decision processes run into difficulty. We should therefore not expect it to lead to outcomes that are as satisfactory as those that evolve when ordinary market and private contractual trade are employed. But we should be able to expect better outcomes than we would achieve by muddling through unsystematically.

We have defended cost-benefit analysis as the most practical of ethically defensible methods and the most ethical of practically usable methods for conducting public decision-making. It cannot substitute for – nor can it adequately encompass, analyze, or consider – the sensitive application of social values. Thus it cannot be made the final arbiter of public decisions. But it does add a useful structure to public debate, and it does enable us to quantify some of the quantifiable aspects of public decisions. Our defense parallels Winston Churchill's argument for democracy: it is not perfect, but it is better than the alternatives.

Questions for Discussion

1. Use the guidelines developed by Josephson to analyze one of the cases for Part 1. For example, what would the guidelines say about Bowen McCoy's decision in "The Parable of the Sadhu"? What would they say about the decision made in "The Ford Pinto"?
2. Heath writes that white-collar crime is not necessarily caused by lack of character, greed, or poor values. He goes on to explain how white-collar criminals excuse and rationalize their behavior, and he says that for the most part there is no real dispute about what the ethical obligations of managers actually are. Is this true? Even granted that the legal obligations of managers are clear, are their ethical obligations clear as well? Might their ethical obligations be no more extensive than their legal obligations?
3. Messick and Bazerman explain in detail how our psychological tendencies systematically undercut good decision making. Consider your analysis of the cases in question 1 above. Can you see any of the tendencies Messick and Bazerman discuss in McCoy, or the managers at Ford? Do you see any in your own estimate of what should be the correct ethical decision in those cases?
4. When tragedies occur – such as air disasters or car crashes that cost human lives – it is not uncommon for courts of law to place a value on human life as a way to compensate the families of the deceased. Is it appropriate to place a value on life in these unfortunate circumstances? What would Kelman, or Leonard and Zeckhauser, say about this practice?

Cases for Part 1

Introduction

The two mini-cases in Part 1 involve individuals facing ethical dilemmas in the workplace. In the mini-case "Tina Wilson," an employee must address a conflict of interest situation, while the mini-case "Tony Benson" involves an employee confronting the fact he may have just disclosed important confidential information. The articles in Chapter 2 involving ethical decision making may be instructive in helping to resolve the dilemmas.

The cases included in Part 1 provide an opportunity for additional discussion of some of the issues raised in the first two chapters of the book. In the first case, "The Parable of the Sadhu," a group of mountain climbers is confronted with a life-and-death decision when they unexpectedly find a Sadhu, a wise man, by the side of the trail. Articles in Chapter 2 by Josephson, Messick and Bazerman, Kelman, and Leonard and Zeckhauser are relevant to this case. The same articles are pertinent to "The Ford Pinto" case, which details Ford's decision to make a car with a defective part. In "The Analyst's Dilemma," someone must decide whether to break a promise to his best friend. The Josephson article is again useful here, as is the article by Heath. A consequence of the recent housing bubble is that many homeowners find themselves unable to pay their mortgage, and "walk away" from it. The implications of this are discussed in "Walk Away from Your Mortgage!" Articles applicable to this case are those by Greenfield, Narveson, Heath, Kelman, and Leonard and Zeckhauser. The final case for Part 1, "The Ok Tedi Copper Mine," examines environmental and other consequences of mining in Papua New Guinea. Articles that apply to this case include those by Rawls, Nozick, Smart, Narveson, Kelman, and Leonard and Zeckhauser. It should be emphasized that the above suggestions for articles related to the cases are no more than that. It may be entirely appropriate to examine the cases from different perspectives using different articles.

Mini-Cases

Tina Wilson

Tina Wilson is an executive assistant for one of the Assurance partners. This morning, while she was talking with the partner about priorities for the day, her meeting was interrupted by one of the managers. Among other things, the manager asked whether one

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Business Ethics: Readings and Cases in Corporate Morality, Fifth Edition.
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of the other executive assistants – a good friend of hers – had been told that she was being let go.

Noting Wilson's shock, the partner explained that the executive assistant's work was way below standard and that the situation was getting worse by the day. He admonished Wilson not to say anything to the executive assistant, observing, "I know this is hard for you because she is a friend. We'll be talking with her at the end of the week."

Later that day, the executive assistant rushed over to Wilson at lunch. "You'll never guess what has happened. The Ford dealer just called and accepted my offer on the car I want. It'll be a stretch, but it'll be worth the hardship. I'll be eating peanut butter and jelly for a while. Anyway, I'm going over tonight to pick the car up."

Wilson feels terrible. What should she do?

Discussion questions

1. Are the firm's interests and personal interests in this situation in conflict?
2. What alternatives does the secretary have for resolving this situation?
3. If the executive assistant elects to tell her friend about the impending termination, what obligations does she then have to the firm (if any)?

Tony Benson

Tony Benson enjoys working in the print shop at PricewaterhouseCoopers LLP. He takes pride in what he does, and he feels that he makes a contribution to the various products that go out the door representing the firm.

Every once in a while, Benson catches a problem, which gives him a sense of real satisfaction. For example, last week he noticed a typo on the cover of a report he was given to copy. It was an assessment of a potential merger between two major companies in the financial services area. Benson felt that he had saved the firm considerable embarrassment – if not more – by catching the mistake.

The problem is that Benson is the one who is embarrassed now. Over a drink after work with some non-PricewaterhouseCoopers LLP friends, Benson reported his good deed, mentioning the names of two high-profile financial firms being assessed. One of the people in the group, someone he did not know well, seemed particularly interested. When he asked a question about the content of the report, Benson began to feel uneasy and quickly changed the conversation.

This morning, the front page of the newspaper carried a brief story about the potential merger. It cited a confidential source. Benson is afraid that it might have been him.

What should Benson do?

Discussion questions

1. How do we want people to handle situations where they have made a mistake?
2. What obligation is there to report this potential breach of confidentiality?
3. What should be done with someone who makes a mistake like this?
4. Does the fact that the person is an administrative staff member affect the situation?

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MBA Student Mini-Dilemmas

Ethical Decision Making and Worker Safety?

You work as a country manager for an energy company in a developing country. In one of the projects, you discover that you must substitute one important piece of equipment that is located in the middle of the nuclear reactor. The intensity of the nuclear radiation in that location was extraordinarily high, which would represent a high nuclear dose potentially affecting the long-term health of the workers performing work there (e.g. workers could be at risk of developing cancer). As project manager, you are responsible for the profit and losses for the project. The contract is the most important for the country, and if the project is profitable you would most likely be promoted, with salary increases for your employees. The nuclear power plant is located in a depressed area of the country, where people have few employment options and are willing to do anything to feed their families. Generally, employers do not respect safety standards for employees. You have two basic options. You can arrange the work so that employees would receive radiation close to but not surpassing the legal limit. Profits would be maximized this way. You could also design and arrange the work in a way to minimize radiation, lowering profits significantly due to the lengthier time it will take to replace the equipment. You know that even if you choose the lower radiation option, you expect that the next manager would in the future make employees work at the higher radiation limits, so the present health benefit would most likely be negligible. You also know that workers sometimes disconnect their radiation-level counters in order to work extra hours and make extra money. The company's senior managers want the equipment to be replaced as soon as possible, regardless of the radiation dose received by the workers. What do you do?

Illegal Workers?

You have begun working as a new supervisor on a construction site. The relatively low-skilled, high-labor positions are filled by men who have recently migrated to the United States. Several weeks after your promotion to supervisor, one of the recently hired managers takes you aside and explains that a previous manager, who is no longer with the company, had hired some employees who had provided false documentation when they were hired. This means that a few of the current employees were not legally permitted to work in the country. It is illegal to hire undocumented employees and this could lead to legal trouble for the firm. On the other hand, you are aware that these employees are merely trying to provide food for their families. What do you do?

The Parable of the Sadhu

Bowen H. McCoy

Former Managing Partner at Morgan Stanley; now real estate and business counselor, teacher, and philanthropist

Last year, as the first participant in the new six-month sabbatical program that Morgan Stanley has adopted, I enjoyed a rare opportunity to collect my thoughts as well as do some traveling. I spent the first three months in Nepal, walking 600 miles through 200 villages in the Himalayas and climbing some 120,000 vertical feet. My sole Western companion on the trip was an anthropologist who shed light on the cultural patterns of the villages that we passed through.

During the Nepal hike, something occurred that has had a powerful impact on my thinking about corporate ethics. Although some might argue that the experience has no relevance to business, it was a situation in which a basic ethical dilemma suddenly intruded into the lives of a group of individuals. How the group responded holds a lesson for all organizations, no matter how defined.

The Sadhu

The Nepal experience was more rugged than I had anticipated. Most commercial treks last two or three weeks and cover a quarter of the distance we traveled.

Bowen McCoy, "Parable of the Sadhu," *Harvard Business Review*, 1983, and appeared in *Harvard Business Review Classic*, May/June 1997, pp. 55–59, 63–64. Reprinted with permission.

My friend Stephen, the anthropologist, and I were halfway through the 60-day Himalayan part of the trip when we reached the high point, an 18,000-foot pass over a crest that we'd have to traverse to reach the village of Muklinath, an ancient holy place for pilgrims.

Six years earlier, I had suffered pulmonary edema, an acute form of altitude sickness, at 16,500 feet in the vicinity of Everest base camp – so we were understandably concerned about what would happen at 18,000 feet. Moreover, the Himalayas were having their wettest spring in 20 years; hip-deep powder and ice had already driven us off one ridge. If we failed to cross the pass, I feared that the last half of our once-in-a-lifetime trip would be ruined.

The night before we would try the pass, we camped in a hut at 14,500 feet. In the photos taken at that camp, my face appears wan. The last village we'd passed through was a sturdy two-day walk below us, and I was tired.

During the late afternoon, four backpackers from New Zealand joined us, and we spent most of the night awake, anticipating the climb. Below, we could see the fires of two other parties, which turned out to be two Swiss couples and a Japanese hiking club.

To get over the steep part of the climb before the sun melted the steps cut in the ice, we departed at 3:30 A.M. The New Zealanders left first, followed by Stephen and myself, our porters and Sherpas, and then the Swiss. The Japanese lingered in their camp. The sky was clear, and we were confident that no spring storm would erupt that day to close the pass.

At 15,500 feet, it looked to me as if Stephen were shuffling and staggering a bit, which are symptoms of altitude sickness. (The initial stage of altitude sickness brings a headache and nausea. As the condition worsens, a climber may encounter difficult breathing, disorientation, aphasia, and paralysis.) I felt strong – my adrenaline was flowing – but I was very concerned about my ultimate ability to get across. A couple of our porters were also suffering from the height, and Pasang, our Sherpa sirdar (leader), was worried.

Just after daybreak, while we rested at 15,500 feet, one of the New Zealanders, who had gone ahead, came staggering down toward us with a body slung across his shoulders. He dumped the almost naked, barefoot body of an Indian holy man – a sadhu – at my feet. He had found the pilgrim lying on the ice, shivering and suffering from hypothermia. I cradled the sadhu's head and laid him out on the rocks. The New Zealander was angry. He wanted to get across the pass before the bright sun melted the snow, He said, "Look, I've done what I can. You have porters and Sherpa guides. You care for him. We're going on!" He turned and went back up the mountain to join his friends.

I took a carotid pulse and found that the sadhu was still alive. We figured he had probably visited the holy shrines at Muklinath and was on his way home. It was fruitless to question why he had chosen this desperately high route instead of the safe, heavily traveled caravan route through the Kali Gandaki gorge. Or why he was shoeless and almost naked, or how he had been lying in the pass. The answers weren't going to solve our problem.

Stephen and the four Swiss began stripping off their outer clothing and opening their packs. The sadhu was soon clothed from head to foot. He was not able to walk, but he was very much alive. I looked down the mountain and spotted the Japanese climbers, marching up with a horse.

Without a great deal of thought, I told Stephen and Pasang that I was concerned about withstanding the heights to come and wanted to get over the pass. I took off after several of our porters who had gone ahead.

On the steep part of the ascent where, if the ice steps had given way, I would have slid down about 3,000 feet, I felt vertigo. I stopped for a breather, allowing the Swiss to catch up with me. I inquired about the sadhu and Stephen. They said that the sadhu was fine and that Stephen was just behind them. I set off again for the summit.

Stephen arrived at the summit an hour after I did. Still exhilarated by victory, I ran down the slope to congratulate him. He was suffering from altitude sickness – walking 15 steps, then stopping, walking 15 steps, then stopping. Pasang accompanied him all the way up. When I reached them, Stephen glared at me and said: "How do you feel about contributing to the death of a fellow man?"

I did not completely comprehend what he meant. "Is the sadhu dead?" I inquired.

"No," replied Stephen, "but he surely will be!"

After I had gone, followed not long after by the Swiss, Stephen had remained with the sadhu. When the Japanese had arrived, Stephen had asked to use their horse to transport the sadhu down to the hut. They had refused. He had then asked Pasang to have a group of our porters carry the sadhu. Pasang had resisted the idea, saying that the porters would have to exert all their energy to get themselves over the pass. He believed they could not carry a man down 1,000 feet to the hut, reclimb the slope, and get across safely before the snow melted. Pasang had pressed Stephen not to delay any longer.

The Sherpas had carried the sadhu down to a rock in the sun at about 15,000 feet and pointed out the hut another 500 feet below. The Japanese had given him food and drink. When they had last seen him, he was listlessly throwing rocks at the Japanese party's dog, which had frightened him.

We do not know if the sadhu lived or died.

For many of the following days and evenings, Stephen and I discussed and debated our behavior toward the sadhu. Stephen is a committed Quaker with deep moral vision. He said, "I feel that what happened with the sadhu is a good example of the breakdown between the individual ethic and the corporate ethic. No one person was willing to assume ultimate responsibility for the sadhu. Each was willing to do his bit just so long as it was not too inconvenient. When it got to be a bother, everyone just passed the buck to someone else and took off. Jesus was relevant to a more individualistic stage of society, but how do we interpret his teaching today in a world filled with large, impersonal organizations and groups?"

I defended the larger group, saying, "Look, we all cared. We all gave aid and comfort. Everyone did his bit. The New Zealander carried him down below the snow line. I took his pulse and suggested we treat him for hypothermia. You and the Swiss gave him clothing and got him warmed up. The Japanese gave him food and water. The Sherpas carried him down to the sun and pointed out the easy trail toward the hut. He was well enough to throw rocks at a dog. What more could we do?"

"You have just described the typical affluent Westerner's response to a problem. Throwing money – in this case, food and sweaters – at it, but not solving the fundamentals!" Stephen retorted.

"What would satisfy you?" I said. "Here we are, a group of New Zealanders, Swiss, Americans, and Japanese who have never met before and who are at the apex of one of the most powerful experiences of our lives. Some years the pass is so bad no one gets over it. What right does an almost naked pilgrim who chooses the wrong trail have to disrupt our lives? Even the Sherpas had no interest in risking the trip to help him beyond a certain point."

Stephen calmly rebutted, "I wonder what the Sherpas would have done if the sadhu had been a well-dressed Nepali, or what the Japanese would have done if the sadhu had been a well-dressed Asian, or what you would have done, Buzz, if the sadhu had been a well-dressed Western woman?"

"Where, in your opinion," I asked, "is the limit of our responsibility in a situation like this? We had our own well-being to worry about. Our Sherpa guides were unwilling to jeopardize us or the porters for the sadhu. No one else on the mountain was willing to commit himself beyond certain self-imposed limits."

Stephen said, "As individual Christians or people with a Western ethical tradition, we can fulfill our obligations in such a situation only if one, the sadhu dies in our care; two, the sadhu demonstrates to us that he can undertake the two-day walk down to the village; or three, we carry the sadhu for two days down to the village and persuade someone there to care for him."

"Leaving the sadhu in the sun with food and clothing – where he demonstrated hand-eye coordination by throwing a rock at a dog – comes close to fulfilling items one and two," I answered. "And it wouldn't have made sense to take him to the village where the people appeared to be far less caring than the Sherpas, so the third condition is impractical. Are you really saying that, no matter what the implications, we should, at the drop of a hat, have changed our entire plan?"

The Individual Versus the Group Ethic

Despite my arguments, I felt and continue to feel guilt about the sadhu. I had literally walked through a classic moral dilemma without fully thinking through the consequences. My excuses for my actions include a high adrenaline flow, a superordinate goal, and a once-in-a-lifetime opportunity – common factors in corporate situations, especially stressful ones.

Real moral dilemmas are ambiguous, and many of us hike right through them, unaware that they exist. When, usually after the fact, someone makes an issue of one, we tend to resent his or her bringing it up. Often, when the full import of what we have done (or not done) hits us, we dig into a defensive position from which it is very difficult to emerge. In rare circumstances, we may contemplate what we have done from inside a prison.

Had we mountaineers been free of stress caused by the effort and the high altitude, we might have treated the sadhu differently. Yet isn't stress the real test of personal and corporate values? The instant decisions that executives make under pressure reveal the most about personal and corporate character.

Among the many questions that occur to me when I ponder my experience with the sadhu are: What are the practical limits of moral imagination and vision? Is there a collective or institutional ethic that differs from the ethics of the individual? At what level of effort or commitment can one discharge one's ethical responsibilities?

Not every ethical dilemma has a right solution. Reasonable people often disagree; otherwise there would be no dilemma. In a business context, however, it is essential that managers agree on a process for dealing with dilemmas.

Our experience with the sadhu offers an interesting parallel to business situations. An immediate response was mandatory. Failure to act was a decision in itself. Up on the mountain we could not resign and submit our resumes to a head-hunter. In contrast to philosophy, business involves action and implementation – getting things done. Managers must come up with answers based on what they see and what they allow to influence their decision-making processes. On the mountain, none of us but Stephen realized the true dimensions of the situation we were facing.

One of our problems was that as a group we had no process for developing a consensus. We had no sense of purpose or plan. The difficulties of dealing with the sadhu were so complex that no one person could handle them. Because the group did not have a set of preconditions that could guide its action to an acceptable resolution, we reacted instinctively as individuals. The cross-cultural nature of the group added a further layer of complexity. We had no leader with whom we could all identify and in whose purpose we believed. Only Stephen was willing to take charge, but he could not gain adequate support from the group to care for the sadhu.

Some organizations do have values that transcend the personal values of their managers. Such values, which go beyond profitability, are usually revealed when the organization is under stress. People throughout the organization generally accept its values, which, because they are not presented as a rigid list of commandments, may be somewhat ambiguous. The stories people tell, rather than printed materials, transmit the organization's conceptions of what is proper behavior.

For 20 years, I have been exposed at senior levels to a variety of corporations and organizations. It is amazing how quickly an outsider can sense the tone and style of an organization and, with that, the degree of tolerated openness and freedom to challenge management.

Organizations that do not have a heritage of mutually accepted, shared values tend to become unhinged during stress, with each individual bailing out for himself or herself. In the great takeover battles we have witnessed during past years, companies that had strong cultures drew the wagons around them and fought it out, while other companies saw executives – supported by golden parachutes – bail out of the struggles.

Because corporations and their members are interdependent, for the corporation to be strong the members need to share a preconceived notion of correct behavior, a "business ethic," and think of it as a positive force, not a constraint.

As an investment banker, I am continually warned by well-meaning lawyers, clients, and associates to be wary of conflicts of interest. Yet if I were to run away from every difficult situation, I wouldn't be an effective investment banker. I have to feel my way through conflicts. An effective manager can't run from risk either; he or she has to confront risk. To feel "safe" in doing that, managers need the guidelines of an agreed-upon process and set of values within the organization.

After my three months in Nepal, I spent three months as an executive-in-residence at both the Stanford Business School and the University of California at Berkeley's Center for Ethics and Social Policy of the Graduate Theological Union. Those six months away from my job gave me time to assimilate 20 years of business experience. My thoughts turned often to the meaning of the leadership role in any large organization. Students at the seminary thought of themselves as antibusiness. But when I questioned them, they agreed that they distrusted all large organizations, including the church. They perceived all large organizations as impersonal and opposed to individual values and needs. Yet we all know of organizations in which people's values and beliefs are respected and their expressions encouraged. What makes the difference? Can we identify the difference and, as a result, manage more effectively?

The word *ethics* turns off many and confuses more. Yet the notions of shared values and an agreed-upon process for dealing with adversity and change – what many people mean when they talk about corporate culture – seem to be at the heart of the ethical issue. People who are in touch with their own core beliefs and the beliefs of others and who are sustained by them can be more comfortable living on the cutting edge. At times, taking a tough line or a decisive stand in a muddle of ambiguity is the only ethical thing to do. If a manager is indecisive about a problem and spends time trying to figure out the "good" thing to do, the enterprise may be lost.

Business ethics, then, has to do with the authenticity and integrity of the enterprise. To be ethical is to follow the business as well as the cultural goals of the corporation, its owners, its employees, and its customers. Those who cannot serve the corporate vision are not authentic businesspeople and, therefore, are not ethical in the business sense.

At this stage of my own business experience, I have a strong interest in organizational behavior. Sociologists are keenly studying what they call corporate stories, legends, and heroes as a way organizations have of transmitting value systems. Corporations such as Arco have even hired consultants to perform an audit of their corporate culture. In a company, a leader is a person who understands, interprets, and manages the corporate value system. Effective managers, therefore, are action-oriented people who resolve conflict, are tolerant of ambiguity, stress, and change, and have a strong sense of purpose for themselves and their organizations.

If all this is true, I wonder about the role of the professional manager who moves from company to company. How can he or she quickly absorb the values and culture of different organizations? Or is there, indeed, an art of management that is totally transportable? Assuming that such fungible managers do exist, is it proper for them to manipulate the values of others?

What would have happened had Stephen and I carried the sadhu for two days back to the village and become involved with the villagers in his care? In four trips to Nepal, my most interesting experience occurred in 1975 when I lived in a Sherpa home in the Khumbu for five days while recovering from altitude sickness. The high point of Stephen's trip was an invitation to participate in a family funeral ceremony in Manang. Neither experience had to do with climbing the high passes of the Himalayas. Why were we so reluctant to try the lower path, the ambiguous trail? Perhaps because we did not have a leader who could reveal the greater purpose of the trip to us.

Why didn't Stephen, with his moral vision, opt to take the sadhu under his personal care? The answer is partly because Stephen was hard-stressed physically himself and partly because, without some support system that encompassed our involuntary and episodic community on the mountain, it was beyond his individual capacity to do so.

I see the current interest in corporate culture and corporate value systems as a positive response to pessimism such as Stephen's about the decline of the role of the individual in large organizations. Individuals who operate from a thoughtful set of personal values provide the foundation for a corporate culture. A corporate tradition that encourages freedom of inquiry, supports personal values, and reinforces a focused sense of direction can fulfill the need to combine individuality with the prosperity and success of the group. Without such corporate support, the individual is lost.

That is the lesson of the sadhu. In a complex corporate situation, the individual requires and deserves the support of the group. When people cannot find such support in their organizations, they don't know how to act. If such support is forthcoming, a person has a stake in the success of the group and can add much to the process of establishing and maintaining a corporate culture. Management's challenge is to be sensitive to individual needs, to shape them, and to direct and focus them for the benefit of the group as a whole.

For each of us the sadhu lives. Should we stop what we are doing and comfort him; or should we keep trudging up toward the high pass? Should I pause to help the derelict I pass on the street each night as I walk by the Yale Club en route to Grand Central Station? Am I his brother? What is the nature of our responsibility if we consider ourselves to be ethical persons? Perhaps it is to change the values of the group so that it can, with all its resources, take the other road.

When Do We Take a Stand?

I wrote about my experiences purposely to present an ambiguous situation. I never found out if the sadhu lived or died. I can attest, though that the sadhu lives on in his story. He lives in the ethics classes I teach each year at business schools and churches. He lives in the classrooms of numerous business schools, where professors have taught the case to tens of thousands of students He lives in several casebooks on ethics and on an educational video. And he lives in organizations such as the American Red Cross and AT&T, which use his story in their ethics training.

As I reflect on the sadhu now, 15 years after the fact, I first have to wonder, What actually happened on that Himalayan slope? When I first wrote about the event, I reported the experience in as much detail as I could remember, but I shaped it to the needs of a good classroom discussion. After years of reading my story, viewing it on video, and hearing others discuss it, I'm not sure I myself know what actually occurred on the mountainside that day!

I've also heard a wide variety of responses to the story. The sadhu, for example, may not have wanted our help at all – he may have been intentionally bringing on his own death as a way to holiness. Why had he taken the dangerous way over the pass instead of the caravan route through the gorge? Hindu businesspeople have told me that in trying to assist the sadhu, we were being typically arrogant Westerners imposing our cultural values on the world.

I've learned that each year along the pass, a few Nepali porters are left to freeze to death outside the tents of the unthinking tourists who hired them. A few years ago, a French group even left one of their own, a young French woman, to die there. The difficult pass seems to demonstrate a perverse version of Gresham's law of currency: The bad practices of previous travelers have driven out the values that new travelers might have followed if they were at home. Perhaps that helps to explain why our porters behaved as they did and why it was so difficult for Stephen or anyone else to establish a different approach on the spot.

Our Sherpa sirdar, Pasang, was focused on his responsibility for bringing us up the mountain safe and sound. (His livelihood and status in the Sherpa ethnic group depended on our safe return.) We were weak, our party was split, the porters were well on their way to the top with all our gear and food, and a storm would have separated us irrevocably from our logistical base.

The fact was, we had no plan for dealing with the contingency of the sadhu. There was nothing we could do to unite our multicultural group in the little time we had. An ethical dilemma had come upon us unexpectedly, an element of drama that may explain why the sadhu's story has continued to attract students.

I am often asked for help in teaching the story. I usually advise keeping the details as ambiguous as possible. A true ethical dilemma requires a decision between two hard choices. In the case of the sadhu, we had to decide how much to sacrifice ourselves to take care of a stranger. And given the constraints of our trek, we had to make a group decision, not an individual one. If a large majority of students in a class ends up thinking I'm a bad person because of my decision on the mountain, the instructor may not have given the case its due. The same is true if the majority sees no problem with the choices we made.

Any class's response depends on its setting, whether it's a business school, a church, or a corporation. I've found that younger students are more likely to see the issue as black-and-white, whereas older ones tend to see shades of gray. Some have seen a conflict between the different ethical approaches that we followed at the time, Stephen felt he had to do everything he could to save the sadhu's life, in accordance with his

Christian ethic of compassion. I had a utilitarian response: do the greatest good for the greatest number. Give a burst of aid to minimize the sadhu's exposure, then continue on our way.

The basic question of the case remains, When do we take a stand? When do we allow a "sadhu" to intrude into our daily lives? Few of us can afford the time or effort to take care of every needy person we encounter. How much must we give of ourselves? And how do we prepare our organizations and institutions so they will respond appropriately in a crisis? How do we influence them if we do not agree with their points of view?

We cannot quit our jobs over every ethical dilemma, but if we continually ignore our sense of values, who do we become? As a journalist asked at a recent conference on ethics, "Which ditch are we willing to die in?" For each of us, the answer is a bit different. How we act in response to that question defines better than anything else who we are, just as, in a collective sense, our acts define our institutions. In effect, the sadhu is always there, ready to remind us of the tensions between our own goals and the claims of strangers.

The Ford Pinto

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I

On August 10, 1978, a tragic automobile accident occurred on U.S. Highway 33 near Goshen, Indiana. Sisters Judy and Lynn Ulrich (ages 18 and 16, respectively) and their cousin Donna Ulrich (age 18) were struck from the rear in their 1973 Ford Pinto by a van. The gas tank of the Pinto ruptured, the car burst into flames, and the three teenagers were burned to death.

Subsequently an Elkhart County grand jury returned a criminal homicide charge against Ford, the first ever against an American corporation. During the following twenty-week trial, Judge Harold R. Staffeldt advised the jury that Ford should be convicted of reckless homicide if it were shown that the company had engaged in "plain, conscious and unjustifiable disregard of harm that might result (from its actions) and the disregard involves a substantial deviation from acceptable standards of conduct."[1]

The key phrase around which the trial hinged, of course, is "acceptable standards." Did Ford knowingly and recklessly choose profit over safety in the design and placement of the Pinto's gas tank? Elkhart County prosecutor Michael A. Cosentino and chief Ford attorney James F. Neal battled dramatically over this issue in a rural Indiana courthouse. Meanwhile, American business anxiously awaited the verdict which could send warning ripples through boardrooms across the nation concerning corporate responsibility and product liability.

II

As a background to this trial some discussion of the Pinto controversy is necessary. In 1977 the magazine *Mother Jones* broke a story by Mark Dowie, general manager of *Mother Jones* business operations, accusing Ford of knowingly putting on the road an unsafe car – the Pinto – in which hundreds of people have needlessly suffered burn deaths and even more have been scarred and disfigured from burns. In his article "Pinto Madness" Dowie charges that:

- Fighting strong competition from Volkswagen for the lucrative small-car market, the Ford Motor Company rushed the Pinto into production in much less than the usual time.
- Ford engineers discovered in preproduction crash tests that rear-end collisions would rupture the Pinto's fuel system extremely easily.

W. Michael Hoffman, "The Ford Pinto." © 1984 by W. Michael Hoffman. Written for the first edition of this book. Reprinted with kind permission of the author.

- Because assembly-line machinery was already tooled when engineers found this defect, top Ford officials decided to manufacture the car anyway – exploding gas tank and all – even though Ford owned the patent on a much safer gas tank.
- For more than eight years afterward, Ford successfully lobbied, with extraordinary vigor and some blatant lies, against a key government safety standard that would have forced the company to change the Pinto's fire-prone gas tank.

> By conservative estimates Pinto crashes have caused 500 burn deaths to people who would not have been seriously injured if the car had not burst into flames. The figure could be as high as 900. Burning Pintos have become such an embarrassment to Ford that its advertising agency, J. Walter Thompson, dropped a line from the ending of a radio spot that read "Pinto leaves you with that warm feeling."
>
> Ford knows that the Pinto is a firetrap, yet it has paid out millions to settle damage suits out of court, and it is prepared to spend millions more lobbying against safety standards. With a half million cars rolling off the assembly lines each year, Pinto is the biggest-selling subcompact in America, and the company's operating profit on the car is fantastic. Finally, in 1977, new Pinto models have incorporated a few minor alterations necessary to meet that federal standard Ford managed to hold off for eight years. Why did the company delay so long in making these minimal, inexpensive improvements ?

- Ford waited eight years because its internal "cost-benefit analysis," which places a dollar value on human life, said it wasn't profitable to make the changes sooner.[2]

Several weeks after Dowie's press conference on the article, which had the support of Ralph Nader and auto safety expert Byron Bloch, Ford issued a news release attributed to Herbert T. Misch, vice president of Environmental and Safety Engineering, countering points made in the *Mother Jones* article. Their statistical studies conflict significantly with each other. For example, Dowie states that more than 3,000 people were burning to death yearly in auto fires; he claims that, according to a National Highway Traffic Safety Administration (NHTSA) consultant, although Ford makes 24 percent of the cars on American roads, these cars account for 42 percent of the collision-ruptured fuel tanks.[3] Ford, on the other hand, uses statistics from the Fatality Analysis Reporting System (FARS) maintained by the government's NHTSA to defend itself, claiming that in 1975 there were 848 deaths related to fire-associated passenger-car accidents and only 13 of these involved Pintos; in 1976, Pintos accounted for only 22 out of 943. These statistics imply that Pintos were involved in only 1.9 percent of such accidents, and Pintos constitute about 1.9 percent of the total registered passenger cars. Furthermore, fewer than half of those Pintos cited in the FARS study were struck in the rear.[4] Ford concludes from this and other studies that the Pinto was never an unsafe car and has not been involved in some 70 burn deaths annually, as *Mother Jones* claims.

Ford admits that early-model Pintos did not meet rear-impact tests at 20 mph but denies that this implies that they were unsafe compared with other cars of that type and era. In fact, according to Ford, some of its tests were conducted with experimental rubber "bladders" to protect the gas tank, in order to determine how best to have its future cars meet a 20-mph rear-collision standard which Ford itself set as an internal performance goal. The government at that time had no such standard. Ford also points out that in every model year the Pinto met or surpassed the government's own standards, and

> it simply is unreasonable and unfair to contend that a car is somehow unsafe if it does not meet standards proposed for future years or embody the technological improvements that are introduced in later model years.[5]

Mother Jones, on the other hand, presents a different view of the situation. If Ford was so concerned about rear-impact safety, why did it delay the federal government's attempts to impose standards? Dowie gives the following answer:

> The particular regulation involved here was Federal Motor Vehicle Safety Standard 301. Ford picked portions of Standard 301 for strong opposition way back in 1968 when the Pinto was still in the blueprint stage. The intent of 301, and the 300 series that followed it, was to protect drivers and passengers after a crash occurs. Without question the worst post-crash hazard is fire. So Standard 301 originally proposed that all cars should be able to withstand a fixed barrier impact of 20 mph (that is, running into a wall at that speed) without losing fuel.

> When the standard was proposed, Ford engineers pulled their crash-test results out of their files. The front ends of most cars were no problem – with minor alterations they could stand the impact without losing fuel. "We were already working on the front end," Ford engineer Dick Kimble admitted. "We knew we could meet the test on the front end." But with the Pinto particularly, a 20 mph rear-end standard meant redesigning the entire rear end of the car. With the Pinto scheduled for production in August of 1970, and with $200 million worth of tools in place, adoption of this standard would have created a minor financial disaster. So Standard 301 was targeted for delay, and with some assistance from its industry associates, Ford succeeded beyond its wildest expectations: the standard was not adopted until the 1977 model year.[6]

Ford's tactics were successful, according to Dowie, not only due to their extremely clever lobbying, which became the envy of lobbyists all over Washington, but also because of the proindustry stance of NHTSA itself.

Furthermore, it is not at all clear that the Pinto was as safe as comparable cars with regard to the positioning of its gas tank. Unlike the gas tank in the Capri, which rode over the rear axle, a "saddle-type" fuel tank on which Ford owned the patent, the Pinto tank was placed just behind the rear bumper. According to Dowie,

> Dr. Leslie Ball, the retired safety chief for the NASA manned space program and a founder of the International Society of Reliability Engineers, recently made a careful study of the Pinto. "The release to production of the Pinto was the most reprehensible decision in the history of American engineering," he said. Ball can name more than 40 European and Japanese models in the Pinto price and weight range with safer gas-tank positioning.
>
> Los Angeles auto safety expert Byron Bloch has made an in-depth study of the Pinto fuel system. "It's a catastrophic blunder," he says. "Ford made an extremely irresponsible decision when they placed such a weak tank in such a ridiculous location in such a soft rear end. It's almost designed to blow up – premeditated."[7]

Although other points could be brought out in the debate between *Mother Jones* and Ford, perhaps the most intriguing and controversial is the cost-benefit analysis study that Ford did entitled "Fatalities Associated with Crash-Induced Fuel Leakage and Fires" released by J. C. Echold, director of automotive safety for Ford. This study apparently convinced Ford and was intended to convince the federal government that a technological improvement costing $11 per car which would have prevented gas tanks from rupturing so easily was not cost effective for society. The costs and benefits are broken down in the following way:

	Benefits
Savings:	180 burn deaths, 180 serious burn injuries, 2,100 burned vehicles
Unit cost:	$200,000 per death, $67,000 per injury, $700 per vehicle
Total benefit:	180 × $200,000 + 180 × $67,000 + 2,100 × $700 = *$49.5 million*
	Costs
Sales:	11 million cars, 1.5 million light trucks
Unit cost:	$11 per car, $11 per truck
Total cost:	11,000,000 × $11 + 1,500,000 × $11 = *$137 million*

And where did Ford come up with the $200,000 figure as the cost per death? This came from a NHTSA study which broke down the estimated social costs of a death as follows:

Component	*1971 Costs*
Future productivity losses	
Direct	$132,000
Indirect	41,300
Medical costs	
Hospital	700
Other	425
Property damage	1,500
Insurance administration	4,700
Legal and court	3,000
Employer losses	1,000
Victim's pain and suffering	10,000
Funeral	900
Assets (lost consumption)	5,000
Miscellaneous	200
Total per fatality	$200,725

(Although this analysis was on all Ford vehicles, a breakout of just the Pinto could be done.) *Mother Jones* reports it could not find anybody who could explain how the $10,000 figure for "pain and suffering" had been arrived at.[8]

Although Ford does not mention this point in its news release defense, one might have replied that it was the federal government, not Ford, that set the figure for a burn death. Ford simply carried out a cost-benefit analysis based on that figure. *Mother Jones*, however, in addition to insinuating that there was industry-agency (NHTSA) collusion, argues that the $200,000 figure was arrived at under intense pressure from the auto industry to use cost-benefit analysis in determining regulations. *Mother Jones* also questions Ford's estimate of burn injuries: "All independent experts estimate that for each person who dies by an auto fire, many more are left with charred hands, faces and limbs." Referring to the Northern California Burn Center, which estimates the ratio of burn injuries to deaths at ten to one instead of one to one, Dowie states that "the true ratio obviously throws the company's calculations way off."[9] Finally, *Mother Jones* claims to have obtained "confidential" Ford documents which Ford did not send to Washington, showing that crash fires could largely be prevented by installing a rubber bladder inside the gas tank for only $5.08 per car, considerably less than the $11 per car Ford originally claimed was required to improve crashworthiness.[10].

Instead of making the $11 improvement, installing the $5.08 bladder, or even giving the consumer the right to choose the additional cost for added safety, Ford continued, according to *Mother Jones*, to delay the federal government for eight years in establishing mandatory rear-impact standards. In the meantime, Dowie argues, thousands of people were burning to death and tens of thousands more were being badly burned and disfigured for life, while many of these tragedies could have been prevented for only a slight cost per vehicle. Furthermore, the delay also meant that millions of new unsafe vehicles went on the road, "vehicles that will be crashing, leaking fuel and incinerating people well into the 1980s."[11]

In concluding his article Dowie broadens his attack beyond just Ford and the Pinto.

> Unfortunately, the Pinto is not an isolated case of corporate malpractice in the auto industry. Neither is Ford a lone sinner. There probably isn't a car on the road without a safety hazard known to its manufacturer. . . .
>
> Furthermore, cost-valuing human life is not used by Ford alone. Ford was just the only company careless enough to let such an embarrassing calculation slip into public records. The process of willfully trading lives for profits is built into corporate capitalism. Commodore Vanderbilt publicly scorned George Westinghouse and his "foolish" air brakes while people died by the hundreds in accidents on Vanderbilt's railroads.[12]

Ford has paid millions of dollars in Pinto jury trials and out-of-court settlements, especially the latter. *Mother Jones* quotes Al Slechter in Ford's Washington office as saying: "We'll never go to a jury again. Not in a fire case. Juries are just too sentimental. They see those charred remains and forget the evidence. No sir, we'll settle."[13] But apparently Ford thought such settlements would be less costly than the safety improvements. Dowie wonders if Ford would continue to make the same decisions "were Henry Ford II and Lee Iacocca serving twenty-year terms in Leavenworth for consumer homicide."[14]

III

On March 13, 1980, the Elkhart County jury found Ford not guilty of criminal homicide in the Ulrich case. Ford attorney Neal summarized several points in his closing argument before the jury. Ford could have stayed out of the small-car market, which would have been the "easiest way," since Ford would have made more profit by sticking to bigger cars. Instead, Ford built the Pinto "to take on the imports, to save jobs for Americans and to make a profit for its stockholders."[15] The Pinto met every fuel-system standard of any federal, state, or local government, and was comparable to other 1973 sub-compacts. The engineers who designed the car thought it was a good, safe car and bought it for themselves and their families. Ford did everything possible to recall the Pinto quickly after NHTSA ordered it to do so. Finally, and more specifically to the case at hand, Highway 33 was a badly designed highway, and the girls were fully stopped when a 4,000-pound van rammed into the rear of their Pinto going at least 50 miles an hour. Given the same circumstances, Neal stated, any car would have suffered the same consequences as the Ulrich's Pinto.[16] As reported in the *New York Times* and *Time*, the verdict brought a "loud cheer" from Ford's board of directors and undoubtedly at least a sigh of relief from other corporations around the nation.

Many thought this case was that of a David against a Goliath because of the small amount of money and volunteer legal help Prosecutor Cosentino had in contrast to the huge resources Ford poured into the trial. In addition, it should be pointed out that Cosentino's case suffered from a ruling by Judge Staffeldt that Ford's own test results on pre-1973 Pintos were inadmissible.These documents confirmed that Ford knew as early as 1971 that the gas tank of the Pinto ruptured at impacts of 20 mph and that the company was aware, because of tests with the Capri, that the over-the-axle position of the gas tank was much safer than mounting it behind the axle. Ford decided to mount it behind the axle in the Pinto to provide more trunk space and to save money. The restrictions of Cosentino's evidence to testimony relating specifically to the 1973 Pinto severely undercut the strength of the prosecutor's case.[17]

Whether this evidence would have changed the minds of the jury will never be known. Some, however, such as business ethicist Richard De George, feel that this evidence shows grounds for charges of recklessness against Ford. Although it is true that there were no federal safety standards in 1973 to which Ford legally had to conform and although Neal seems to have proved that all subcompacts were unsafe when hit at 50 mph by a 4,000-pound van, the fact that the NHTSA ordered a recall of the Pinto and not other subcompacts is, according to De George, "*prima facie* evidence that Ford's Pinto gas tank mounting was substandard."[18] De George argues that these grounds for recklessness are made even stronger by the fact that Ford did not give the consumer a choice to make the Pinto gas tank safer by installing a rubber bladder for a rather modest fee.[19] Giving the consumer such a choice, of course, would have made the Pinto gas tank problem known and therefore probably would have been bad for sales.

Richard A. Epstein, professor of law at the University of Chicago Law School, questions whether Ford should have been brought up on criminal charges of reckless homicide at all. He also points out an interesting historical fact. Before 1966 an injured party in Indiana could not even bring civil charges against an automobile manufacturer solely because of the alleged "uncrashworthiness" of a car; one would have to seek legal relief from the other party involved in tire accident, not from the manufacturer. But after *Larson v. General Motors Corp.* in 1968, a new era of crashworthiness suits against automobile manufacturers began. "Reasonable" precautions must now be taken by manufacturers to minimize personal harm in crashes.[20] How to apply criteria of reasonableness in such cases marks the whole nebulous ethical and legal arena of product liability.

If such a civil suit had been brought against Ford, Epstein believes, the corporation might have argued, as it did to a large extent in the criminal suit, that the Pinto conformed to all current applicable safety standards and with common industry practice. (Epstein cites that well over 90 percent of United States standard production cars had their gas tanks in the same position as the Pinto.) But in a civil trial the adequacy of industry standards are ultimately up to the jury, and had civil charges been brought against Ford in this case the plaintiffs might have had a better chance of winning.[21] Epstein feels that a criminal suit, on the other hand, had no chance from the very outset, because the prosecutor would have had to establish criminal intent on the part of Ford. To use an analogy, if a hunter shoots at a deer and wounds an unseen person, he may be held civilly responsible but not criminally responsible because he did not intend to harm. And even though it may be more difficult to determine the mental state of a corporation (or its principal agents), it seems clear to Epstein that the facts of this case do not prove any such criminal intent even though Ford may have known that some burn deaths and injuries could have been avoided by a different placement of its Pinto gas tank and that Ford consciously decided not to spend more money to save lives.[22] Everyone recognizes that there are trade-offs between safety and costs. Ford could have built a "tank" instead of a Pinto, thereby considerably reducing risks, but it would have been relatively unaffordable for most and probably unattractive to all potential consumers.

To have established Ford's reckless homicide it would have been necessary to establish the same of Ford's agents, since a corporation can only act through its agents. Undoubtedly, continues Epstein, the reason why the prosecutor did not try to subject Ford's officers and engineers to fines and imprisonment for their design choices is "the good faith character of their judgment, which was necessarily decisive in Ford's behalf as well."[23] For example, Harold C. MacDonald, Ford's chief engineer on the Pinto, testified that he felt it was important to keep the gas tank as far from the passenger compartment as possible, as it was in the Pinto. And other Ford engineers testified that they used the car for their own families. This is relevant information in a criminal case which must be concerned about the intent of the agents.

Furthermore, even if civil charges had been made in this case, it seems unfair and irrelevant to Epstein to accuse Ford of trading cost for safety. Ford's use of cost-benefit formulas, which must assign monetary values to human life and suffering, is precisely what the law demands in assessing civil liability suits. The court may disagree with the decision, but to blame industry for using such a method would violate the very rules of civil liability. Federal automobile officials (NHTSA) had to make the same calculations in order to discharge their statutory duties. In allowing the Pinto design, are not they too (and in turn their employer, the United States) just as guilty as Ford's agents?[24]

IV

The case of the Ford Pinto raises many questions of ethical importance. Some people conclude that Ford was definitely wrong in designing and marketing the Pinto. The specific accident involving the Ulrich girls, because of the circumstances, was simply not the right one to have attacked Ford on. Other people believe that Ford was neither criminally nor civilly guilty of anything and acted completely responsibly in producing the Pinto. Many others, I suspect, find the case morally perplexing, too complex to make sweeping claims of guilt or innocence.

Was Ford irresponsible in rushing the production of the Pinto? Even though Ford violated no federal safety standards or laws, should it have made the Pinto safer in terms of rear-end collisions, especially regarding the placement of the gas tank? Should Ford have used cost-benefit analysis to make decisions relating to safety, specifically placing dollar values on human life and suffering? Knowing that the Pinto's gas tank could have been made safer by installing a protective bladder for a relatively small cost per consumer, perhaps Ford should have made that option available to the public. If Ford did use heavy lobbying efforts to delay and/or influence federal safety standards, was this ethically proper for a corporation to do? One might ask, if Ford was guilty, whether the engineers, the managers, or both are to blame. If Ford had been found guilty of criminal homicide, was the proposed penalty stiff enough ($10,000 maximum fine for each of the three counts equals $30,000 maximum), or should agents of the corporations such as MacDonald, Iacocca, and Henry Ford II be fined and possibly jailed?

A number of questions concerning safety standards are also relevant to the ethical issues at stake in the Ford trial. Is it just to blame a corporation for not abiding by "acceptable standards" when such standards are not yet determined by society? Should corporations like Ford play a role in setting such standards? Should individual juries be determining such standards state by state, incident by incident? If Ford should be setting safety standards. how does it decide how safe to make its product and still make it affordable and desirable to the public without using cost-benefit analysis? For that matter, how does anyone decide? Perhaps it is putting Ford, or any corporation, in a catch-22 position to ask it both to set safety standards and to make a competitive profit for its stockholders.

Regardless of how we answer these and other questions it is clear that the Pinto case raises fundamental issues concerning the responsibilities of corporations, how corporations should structure themselves in order to make ethical decisions, and how industry, government, and society in general ought to interrelate to form a framework within which such decisions can properly be made in the future.

Notes

[1] *The Indianapolis Star*, Sunday, Mar. 9, 1980, Section 3, p. 2.

[2] Mark Dowie, "Pinto Madness," *Mother Jones*, September–October, 1977, pp. 18, 20. Subsequently Mike Wallace for "Sixty Minutes" and Sylvia Chase for "20-20" came out with similar exposés.

[3] *Ibid.*, p. 30.

[4] Ford news release (Sept. 9, 1977), pp. 1–3.

[5] *Ibid.*, p. 5.

[6] Dowie, p. 29.

[7] *Ibid.*, pp. 22–23.

[8] *Ibid.*, pp. 24, 28.

[9] *Ibid.*, p. 28.

[10] *Ibid*, pp. 28–29.

[11] *Ibid.*, p, 30.

[12] *Ibid.*, p. 32. Dowie might have cited another example which emerged in the private correspondence which transpired almost a half-century ago between Lammot du Pont and Alfred P. Sloan, Jr., then president of GM. Du Pont was trying to convince Sloan to equip GM's lowest-priced cars, Chevrolets, with safety glass. Sloan replied by saying: "It is not my responsibility to sell safety glass. . . .You can say, perhaps, that I am selfish, but business is selfish. We are not a charitable institution – we are trying to make a profit for our stockholders." [Quoted in Morton Mintz and Jerry S. Cohen, *Power*, Inc. (New York: The Viking Press, 1976), p. 110.]

[13] *Ibid.*, p. 31.

[14] *Ibid.*, p. 32.

[15] Transcript of report of proceedings in *State of Indiana* v. *Ford Motor Company*, Case No. 11–431, Monday, Mar, 10, 1980, pp. 6202–6203. How Neal reconciled his "easiest way" point with his "making more profit for stockholders" point is not clear to this writer.

[16] *Ibid.*, pp. 6207–6209.

[17] *Chicago Tribune*, Oct. 13, 1979, p. 1, and Section 2, p. 12; *New York Times*, Oct. 14, 1979, p. 26; *The Atlanta Constitution*, Feb. 7, 1980.

[18] Richard De George, "Ethical Responsibilities of Engineers in Large Organizations: The Pinto Case," *Business and Professional Ethics Journal*, vol. 1., No. 1 (Fall 1981), p. 4. *The New York Times*, Oct. 26, 1978, p. 103, also points out that during 1976 and 1977 there were thirteen fiery fatal rear-end collisions involving Pintos, more than double that of other United States comparable cars, with VW Rabbits and Toyota Corollas having none.

[19] *Ibid.*, p. 5.

[20] Richard A. Epstein, "Is Pinto a Criminal?" *Regulation*, March–April, 1980, pp. 16–17.

[21] A California jury awarded damages of $127.8 million (reduced later to $6.3 million on appeal) in a Pinto crash in which a youth was burned over 95 percent of his body. See *New York Times*, Feb. 8, 1978, p. 8.

[22] Epstein, p. 19.

[23] *Ibid.*, pp. 20–21.

[24] *Ibid.*, pp. 19–21.

The Analyst's Dilemma (A)

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Joseph L. Badaracco Jr. and Jerry Useem "The Analyst's Dilemma (A)," Harvard Business School Case, October 1993 (Case #: 394056-PDF-ENG). Reprinted with permission of Harvard Business Publishing.

During the spring of 1989, I faced an ethical dilemma which forced me to choose between my moral duty to respect my best friend's right to confidentiality and my obligation to my employer. I was working in investment banking at the time at Bullard & Bartell (B&B).

The loyalty and commitment that investment bankers, particularly analysts, feel toward their employers is difficult for many to understand. At B&B, a medium-sized firm with about 150 investment bankers in New York, we understood that our loyalty to our career and to our employer was, with few exceptions, our first priority. There exists almost a cult mentality in these organizations, and those who stay accept that one's loyalty to the firm, in many instances, takes precedence over one's health, family and friends. It was this loyalty that made my dilemma so difficult.

While working at B&B, I was living with my best friend Lori, who was an analyst in the capital finance group at Universal Bank, a large commercial bank with more than $20 billion in assets, Lori was one of four Universal bankers who were working on the leveraged buyout of Suntech Corporation, which was in the frozen foods business. B&B was orchestrating the Suntech leveraged buyout. In addition to providing the short-term financing for the transaction through a bridge loan, B&B had arranged to purchase 65% of the Suntech stock and hold it on a long-term basis. Universal, the agent bank on the deal, structured and underwrote the loan for the senior debt. Not only did I know the entire B&B team working on the deal, but the vice president, Steven – the second in command on the team – was my advisor and friend.

I had always felt strongly that my personal life was my business and that when I walked into my apartment at night I took my B&B hat off. Although we couldn't discuss the specifics of our business transactions, Lori and I often discussed issues that we faced at work and solicited advice from one another. As analysts, we had both been advised of our duty to respect the confidentiality of the information to which we would be privy. For example, I knew that she was working on "igloo" with the B&B team; eventually, I became aware that "igloo" was the code name for Suntech. For a long time, however, I hadn't known the identity of "igloo" nor would I ask. I respected the confidential nature of the business. Neither one of us was offended by the other using the code name for a company; it wasn't that we didn't trust each other, but rather that we respected our duties to preserve confidentiality.

One Friday evening, I came home very late from work and Lori was still awake and obviously upset. She told me that she couldn't talk to me about her problem. I found this very hard to believe because we had always told each other everything. Eventually Lori said that she really needed to talk to me about her problem but explained that it might put me in a difficult situation. She asked me to promise that I would keep what she was about to tell me in confidence; I agreed, assuming that it must be a personal problem. She told me that she had lost her job that day because Universal was dissolving its capital finance group. My first concern was for Lori and the fact that she would be unemployed within a couple of weeks. We spent a great deal of time discussing her options in a difficult economic environment; many people in the financial community were losing their jobs and having a very difficult time finding new opportunities. Later, I asked about Suntech, and we discussed the potentially disastrous ramifications that Universal's decision would have upon this deal. We both knew that a last-minute pull-out by one of the major players in a leveraged buyout could put a deal in serious jeopardy. Little problems can prevent a deal from happening on Wall Street, and this was a big problem.

In dissolving its capital finance group, Universal would be selling off its entire loan portfolio to other banks. Because the Suntech deal had not been completed, however, Universal was going to back out of the Suntech loan agreement altogether, and B&B would have to find a new agent bank. Universal's sudden withdrawal left B&B in an extremely precarious position. Although the tender offer had already been made, the deal would not be complete until a sufficient number of Suntech stockholders sold their shares. In the meantime, B&B had put $112 million on the line in bridge financing until the stock purchase could be refinanced with high yield bonds. Most problematic was the fact that Bill, the senior banker from Universal on the deal, was out of the country, and his team intended to wait until he returned to New York to inform the B&B deal team of the situation. He would be back on Monday at the earliest.

My primary concern was that the news of the event would be leaked to the press over the weekend before the B&B team had a chance to reassure the high yield market, and that the uncertainty concerning the agent bank would scare away potential investors. If B&B could not raise money immediately on the high yield market, several bad scenarios could ensue. In the worst case, the bonds would not be sold and the deal would fall apart. A delay in selling the bonds was a more likely scenario, but this possibility would have serious consequences as well. B&B would have to maintain its bridge loan during this period, thereby tying up almost all of the bank's lending money and preventing it from transacting other deals. In either case, the cost to B&B's reputation would be severe: if the market found out about Universal's withdrawal from this high-profile deal before B&B did, the people on the B&B team would look foolish. Individual careers and the firm as a whole might be damaged badly.

The success of the high-yield bond issue was not my only concern.The less time B&B had to line up a new agent bank, the greater the likelihood the new agent bank would take advantage of Suntech's compromised position to tighten the terms of the loan agreement in a way that would be detrimental to Suntech. The Suntech management had haggled for months with Universal to obtain the loan terms it needed to pursue its high-growth strategy. Now, because it desperately needed an agent bank to finance the leveraged buyout, Suntech might be forced into hastily accepting terms that would impede this strategy. In addition, higher uncertainty (and therefore higher risk) surrounding the deal might require Suntech to borrow at higher interest rates. The increased interest payments could create liquidity problems within the company which in turn would make a high-growth strategy difficult. If Suntech could not grow as quickly as it had planned, B&B's 65% equity in the company would be worth less.

The main issue was that if the B&B team could have the next few days to line up a well-respected agent bank and prepare responses to the market's concern, both the deal and B&B's reputation could be saved. I wanted to tell Steven the next day out of a sense of loyalty to the firm and to him; however, I had given my word to Lori that I would not repeat what she had told me.

As my official "mentor" at the firm, Steven had become a good friend. He and Lori had also gotten to know each other well while working together on the Suntech deal. In contrast to some of the other bankers who seemed to be obsessed with living out the image of the cold, '80s investment banker, Steven was a genuinely nice, normal person who showed more of a human side than most. For example, every evening at six o'clock, B&B would bring food into the office so that people could take a short break. As we congregated in the hall to eat cookies and chat, Steven sometimes would notice that I looked like I was under a lot of stress and would invite me into his office to sit down and talk. We would discuss the pressure and deadlines that I was facing, but we also would talk about other matters such as our families, or where I wanted to go to business school.

Often, Steven would tell me to leave the investment banking business before I burned out. He was glad that his sister, who was about my age, had quit investment banking after working on Wall Street for a year. Steven himself was in his early thirties, and he explained that people who stayed in the business as long as he did reached a point where it became difficult to change professions; they became "sucked in" by the money, he said, and found that they weren't trained to do anything else. "Get out before it's too late," he would warn me. "You're young, go to business school, go do something different."The dilemma that I now faced was precisely the type of situation in which I would have asked Steven for advice. Unfortunately, going to him in this instance was obviously out of the question. How I solved the dilemma, furthermore, might have a serious impact on Steven: if the deal fell apart, Steven would probably lose part of his annual bonus and possibly have a harder time finding a job at another bank if he ever chose to leave B&B.

My obligations to Lori were the other half of my dilemma. Lori and I had been best friends since my freshman year in college. She was a year older than I, but we both had been finance majors and members of the same sorority. Lori was the kind of person who would do anything for me. There were times in college when I would be worrying about an accounting exam I had the next day, and Lori would put aside her own work to stay up until one in the morning helping me understand balance sheets and income statements. Lori also had a lot to do with my plans after college.When I was looking for a job my senior year, she got me interested in B&B by putting me in touch with a friend of hers who worked there. Even before I got the job at B&B, we had been planning to live together in New York once I graduated.

Lori was not an investment banker and could not quite understand why work had come to dominate my life so completely. Lori worked hard, but she would be home by six or seven o'clock every night and did not work weekends. The mentality at B&B, on the other hand, was that you lived, ate and breathed your work. I would come home from the office after Lori was in bed and leave before she was awake; sometimes she wouldn't see me for days at a time. Because Lori did not work in the same kind of high-pressure culture, she viewed work responsibilities differently than I. From my own perspective inside the charged environment of B&B, matters such as the Suntech deal were all-absorbing and seemed to be of astronomical importance. But from Lori's viewpoint on the outside, my degree of devotion to B&B – not to mention the number of hours I worked – simply did not make sense. As a result, I knew it would be difficult for my roommate to grasp how important it was to me to save the Suntech deal.

I was extremely uncomfortable. I realized that compromise was essential and that there seemed to be no course of action that would leave me feeling good about myself. Clearly, from a utilitarian perspective, I should have told Steven and the B&B team. The employees of B&B, the "owners" of its parent company, the employees of Suntech, the bondholders and equity holders would all have been much better off if this deal were completed successfully. However, I felt a personal obligation to honor my word to my best friend.

I had grown up with a very strong sense of what was right and wrong, so it had never taken me long to figure out what to do in difficult situations such as this one. It came naturally to me to do the honest thing. But for the first time, I found myself in circumstances in which the definitions of right and wrong were blurry. I had been privy to information in the past that could have benefitted others, but I had always made my decision based on the law. In this case, I didn't have the law to guide me; I had to base my decision on my personal code of ethics. It was also the first time that I faced a dilemma with such potentially huge ramifications: if the problem were handled improperly, the deal could fall apart. If the B&B team realized that I could have helped to prevent this disaster, I could find myself in the ranks of the unemployed.

While I understood Universal's rationale in deciding to wait for Bill to get back to the country so that he could handle the matter in person, I felt that this valuable time could truly make or break the deal. In fact, I felt that the Universal team had made an unethical decision in deciding not to disclose this valuable information immediately to B&B. I also realized that they had put their loyalty to one person (their boss) above their business obligation to B&B. Was I prepared to do the same thing?

I also wondered if I was using my obligation to Lori as a way of avoiding a very difficult situation. It certainly would have been easier to stay out of the situation entirely and pretend that I had never heard a thing; however, if the deal did not close I would have to live with the fact that I could have possibly prevented the disaster. I struggled with the situation and searched for a perspective and course of action with which I could live. I reasoned that since I had been in my apartment when I heard about the situation and had been acting in the capacity of a "private citizen," B&B was not entitled to the information. Somehow, though, I felt that this was a copout. Perhaps, as an analyst, I felt an unusually strong sense of commitment to my employer. I spent 90% of my waking hours at the office and had given up most of my outside interests and pleasures in life to work at this company; I was "brought up" to believe that one's commitment to the company came first.

The fact that I was even considering breaking my word to my best friend made me wonder if my perspective had become warped over the last couple of years. I could imagine situations in which I would definitely break my word to a friend in order to "do the right thing," but all of these situations involved saving other people from physical harm rather than economic harm. This situation did not seem to have a comfortable solution. I had only a few choices. Unfortunately, Lori was extremely reluctant to inform her group that she had told me about Universal's situation and pleaded with me to keep my promise. We had always been careful in the past not to share confidential information in order to avoid situations such as this.

Walk Away From Your Mortgage!

Roger Lowenstein

Outside Director, Sequoia Fund and author of *The End of Wall Street*

John Courson, president and C.E.O. of the Mortgage Bankers Association, recently told *The Wall Street Journal* that homeowners who default on their mortgages should think about the "message" they will send to "their family and their kids and their friends." Courson was implying that homeowners – record numbers of whom continue to default – have a responsibility to make good. He wasn't referring to the people who have no choice, who can't afford their payments. He was speaking about the rising number of folks who are *voluntarily* choosing not to pay.

Such voluntary defaults are a new phenomenon. Time was, Americans would do anything to pay their mortgage – forgo a new car or a vacation, even put a younger family member to work. But the housing collapse left 10.7 million families owing more than their homes are worth. So some of them are making a calculated decision to hang onto their money and let their homes go. Is this irresponsible?

Businesses – in particular Wall Street banks – make such calculations routinely. Morgan Stanley recently decided to stop making payments on five San Francisco office buildings. A Morgan Stanley fund purchased the buildings at the height of the boom, and their value has plunged. Nobody has said Morgan Stanley is immoral – perhaps because no one assumed it was moral to begin with. But the average American, as if sprung from some Franklinesque mythology, is supposed to honor his debts, or so says the mortgage industry as well as government officials. Former Treasury Secretary Henry M. Paulson Jr. declared that "any homeowner who can afford his mortgage payment but chooses to walk away from an underwater property is simply a speculator – and one who is not honoring his obligation." (Paulson presumably was not so censorious of speculation during his 32-year career at Goldman Sachs.)

The moral suasion has continued under President Obama, who has urged that homeowners follow the "responsible" course. Indeed, HUD-approved housing counselors are supposed to counsel people against foreclosure. In many cases, this means counseling people to throw away money. Brent White, a University of Arizona law professor, notes that a family who bought a three-bedroom home in Salinas, Calif., at the market top in 2006, with no down payment (then a common-enough occurrence), could theoretically have to wait 60 years to recover their equity. On the other hand, if they walked, they could rent a similar house for a pittance of their monthly mortgage.

There are two reasons why so-called strategic defaults have been considered antisocial and perhaps amoral. One is that foreclosures depress the neighborhood and drive down prices. But in a market society, since when are people responsible for the economic effects of their actions? Every oil speculator helps to drive up gasoline prices. Every hedge fund that speculated against a bank by purchasing credit-default swaps on its bonds signaled skepticism about the bank's creditworthiness and helped to make it more costly for the bank to borrow, and thus to issue loans. We are all economic pinballs, insensibly colliding for better or worse.

The other reason is that default (supposedly) debases the character of the borrower. Once, perhaps, when bankers held onto mortgages for 30 years, they occupied a moral high ground. These days, lenders typically unload mortgages within days (or minutes). And not just in mortgage finance, but in virtually every realm of our transaction-obsessed society, the message is that enduring relationships count for less than the value put on assets for sale.

Think of private-equity firms that close a factory – essentially deciding that the company is worth more dead than alive. Or the New York Yankees and their

Roger Lowenstein, "The Way We Live Now: Walk Away from Your Mortgage," *The New York Times Magazine*, January 10, 2010. http://www.nytimes.com/2010/01/10/magazine/10FOB-wwln-t.html. Reprinted with permission of Pars International.

World Series M.V.P. Hideki Matsui, who parted company as soon as the cheering stopped. Or money-losing hedge-fund managers: rather than try to earn back their investors' lost capital, they start new funds so they can rake in fresh incentives. Sam Zell, a billionaire, let the Tribune Company, which he had previously acquired, file for bankruptcy. Indeed, the owners of any company that defaults on bonds and chooses to let the company fail rather than invest more capital in it are practicing "strategic default." Banks signal their complicity with this ethos when they send new credit cards to people who failed to stay current on old ones.

Mortgage holders do sign a promissory note, which is a promise to pay. But the contract explicitly details the penalty for nonpayment – surrender of the property. The borrower isn't escaping the consequences; he is suffering them.

In some states, lenders also have recourse to the borrowers' unmortgaged assets, like their car and savings accounts. A study by the Federal Reserve Bank of Richmond found that defaults are lower in such states, apparently because lenders threaten the borrowers with judgments against their assets. But actual lawsuits are rare.

And given that nearly a quarter of mortgages are underwater, and that 10 percent of mortgages are delinquent, White, of the University of Arizona, is surprised that more people haven't walked. He thinks the desire to avoid shame is a factor, as are overblown fears of harm to credit ratings. Probably, homeowners also labor under a delusion that their homes will quickly return to value. White has argued that the government should stop perpetuating default "scare stories" and, indeed, should encourage borrowers to default when it's in their economic interest. This would correct a prevailing imbalance: homeowners operate under a "powerful moral constraint" while lenders are busily trying to maximize profits. More important, it might get the system unstuck. If lenders feared an avalanche of strategic defaults, they would have an incentive to renegotiate loan terms. In theory, this could produce a wave of loan modifications – the very goal the Treasury has been pursuing to end the crisis.

No one says defaulting on a contract is pretty or that, in a perfectly functioning society, defaults would be the rule. But to put the onus for restraint on ordinary homeowners seems rather strange. If the Mortgage Bankers Association is against defaults, its members, presumably the experts in such matters, might take better care not to lend people more than their homes are worth.

The Ok Tedi Copper Mine[1]

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Paul Anderson, chief executive officer of Broken Hill Proprietary Company Limited (BHP) was unsure what to do. In November 1998, he had left Duke Energy Corporation in the United States and moved to Australia with his wife, Kathy, to take over as CEO of BHP, a global mining company. Only a year and a half later, he was faced with having to decide how to manage what was being called one of the world's greatest ongoing "environmental disasters," a pollution catastrophe that was even then being created by BHP's Ok Tedi copper mine in the western part of Papua New Guinea. BHP owned 52 percent of the mine, the government of Papua New Guinea owned 30 percent, and Inmet Mining Corporation, a Canadian company, owned 18 percent.

For almost two decades, the mine had been discharging 80,000 tons of mine tailings and 120,000 tons of waste rock a day into the Ok Tedi River, which flows into the Fly River, which in turn meanders through the western part of Papua New Guinea

Manuel G. Velasquez, "The Ok Tedi Copper Mine," in Manuel G. Velasquez, *Business Ethics: Concepts and Cases,* 7th edn (Upper Saddle River, NJ: Pearson, 2012), pp. 293–297. © Manuel G. Velasquez. Reprinted with kind permission of the author.

before flowing through a large delta into the sea. The ongoing buildup of wastes was destroying the ecology of the tropical rain forests and wetlands through which the rivers flowed and had already devastated 120 riverside villages, whose 50,000 inhabitants had depended on the rivers for subsistence fishing and farming. The villagers and the government of Papua New Guinea were now economically dependent on the mine. Because of their dependence on the mine, they did not want the mine to shut down even though it continued to dump 200,000 tons of waste daily into the Ok Tedi River and continued wreaking havoc on the environment. In September, 1999, BHP had begun discussing its options with the government of Papua New Guinea, but by January, 2000, the company had not yet decided what it would do about the growing tragedy. Anderson was anxious to resolve the issue by the end of the year.

BHP (renamed BHP Billiton since its 2001 merger with Billiton PLC.) was founded in Australia in 1885 as a natural resources company engaged in the discovery, development, production, and marketing of iron ore, steel, coal, copper, oil and gas, diamonds, silver, gold, lead, zinc, and other natural resources. By the twentieth century, the company had become a global leader in its three main operating businesses: minerals, petroleum, and steel. Headquartered in Melbourne, Australia, the company had about 30,000 employees worldwide.

In 1976, Papua New Guinea chose BHP to develop a mine to exploit the large copper deposits discovered in 1963 on the western side of Papua New Guinea in the interior highlands. Papua New Guinea occupies the eastern half of the island of New Guinea (the other half belongs to Indonesia), just 150 miles from the northernmost tip of Australia. The deposits were located in the Star Mountains region in the center of the island along the border with Indonesia. The mine would be located on Mount Fubilan, which is about 1,800 meters above sea level at the headwaters of the Ok Tedi River, whose waters flow south, down into the Fly River, through lowlands, and on over an immense delta to finally empty into the Gulf of Papua on the Coral Sea.

The previous year, in 1975, Papua New Guinea had won its independence from Australia. Its new and inexperienced government was eager to prove itself in the face of high expectations from its people and pressures from the World Bank and the International Monetary Fund. The government wanted to use the income from mining to develop infrastructure and services for its people.

Papua New Guinea is a rugged tropical island covered with rain forests inhabited by several population groups. Isolated from each other by the high rugged mountains and dense forests, the groups had developed fascinating and distinctive tribal cultures and different languages. The tribes living on the southern part of the island, for example, were once notorious for cannibalism and headhunting, whereas the Huli, discovered in 1954 in the interior, were peaceful people who wore spectacular wigs embellished with feathers, human hair, flowers, and fur. Many tribespeople today continue to live traditional lives in hundreds of small villages scattered in virtually inaccessible areas throughout the island. Along the Ok Tedi and Fly River drainage area lived an estimated 73,500 villagers whose subsistence life style was based on traditional gardening, hunting, and fishing centered on the river. There were few schools, no health care, and little infrastructure such as paved highways, public buildings, electricity, etc. Child mortality was high and life expectancy short. Ecologists called the island a "botanical treasure" because its pristine rain forests, mountains, rivers, and surrounding coral reefs are home to a multitude of rare plants, animals, birds, and insects. Fish abounded in its rivers, which are used as waterways by canoeing natives who grow food gardens along the banks.

In 1976, the government of Papua New Guinea passed the Ok Tedi Agreement Mining Act, which defined the obligations and rights related to the development of the Ok Tedi Mine. In 1980, the government officially granted permission for the formation of the group that became the Ok Tedi Mining Limited Company (OTML), a joint-venture company established to develop the Ok Tedi Mine. The mine would use conventional open-pit mining techniques to extract annually about 30 million tons of copper ore and 55 million tons of waste rock. The 1976 Mining Act required that conventional environmental controls would be used by the Ok Tedi Mining Limited Company to minimize environmental damage, including a large storage facility behind a dam that would be used to hold about 80 percent of the tailings and waste produced by the mine. (Tailings are fine sands left over after the ore containing a mineral is crushed and the mineral removed.) Construction of the tailings storage facility began in 1983, about a year before the mine was scheduled to open. However, in 1984, a large landslide destroyed the foundations of the storage dam. The Ok Tedi Mining Limited Company proposed to the government that it be allowed to proceed temporarily without the storage facility since otherwise the mine would not be able to open as scheduled. The government of Papua New Guinea agreed and passed the Interim Tailings License Act, which allowed the mine to begin operation without a waste storage facility.

In 1984, the mine started operating and began discharging its waste rock and tailings into the Ok Tedi River. The ore not only contained copper but had significant quantities of gold and silver. BHP now commissioned a study of the area where the storage facility was to be built and discovered that a storage dam built in the vicinity would probably collapse again. The area was prone to landslides, frequent earthquakes of magnitude 7.0 on the Richter scale, and huge quantities of rainfall throughout the year. The company reported this to the government, which agreed in 1986 to pass the "Eighth Supplemental Agreement," which licensed the company to defer construction of a permanent waste storage facility; this license was renewed in 1988 and was never revoked. All water, rock, and tailings produced by the mining operations were now flowing directly into the Ok Tedi River and downstream into the Fly River.

The effects on the rain forests surrounding the Ok Tedi and Fly Rivers were evident by the late 1980s when the sediment levels of the rivers more than quadrupled, from their previous natural level of 100 parts per million to 450–500 parts per million. In many places, the sediment and rock raised the level of the river bed by 5–6 meters, increasing the frequency of flooding and overflows. Over the years, repeated rains and floods carried the sediment onto the floor of the forests surrounding the rivers. The sediment on the forest floors was waterlogged, reducing the oxygen level in the soil, starving the roots of trees and vegetation, and gradually killing them (an effect called *dieback*). The area of forest dieback grew from 18 square kilometers in 1992 to 480 square kilometers in 2000 and was predicted to eventually increase to between 1,278 square kilometers and 2,725 square kilometers.

Since the mining operations extracted only 80 percent of the copper, the rest was flowing into the river, where dissolved copper levels now rose, sometimes exceeding 0.02 milligrams per liter. Fish in the rivers declined by 90 percent, a possible result of the increased copper levels, or of sedimentation, or of a loss of food supplies.

The sediments and mud deposited by flooding ruined the garden crops of villagers (mostly from the Yonggom tribe) living along the rivers. Canoes became difficult to navigate in the river because the raised river beds created shallows in which the canoes got stuck and created rapids in other areas where water was funneled into narrow, rock-strewn channels. Fishing collapsed as the fish levels declined. Several unique species of fish and aquatic organisms had disappeared from the river waters. Where a simple trade economy had existed prior to the mine, the new roads and money flowing from the mine introduced supermarkets and a money economy to the highlands. Villagers abandoned their previous simple dress for Western-style clothes.

The mine brought other changes to the Papua New Guinea, many of them beneficial. Since the mine had begun operations, it contributed about $155 million a year in royalties and taxes to the national government. Between 1985 and 2000, the mine had produced 9.2 million tons of copper, 228 tons of gold, and 382 tons of silver. The copper, gold, and silver production of the mine made up about 18 percent of the nation's exports and constituted 10 percent of its gross domestic product. Half of the revenues of the government for the Western Province (the province where the mine was located) came from the mine. In addition, the mine employed about 2,000 workers directly and another 1,000 who worked for contractors hired to provide support services to the mine, plus a few thousand others who provided goods and services to the miners and their families. The training programs of the Ok Tedi Mine were considered exemplary, and many former employees had found other companies who were interested in their newly developed skills. The mine had sponsored several health projects, and as a result infant mortality in the area around the mine fell from 27 percent to about 2 percent, while life expectancy grew from about 30 years to over 50 years. The incidence of malaria in children of the surrounding area decreased from 70 percent to less than 15 percent, and in adults it fell from 35 percent to less than 6 percent. The mine had also set up the Fly River Development Trust to ensure that downstream residents along the Fly River received some of the economic benefits of the mine. The company had contributed about $3 million annually to the trust, which developed the area by building 133 community halls, 40 classrooms, 2 school libraries, 400 solar lights and pumps, 600 water tanks, 23 women's clubs, and 15 clinics. In effect, the mine had become the principle social agent in the Ok Tedi and Fly River areas, providing local social services such as health, education, training programs, infrastructure development, and local business development.

In 1989, a number of the landowners living along the polluted Ok Tedi and Fly Rivers began petitioning the government to take some action to prevent the discharge of the tailings into the river and to provide them with some compensation for their losses. In 1992, over 30,000 of these landowners joined together and sued BHP, the major nongovernment owner of the mine. After a great deal of legal wrangling, the case was settled out of court on June 12, 1996 when BHP agreed to give the landowners a total of $500 million: $90 million would be paid in cash to the 30,000 people who were living along the Ok Tedi and Fly Rivers; $35 million would be paid to the villagers living along the lower Ok Tedi River, the area that had been most devastated by the mine. And a 10 percent ownership share in the mine, valued at about $375 million, would be held by the government of Papua New Guinea in trust for the people of the Western Province, the province where the mine and the rivers were located. In addition, BHP agreed to implement a tailings containment plan if practical, after commissioning a 2-year study to assess the practicality of a containment facility and to recommend a plan for the mine.

The study examining the engineering, environmental, social, and risk aspects of managing the mine and its wastes was launched in 1996. As part of the study, a dredging operation was begun in 1998 along the lower section of the Ok Tedi River to see if dredging could mitigate the effects of the sediment accumulations.

On June 4, 1999, several months past the deadline, Ok Tedi Mining Limited announced that it had received a draft of the study of the environmental and social aspects of the mine operations. The report was passed on to Paul Anderson at BHP's headquarters. The study had found that the environmental impact of the mine, as well as the area affected by the pollution, was significantly greater than had been indicated by earlier studies the mine had commissioned. In addition, the study found that even if the mine were to close immediately, the sediments already deposited in the river would continue to kill the surrounding forests for perhaps 40 more years. Over the next 10 to 15 years, dieback would expand from the Ok Tedi River well into the forests of the downstream Fly River. The study had examined four possible options:

1. continue operating the mine and continue the current dredging in the lower Ok Tedi River;
2. continue operating the mine and continue dredging, and in addition construct a new storage facility for future mine tailings;
3. continue operating the mine and do nothing else;
4. close down the mine immediately.

None of these four options offered a good solution to the environmental impacts of the mine.

The study found that the ongoing dredging would lower the sand levels in the Ok Tedi, which would decrease flooding. But sediment would continue to accumulate downstream from the dredging, and dredging would not significantly halt the continuing degradation of the forests. In addition, dredging absorbed funds (see the following Table) that could be invested in health, education, or worker training.

Construction of a new storage facility would involve significant expenses (see Table) and would also create social problems because the amount of land required would destroy the whole area of one of the tribal clans. In addition, a storage facility might rupture, creating even more damage, and the stored tailings would generate acids that themselves would become an environmental threat.

To continue operating the mine while doing nothing would allow the environmental damage to continue unabated. If the mine continued operating until its originally scheduled date of 2010, an additional 200–300 million tons of tailings and rock would be created and these would be added to the sediments already in the rivers. This would significantly lengthen the already long period before the rivers would recover.

Closing down the mine immediately would limit the environmental damage that continued operations would create and would shorten the time the river would need to recover. But immediate closing of the mine would be an economic and social blow to national, provincial, and local communities. The study predicted that if the mine closed immediately, the many workers who had migrated into the mine area would suffer shortages in food supply resulting from overhunting and increases in store food prices. The high population around the mine would probably not decline until driven away by rising hunger and malnutrition. The national government would see its exports decline by almost 20 percent, its gross national product would decline by 10 percent, and its annual tax revenues would drop by more than 100 million dollars. The provincial government of the Western Province would lose half of its revenues, which came from the mine, and this would degrade its education and health services. In short, the economic, health, and social benefits that the mine was producing would end, and because the area had become dependent on the mine and had not prepared itself for life without the mine, the risk of social and economic decline was high.

The study also estimated the costs the mine itself would lose under each of the options by first calculating the basic cost of the option, then adding to it the potential additional costs that the option risked. The following table summarizes these costs in millions of 1999 U.S. dollars:

Option	*Basic cost*	*Potential added costs*	*Total likely costs*
Mine and dredge	$294	$20–$70	$300–$400
Mine only	$177	$30–$140	$200–$300
Mine and dredge and store	$426	$20–$70	$400–$500
Early closure	$479	$30–$90	$500–$600

When Paul Anderson and BHP were presented with these options, he was uncertain how to weigh them. By now the situation at Ok Tedi had become international news. Anderson convened a committee of top-level managers from BHP and initiated a series of discussions with them. The committee discussed the four options proposed in the study and suggested others, such as simply walking away from the mine, giving the government of Papua New Guinea the 52 percent share of the mine that BHP still owned, gradually phasing down operation of the mine over several years, etc. As the discussions progressed through the summer of 2000, however, the BHP managers came to feel that if the company was to limit the environmental disaster that its operations were creating, the best option was to immediately close the mine. Only this option, Paul Anderson felt, was consistent with the environmental stewardship that he wanted BHP to demonstrate during his tenure as CEO. This option was also the option that various international groups were recommending, including the World Bank and virtually every environmental group familiar with the issues.

On August, 1999, Paul Anderson communicated to the government of Papua New Guinea BHP's view that the best option was to close down the mine. The government, however, was not favorable to his view. On August 28, Anderson commented to a group of analysts: "Ok Tedi is not an easy one to reach a simple conclusion on because the other shareholders in Ok Tedi, and the government of Papua New Guinea, in its role as a regulator, as opposed to as a shareholder, but in addition to its role as a shareholder, are not in favor of early closure. So you get into a situation where it's very hard to play out exactly how this is going to come to an end. …" (Financial Markets Presentation, Melbourne Australia, Monday August 28, 2000; taken from BHP archives).

The view of the government of Papua New Guinea was that the mine had to continue to operate because of the human and economic costs that closing the mine would inflict on the people. Villagers downriver from the mine supported the government's view. As one villager put it: "If the mine shuts, I will revert to wearing penis gourds [the traditional form of male dress.]"[2] The government also favored continued dredging since this would mitigate flooding for people living along the rivers. However, because constructing a storage facility carried additional risks and would absorb a major portion of the profits the mine would produce, the government did not support building a storage facility for tailings. In this, too, the villagers supported their government. Said one tribesman: "If it [the water] is safe for people, then they should continue to dump tailings into the river. They will never fix this river – it is already dead. They should give us money instead."[3]

On November, 2000, BHP reported that although it understood why the government wanted the mine to remain open, BHP's own continued involvement with the mine "would not be appropriate," and so the company had decided to "exit" its stake in the mine "in a way that ensures a smooth transition, minimizes the environmental impact, maximizes the social benefits," and ensures that BHP "does not incur liabilities for the future operations of the mine."[4] On February 8, 2001, BHP announced that it had reached an agreement with the government of Papua New Guinea and with the other shareholders of the Ok Tedi Mine. BHP had agreed to transfer its entire share of the mine (52 percent) to a trust (the Papua New Guinea Sustainable Development Program) that would use the money generated by BHP's former share of the mine to fund social projects for the government of Papua New Guinea. The mine would continue to operate at least until 2010 (with dredging but without a containment facility for tailings). It was expected that the next several years of the mine would be its most productive and lucrative years. BHP wrote down the transfer of its share of mine revenues as a one-time loss. In return, the government of Papua New Guinea passed legislation releasing BHP from any and all liability stemming from its past actions at the mine.

In 2011 the government of Papua New Guinea announced the mine would continue operating until 2013 and possibly until 2022, which would allow it to produce an additional 700,000 tons of copper and 2.3 million ounces of gold. The mine continued to discharge about 90 million tons of waste rock and tailings into the Ok Tedi river each year, raising the river bed by several more meters and causing the dieback area to expand. It was expected that dieback would eventually cover about 3,000 square meters and would take about two centuries to recover. A statement on the Ok Tedi Mining web site indicated that despite the mine's impact on the "river system and their subsistence livelihoods," the people of the Ok Tedi and Fly River "strongly endorsed its continued operation" and their losses were "compensated under a number of compensation arrangements."

Notes

[1] Sources used throughout this case include: International Institute for Environment and Development, "Ok Tedi Riverine Disposal Case" in Dirk van Zyl, Meredith Sassoon, Anne-Marie Fleury, and Silvia Kyeyune, eds., *Mining for the Future*, a report commissioned by the Mining, Minerals and Sustainable Development Project of the International Institute for Environment and Development, accessed June 2, 2004 at http://www.iied.org/mmsd/mmsd_pdfs/068a_mftf-b.pdf, Polly Ghazi, "Ok Tedi Mine: Unearthing Controversy," in World Resource Institute, *World Resources 2002–2004: Decisions for the Earth: Balance, Voice and Power* (July 2003), United Nations Development Program, accessed June 2, 2004 at http://tvww.governance.wri.org/pubs_content_text.cfm?ContentID=l860; World Bank, *Ok Tedi Mining Ltd. Mine Waste Management Project Risk Assessment and Supporting Documents* (1999), accessed June 2, 2004, at http://www.mpi.org.au/oktedi/world_bank_full_report.html; and the Ok Tedi Mining web site at http://www.oktedi.com, accessed April 15, 2011.

[2] Kevin Pamba, "Ok Tedi: What to Do about the Damage Done," September 17, 1999, *Asia Times Online*, accessed July 25, 2004 at http://www.atimes.com/oceana/A117Ah01.html.

[3] Stuart Kirsch, "An Incomplete Victory at Ok Tedi," article accessed June 15, 2004 at http://www.carnegiecouncil.org/*viewMedia.php/prmTemplateID/8/prmID/614.*

[4] Broken Hill Proprietary Company Limited, "Case Study: Ok Tedi," *BHP Environment and Community Report 2000* (November 2000), accessed June 19, 2004 at http://www.envcommreport.bhp.com/Closure/okTedi.html.

Part 2

The Nature of the Corporation

Introduction

In Part 1 we examined the ethical dimensions of the economic system in which business operates. Here, we turn our attention to the nature and role of the corporation within that system. Reflection on the nature of the corporation is important because our understanding of the corporation shapes our beliefs about the corporation's responsibilities. If we hold that a corporation is a privately owned enterprise designed to make a profit, for example, we are likely to have a narrower view of corporate responsibility than if we hold it to be a quasi-public institution. In Chapter 3 we approach the problem of the nature of the corporation from the perspective of the corporate social responsibility debate. The first article in Chapter 3 makes the case that, not unlike persons, corporations can be held morally responsible for what they do.The second and third articles argue that corporate managers have few if any ethical responsibilities to the wider community, while the fourth argues that managers in fact are accountable to a much broader constituency.The fifth article is a specific reply to the second and third, and contends that the arguments made by those authors are flawed.The sixth article is a criticism of the widely held view that stockholders are in some sense owners of the corporation.

In Chapter 4 we investigate the nature of the corporation from the perspective of its internal structure and governance. In the first three articles in the chapter we focus on the corporate board of directors. Who should sit on the board? What is and what should be the relationship between the board, management, and stockholders? How far should the board's power extend? In the fourth article we investigate the implications of an ethics code for corporate directors, and the final article is a discussion of executive pay, which is under the control of boards of directors.

The Corporate Social Responsibility Debate

Before discussing the corporate responsibility debate it is important to clarify the meaning of two concepts that are often confused: "business ethics" and "corporate social responsibility." Some use the concepts interchangeably, while others believe that they are distinct. In some cases business ethics is considered part of corporate social responsibility, whereas in others corporate social responsibility is thought to be just one aspect of business ethics. For the purpose of this text the latter approach is taken. Business ethics, as the study of what is good and right for business, also examines the specific issue of corporate social responsibility, i.e. the proper role and obligations of corporations within society.

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For example, what does it mean to say that General Motors or IBM is responsible in a particular action? Who is to blame for immoral corporate actions? Does it make sense to look at a corporation as a moral agent comparable to a person? And if not, does this mean that we cannot judge corporate actions according to ethical standards?

In their article "Can a Corporation Have a Conscience?," Kenneth Goodpaster and John Matthews argue that there is an analogy between individual and organizational behavior, and that for this reason corporate conduct can be evaluated in moral terms. Some thinkers have claimed that only persons are capable of moral responsibility in the fullest sense, because such responsibility presupposes the ability to reason, to have intentions, and to make autonomous choices. But although the corporation is not a person in a literal sense, Goodpaster and Matthews respond, it is made up of persons. For this reason, we can project many of the attributes of individual human beings to the corporate level. We already speak of corporations having goals, values, interests, strategies. Why, ask Goodpaster and Matthews, shouldn't we also speak of the corporate conscience?

Thinkers who assume that corporations cannot exercise moral responsibility advocate trust in the "invisible hand" of the market system to "moralize" the actions of corporations. Milton Friedman is one of these. Others feel that the "hand of the government" is required to ensure moral corporate behavior. Both of these views, however, fail to locate the source of responsible corporate action in the corporation itself. Both rely upon systems and forces external to the corporation. Goodpaster and Matthews argue for a third alternative: endowing the corporation with a conscience analogous to that of an individual, recognizing the ability of corporations to exercise independent moral judgment, and locating the responsibility for corporate behavior in the hands of corporate managers. This "hand of management" alternative, they admit, is not without its problems – and it requires more thorough analysis on both the conceptual and practical levels. But Goodpaster and Matthews believe that it is the best alternative of the three because it provides a framework for an inventory of corporate responsibilities and accepts corporations as legitimate members of the moral community.

In contrast to Goodpaster and Matthews, a more common view is that businesses are understood as private property, as instruments of their owners that are designed primarily to make money. Because the pressure of free markets ensures that each entrepreneur's pursuit of his or her own profit will result in the good of the whole, and because businesses are the property of their owners to do with as they please, business has no other responsibility than to perform efficiently its economic function. Its ethical responsibilities are therefore quite limited. Two proponents of this view are Albert Z. Carr and Milton Friedman.

Albert Carr in his article "Is Business Bluffing Ethical?" argues that businesspeople have at least two distinct social roles. In their private lives they conform to the usual ethical rules we are all familiar with, but in their business lives they are or should be guided by a different set of ethical rules. These are similar to the rules of a game like poker. In a poker game one plays to win, and provided the rules of the game are followed, anything is allowed that contributes to victory. For Carr, the rules for business are set by law and regulation – not by the ethical standards appropriate to private life. So in business, anything not prohibited by law is permissible, even if not sanctioned by the normal ethical rules followed outside of business. Should the occasion arise where, say, something short of honest behavior is required to win, the businessperson must put aside any personal ethical qualms and make an impersonal decision to win at business. That is the way the game is played.

Carr seems to assume that business is somehow separate from the rest of society; it is a private game that operates according to a different set of ethical rules. However, one might object that this view of business as a private affair with few ethical connections to the larger society is no longer appropriate. Today's giant corporations no longer seem to fit a model in which the game of making profit is played for the benefit of stockholders. One reason is that the modern corporation is owned by stockholders who have little or no psychological or operational involvement in it. As ownership separates from control, corporations seem less like mere instruments of their owners and more like autonomous entities capable of their own goals and decisions. Hence corporations are social agents, and so should be subject to the same ethical rules that govern other social agents.

Another reason is the tremendous impact on and power over our society exerted by corporations. Many thinkers argue that social power inevitably implies social responsibility, and suggest that those who fail to exercise responsibility commensurate with their power should lose that power. As the power of business has grown, we have become increasingly aware of the external costs – pollution, hazardous products, job dissatisfaction – which corporations have passed on to society at large. These social costs in turn call into question what seems to be a fundamental implication of Carr's position, namely, that businesses have no ethical responsibility to prevent or repair the harm they cause as long as they operate within the law. Put another way, corporations have no ethical obligation to "do no harm." Why the rest of us should agree to this is something Carr does not explain.

The corporation's evolution away from the kind of private game Carr seems to presuppose leaves us with at least two alternatives. We can explicitly acknowledge the new idea that corporations have extensive social responsibilities and that managers have ethical obligations to society, or we can attempt to make reality fit the old view once again.

Milton Friedman in his article "The Social Responsibility of Business Is to Increase Its Profits" holds fast to the traditional values of a free-market system and rejects the idea of corporate social responsibility because he feels it is "fundamentally subversive" of these values. For Friedman, the sole social responsibility of business is to increase its profits while staying within the legal and moral "rules of the game."

It is important to realize that Friedman is not claiming that the corporation has no responsibilities or obligations. Rather, he is arguing that corporations are directly responsible only to one set of people – their stockholders. Regardless of the actual relationship between ownership and control in the modern corporation, Friedman believes they ought not to be separate. Because the stockholders own the corporation and hire managers to run it for them, Friedman argues, managers are "fiduciaries" of the stockholders – they have an obligation to act in the stockholders' interest, which means, according to Friedman, that they should maximize profit. To demand that corporate managers exercise responsibility to society at large is to ask them to violate their obligations to stockholders.

Managers who assume "social responsibility," Friedman argues, are actually using stockholders' money to solve social problems without their permission. They are in effect "taxing" stockholders, but because they are private employees rather than publicly elected officials, their actions lack authority and legitimacy. Behind Friedman's argument lies a conviction that each social institution exists to perform a particular function. The legitimacy of corporate activity depends on executives confining themselves to the role of agents serving the interests of those who own stock in the corporation. "Social responsibility" is the job of government, not business.

In "Ethics in Business: Two Skeptical Challenges," Robert Frederick argues that Carr and Friedman are mistaken about the role of ethics in business. Frederick points out that, contrary to what Carr seems to believe, many businesses take ethics very seriously. All, or almost all, large corporations have detailed codes of ethics. And many thousands of corporations have voluntarily signed documents such as the UN Global Compact, which outlines the appropriate ethical duties of corporations. Thus Carr's position is at odds with actual business practice. In addition, even though business has a specific economic function in society, there are other social institutions – medical, religious, educational, governmental – that have specific functions that are not exempt from the ordinary rules of ethics. Business, Frederick argues, is no different: there is nothing special about business that exempts its practitioners from the ordinary rules of ethics.

Frederick's response to Friedman's assertion that business managers are responsible for following the desires of stockholders is that even if this is true it does not obligate managers to violate their ordinary ethical obligations. The desires of stockholders cannot obligate managers to break the law, nor can they obligate managers to behave unethically. Managers have obligations to obey the law and follow ordinary ethical rules that take precedence over their obligations to stockholders. For example, managers are obligated to "do no harm" without very good reason, and they are obligated to minimize the harm they cause. This is true regardless of whether the stockholders desire it or not. Here again, business cannot escape ethics.

Frederick suggests that managers have ethical obligations to "stakeholders," i.e. groups such as employees and bondholders, in addition to stockholders. In R. Edward Freeman's article, "Stakeholder Theory of the Modern Corporation," this idea is developed in more detail. Using arguments that hark back to Kant and Rawls, Freeman argues that managers have obligations to a variety of groups that depend on the corporation in some way, e.g. stockholders, employees, bondholders, suppliers, local communities, and customers. These relationships create managerial obligations, more specifically, the obligation to balance competing stakeholder interests in a way that is beneficial for all over the long term. No one stakeholder can be used solely as a means to achieve benefits for some other stakeholder. For example, employee wages cannot be squeezed for no other reason than to increase returns to stockholders.Viewing the corporation in this way, Freeman claims, eliminates the idea that "business" is somehow separate from "ethics." And it captures the basic liberal idea of fairness, that all stakeholders share a basic equality of moral rights that managers are obligated to respect. The ethical challenge for management is thus to meet the claims made by a variety of corporate stakeholders, which includes, of course, those who hold stock in the corporation. Sometimes one of these groups may benefit at the expense of others, but management's job is to keep the balance between them as best it can, coordinating and maximizing their joint interests.

A number of writers contest Freeman's stakeholder view of the corporation on the grounds that stockholders are the owners of the corporation, and hence should be given priority when it comes to allocating benefits generated by corporate actions. In the final article in Chapter 3, "Commentary on the Social Responsibility of Corporate Entities: Bad and Not-So-Bad Arguments for Shareholder Primacy," Lynn Stout examines the legal role of stockholders. She argues that it is misleading to describe stockholders as owners because they exercise no direct control over corporate assets. For instance, stockholders have no right to dividends. Only the board of directors can decide whether to declare a dividend, and the stockholders influence over the board is indirect and tenuous at best. She continues that other arguments for stockholder primacy, e.g. that stockholders are sole residual claimants, are equally flawed. She concludes by noting that corporate law does provide space for managers and directors to pursue strategies that reduce share price provided doing so serves the interest of other constituencies. There are, then, few if any legal barriers to a stakeholder approach to the corporation.

Corporate Accountability and the Board of Directors

Central to the issue of corporate legitimacy, responsibility, and liability taken up in Chapter 3 is the issue of corporate accountability. To whom ought corporations be accountable? How can such accountability be implemented? The authors included in Chapter 4 look not to regulations imposed on the corporation from outside, but to the corporate internal structure itself for answers to these questions. Because historically the board of directors has been conceived of as one important locus of corporate accountability and because suggestions for changes in the role, election, and staffing of boards have been at the heart of several important proposals for reform, it is appropriate that they focus their attention on the nature, role, and composition of corporate boards.

Traditionally, corporate governance has been conceived on a rough analogy with the American political system. As the owners of the corporation, stockholders elect representatives – the board of directors – to establish broad objectives and direct corporate activities. The directors in turn select corporate officers to execute their policies. Management is thus accountable to the board of directors, and the board to stockholders.

But as was noted in articles in Chapter 3, it is increasingly unclear that this picture represents the reality of corporate governance. Such writers as Ralph Nader, Mark Green, and Joel Seligman in their article "Who Rules the Corporation" hold that management really controls the election of board members through its power over the machinery of proxy voting. The board, they claim, does not provide a check on the power of management; it does not really make policies or select executive officers, but routinely rubber-stamps the decisions of management.

Nader, Green, and Seligman see an urgent need for a truly effective board which will make accountable the unbridled power of management. Their suggestions for achieving this goal include a revamping of the stockholder electoral system; the institutionalizing of a new profession, that of the professional director who works full time to supervise the activities of the corporation; and the prohibition of interlocking directorates.

Still other issues of corporate governance are raised by the vast power of the corporation in modern society. The traditional model of corporate governance assumes that the most important constituency of the corporation is its stockholders, and that it is primarily to stockholders that the corporation ought to be accountable. This view is based on the assumption that the corporation is a piece of private property; the stockholders are the owners of the corporation and therefore the corporation is answerable only to them. But we have already noted that this assumption has been challenged. If the challenge is correct, presumably there ought to be some way to represent all relevant constituencies of the corporation in its internal structure. Milton Friedman has argued that to ask corporations to exercise "social" power is to make them into miniature governments; but Nader, Green, and Seligman claim that corporations do in fact exert such power and that they are in a sense governments for this reason. To ask corporations to be accountable only to stockholders is to permit governments to exist without the consent of the governed, an idea which is fundamentally at odds with the political philosophy of the United States. The election of "public interest directors," each of whom is placed in charge of overseeing such areas as consumer protection, employee welfare, and stockholder rights, may be one way to ensure corporate accountability to those whom it affects. And Nader, Green, and Seligman propose that the board should be made up only of "outside" directors – persons who have no other relationship to the corporation.

The interpretation of the corporation as a public institution is precisely what Irving Shapiro objects to in his essay on corporate governance entitled "Power and Accountability: The Changing Role of the Corporate Board of Directors." Corporations are not analogous to governments, he argues. They are private enterprises formed to execute the essential task of providing goods and services – a task, Shapiro suggests, government could not perform efficiently. The corporation has an important external locus of accountability government does not: the competition engendered by the free-market system. For these reasons Shapiro defends the rationale behind the present system of corporate governance. He does not believe that a radical overhaul is required.

Shapiro does not look favorably on proposals that the board contain more "outside" directors representative of various interest groups. Although independence of judgment is crucial in a corporate director, he fears that outside directors may lack the depth of understanding of an industry's problems necessary for informed decision making. Such directors might find themselves dependent on the explanations of the chief executive officer, and thus unable to exert adequate control over management activities. And although the presence of public interest directors on the board could generate a healthy tension, it might also lead to conflicts of interest and paralysis. A clear division of labor between boards of directors and management and a conscientious execution of their respective tasks, Shapiro concludes, are all that is necessary to produce an effective system of corporate governance that ensures accountability.

In "Who Should Control the Corporation?" Henry Mintzberg hopes to clarify the debate about who should control the corporation. He argues that the answer we eventually accept will determine what kind of society we and our children will live in. He identifies a number of different possibilities for controlling the corporation, such as nationalize it, regulate it, trust it, and ignore it. He considers the implications of the various alternatives, and concludes that the one thing we cannot do is hope for the best and ignore the power and influence of corporations. They are much too influential a force in our lives. The challenge, he concludes, is to find ways to direct and channel the power of corporations in ways that ensure that they remain responsive to our interests.

One way to influence corporate boards is to encourage them to adopt codes of ethics specifically focused on board responsibilities. In "Tone at the Top: An Ethics Code for Directors?," Mark Schwartz, Thomas Dunfee, and Michael Kline contend that recent corporate scandals, e.g. Enron and WorldCom, make it imperative to consider the ethical as well as the legal responsibilities of boards. Since boards play a leading role in corporate governance, reforms to improve corporate ethical performance must encompass their role. Schwartz *et al.* maintain that legal reforms without proper attention to ethical obligations are likely to prove ineffective. The ethical role of boards is critical, and the tone at the top they set is central to the overall ethical environment of the corporation. The best way to acknowledge and accommodate the ethical role of directors, the authors argue, is by establishing codes of ethics for directors.

Underlying this argument is the assumption that ethical behavior, especially on the part of senior corporate leaders, contributes to the long-term success of the corporation. If so, then codes for directors are important for both tactical and strategic reasons, since they help ensure that directors pay attention to factors for corporate success beyond the usual financial measures. The code proposed by the authors is based on the core ethical values of honesty, integrity, loyalty, responsibility, fairness, and citizenship. If such a code is adopted, the authors conclude, then the likelihood of corporate ethical disasters such as those we have witnessed in recent years will be reduced. Corporate governance is not and should not be considered to be distinct from ethics.

In the final article in Chapter 4, "Do CEOs Get Paid Too Much?," Jeffrey Moriarty considers the problem of executive pay – which is set by the board of directors. As has been frequently reported in the press, CEOs are paid enormous amounts, hundreds of times more than average workers. Further, in recent years the percentage increase in CEO pay over that of the average worker is even more extraordinary. Whether these huge sums are just is the issue Moriarty investigates.

He considers three arguments concerning the justice of executive pay: (1) the agreement view, in which CEO pay is set by a fair bargaining process; (2) the desert view, in which CEO pay is just if and only if they deserve it; and (3) the utility view, in which CEO pay is regarded as an incentive for future work. Moriarty argues that regardless of which of these views about compensation is correct, CEOs are paid too much. In short, neither (1), (2), nor (3) is sufficient to justify current levels of CEO pay. Hence, if Moriarty is correct, directors have failed in one of their primary obligations, i.e. establishing just and proper levels of CEO pay.

Moriarty suggests two things that might help ameliorate this problem. The first is that CEOs should not be a part of the election of directors, so that directors will not feel obligated to CEOs for their position. The second is that directors be required to invest in the firms they direct. In this way they will feel more obligated to the interests of the firm than to the interests of the CEO.

3

Agency, Legitimacy, and Responsibility

Can a Corporation Have a Conscience?

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During the severe racial tensions of the 1960s, Southern Steel Company (actual case, disguised name) faced considerable pressure from government and the press to explain and modify its policies regarding discrimination both within its plants and in the major city where it was located. SSC was the largest employer in the area (it had nearly 15,000 workers, one-third of whom were black) and had made great strides toward removing barriers to equal job opportunity in its several plants. In addition, its top executives (especially its chief executive officer, James Weston) had distinguished themselves as private citizens for years in community programs for black housing, education, and small business as well as in attempts at desegregating all-white police and local government organizations.

SSC drew the line, however, at using its substantial economic influence in the local area to advance the cause of the civil rights movement by pressuring banks, suppliers, and the local government:

> "As individuals we can exercise what influence we may have as citizens," James Weston said, "but for a corporation to attempt to exert any land of economic compulsion to achieve a particular end in a social area seems to me to be quite beyond what a corporation should do and quite beyond what a corporation can do. I believe that while government may seek to compel social reforms, any attempt by a private organization like SSC to impose its views, its beliefs, and its will upon the community would be repugnant to our American constitutional concepts and that appropriate steps to correct this abuse of corporate power would be universally demanded by public opinion."

Kenneth E. Goodpaster and John B. Matthews Jr., "Can a Corporation Have a Conscience?" Excerpted from "Can a Corporation Have a Conscience?" by Kenneth E. Goodpaster and John B. Matthews Jr., *Harvard Business Review*, January–February 1982. Reprinted with permission.

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Weston could have been speaking in the early 1980s on any issue that corporations around the United States now face. Instead of social justice, his theme might be environmental protection, product safety, marketing practice, or international bribery. His statement for SSC raises the important issue of corporate responsibility. Can a corporation have a conscience?

Weston apparently felt comfortable saying it need not. The responsibilities of ordinary persons and of "artificial persons" like corporations are, in his view, separate. Persons' responsibilities go beyond those of corporations. Persons, he seems to have believed, ought to care not only about themselves but also about the dignity and well-being of those around them – ought not only to care but also to act. Organizations, he evidently thought, are creatures of, and to a degree prisoners of, the systems of economic incentive and political sanction that give them reality and therefore should not be expected to display the same moral attributes that we expect of persons.

Others inside business as well as outside share Weston's perception. One influential philosopher – John Ladd – carries Weston's view a step further: "It is improper to expect organizational conduct to conform to the ordinary principles of morality," he says. "We cannot and must not expect formal organizations, or their representatives acting in their official capacities, to be honest, courageous, considerate, sympathetic, or to have any kind of moral integrity. Such concepts are not in the vocabulary, so to speak, of the organizational language game."[1]

In our opinion, this line of thought represents a tremendous barrier to the development of business ethics both as a field of inquiry and as a practical force in managerial decision making. This is a matter about which executives must be philosophical and philosophers must be practical. A corporation can and should have a conscience. The language of ethics does have a place in the vocabulary of an organization. There need not be and there should not be a disjunction of the sort attributed to SSC's James Weston. Organizational agents such as corporations should be no more and no less morally responsible (rational, self-interested, altruistic) than ordinary persons.

We take this position because we think an analogy holds between the individual and the corporation. If we analyze the concept of moral responsibility as it applies to persons, we find that projecting it to corporations as agents in society is possible.

Defining the Responsibility of Persons

When we speak of the responsibility of individuals, philosophers say that we mean three things: someone is to blame, something has to be done, or some kind of trustworthiness can be expected.

We apply the first meaning, what we shall call the *causal* sense, primarily to legal and moral contexts where what is at issue is praise or blame for a past action. We say of a person that he or she was responsible for what happened, is to blame for it, should be held accountable. In this sense of the word, *responsibility* has to do with tracing the causes of actions and events, of finding out who is answerable in a given situation. Our aim is to determine someone's intention, free will, degree of participation, and appropriate reward or punishment.

We apply the second meaning of *responsibility* to rule following, to contexts where individuals are subject to externally imposed norms often associated with some social role that people play. We speak of the responsibilities of parents to children, of doctors to patients, of lawyers to clients, of citizens to the law. What is socially expected and what the party involved is to answer for are at issue here.

We use the third meaning of *responsibility* for decision making. With this meaning of the term, we say that individuals are responsible if they are trustworthy and reliable, if they allow appropriate factors to affect their judgment; we refer primarily to a person's independent thought processes and decision making, processes that justify an attitude of trust from those who interact with him or her as a responsible individual.

The distinguishing characteristic of moral responsibility, it seems to us, lies in this third sense of the term. Here the focus is on the intellectual and emotional processes in the individual's moral reasoning. Philosophers call this "taking a moral point of view" and contrast it with such other processes as being financially prudent and attending to legal obligations.

To be sure, characterizing a person as "morally responsible" may seem rather vague. But vagueness is a contextual notion. Everything depends on how we fill in the blank in "vague for _____ purposes."

In some contexts the term "six o'clockish" is vague, while in others it is useful and informative. As a response to a space-shuttle pilot who wants to know when to fire the reentry rockets, it will not do, but it might do in response to a spouse who wants to know when one will arrive home at the end of the workday.

We maintain that the processes underlying moral responsibility can be defined and are not themselves vague, even though gaining consensus on specific moral norms and decisions is not always easy.

What, then, characterizes the processes underlying the judgment of a person we call morally responsible? Philosopher William K. Frankena offers the following answer:

> A morality is a normative system in which judgments are made, more or less consciously, [out of a] consideration of the effects of actions … on the lives of persons … including the lives of others besides the person acting. … David Hume took a similar position when he argued that what speaks in a moral judgment is a kind of sympathy. … A little later, … Kant put the matter somewhat better by characterizing morality as the business of respecting persons as ends and not as means or as things. …[2]

Frankena is pointing to two traits, both rooted in a long and diverse philosophical tradition:

1. *Rationality.* Taking a moral point of view includes the features we usually attribute to rational decision making, that is, lack of impulsiveness, care in mapping out alternatives and consequences, clarity about goals and purposes, attention to details of implementation.
2. *Respect.* The moral point of view also includes a special awareness of and concern for the effects of one's decisions and policies on others, special in the sense that it goes beyond the kind of awareness and concern that would ordinarily be part of rationality, that is, beyond seeing others merely as instrumental to accomplishing one's own purposes. This is respect for the lives of others and involves taking their needs and interests seriously, not simply as resources in one's own decision making but as limiting conditions which change the very definition of one's habitat from a self-centered to a shared environment. It is what philosopher Immanuel Kant meant by the "categorical imperative" to treat others as valuable in and for themselves.

It is this feature that permits us to trust the morally responsible person. We know that such a person takes our point of view into account not merely as a useful precaution (as in "honesty is the best policy") but as important in its own right.

These components of moral responsibility are not too vague to be useful. Rationality and respect affect the manner in which a person approaches practical decision making: they affect the way in which the individual processes information and makes choices. A rational but not respectful Bill Jones will not lie to his friends *unless* he is reasonably sure he will not be found out. A rational but not respectful Mary Smith will defend an unjustly treated party *unless* she thinks it may be too costly to herself. A rational *and* respectful decision maker, however, notices – and cares – whether the consequences of his or her conduct lead to injuries or indignities to others.

Two individuals who take "the moral point of view" will not of course always agree on ethical matters, but they do at least have a basis for dialogue.

Projecting Responsibility to Corporations

Now that we have removed some of the vagueness from the notion of moral responsibility as it applies to persons, we can search for a frame of reference in which, by analogy with Bill Jones and Mary Smith, we can meaningfully and appropriately say that corporations are morally responsible. This is the issue reflected in the SSC case.

To deal with it, we must ask two questions: Is it meaningful to apply moral concepts to actors who are not persons but who are instead made up of persons? And even if meaningful, is it advisable to do so?

If a group can act like a person in some ways, then we can expect it to behave like a person in other ways. For one thing, we know that people organized into a group can act as a unit. As business people well know, legally a corporation is considered a unit. To approach unity, a group usually has some sort of internal decision structure, a system of rules that spell out authority relationships and specify the conditions under which certain individuals' actions become official actions of the group.[3]

If we can say that persons act responsibly only if they gather information about the impact of their actions on others and use it in making decisions, we can reasonably do the same for organizations. Our proposed frame of reference for thinking about and implementing corporate responsibility aims at spelling out the processes associated with the moral responsibility of individuals and projecting them to the level of organizations.This is similar to, though an inversion of, Plato's famous method in the *Republic*, in which justice in the community is used as a model for justice in the individual.

Hence, corporations that monitor their employment practices and the effects of their production processes and products on the environment and human health show the same kind of rationality and respect that morally responsible individuals do. Thus, attributing actions, strategies, decisions, and moral responsibilities to corporations as entities distinguishable from those who hold offices in them poses no problem.

And when we look about us, we can readily see differences in moral responsibility among corporations in much the same way that we see differences among persons. Some corporations have built features into their management incentive systems, board structures, internal control systems, and research agendas that in a person we would call self-control, integrity, and conscientiousness. Some have institutionalized awareness and concern for consumers, employees, and the rest of the public in ways that others clearly have not.

As a matter of course, some corporations attend to the human impact of their operations and policies and reject operations and policies that are questionable.Whether the issue be the health effects of sugared cereal or cigarettes, the safety of tires or tampons, civil liberties in the corporation or the community, an organization reveals its character as surely as a person does.

Indeed, the parallel may be even more dramatic. For just as the moral responsibility displayed by an individual develops over time from infancy to adulthood,[4] so too we may expect to find stages of development in organizational character that show significant patterns.

Evaluating the Idea of Moral Projection

Concepts like moral responsibility not only make sense when applied to organizations but also provide touchstones for designing more effective models than we have for guiding corporate policy.

Now we can understand what it means to invite SSC as a corporation to be morally responsible both in-house and in its community, but *should* we issue the invitation? Here we turn to the question of advisability. Should we require the organizational agents in our society to have the same moral attributes we require of ourselves?

Our proposal to spell out the processes associated with moral responsibility for individuals and then to project them to their organizational counterparts takes on added meaning when we examine alternative frames of reference for corporate responsibility.

Two frames of reference that compete for the allegiance of people who ponder the question of corporate responsibility are emphatically opposed to this principle of moral projection – what we might refer to as the "invisible hand" view and the "hand of government" view.

The invisible hand

The most eloquent spokesman of the first view is Milton Friedman (echoing many philosophers and economists since Adam Smith). According to this pattern of thought, the true and only social responsibilities of business organizations are to make profits and obey the laws. The workings of the free and competitive marketplace will "moralize" corporate behavior quite independently of any attempts to expand or transform decision making via moral projection.

A deliberate amorality in the executive suite is encouraged in the name of systemic morality: the common good is best served when each of us and our economic institutions pursue not the common good or moral purpose, advocates say, but competitive advantage. Morality, responsibility, and conscience reside in the invisible hand of the free market system, not in the hands of the organizations within the system, much less the managers within the organizations.

To be sure, people of this opinion admit, there is a sense in which social or ethical issues can and should enter the corporate mind, but the filtering of such issues is thorough: they go through the screens of custom, public opinion, public relations, and the law. And, in any case, self-interest maintains primacy as an objective and a guiding star.

The reaction from this frame of reference to the suggestion that moral judgment be integrated with corporate strategy is clearly negative. Such an integration is seen as inefficient and arrogant, and in the end both an illegitimate use of corporate power and an abuse of the manager's fiduciary role. With respect to our SSC case, advocates of the invisible hand model would vigorously resist efforts, beyond legal requirements, to make SSC right the wrongs of racial injustice. SSC's responsibility would be to make steel of high quality at least cost, to deliver it on time, and to satisfy its customers and stockholders. Justice would not be part of SSC's corporate mandate.

The hand of government

Advocates of the second dissenting frame of reference abound, but John Kenneth Galbraith's work has counterpointed Milton Friedman's with insight and style. Under this view of corporate responsibility, corporations are to pursue objectives that are rational and purely economic. The regulatory hands of the law and the political process rather than the invisible hand of the marketplace turns these objectives to the common good.

Again, in this view, it is a system that provides the moral direction for corporate decision making – a system, though, that is guided by political managers, the custodians of the public purpose. In the case of SSC, proponents of this view would look to the state for moral direction and responsible management, both within SSC and in the community. The corporation would have no moral responsibility beyond political and legal obedience.

What is striking is not so much the radical difference between the economic and social philosophies that underlie these two views of the source of corporate responsibility but the conceptual similarities. Both views locate morality, ethics, responsibility, and conscience in the systems of rules and incentives in which the modern corporation finds itself embedded. Both views reject the exercise of independent moral judgment by corporations as actors in society.

Neither view trusts corporate leaders with stewardship over what are often called noneconomic values. Both require corporate responsibility to march to the beat of drums outside. In the jargon of moral philosophy, both views press for a rule-centered or a system-centered ethics instead of an agent-centered ethics. These frames of reference countenance corporate rule-following responsibility for corporations but not corporate decision-making responsibility.

The hand of management

To be sure, the two views under discussion differ in that one looks to an invisible moral force in the market while the other looks to a visible moral force in government. But both would advise against a principle of moral projection that permits or encourages corporations to exercise independent, noneconomic judgment over matters that face them in their short- and long-term plans and operations.

Accordingly, both would reject a third view of corporate responsibility that seeks to affect the thought processes of the organization itself – a sort of "hand of management" view – since neither seems willing or able to see the engines of profit regulate themselves to the degree that would be implied by taking the principle of moral projection seriously. Cries of inefficiency and moral imperialism from the right would be matched by cries of insensitivity and illegitimacy from the left, all in the name of preserving us from corporations and managers run morally amok.

Better, critics would say, that moral philosophy be left to philosophers, philanthropists, and politicians than to business leaders. Better that corporate morality be kept to glossy annual reports, where it is safely insulated from policy and performance.

The two conventional frames of reference locate moral restraint in forces external to the person and the corporation. They deny moral reasoning and intent to the corporation in the name of either market competition or society's system of explicit legal constraints and presume that these have a better moral effect than that of rationality and respect.

Although the principle of moral projection, which underwrites the idea of a corporate conscience and patterns it on the thought and feeling processes of the person, is in our view compelling, we must acknowledge that it is neither part of the received wisdom, nor is its advisability beyond question or objection. Indeed, attributing the role of conscience to the corporation seems to carry with it new and disturbing implications for our usual ways of thinking about ethics and business.

Perhaps the best way to clarify and defend this frame of reference is to address the objections to the principle found in the last pages of this article. There we see a summary of the criticisms and counterarguments we have heard during hours of discussion with business executives and business school students. We believe that the replies to the objections about a corporation having a conscience are convincing.

Leaving the Double Standard Behind

We have come some distance from our opening reflection on Southern Steel Company and its role in its community. Our proposal – clarified, we hope, through these objections and replies – suggests that it is not sufficient to draw a sharp line between individuals' private ideas and efforts and a corporation's institutional efforts but that the latter can and should be built upon the former.

Does this frame of reference give us an unequivocal prescription for the behavior of SSC in its circumstances? No, it does not. Persuasive arguments might be made now and might have been made then that SSC should not have used its considerable economic clout to threaten the community into desegregation. A careful analysis of the realities of the environment might have disclosed that such a course would have been counterproductive, leading to more injustice than it would have alleviated.

The point is that some of the arguments and some of the analyses are or would have been moral arguments, and thereby the ultimate decision that of an ethically responsible organization. The significance of this point can hardly be overstated, for it represents the adoption of a new perspective on corporate policy and a new way of thinking about business ethics. We agree with one authority, who writes that "the business firm, as an organic entity intricately affected by and affecting its environment, is as appropriately adaptive … to demands for responsible behavior as for economic service."[5]

The frame of reference here developed does not offer a decision procedure for corporate managers. That has not been our purpose. It does, however, shed light on the conceptual foundations of business ethics by training attention on the corporation as a moral agent in society. Legal systems of rules and incentives are insufficient, even though they may be necessary, as frameworks for corporate responsibility. Taking conceptual cues from the features of moral responsibility normally expected of the person in our opinion deserves practicing managers' serious consideration.

The lack of congruence that James Weston saw between individual and corporate moral responsibility can be, and we think should be, overcome. In the process, what a number of writers have characterized as a double standard – a discrepancy between our personal lives and our lives in organizational settings – might be dampened. The principle of moral projection not only helps us to conceptualize the kinds of demands that we might make of corporations and other organizations but also offers the prospect of harmonizing those demands with the demands that we make of ourselves.

Is a Corporation a Morally Responsible "Person"?

Objection 1 to the analogy

Corporations are not persons. They are artificial legal constructions, machines for mobilizing economic investments toward the efficient production of goods and services. We cannot hold a corporation responsible. We can only hold individuals responsible.

Reply

Our frame of reference does not imply that corporations are persons in a literal sense. It simply means that in certain respects concepts and functions normally attributed to persons can also be attributed to organizations made up of persons. Goals, economic values, strategies, and other such personal attributes are often usefully projected to the corporate level by managers and researchers. Why should we not project the functions of conscience in the same way? As for holding corporations responsible, recent criminal prosecutions such as the case of Ford Motor Company and its Pinto gas tanks suggest that society finds the idea both intelligible and useful.

Objection 2

A corporation cannot be held responsible at the sacrifice of profit. Profitability and financial health have always been and should continue to be the "categorical imperatives" of a business operation.

Reply

We must of course acknowledge the imperatives of survival, stability, and growth when we discuss corporations, as indeed we must acknowledge them when we discuss the life of an individual. Self-sacrifice has been identified with moral responsibility in only the most extreme cases. The pursuit of profit and self-interest need not be pitted against the demands of moral responsibility. Moral demands are best viewed as containments – not replacements – for self-interest.

This is not to say that profit maximization never conflicts with morality. But profit maximization conflicts with other managerial values as well. The point is to coordinate imperatives, not deny their validity.

Objection 3

Corporate executives are not elected representatives of the people, nor are they anointed or appointed as social guardians. They therefore lack the social mandate that a democratic society rightly demands of those who would pursue ethically or socially motivated policies. By keeping corporate policies confined to economic motivations, we keep the power of corporate executives in its proper place.

Reply

The objection betrays an oversimplified view of the relationship between the public and the private sector. Neither private individuals nor private corporations that guide their conduct by ethical or social values beyond the demands of law should be constrained merely because they are not elected to do so. The demands of moral responsibility are independent of the demands of political legitimacy and are in fact presupposed by them.

To be sure, the state and the political process will and must remain the primary mechanisms for protecting the public interest, but one might be forgiven the hope that the political process will not substitute for the moral judgment of the citizenry or other components of society such as corporations.

Objection 4

Our system of law carefully defines the role of agent or fiduciary and makes corporate managers accountable to shareholders and investors for the use of their assets. Management cannot, in the name of corporate moral responsibility, arrogate to itself the right to manage those assets by partially noneconomic criteria.

Reply

First, it is not so clear that investors insist on purely economic criteria in the management of their assets, especially if some of the shareholders' resolutions and board reforms of the last decade are any indication. For instance, companies doing business in South Africa have had stockholders question their activities, other companies have instituted audit committees for their boards before such auditing was mandated, and mutual funds for which "socially responsible behavior" is a major investment criterion now exist.

Second, the categories of "shareholder" and "investor" connote wider time spans than do immediate or short-term returns. As a practical matter, considerations of stability and long-term return on investment enlarge the class of principals to which managers bear a fiduciary relationship.

Third, the trust that managers hold does not and never has extended to "any means available" to advance the interests of the principals. Both legal and moral constraints must be understood to qualify that trust – even, perhaps, in the name of a larger trust and a more basic fiduciary relationship to the members of society at large.

Objection 5

The power, size, and scale of the modern corporation – domestic as well as international – are awesome. To unleash, even partially, such power from the discipline of the marketplace and the narrow or possibly nonexistent moral purpose implicit in that discipline would be socially dangerous. Had SSC acted in the community to further racial justice, its purposes might have been admirable, but those purposes could have led to a kind of moral imperialism or worse. Suppose SSC had thrown its power behind the Ku Klux Klan.

Reply

This is a very real and important objection. What seems not to be appreciated is the fact that power affects when it is used as well as when it is not used. A decision by SSC not to exercise its economic influence according to "noneconomic" criteria is inevitably a moral decision and just as inevitably affects the community. The issue in the end is not whether corporations (and other organizations) should be "unleashed" to exert moral force in our society but rather how critically and self-consciously they should choose to do so.

The degree of influence enjoyed by an agent, whether a person or an organization, is not so much a factor recommending moral disengagement as a factor demanding a high level of moral awareness. Imperialism is more to be feared when moral reasoning is absent than when it is present. Nor do we suggest that the "discipline of the marketplace" be diluted; rather, we call for it to be supplemented with the discipline of moral reflection.

Objection 6

The idea of moral projection is a useful device for structuring corporate responsibility only if our understanding of moral responsibility at the level of the person is in some sense richer than our understanding of moral responsibility on the level of the organization as a whole. If we are not clear about individual responsibility, the projection is fruitless.

Reply

The objection is well taken. The challenge offered by the idea of moral projection lies in our capacity to articulate criteria or frameworks of reasoning for the morally responsible person. And though such a challenge is formidable, it is not clear that it cannot be met, at least with sufficient consensus to be useful.

For centuries, the study and criticism of frameworks have gone on, carried forward by many disciplines, including psychology, the social sciences, and philosophy. And though it would be a mistake to suggest that any single framework (much less a decision mechanism) has emerged as the right one, it is true that recurrent patterns are discernible and well enough defined to structure moral discussion.

In the body of the article, we spoke of rationality and respect as components of individual responsibility. Further analysis of these components would translate them into social costs and benefits, justice in the distribution of goods and services, basic rights and duties, and fidelity to contracts. The view that pluralism in our society has undercut all possibility of moral agreement is anything but self-evident. Sincere moral disagreement is, of course, inevitable and not clearly lamentable. But a process and a vocabulary for articulating such values as we share is no small step forward when compared with the alternatives. Perhaps in our exploration of the moral projection we might make some surprising and even reassuring discoveries about ourselves.

Objection 7

Why is it necessary to project moral responsibility to the level of the organization? Isn't the task of defining corporate responsibility and business ethics sufficiently discharged if we clarify the responsibilities of men and women in business as individuals? Doesn't ethics finally rest on the honesty and integrity of the individual in the business world?

Reply

Yes and no. Yes, in the sense that the control of large organizations does finally rest in the hands of managers, of men and women. No, in the sense that what is being controlled is a cooperative system for a cooperative purpose. The projection of responsibility to the organization is simply an acknowledgment of the fact that the whole is more than the sum of its parts. Many intelligent people do not an intelligent organization make. Intelligence needs to be structured, organized, divided, and recombined in complex processes for complex purposes.

Studies of management have long shown that the attributes, successes, and failures of organizations are phenomena that emerge from the coordination of persons' attributes and that explanations of such phenomena require categories of analysis and description beyond the level of the individual. Moral responsibility is an attribute that can manifest itself in organizations as surely as competence or efficiency.

Objection 8

Is the frame of reference here proposed intended to replace or undercut the relevance of the "invisible hand" and the "government hand" views, which depend on external controls?

Reply

No, just as regulation and economic competition are not substitutes for corporate responsibility, so corporate responsibility is not a substitute for law and the market. The imperatives of ethics cannot be relied on – nor have they ever been relied on – without a context of external sanctions. And this is true as much for individuals as for organizations.

This frame of reference takes us beneath, but not beyond, the realm of external systems of rules and incentives and into the thought processes that interpret and respond to the corporation's environment. Morality is more than merely part of that environment. It aims at the projection of conscience, not the enthronement of it in either the state or the competitive process.

The rise of the modern large corporation and the concomitant rise of the professional manager demand a conceptual framework in which these phenomena can be accommodated to moral thought. The principal of moral projection furthers such accommodation by recognizing a new level of agency in society and thus a new level of responsibility.

Objection 9

Corporations have always taken the interests of those outside the corporation into account in the sense that customer relations and public relations generally are an integral part of rational economic decision making. Market signals and social signals that filter through the market mechanism inevitably represent the interests of parties affected by the behavior of the company. What, then, is the point of adding respect to rationality?

Reply

Representing the affected parties solely as economic variables in the environment of the company is treating them as means or resources and not as ends in themselves. It implies that the only voice which affected parties should have in organizational decision making is that of potential buyers, sellers, regulators, or boycotters. Besides, many affected parties may not occupy such roles, and those who do may not be able to signal the organization with messages that effectively represent their stakes in its actions.

To be sure, classical economic theory would have us believe that perfect competition in free markets (with modest adjustments from the state) will result in all relevant signals being "heard," but the abstractions from reality implicit in such theory make it insufficient as a frame of reference for moral responsibility. In a world in which strict self-interest was congruent with the common good, moral responsibility might be unnecessary. We do not, alas, live in such a world.

The element of respect in our analysis of responsibility plays an essential role in ensuring the recognition of unrepresented or underrepresented voices in the decision making of organizations as agents. Showing respect for persons as ends and not mere means to organizational purposes is central to the concept of corporate moral responsibility.

Notes

[1] See John Ladd, "Morality and the Ideal of Rationality in Formal Organizations," *The Monist*, October 1970, p. 499.

[2] See William K. Frankena, *Thinking About Morality* (Ann Arbor: University of Michigan Press, 1980), p. 26.

[3] See Peter French, "The Corporation as a Moral Person," *American Philosophical Quarterly*, July 1979, p. 207.

[4] A process that psychological researchers from Jean Piaget to Lawrence Kohlberg have examined carefully; see Jean Piaget, *The Moral Judgement of the Child* (New York: Free Press, 1965) and Lawrence Kohlberg, *The Philosophy of Moral Development* (New York: Harper & Row, 1981).

[5] See Kenneth R. Andrews, *The Concept of Corporate Strategy*, revised edition (Homewood, III.: Dow Jones-Irwin, 1980), p. 99.

Is Business Bluffing Ethical?

Albert Z. Carr

Author and former U.S. government official

The ethics of business are not those of society,
but rather those of the poker game

Foreword

"If the law as written gives a man a wide-open chance to make a killing, he'd be a fool not to take advantage of it. If he doesn't, somebody else will," remarked a friend of the author. Mr. Carr likens such behavior to the bluffing of the poker player who seizes every opportunity to win, as long as it does not involve outright cheating. "No one thinks any the worse of poker on that account," says the author. "And no one should think any the worse of the game of business because its standards of right and wrong differ from the prevailing traditions of morality in our society."

Mr. Carr became interested in this subject when he was a member of a New York firm of consultants to large corporations in many fields. The confidences of many stress-ridden executives made him aware of the extent to which tensions can arise from conflicts between an individual's ethical sense and the realities of business. He was struck also by the similarity of the special ethical attitude shown by many successful and stress-free businessmen in their work to that of good poker players.

Mr. Carr was Assistant to the Chairman of the War Production Board during World War II and later served on the White House staff and as a Special Consultant to President Truman. He is now writing full-time. Among his books is *John D. Rockefeller's Secret Weapon*, a study of corporate development. This article is adapted from a chapter in his newest book, *Business As a Game*, to be published by New American Library in March 1968.

Albert Z. Carr, "Is Business Bluffing Ethical?," *Harvard Business Review,* 46(1), 1968, pp. 143–153. Reprinted with permission.

A respected businessman with whom I discussed the theme of this article remarked with some heat, "You mean to say you're going to encourage men to bluff? Why, bluffing is nothing more than a form of lying! You're advising them to lie!"

I agreed that the basis of private morality is a respect for truth and that the closer a businessman comes to the truth, the more he deserves respect. At the same time, I suggested that most bluffing in business might be regarded simply as game strategy – much like bluffing in poker, which does not reflect on the morality of the bluffer.

I quoted Henry Taylor, the British statesman who pointed out that "falsehood ceases to be falsehood when it is understood on all sides that the truth is not expected to be spoken" – an exact description of bluffing in poker, diplomacy, and business. I cited the analogy of the criminal court, where the criminal is not expected to tell the truth when he pleads "not guilty." Everyone from the judge down takes it for granted that the job of the defendant's attorney is to get his client off, not to reveal the truth; and this is considered ethical practice. I mentioned Representative Omar Burleson, the Democrat from Texas, who was quoted as saying, in regard to the ethics of Congress, "Ethics is a barrel of worms"[1] – a pungent summing up of the problem of deciding who is ethical in politics.

I reminded my friend that millions of businessmen feel constrained every day to say *yes* to their bosses when they secretly believe *no* and that this is generally accepted as permissible strategy when the alternative might be the loss of a job. The essential point, I said, is that the ethics of business are game ethics, different from the ethics of religion.

He remained unconvinced. Referring to the company of which he is president, he declared: "Maybe that's good enough for some businessmen, but I can tell you that we pride ourselves on our ethics. In 30 years not one customer has ever questioned my word or asked to check our figures. We're loyal to our customers and fair to our suppliers. I regard my handshake on a deal as a contract. I've never entered into price-fixing schemes with my competitors. I've never allowed my salesmen to spread injurious rumors about other companies. Our union contract is the best in our industry. And, if I do say so myself, our ethical standards are of the highest!"

He really was saying, without realizing it, that he was living up to the ethical standards of the business game – which are a far cry from those of private life. Like a gentlemanly poker player, he did not play in cahoots with others at the table, try to smear their reputations, or hold back chips he owed them.

But this same fine man, at that very time, was allowing one of his products to be advertised in a way that made it sound a great deal better than it actually was. Another item in his product line was notorious among dealers for its "built-in obsolescence." He was holding back from the market a much-improved product because he did not want it to interfere with sales of the inferior item it would have replaced. He had joined with certain of his competitors in hiring a lobbyist to push a state legislature, by methods that he preferred not to know too much about, into amending a bill then being enacted.

In his view these things had nothing to do with ethics; they were merely normal business practice. He himself undoubtedly avoided outright falsehoods – never lied in so many words. But the entire organization that he ruled was deeply involved in numerous strategies of deception.

Pressure to Deceive

Most executives from time to time are almost compelled, in the interests of their companies or themselves, to practice some form of deception when negotiating with customers, dealers, labor unions, government official, or even other departments of their companies. By conscious misstatements, concealment of pertinent facts, or exaggeration – in short, by bluffing – they seek to persuade others to agree with them. I think it is fair to say that if the individual executive refuses to bluff from time to time – if he feels obligated to tell the truth, the whole truth, and nothing but the truth – he is ignoring opportunities permitted under the rules and is at a heavy disadvantage in his business dealings.

But here and there a businessman is unable to reconcile himself to the bluff in which he plays a part. His conscience, perhaps spurred by religious idealism, troubles him. He feels guilty; he may develop an ulcer or a nervous tic. Before any executive can make profitable use of the strategy of the bluff, he needs to make sure that in bluffing he will not lose self-respect or become emotionally disturbed. If he is to reconcile personal integrity and high standards of honesty with the practical requirements of business, he must feel that his bluffs are ethically justified. The justification rests on the fact that business, as practiced by individuals as well as by corporations, has the impersonal character of a game – a game that demands both special strategy and an understanding of its special ethics.

The game is played at all levels of corporate life, from the highest to the lowest. At the very instant that a man decides to enter business, he may be forced into a game situation, as is shown by the recent experience of a Cornell honor graduate who applied for a job with a large company:

> This applicant was given a psychological test which included the statement, "Of the following magazines, check any that you have read either regularly or from time to time, and double-check those which interest you most. *Reader's Digest, Time, Fortune, Saturday Evening Post, The New Republic, Life, Look, Ramparts, Newsweek, Business Week, U.S. News & World Report, The Nation, Playboy, Esquire, Harper's, Sports Illustrated*."

His tastes in reading were broad, and at one time or another he had read almost all of these magazines.

He was a subscriber to *The New Republic*, an enthusiast for *Ramparts*, and an avid student of the pictures in *Playboy*. He was not sure whether his interest in *Playboy* would be held against him, but he had a shrewd suspicion that if he confessed to an interest in *Ramparts* and *The New Republic*, he would be thought a liberal, a radical, or at least an intellectual, and his chances of getting the job, which he needed, would greatly diminish. He therefore checked five of the more conservative magazines. Apparently it was a sound decision, for he got the job.

He had made a game player's decision, consistent with business ethics.

A similar case is that of a magazine space salesman who, owing to a merger, suddenly found himself out of a job:

> This man was 58, and, in spite of a good record, his chance of getting a job elsewhere in a business where youth is favored in hiring practice was not good. He was a vigorous, healthy man, and only a considerable amount of gray in his hair suggested his age. Before beginning his job search he touched up his hair with a black dye to confine the gray to his temples. He knew that the truth about his age might well come out in time, but he calculated that he could deal with that situation when it arose. He and his wife decided that he could easily pass for 45, and he so stated his age on his résumé.

This was a lie; yet within the accepted rules of the business game, no moral culpability attaches to it.

The Poker Analogy

We can learn a good deal about the nature of business by comparing it with poker. While both have a large element of chance, in the long run the winner is the man who plays with steady skill. In both games ultimate victory requires intimate knowledge of the rules, insight into the psychology of the other players, a bold front, a considerable amount of self-discipline, and the ability to respond swiftly and effectively to opportunities provided by chance.

No one expects poker to be played on the ethical principles preached in churches. In poker it is right and proper to bluff a friend out of the rewards of being dealt a good hand. A player feels no more than a slight twinge of sympathy, if that, when – with nothing better than a single ace in his hand – he strips a heavy loser, who holds a pair, of the rest of his chips. It was up to the other fellow to protect himself. In the words of an excellent poker player, former President Harry Truman, "If you can't stand the heat, stay out of the kitchen." If one shows mercy to a loser in poker, it is a personal gesture, divorced from the rules of the game.

Poker has its special ethics, and here I am not referring to rules against cheating, The man who keeps an ace up his sleeve or who marks the cards is more than unethical; he is a crook, and can be punished as such – kicked out of the game or, in the Old West, shot.

In contrast to the cheat, the unethical poker player is one who, while abiding by the letter of the rules, finds ways to put the other players at an unfair disadvantage. Perhaps he unnerves them with loud talk. Or he tries to get them drunk. Or he plays in cahoots with someone else at the table. Ethical poker players frown on such tactics.

Poker's own brand of ethics is different from the ethical ideals of civilized human relationships. The game calls for distrust of the other fellow. It ignores the claim of friendship. Cunning deception and concealment of one's strength and intentions, not kindness and open-heartedness, are vital in poker. No one thinks any the worse of poker on that account. And no one should think any the worse of the game of business because its standards of right and wrong differ from the prevailing traditions of morality in our society.

Discard the Golden Rule

This view of business is especially worrisome to people without much business experience. A minister of my acquaintance once protested that business cannot possibly function in our society unless it is based on the Judeo-Christian system of ethics. He told me:

> I know some businessmen have supplied call girls to customers, but there are always a few rotten apples in every barrel. That doesn't mean the rest of the fruit isn't sound.

> Surely the vast majority of businessmen are ethical. I myself am acquainted with many who adhere to strict codes of ethics based fundamentally on religious teachings. They contribute to good causes. They participate in community activities. They cooperate with other companies to improve working conditions in their industries. Certainly they are not indifferent to ethics.

That most businessmen are not indifferent to ethics in their private lives, everyone will agree. My point is that in their office lives they cease to be private citizens; they become game players who must be guided by a somewhat different set of ethical standards.

The point was forcefully made to me by a Midwestern executive who has given a good deal of thought to the question:

> So long as a businessman complies with the laws of the land and avoids telling malicious lies, he's ethical. If the law as written gives a man a wide-open chance to make a killing, he'd be a fool not to take advantage of it. If he doesn't, somebody else will. There's no obligation on him to stop and consider who is going to get hurt. If the law says he can do it, that's all the justification he needs. There's nothing unethical about that. It's just plain business sense.

This executive (call him Robbins) took the stand that even industrial espionage, which is frowned on by some businessmen, ought not to be considered unethical. He recalled a recent meeting of the National Industrial Conference Board where an authority on marketing made a speech in which he deplored the employment of spies by business organizations. More and more companies, he pointed out, find it cheaper to penetrate the secrets of competitors with concealed cameras and microphones or by bribing employees than to set up costly research and design departments of their own. A whole branch of the electronics industry has grown up with this trend, he continued, providing equipment to make industrial espionage easier.

Disturbing? The marketing expert found it so. But when it came to a remedy, he could only appeal to "respect for the golden rule." Robbins thought this a confession of defeat, believing that the golden rule, for all its value as an ideal for society, is simply not feasible as a guide for business. A good part of the time the businessman is trying to do unto others as he hopes others will not do unto him.[2] Robbins continued:

> Espionage of one kind or another has become so common in business that it's like taking a drink during Prohibition – it's not considered sinful. And we don't even have Prohibition where espionage is concerned; the law is very tolerant in this area. There's no more shame for a business that uses secret agents than there is for a nation. Bear in mind that there already is at least one large corporation – you can buy its stock over the counter – that makes millions by providing counterespionage service to industrial firms. Espionage in business is not an ethical problem; it's an established technique of business competition.

"We don't make the laws"

Wherever we turn in business, we can perceive the sharp distinction between its ethical standards and those of the churches. Newspapers abound with sensational stories growing out of this distinction:

- We read one day that Senator Philip A. Hart of Michigan has attacked food processors for deceptive packaging of numerous products.[3]
- The next day there is a Congressional to-do over Ralph Nader's book, *Unsafe At Any Speed*, which demonstrates that automobile companies for years have neglected the safety of car-owning families.[4]
- Then another Senator, Lee Metcalf of Montana, and journalist Vic Reinemer show in their book, *Overcharge*, the methods by which utility companies elude regulating government bodies to extract unduly large payments from users of electricity.[5]

These are merely dramatic instances of a prevailing condition; there is hardly a major industry at which a similar attack could not be aimed. Critics of business regard such behavior as unethical, but the companies concerned know that they are merely playing the business game.

Among the most respected of our business institutions are the insurance companies. A group of insurance executives meeting recently in New England was startled when their guest speaker, social critic

Daniel Patrick Moynihan, roundly berated them for "unethical" practices. They had been guilty, Moynihan alleged, of using outdated actuarial tables to obtain unfairly high premiums. They habitually delayed the hearings of lawsuits against them in order to tire out the plaintiffs and win cheap settlements. In their employment policies they used ingenious devices to discriminate against certain minority groups.[6]

It was difficult for the audience to deny the validity of these charges. But these men were business game players. Their reaction to Moynihan's attack was much the same as that of the automobile manufacturers to Nader, of the utilities to Senator Metcalf, and of the food processors to Senator Hart. If the laws governing their businesses change, or if public opinion becomes clamorous, they will make the necessary adjustments. But morally they have in their view done nothing wrong. As long as they comply with the letter of the law, they are within their rights to operate their businesses as they see fit.

The small business is in the same position as the great corporation in this respect. For example:

> In 1967 a key manufacturer was accused of providing master keys for automobiles to mail-order customers, although it was obvious that some of the purchasers might be automobile thieves. His defense was plain and straightforward. If there was nothing in the law to prevent him from selling his keys to anyone who ordered them, it was not up to him to inquire as to his customers' motives. Why was it any worse, he insisted, for him to sell car keys by mail, than for mail-order houses to sell guns that might be used for murder? Until the law was changed, the key manufacturer could regard himself as being just as ethical as any other businessman by the rules of the business game.[7]

Violations of the ethical ideals of society are common in business, but they are not necessarily violations of business principles. Each year the Federal Trade Commission orders hundreds of companies, many of them of the first magnitude, to "cease and desist" from practices which, judged by ordinary standards, are of questionable morality but which are stoutly defended by the companies concerned.

In one case, a firm manufacturing a well-known mouthwash was accused of using a cheap form of alcohol possibly deleterious to health. The company's chief executive, after testifying in Washington, made this comment privately:

> We broke no law. We're in a highly competitive industry. If we're going to stay in business, we have to look for profit wherever the law permits. We don't make the laws. We obey them. Then why do we have to put up with this 'holier than thou' talk about ethics? It's sheer hypocrisy. We're not in business to promote ethics. Look at the cigarette companies, for God's sake! If the ethics aren't embodied in the laws by the men who made them, you can't expect businessmen to fill the lack. Why, a sudden submission to Christian ethics by businessmen would bring about the greatest economic upheaval in history!

It may be noted that the government failed to prove its case against him.

Cast illusions aside

Talk about ethics by businessmen is often a thin decorative coating over the hard realities of the game:

> Once I listened to a speech by a young executive who pointed to a new industry code as proof that his company and its competitors were deeply aware of their responsibilities to society. It was a code of ethics, he said. The industry was going to police itself, to dissuade constituent companies from wrongdoing. His eyes shone with conviction and enthusiasm.
>
> The same day there was a meeting in a hotel room where the industry's top executives met with the "czar" who was to administer the new code, a man of high repute. No one who was present could doubt their common attitude. In their eyes the code was designed primarily to forestall a move by the federal government to impose stern restrictions on the industry. They felt that the code would hamper them a good deal less than new federal laws would. It was, in other words, conceived as a protection for the industry, not for the public.
>
> The young executive accepted the surface explanation of the code; these leaders, all experienced game players, did not deceive themselves for a moment about its purpose.

The illusion that business can afford to be guided by ethics as conceived in private life is often fostered by speeches and articles containing such phrases as, "It pays to be ethical," or, "Sound ethics is good business," Actually this is not an ethical position at all; it is a self-serving calculation in disguise. The speaker is really saying that in the long run a company can make more money if it does not antagonize competitors, suppliers, employees, and customers by squeezing them too hard. He is saying that oversharp policies reduce ultimate gains. That is true, but it has nothing to do with ethics. The underlying attitude is much like that in the familiar story of the shopkeeper who finds an extra $20 bill in the cash register, debates with himself the ethical problem – should he tell his partner? – and finally decides to share the money because the gesture will give him an edge over the s.o.b. the next time they quarrel.

I think it is fair to sum up the prevailing attitude of businessmen on ethics as follows:

We live in what is probably the most competitive of the world's civilized societies. Our customs encourage a high degree of aggression in the individual's striving for success. Business is our main area of competition, and it has been ritualized into a game of strategy. The basic rules of the game have been set by the government, which attempts to detect and punish business frauds. But as long as a company does not transgress the rules of the game set by law, it has the legal right to shape its strategy without reference to anything but its profits. If it takes a long-term view of its profits, it will preserve amicable relations, so far as possible, with those with whom it deals. A wise businessman will not seek advantage to the point where he generates dangerous hostility among employees, competitors, customers, government, or the public at large. But decisions in this area are, in the final test, decisions of strategy, not of ethics.

The Individual and the Game

An individual within a company often finds it difficult to adjust to the requirements of the business game. He tries to preserve his private ethical standards in situations that call for game strategy. When he is obliged to carry out company policies that challenge his conception of himself as an ethical man, he suffers.

It disturbs him when he is ordered, for instance, to deny a raise to a man who deserves it, to fire an employee of long standing, to prepare advertising that he believes to be misleading, to conceal facts that he feels customers are entitled to know, to cheapen the quality of materials used in the manufacture of an established product, to sell as new a product that he knows to be rebuilt, to exaggerate the curative powers of a medicinal preparation, or to coerce dealers.

There are some fortunate executives who, by the nature of their work and circumstances, never have to face problems of this kind. But in one form or another the ethical dilemma is felt sooner or later by most businessmen. Possibly the dilemma is most painful not when the company forces the action on the executive but when he originates it himself – that is, when he has taken or is contemplating a step which is in his own interest but which runs counter to his early moral conditioning. To illustrate:

- The manager of an export department, eager to show rising sales, is pressed by a big customer to provide invoices which, while containing no overt falsehood that would violate a U.S. law, are so worded that the customer may be able to evade certain taxes in his homeland.
- A company president finds that an aging executive, within a few years of retirement and his pension, is not as productive as formerly. Should he be kept on?
- The produce manager of a supermarket debates with himself whether to get rid of a lot of half-rotten tomatoes by including one, with its good side exposed, in every tomato six-pack.
- An accountant discovers that he has taken an improper deduction on his company's tax return and fears the consequences if he calls the matter to the president's attention, though he himself has done nothing illegal. Perhaps if he says nothing, no one will notice the error.
- A chief executive officer is asked by his directors to comment on a rumor that he owns stock in another company with which he has placed large orders. He could deny it, for the stock is in the name of his son-in-law and he has earlier formally instructed his son-in-law to sell the holding.

Temptations of this kind constantly arise in business. If an executive allows himself to be torn between a decision based on business considerations and one based on his private ethical code, he exposes himself to a grave psychological strain.

This is not to say that sound business strategy necessarily runs counter to ethical ideals. They may frequently coincide; and when they do, everyone is gratified. But the major tests of every move in business, as in all games of strategy, are legality and profit. A man who intends to be a winner in the business game must have a game player's attitude.

The business strategist's decisions must be as impersonal as those of a surgeon performing an operation – concentrating on objective and technique, and subordinating personal feelings. If the chief executive admits that his son-in-law owns the stock, it is because he stands to lose more if the fact comes out later than if he states it boldly and at once. If the supermarket manager orders the rotten tomatoes to be discarded, he does so to avoid an increase in consumer complaints and a loss of goodwill. The company president decides not to fire the elderly executive in the belief that the negative reaction of other employees would in the long run cost the company more than it would lose in keeping him and paying his pension.

All sensible businessmen prefer to be truthful, but they seldom feel inclined to tell the *whole* truth. In the business game truth-telling usually has to be kept within narrow limits if trouble is to be avoided. The point was neatly made a long time ago (in 1888) by one of John D. Rockefeller's associates, Paul Babcock, to Standard Oil Company executives who were about to testify before a government investigating committee: "Parry every question with answers which, while perfectly truthful, are evasive of *bottom* facts."[8] This was, is, and probably always will be regarded as wise and permissible business strategy.

For office use only

An executive's family life can easily be dislocated if he fails to make a sharp distinction between the ethical systems of the home and the office – or if his wife does not grasp that distinction. Many a businessman who has remarked to his wife, "I had to let Jones go today" or "I had to admit to the boss that Jim has been goofing off lately," has been met with an indignant protest. "How could you do a thing like that? You know Jones is over 50 and will have a lot of trouble getting another job." Or, "You did that to Jim? With his wife ill and all the worry she's been having with the kids?"

If the executive insists that he had no choice because the profits of the company and his own security were involved, he may see a certain cool and ominous reappraisal in his wife's eyes. Many wives are not prepared to accept the fact that business operates with a special code of ethics. An illuminating illustration of this comes from a Southern sales executive who related a conversation he had had with his wife at a time when a hotly contested political campaign was being waged in their state:

"I made the mistake of telling her that I had had lunch with Colby, who gives me about half my business. Colby mentioned that his company had a stake in the election. Then he said, 'By the way, I'm treasurer of the citizens' committee for Lang. I'm collecting contributions. Can I count on you for a hundred dollars?'

"Well, there I was. I was opposed to Lang, but I knew Colby. If he withdrew his business I could be in a bad spot. So I just smiled and wrote out a check then and there. He thanked me, and we started to talk about his next order. Maybe he thought I shared his political views. If so, I wasn't going to lose any sleep over it.

"I should have had sense enough not to tell Mary about it. She hit the ceiling. She said she was disappointed in me. She said I hadn't acted like a man, that I should have stood up to Colby.

"I said, 'Look, it was an either-or situation. I had to do it or risk losing the business.'

"She came back at me with, 'I don't believe it. You could have been honest with him. You could have said that you didn't feel you ought to contribute to a campaign for a man you weren't going to vote for. I'm sure he would have understood.'

"I said, 'Mary, you're a wonderful woman, but you're way off the track. Do you know what would have happened if I had said that? Colby would have smiled and said, "Oh, I didn't realize. Forget it." But in his eyes from that moment I would be an oddball, maybe a bit of a radical. He would have listened to me talk about his order and would have promised to give it consideration. After that I wouldn't hear from him for a week. Then I would telephone and learn from his secretary that he wasn't yet ready to place the order. And in about a month I would hear through the grapevine that he was giving his business to another company. A month after that I'd be out of a job.'

"She was silent for a while. Then she said, 'Tom, something is wrong with business when a man is forced to choose between his family's security and his moral obligation to himself. It's easy for me to say you should have stood up to him – but if you had, you might have felt you were betraying me and the kids. I'm sorry that you did it, Tom, but I can't blame you. Something is wrong with business!'"

This wife saw the problem in terms of moral obligation as conceived in private life; her husband saw it as a matter of game strategy. As a player in a weak position, he felt that he could not afford to indulge an ethical sentiment that might have cost him his seat at the table.

Playing to win

Some men might challenge the Colbys of business – might accept serious setbacks to their business careers rather than risk a feeling of moral cowardice. They merit our respect – but as private individuals, not businessmen. When the skillful player of the business game is compelled to submit to unfair pressure, he does not castigate himself for moral weakness. Instead, he strives to put himself into a strong position where he can defend himself against such pressures in the future without loss.

If a man plans to take a seat in the business game, he owes it to himself to master the principles by which the game is played, including its special ethical outlook. He can then hardly fail to recognize that an occasional bluff may well be justified in terms of the game's ethics and warranted in terms of economic necessity. Once he clears his mind on this point, he is in a good position to match his strategy against that of the other players. He can then determine objectively whether a bluff in a given situation has a good chance of succeeding and can decide when and how to bluff, without a feeling of ethical transgression.

To be a winner, a man must play to win. This does not mean that he must be ruthless, cruel, harsh, or treacherous. On the contrary, the better his reputation for integrity, honesty, and decency, the better his chances of victory will be in the long run. But from time to time every businessman, like every poker player, is offered a choice between certain loss or bluffing within the legal rules of the game. If he is not resigned to losing, if he wants to rise in his company and industry, then in such a crisis he will bluff – and bluff hard.

Every now and then one meets a successful businessman who has conveniently forgotten the small or large deceptions that he practiced on his way to fortune. "God gave me my money," old John D. Rockefeller once piously told a Sunday school class. It would be a rare tycoon in our time who would risk the horse laugh with which such a remark would be greeted.

In the last third of the twentieth century even children are aware that if a man has become prosperous in business, he has sometimes departed from the strict truth in order to overcome obstacles or has practiced the more subtle deceptions of the half-truth or the misleading omission. Whatever the form of the bluff, it is an integral part of the game, and the executive who does not master its techniques is not likely to accumulate much money or power.

Notes

[1] *The New York Times*, March 9, 1967.

[2] See Bruce D. Henderson, "Brinkmanship in Business," HBR March–April 1967, p. 49.

[3] *The New York Times*, November 21, 1966.

[4] New York, Grossman Publishers, Inc., 1965.

[5] New York, David McKay Company, Inc., 1967.

[6] *The New York Times*, January 17, 1967.

[7] Cited by Ralph Nader in "Business Crime," *The New Republic*, July 1, 1967, p. 7.

[8] Babcock in a memorandum to Rockefeller (Rockefeller Archives).

The Social Responsibility of Business is to Increase its Profits

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When I hear businessmen speak eloquently about the "social responsibilities of business in a free-enterprise system," I am reminded of the wonderful line about the Frenchman who discovered at the age of 70 that he had been speaking prose all his life. The businessmen believe that they are defending free enterprise when they declaim that business is not concerned "merely" with profit but also with promoting desirable "social" ends; that business has a "social conscience" and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers. In fact they are – or would be if they or anyone else took them seriously – preaching pure and unadulterated socialism. Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades.

The discussions of the "social responsibilities of business" are notable for their analytical looseness and lack of rigor. What does it mean to say that "business" has responsibilities? Only people can have responsibilities. A corporation is an artificial person and in this sense may have artificial responsibilities, but "business" as a whole cannot be said to have responsibilities, even in this vague sense. The first step toward clarity in examining the doctrine of the social responsibility of business is to ask precisely what it implies for whom.

Presumably, the individuals who are to be responsible are businessmen, which means individual proprietors or corporate executives. Most of the discussion of social responsibility is directed at corporations, so in what follows I shall mostly neglect the individual proprietors and speak of corporate executives.

In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom. Of course, in some cases his employers may have a different objective. A group of persons might establish a corporation for an eleemosynary purpose – for example, a hospital or a school. The manager of such a corporation will not have money profit as his objectives but the rendering of certain services.

In either case, the key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them.

Needless to say, this does not mean that it is easy to judge how well he is performing his task. But at least the criterion of performance is straightforward, and the persons among whom a voluntary contractual arrangement exists are clearly defined.

Of course, the corporate executive is also a person in his own right. As a person, he may have many other responsibilities that he recognizes or assumes voluntarily – to his family, his conscience, his feelings of charity, his church, his clubs, his city, his country. He may feel impelled by these responsibilities to devote part of his income to causes he regards as worthy, to refuse to work for particular corporations, even to leave his job, for example, to join his country's armed forces. If we wish, we may refer to some of these responsibilities as "social responsibilities." But in these respects he is acting as a principal, not as an agent; he is spending his own money or time or energy, not the money of his employers or the time or energy he has contracted to devote to their purposes. If these are "social responsibilities," they are the social responsibilities of individuals, not of business.

Milton Friedman, "The Social Responsibility of Business is to Increase its Profits," *The New York Times Magazine*, September 13, 1970. Reprinted with permission of Pars International.

What does it mean to say that the corporate executive has a "social responsibility" in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers. For example, that he is to refrain from increasing the price of the product in order to contribute to the social objective of preventing inflation, even though a price increase would be in the best interests of the corporation. Or that he is to make expenditures on reducing pollution beyond the amount that is in the best interests of the corporation or that is required by law in order to contribute to the social objective of improving the environment. Or that, at the expense of corporate profits, he is to hire "hard-core" unemployed instead of better qualified available workmen to contribute to the social objective of reducing poverty.

In each of these cases, the corporate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his "social responsibility" reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some employees, he is spending their money.

The stockholders or the customers or the employees could separately spend their own money on the particular action if they wished to do so. The executive is exercising a distinct "social responsibility," rather than serving as an agent of the stockholders or the customers or the employees, only if he spends the money in a different way than they would have spent it.

But if he does this, he is in effect imposing taxes, on the one hand, and deciding how the tax proceeds shall be spent, on the other.

This process raises political questions on two levels: principle and consequences. On the level of political principle, the imposition of taxes and the expenditure of tax proceeds are governmental functions. We have established elaborate constitutional, parliamentary and judicial provisions to control these functions, to assure that taxes are imposed so far as possible in accordance with the preferences and desires of the public – after all, "taxation without representation" was one of the battle cries of the American Revolution. We have a system of checks and balances to separate the legislative function of imposing taxes and enacting expenditures from the executive function of collecting taxes and administering expenditure programs and from the judicial function of mediating disputes and interpreting the law.

Here the businessman – self-selected or appointed directly or indirectly by stockholders – is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose, and he is to spend the proceeds – all this guided only by general exhortations from on high to restrain inflation, improve the environment, fight poverty and so on and on.

The whole justification for permitting the corporate executive to be selected by the stockholders is that the executive is an agent serving the interests of his principal. This justification disappears when the corporate executive imposes taxes and spends the proceeds for "social" purposes. He becomes in effect a public employee, a civil servant, even though he remains in name an employee of a private enterprise. On grounds of political principle, it is intolerable that such civil servants – insofar as their actions in the name of social responsibility are real and not just window-dressing – should be selected as they are now. If they are to be civil servants, then they must be elected through a political process. If they are to impose taxes and make expenditures to foster "social" objectives, then political machinery must be set up to make the assessment of taxes and to determine through a political process the objectives to be served.

This is the basic reason why the doctrine of "social responsibility" involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses.

On the grounds of consequences, can the corporate executive in fact discharge his alleged "social responsibilities"? On the other hand, suppose he could get away with spending the stockholders' or customers' or employees' money. How is he to know how to spend it? He is told that he must contribute to fighting inflation. How is he to know what action of his will contribute to that end? He is presumably an expert in running his company – in producing a product or selling it or financing it. But nothing about his selection makes him an expert on inflation. Will his holding down the price of his product reduce inflationary pressure? Or, by leaving more spending power in the hands of his customers, simply divert it elsewhere? Or, by forcing him to produce less because of the lower price, will it simply contribute to shortages? Even if he could answer these questions, how much cost is he justified in imposing on his stockholders, customers and employees for this social purpose? What is his appropriate share and what is the appropriate share of others?

And, whether he wants to or not, can he get away with spending his stockholders', customers' or employees' money? Will not the stockholders fire him? (Either the present ones or those who take over when his actions in the name of social responsibility have reduced the corporation's profits and the price of its stock.) His customers and his employees can desert him for other producers and employers less scrupulous in exercising their social responsibilities.

This facet of "social responsibility" doctrine is brought into sharp relief when the doctrine is used to justify wage restraint by trade unions. The conflict of interest is naked and clear when union officials are asked to subordinate the interest of their members to some more general purpose. If the union officials try to enforce wage restraint, the consequence is likely to be wildcat strikes, rank-and-file revolts and the emergence of strong competitors for their jobs. We thus have the ironic phenomenon that union leaders – at least in the U.S. – have objected to Government interference with the market far more consistently and courageously than have business leaders.

The difficulty of exercising "social responsibility" illustrates, of course, the great virtue of private competitive enterprise – it forces people to be responsible for their own actions and makes it difficult for them to "exploit" other people for either selfish or unselfish purposes. They can do good – but only at their own expense.

Many a reader who has followed the argument this far may be tempted to remonstrate that it is all well and good to speak of Government's having the responsibility to impose taxes and determine expenditures for such "social" purposes as controlling pollution or training the hard-core unemployed, but that the problems are too urgent to wait on the slow course of political processes, that the exercise of social responsibility by businessmen is a quicker and surer way to solve pressing current problems.

Aside from the question of fact – I share Adam Smith's skepticism about the benefits that can be expected from "those who affected to trade for the public good" – this argument must be rejected on grounds of principle. What it amounts to is an assertion that those who favor the taxes and expenditures in question have failed to persuade a majority of their fellow citizens to be of like mind and that they are seeking to attain by undemocratic procedures what they cannot attain by democratic procedures. In a free society, it is hard for "evil" people to do "evil," especially since one man's good is another's evil.

I have, for simplicity, concentrated on the special case of the corporate executive, except only for the brief digression on trade unions. But precisely the same argument applies to the newer phenomenon of calling upon stockholders to require corporations to exercise social responsibility (the recent G. M. crusade for example). In most of these cases, what is in effect involved is some stockholders trying to get other stockholders (or customers or employees) to contribute against their will to "social" causes favored by the activists. Insofar as they succeed, they are again imposing taxes and spending the proceeds.

The situation of the individual proprietor is somewhat different. If he acts to reduce the returns of his enterprise in order to exercise his "social responsibility," he is spending his own money, not someone else's. If he wishes to spend his money on such purposes, that is his right, and I cannot see that there is any objection to his doing so. In the process, he, too, may impose costs on employees and customers. However, because he is far less likely than a large corporation or union to have monopolistic power, any such side effects will tend to be minor.

Of course, in practice the doctrine of social responsibility is frequently a cloak for actions that are justified on other grounds rather than a reason for those actions.

To illustrate, it may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government. That may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects. Or it may be that, given the laws about the deductibility of corporate charitable contributions, the stockholders can contribute more to charities they favor by having the corporation make the gift than by doing it themselves, since they can in that way contribute an amount that would otherwise have been paid as corporate taxes.

In each of these – and many similar – cases, there is a strong temptation to rationalize these actions as an exercise of "social responsibility." In the present climate of opinion, with its widespread aversion to "capitalism," "profits," the "soulless corporation" and so on, this is one way for a corporation to generate goodwill as a by-product of expenditures that are entirely justified in its own self-interest.

It would be inconsistent of me to call on corporate executives to refrain from this hypocritical window-dressing because it harms the foundations of a free society. That would be to call on them to exercise a "social responsibility"! If our institutions, and the attitudes of the public make it in their self-interest to cloak their actions in this way, I cannot summon much indignation to denounce them. At the same time, I can express admiration for those individual proprietors or owners of closely held corporations or stockholders of more broadly held corporations who disdain such tactics as approaching fraud.

Whether blameworthy or not, the use of the cloak of social responsibility, and the nonsense spoken in its name by influential and prestigious businessmen, does clearly harm the foundations of a free society. I have been impressed time and again by the schizophrenic character of many businessmen. They are capable of being extremely farsighted and clear-headed in matters that are internal to their businesses. They are incredibly short-sighted and muddle-headed in matters that are outside their businesses but affect the possible survival of business in general. This short-sightedness is strikingly exemplified in the calls from many businessmen for wage and price guidelines or controls or income policies. There is nothing that could do more in a brief period to destroy a market system and replace it by a centrally controlled system than effective governmental control of prices and wages.

The short-sightedness is also exemplified in speeches by businessmen on social responsibility. This may gain them kudos in the short run. But it helps to strengthen the already too prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces. Once this view is adopted, the external forces that curb the market will not be the social consciences, however highly developed, of the pontificating executives; it will be the iron fist of government bureaucrats. Here, as with price and wage controls, businessmen seem to me to reveal a suicidal impulse.

The political principle that underlies the market mechanism is unanimity. In an ideal free market resting on private property, no individual can coerce any other, all cooperation is voluntary, all parties to such cooperation benefit or they need not participate. There are no values, no "social" responsibilities in any sense other than the shared values and responsibilities of individuals. Society is a collection of individuals and of the various groups they voluntarily form.

The political principle that underlies the political mechanism is conformity. The individual must serve a more general social interest – whether that be determined by a church or a dictator or a majority. The individual may have a vote and say in what is to be done, but if he is overruled, he must conform. It is appropriate for some to require others to contribute to a general social purpose whether they wish to or not.

Unfortunately, unanimity is not always feasible. There are some respects in which conformity appears unavoidable, so I do not see how one can avoid the use of the political mechanism altogether.

But the doctrine of "social responsibility" taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly collectivist doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means. That is why, in my book "Capitalism and Freedom," I have called it a "fundamentally subversive doctrine" in a free society, and have said that in such a society, "there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

Stakeholder Theory of the Modern Corporation

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Introduction

> Corporations have ceased to be merely legal devices through which the private business transactions of individuals may be carried on. Though still much used for this purpose, the corporate form has acquired a larger significance. The corporation has, in fact, become both a method of property tenure and a means of organizing economic life. Grown to tremendous proportions, there may be said to have evolved a "corporate system" – which has attracted to itself a combination of attributes and powers, and has attained a degree of prominence entitling it to be dealt with as a major social institution.[1]

Despite these prophetic words of Berle and Means (1932), scholars and managers alike continue to hold sacred the view that managers bear a special relationship to the stockholders in the firm. Since stockholders own shares in the firm, they have certain rights and privileges, which must be granted to them by management, as well as by others. Sanctions, in the form of "the law of corporations," and other protective mechanisms in the form of social custom, accepted management practice, myth, and ritual, are thought to reinforce the assumption of the primacy of the stockholder.

The purpose of this chapter is to pose several challenges to this assumption, from within the framework of managerial capitalism, and to suggest the bare bones of an alternative theory, *a stakeholder theory of the modern corporation*. I do not seek the demise of the modern corporation, either intellectually or in fact. Rather, I seek its transformation. In the words of Neurath, we shall attempt to "rebuild the ship, plank by plank, while it remains afloat."[2]

My thesis is that we can revitalize the concept of managerial capitalism by replacing the notion that managers have a duty to stockholders with the concept that managers bear a fiduciary relationship to stakeholders. Stakeholders are those groups who have a stake in or claim on the firm. Specifically I include suppliers, customers, employees, stockholders, and the local community, as well as management in its role as agent for these groups. I argue that the legal, economic, political, and moral challenges to the currently received theory of the firm, as a nexus of contracts among the owners of the factors of production and customers, require us to revise this concept. That is, each of these stakeholder groups has a right not to be treated as a means to some end, and therefore must participate in determining the future direction of the firm in which they have a stake.

The crux of my argument is that we must reconceptualize the firm around the following question: For whose benefit and at whose expense should the firm be managed? I shall set forth such a reconceptualization in the form of a *stakeholder theory of the firm*. I shall then critically examine the stakeholder view and its implications for the future of the capitalist system.

The Attack on Managerial Capitalism

The legal argument

The basic idea of managerial capitalism is that in return for controlling the firm, management vigorously pursues the interests of stockholders. Central to the managerial view of the firm is the idea that management can pursue market transactions with suppliers and customers in an unconstrained manner.

The law of corporations gives a less clear-cut answer to the question: In whose interest and for whose benefit should the modern corporation be governed? While it says that the corporations should be run primarily in the interests of the stockholders in

R. Edward Freeman, "Stakeholder Theory of the Modern Corporation." From the fourth edition of this book. Reprinted with kind permission of the author.

the firm, it says further that the corporation exists "in contemplation of the law" and has personality as a "legal person," limited liability for its actions, and immortality, since its existence transcends that of its members. Therefore, directors and other officers of the firm have a fiduciary obligation to stockholders in the sense that the "affairs of the corporation" must be conducted in the interest of the stockholders. And stockholders can theoretically bring suit against those directors and managers for doing otherwise. But since the corporation is a legal person, existing in contemplation of the law, managers of the corporation are constrained by law.

Until recently, this was no constraint at all. In this century, however, the law has evolved to effectively constrain the pursuit of stockholder interests at the expense of other claimants on the firm. It has, in effect, required that the claims of customers, suppliers, local communities, and employees be taken into consideration, though in general they are subordinated to the claims of stockholders.

For instance, the doctrine of "privity of contract," as articulated in *Winterbottom v. Wright* in 1842, has been eroded by recent developments in products liability law. Indeed, *Greenman v. Yuba Power* gives the manufacturer strict liability for damage caused by its products, even though the seller has exercised all possible care in the preparation and sale of the product and the consumer has not bought the product from nor entered into any contractual arrangement with the manufacturer. Caveat emptor has been replaced, in large part, with caveat venditor.[3] The Consumer Product Safety Commission has the power to enact product recalls, and in 1980 one U.S. automobile company recalled more cars than it built. Some industries are required to provide information to customers about a product's ingredients, whether or not the customers want and are willing to pay for this information.[4]

The same argument is applicable to management's dealings with employees. The National Labor Relations Act gave employees the right to unionize and to bargain in good faith. It set up the National Labor Relations Board to enforce these rights with management. The Equal Pay Act of 1963 and Title VII of the Civil Rights Act of 1964 constrain management from discrimination in hiring practices; these have been followed with the Age Discrimination in Employment Act of 1967.[5] The emergence of a body of administrative case law arising from labor-management disputes and the historic settling of discrimination claims with large employers such as AT&T have caused the emergence of a body of practice in the corporation that is consistent with the legal guarantee of the rights of the employees. The law has protected the due process rights of those employees who enter into collective bargaining agreements with management. As of the present, however, only 30 percent of the labor force are participating in such agreements; this has prompted one labor law scholar to propose a statutory law prohibiting dismissals of the 70 percent of the work force not protected.[6]

The law has also protected the interests of local communities. The Clean Air Act and Clean Water Act have constrained management from "spoiling the commons." In an historic case, *Marsh* v. *Alabama*, the Supreme Court ruled that a company-owned town was subject to the provisions of the U.S. Constitution, thereby guaranteeing the rights of local citizens and negating the "property rights" of the firm. Some states and municipalities have gone further and passed laws preventing firms from moving plants or limiting when and how plants can be closed. In sum, there is much current legal activity in this area to constrain management's pursuit of stockholders' interests at the expense of the local communities in which the firm operates.

I have argued that the result of such changes in the legal system can be viewed as giving some rights to those groups that have a claim on the firm, for example, customers, suppliers, employees, local communities, stockholders, and management. It raises the question, at the core of a theory of the firm: In whose interest and for whose benefit should the firm be managed? The answer proposed by managerial capitalism is clearly "the stockholders," but I have argued that the law has been progressively circumscribing this answer.

The economic argument

In its pure ideological form managerial capitalism seeks to maximize the interests of stockholders. In its perennial criticism of government regulation, management espouses the "invisible hand" doctrine. It contends that it creates the greatest good for the greatest number, and therefore government need not intervene. However, we know that externalities, moral hazards, and monopoly power exist in fact, whether or not they exist in theory. Further, some of the legal apparatus mentioned above has evolved to deal with just these issues.

The problem of the "tragedy of the commons" or the free-rider problem pervades the concept of public goods such as water and air. No one has an incentive to incur the cost of clean-up or the cost of nonpollution, since the marginal gain of one firm's action is small. Every firm reasons this way, and the result is pollution of water and air. Since the Industrial Revolution, firms have sought to internalize the benefits and externalize the costs of their actions. The cost must be borne by all, through taxation and regulation; hence we have the emergence of the environmental regulations of the 1970s.

Similarly, moral hazards arise when the purchaser of a good or service can pass along the cost of that good. There is no incentive to economize, on the part of either the producer or the consumer, and there is excessive use of the resources involved. The institutionalized practice of third-party payment in health care is a prime example.

Finally, we see the avoidance of competitive behavior on the part of firms, each seeking to monopolize a small portion of the market and not compete with one another. In a number of industries, oligopolies have emerged, and while there is questionable evidence that oligopolies are not the most efficient corporate form in some industries, suffice it to say that the potential for abuse of market power has again led to regulation of managerial activity. In the classic case, AT&T, arguably one of the great technological and managerial achievements of the century, was broken up into eight separate companies to prevent its abuse of monopoly power.

Externalities, moral hazards, and monopoly power have led to more external control on managerial capitalism. There are de facto constraints, due to these economic facts of life, on the ability of management to act in the interests of stockholders.

A Stakeholder Theory of the Firm

The stakeholder concept

Corporations have stakeholders, that is, groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by, corporate actions. The concept of stakeholders is a generalization of the notion of stockholders, who themselves have some special claim on the firm. Just as stockholders have a right to demand certain actions by management, so do other stakeholders have a right to make claims. The exact nature of these claims is a difficult question that I shall address, but the logic is identical to that of the stockholder theory. Stakes require action of a certain sort, and conflicting stakes require methods of resolution.

Freeman and Reed (1983)[7] distinguish two senses of *stakeholder*. The "narrow definition" includes those groups who are vital to the survival and success of the corporation. The "wide definition" includes any group or individual who can affect or is affected by the corporation. I shall begin with a modest aim: to articulate a stakeholder theory using the narrow definition.

Stakeholders in the modern corporation

Figure 1 depicts the stakeholder in a typical large corporation. The stakes of each are reciprocal, since each can affect the other in terms of harms and benefits as well as rights and duties. The stakes of each are not univocal and would vary by particular corporation. We merely set forth some general notions that seem to be common to many large firms.

Owners have financial stakes in the corporation in the form of stocks, bonds, and so on, and they expect some kind of financial return from them. Either they have given money directly to the firm, or they have

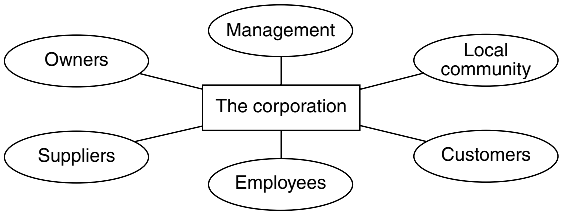

Figure 1 A stakeholder model of the corporation.

some historical claim made through a series of morally justified exchanges. The firm affects their livelihood or, if a substantial portion of their retirement income is in stocks or bonds, their ability to care for themselves when they can no longer work. Of course, the stakes of owners will differ by type of owner, preferences for money, moral preferences, and so on, as well as by type of firm. The owners of AT&T are quite different from the owners of Ford Motor Company, with stock of the former company being widely dispersed among 3 million stockholders and that of the latter being held by a small family group as well as by a large group of public stockholders.

Employees have their jobs and usually their livelihoods at stake; they often have specialized skills for which there is usually no perfectly elastic market. In return for their labor, they expect security, wages, benefits, and meaningful work. In return for their loyalty, the corporation is expected to provide for them and carry them through difficult times. Employees are expected to follow the instructions of management most of the time, to speak favorably about the company, and to be responsible citizens in the local communities in which the company operates. Where they are used as means to an end, they must participate in decisions affecting such use. The evidence that such policies and values as described here lead to productive company-employee relationships is compelling. It is equally compelling to realize that the opportunities for "bad faith" on the part of both management and employees are enormous. "Mock participation" in quality circles, singing the company song, and wearing the company uniform solely to please management all lead to distrust and unproductive work.

Suppliers, interpreted in a stakeholder sense, are vital to the success of the firm, for raw materials will determine the final product's quality and price. In turn the firm is a customer of the supplier and is therefore vital to the success and survival of the supplier. When the firm treats the supplier as a valued member of the stakeholder network, rather than simply as a source of materials, the supplier will respond when the firm is in need. Chrysler traditionally had very close ties to its suppliers, even to the extent that led some to suspect the transfer of illegal payments. And when Chrysler was on the brink of disaster, the suppliers responded with price cuts, accepting late payments, financing, and so on. Supplier and company can rise and fall together. Of course, again, the particular supplier relationships will depend on a number of variables such as the number of suppliers and whether the supplies are finished goods or raw materials.

Customers exchange resources for the products of the firm and in return receive the benefits of the products. Customers provide the lifeblood of the firm in the form of revenue. Given the level of reinvestment of earnings in large corporations, customers indirectly pay for the development of new products and services. Peters and Waterman (1982)[8] have argued that being close to the customer leads to success with other stakeholders and that a distinguishing characteristic of some companies that have performed well is their emphasis on the customer. By paying attention to customers' needs, management automatically addresses the needs of suppliers and owners. Moreover, it seems that the ethic of customer service carries over to the community. Almost without fail the "excellent companies" in Peters and Waterman's study have good reputations in the community. I would argue that Peters and Waterman have found multiple applications of Kant's dictum, "Treat persons as ends unto themselves," and it should come as no surprise that persons respond to such respectful treatment, be they customers, suppliers, owners, employees, or members of the local community. The real surprise is the novelty of the application of Kant's rule in a theory of good management practice.

The local community grants the firm the right to build facilities and, in turn, it benefits from the tax base and economic and social contributions of the firm. In return for the provision of local services, the firm is expected to be a good citizen, as is any person, either "natural or artificial." The firm cannot expose the community to unreasonable hazards in the form of pollution, toxic waste, and so on. If for some reason the firm must leave a community, it is expected to work with local leaders to make the transition as smoothly as possible. Of course, the firm does not have perfect knowledge, but when it discovers some danger or runs afoul of new competition, it is expected to inform the local community and to work with the community to overcome any problem.When the firm mismanages its relationship with the local community, it is in the same position as a citizen who commits a crime. It has violated the implicit social contract with the community and should expect to be distrusted and ostracized. It should not be surprised when punitive measures are invoked.

I have not included "competitors" as stakeholders in the narrow sense, since strictly speaking they are not necessary for the survival and success of the firm; the stakeholder theory works equally well in monopoly contexts. However, competitors and government would be the first to be included in an extension of this basic theory. It is simply not true that the interests of competitors in an industry are always in conflict. There is no reason why trade associations and other multiorganizational groups cannot band together to solve common problems that have little to do with how to restrain trade. Implementation of stakeholder management principles, in the long run, mitigates the need for industrial policy and an increasing role for government intervention and regulation.

The role of management

Management plays a special role, for it too has a stake in the modern corporation. On the one hand, management's stake is like that of employees, with some kind of explicit or implicit employment contract. But, on the other hand, management has a duty of safeguarding the welfare of the abstract entity that is the corporation. In short, management, especially top management, must look after the health of the corporation, and this involves balancing the multiple claims of conflicting stakeholders. Owners want higher financial returns, while customers want more money spent on research and development. Employees want higher wages and better benefits, while the local community wants better parks and day-care facilities.

The task of management in today's corporation is akin to that of King Solomon.The stakeholder theory does not give primacy to one stakeholder group over another, though there will surely be times when one group will benefit at the expense of others. In general, however, management must keep the relationships among stakeholders in balance.When these relationships become imbalanced, the survival of the firm is in jeopardy.

When wages are too high and product quality is too low, customers leave, suppliers suffer, and owners sell their stocks and bonds, depressing the stock price and making it difficult to raise new capital at favorable rates. Note, however, that the reason for paying returns to owners is not that they "own" the firm, but that their support is necessary for the survival of the firm, and that they have a legitimate claim on the firm. Similar reasoning applies in turn to each stakeholder group.

A stakeholder theory of the firm must redefine the purpose of the firm. The stockholder theory claims that the purpose of the firm is to maximize the welfare of the stockholders, perhaps subject to some moral or social constraints, either because such maximization leads to the greatest good or because of property rights.The purpose of the firm is quite different in my view.

"The stakeholder theory" can be unpacked into a number of stakeholder theories, each of which has a "normative core," inextricably linked to the way that corporations should be governed and the way that managers should act. So, attempts to more fully define, or more carefully define, a stakeholder theory are misguided. Following Donaldson and Preston, I want to insist that the normative, descriptive, instrumental, and metaphorical (my addition to their framework) uses of "stakeholder" are tied together in particular political constructions to yield a number of possible "stakeholder theories." "Stakeholder theory" is thus a genre of stories about how we could live. Let me be more specific.

A "normative core" of a theory is a set of sentences that includes among others, sentences like:

1. Corporations ought to be governed . . .
2. Managers ought to act to . . . .

where we need arguments or further narratives which include business and moral terms to fill in the blanks. This normative core is not always reducible to a fundamental ground like the theory of property, but certain normative cores are consistent with modern understandings of property. Certain elaborations of the theory of private property plus the other

Exhibit 1 A reasonable pluralism.

	A. *Corporations ought to be governed …*	*B.* *Managers ought to act …*	*C.* *The background disciplines of "value creations" are …*
Doctrine of Fair Contracts	… in accordance with the six principles.	… in the interests of stakeholders.	– business theories – theories that explain stakeholder behavior
Feminist Standpoint Theory	… in accordance with the principles of caring/ connection and relationships.	… to maintain and care for relationships and networks of stakeholders.	– business theories – feminist theory – social science understanding of networks
Ecological Principles	… in accordance with the principle of caring for the earth.	… to care for the earth.	– business theories – ecology – other

institutions of political liberalism give rise to particular normative cores. But there are other institutions, other political conceptions of how society ought to be structured, so that there are different possible normative cores.

So, one normative core of a stakeholder theory might be a feminist standpoint one, rethinking how we would restructure "value-creating activity" along principles of caring and connection.[9] Another would be an ecological (or several ecological) normative cores. Mark Starik has argued that the very idea of a stakeholder theory of the *firm* ignores certain ecological necessities.[10] Exhibit 1 is suggestive of how these theories could be developed.

In the next section I shall sketch the normative core based on pragmatic liberalism. But, any normative core must address the questions in columns A or B, or explain why these questions may be irrelevant, as in the ecological view. In addition, each "theory," and I use the word hesitantly, must place the normative core within a more full-fledged account of how we could understand value-creating activity differently (column C). The only way to get on with this task is to see the stakeholder idea as a metaphor. The attempt to prescribe one and only one "normative core" and construct "a stakeholder theory" is at best a disguised attempt to smuggle a normative core past the unsophisticated noses of other unsuspecting academics who are just happy to see the end of the stockholder orthodoxy.

If we begin with the view that we can understand value-creation activity as a contractual process among those parties affected, and if for simplicity's sake we initially designate those parties as financiers, customers, suppliers, employees, and communities, then we can construct a normative core that reflects the liberal notions of autonomy, solidarity, and fairness as articulated by John Rawls, Richard Rorty, and others.[11] Notice that building these moral notions into the foundations of how we understand value creation and contracting requires that we eschew separating the "business" part of the process from the "ethical" part, and that we start with the presumption of equality among the contractors, rather than the presumption in favor of financier rights.

The normative core for this redesigned contractual theory will capture the liberal idea of fairness if it ensures a basic equality among stakeholders in terms of their moral rights as these are realized in the firm, and if it recognizes that inequalities among stakeholders are justified if they raise the level of the least well-off stakeholder. The liberal ideal of autonomy is captured by the realization that each stakeholder must be free to enter agreements that create value for themselves, and solidarity is realized by the recognition of the mutuality of stakeholder interests.

One way to understand fairness in this context is to claim *à la* Rawls that a contract is fair if parties to the contract would agree to it in ignorance of their actual stakes. Thus, a contract is like a fair bet, if each party is willing to turn the tables and accept the other side. What would a fair contract among corporate stakeholders look like? If we can articulate this ideal, a sort of corporate constitution, we could then ask whether actual corporations measure up to this standard, and we also begin to design corporate structures which are consistent with this Doctrine of Fair Contracts.

Imagine if you will, representative stakeholders trying to decide on "the rules of the game." Each is rational in a straightforward sense, looking out for its own self-interest. At least *ex ante*, stakeholders are the relevant parties since they will be materially affected, Stakeholders know how economic activity is organized and could be organized. They know general facts about the way the corporate world works. They know that in the real world there are or could be transaction costs, externalities, and positive costs of contracting. Suppose they are uncertain about what other social institutions exist, but they know the range of those institutions. They do not know if government exists to pick up the tab for any externalities, or if they will exist in the nightwatchman state of libertarian theory. They know success and failure stories of businesses around the world. In short, they are behind a Rawls-like veil of ignorance, and they do not know what stake each will have when the veil is lifted. What groundrules would they choose to guide them?

The first groundrule is "The Principle of Entry and Exit." Any contract that is the corporation must have clearly defined entry, exit, and renegotiation conditions, or at least it must have methods or processes for so defining these conditions. The logic is straightforward: each stakeholder must be able to determine when an agreement exists and has a chance of fulfillment. This is not to imply that contracts cannot contain contingent claims or other methods for resolving uncertainty, but rather that it must contain methods for determining whether or not it is valid.

The second groundrule I shall call "The Principle of Governance," and it says that the procedure for changing the rules of the game must be agreed upon by unanimous consent. Think about the consequences of a majority of stakeholders systematically "selling out" a minority. Each stakeholder, in ignorance of its actual role, would seek to avoid such a situation. In reality this principle translates into each stakeholder never giving up its right to participate in the governance of the corporation, or perhaps into the existence of stakeholder governing boards.

The third groundrule I shall call "The Principle of Externalities," and it says that if a contract between A and B imposes a cost on C, then C has the option to become a party to the contract, and the terms are renegotiated. Once again the rationality of this condition is clear. Each stakeholder will want insurance that it does not become C.

The fourth groundrule is "The Principle of Contracting Costs," and it says that all parties to the contract must share in the cost of contracting. Once again the logic is straightforward. Any one stakeholder can get stuck.

A fifth groundrule is "The Agency Principle" that says that any agent must serve the interests of all stakeholders. It must adjudicate conflicts within the bounds of the other principals. Once again the logic is clear. Agents for any one group would have a privileged place.

A sixth and final groundrule we might call, "The Principle of Limited Immortality." The corporation shall be managed as if it can continue to serve the interests of stakeholders through time. Stakeholders are uncertain about the future but, subject to exit conditions, they realize that the continued existence of the corporation is in their interest. Therefore, it would be rational to hire managers who are fiduciaries to their interest and the interest of the collective. If it turns out the "collective interest" is the empty set, then this principle simply collapses into the Agency Principle.

Thus, the Doctrine of Fair Contracts consists of these six groundrules or principles:

1. The Principle of Entry and Exit
2. The Principle of Governance
3. The Principle of Externalities
4. The Principle of Contracting Costs
5. The Agency Principle
6. The Principle of Limited Immortality

Think of these groundrules as a doctrine which would guide actual stakeholders in devising a corporate constitution or charter. Think of management as having the duty to act in accordance with some specific constitution or charter.

Obviously, if the Doctrine of Fair Contacts and its accompanying background narratives are to effect real change, there must be requisite changes in the enabling laws of the land. I propose the following three principles to serve as constitutive elements of attempts to reform the law of corporations.

The stakeholder enabling principle

Corporations shall be managed in the interests of their stakeholders, defined as employees, financiers, customers, employees, and communities.

The principle of director responsibility

Directors of the corporation shall have a duty of care to use reasonable judgment to define and direct the affairs of the corporation in accordance with the Stakeholder Enabling Principle.

The principle of stakeholder recourse

Stakeholders may bring an action against the directors for failure to perform the required duty of care.

Obviously, there is more work to be done to spell out these principles in terms of model legislation. As they stand, they try to capture the intuitions that drive the liberal ideals. It is equally plain that corporate constitutions which meet a test like the doctrine of fair contracts are meant to enable directors and executives to manage the corporation in conjunction with these same liberal ideals.

Notes

[1] Cf. A. Berle and G. Means, *The Modern Corporation and Private Property* (New York; Commerce Clearing House, 1932), 1. For a reassessment of Berle and Means' argument after 50 years, see *Journal of Law and Economics* 26 (June 1983), especially G. Stigler and C. Friedland, "The Literature of Economics: The Case of Berle and Means," 257–68; D. North, "Comment on Stigler and Friedland," 269–72; and G. Means, "Corporate Power in the Marketplace," 467–85.

[2] The metaphor of rebuilding the ship while afloat is attributed to Neurath by W. Quine, *Word and Object* (Cambridge: Harvard University Press, 1960), and W. Quine and J. Ullian, *The Web of Belief* (New York: Random House, 1978). The point is that to keep the ship afloat during repairs we must replace a plank with one that will do a better job. Our argument is that stakeholder capitalism can so replace the current version of managerial capitalism.

[3] See R. Charan and E. Freeman, "Planning for the Business Environment of the 1980s," *The Journal of Business Strategy* 1 (1980): 9–19, especially p. 15 for a brief account of the major developments in products liability law.

[4] See S. Breyer, *Regulation and Its Reform* (Cambridge: Harvard University Press, 1983), 133, for an analysis of food additives.

[5] See I. Millstein and S. Katsh, *The Limits of Corporate Power* (New York: Macmillan, 1981), Chapter 4.

[6] Cf. C. Summers, "Protecting All Employees Against Unjust Dismissal," *Harvard Business Review* 58 (1980): 136, for a careful statement of the argument.

[7] See E. Freeman and D. Reed, "Stockholders and Stakeholders: A New Perspective on Corporate Governance," in C. Huizinga, ed., *Corporate Governance: A Definitive Exploration of the Issues* (Los Angeles: UCLA Extension Press, 1983).

[8] See T. Peters and R. Waterman, *In Search of Excellence* (New York: Harper and Row, 1982).

[9] See, for instance, A. Wicks, D. Gilbert, and E. Freeman, "A Feminist Reinterpretation of the Stakeholder Concept," *Business Ethics Quarterly*, Vol. 4, No. 4, October 1994; and E. Freeman and J. Liedtka, "Corporate Social Responsibility: A Critical Approach," *Business Horizons*, Vol. 34, No. 4, July-August 1991, pp. 92–98.

[10] At the Toronto workshop Mark Starik sketched how a theory would look if we took the environment to be a stakeholder. This fruitful line of work is one example of my main point about pluralism.

[11] J. Rawls, *Political Liberalism* (New York: Columbia University Press, 1993); and R. Rorty, "The Priority of Democracy to Philosophy" in *Reading Rorty: Critical Responses to Philosophy and the Mirror of Nature (and Beyond)*, ed. Alan R. Malachowski (Cambridge, MA: Blackwell, 1990).

Ethics in Business
Two Skeptical Challenges

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Many people claim to have grave doubts about the relevance of ethics in business. They claim that business has one and only one overriding goal – to make as much profit as possible. To achieve this goal, they continue, businesspeople will not hesitate to take advantage of others, to misuse their trust, or exploit their weaknesses. Business is a tough and ruthless competition with no pity for the weak, no compassion for the unfortunate, no equity for the unwary, and no thought of ethics.

Those who accept this view sometimes try to motivate it by pointing to actual business practices. Think about it for a minute, they say. Isn't it true that the business of business is to make a profit? And isn't it common knowledge that profit comes before ethics? Just reflect on the frequent accounts of alleged wrongdoing and questionable practices in business. Almost daily there are reports of dangerous products, financial trickery, consumer fraud, and indifference toward the welfare of employees and communities. Surely this is proof enough, the story goes, to show that business people put profit first and will do whatever they think is necessary to make it, even if it means acting unethically.

The problem with this story, assuming it is true that profit is the only goal of business, is that it doesn't license businesses to make a profit by ignoring ethics. The fact, if it is a fact, that businesses behave this way doesn't imply that it's okay for them to do it. Consider a simple analogy. Suppose Poor Jones has one aim in life – to become Rich Jones. He resolves to use any means available to achieve his goal. He will lie, steal, cheat, do whatever it takes to finally get a big piece of that pie. How should we respond to Poor Jones other than by pointing out that he's a liar, a thief, a cheater, and an all around bad egg? The answer is straightforward. Just because Poor Jones has a goal that's important for him doesn't mean that the rest of us have to play the patsy. We need neither pardon nor tolerate his actions. We can, and should, take action to protect our interests and the interests of others from Poor Jones's rapacious behavior.

The same is true for business. Profit seeking does not automatically justify unethical behavior. Simply because the goal of business is to make as much profit as possible (again, assuming this is true) doesn't mean that we have to condone the unethical means sometimes used to achieve it. Here again we can, and should, take action to protect ourselves from such behavior.

You overlook one thing, someone might respond. Unlike the case of Poor Jones, when businesses make a profit everyone benefits. Jobs are provided, investments made, dividends dispersed, and so on. We all do better when businesses maximize profits. If a little problematic behavior occurs along the way, well, it's a price we pay for prosperity.

Given the recent unpleasantness in financial markets this response may not convince as many as once it would have. But we need not replay all that here. Let us grant that profit is a good thing, a necessary thing for the thriving businesses we all want to see. Is it impossible for businesses to make a profit and act ethically at the same time? Surely not. Fair and honest dealings are no barrier to making money. Indeed, some would say, and I count myself among them, that over the long term more money will be made by ethical businesses than by unethical ones. Poverty is not a consequence of ethical behavior in business.

However, skeptics about ethics in business have a second and more subtle line of attack. They try to establish, not that businesses in fact put profit before ethics, but rather that ethics ought to have no role in business, or that the role of ethics is very limited. If successful, these arguments undercut the focus on ethics education in business schools. If ethics has no role or only a minor role in business, then there is little reason to include it in the curriculum.

In this chapter I will try to show that two of the most prominent of these skeptical arguments do not succeed, and thus provide no reason to disallow a place for ethics in business education. I will conclude with some comments about how emphasizing the ethical aspect of business adds value to the education of business students.

Robert E. Frederick, "Ethics in Business: Two Skeptical Challenges." Original article. Reprinted with kind permission of the author.

The Skeptic's Challenge: Part 1

There is no denying that unethical behavior in business sometimes seems to be a problem, occasionally a serious problem. Enron and Worldcom come to mind among many other examples. This suggests that what is needed is more ethics in business, not less. Yet some writers deny this. They agree that illegal behavior in business is a problem, but argue that unethical behavior is not. The reason is that ordinary ethical principles such as "one ought to tell the truth" or "one ought to keep promises" do not apply in business. Instead, business has its own special set of rules; call them the "rules of business competition." In private life one is supposed to follow ordinary ethical principles, but in business life one should put aside ordinary ethics and follow the rules of business competition. These are like the rules of a game. Albert Carr explains it like this:

> That most businessmen are not indifferent to ethics in their private lives, everyone will agree. My point is that in their office lives they cease to be private citizens; they become game players who must be guided by a somewhat different set of standards. (See article by Carr "Is Business Bluffing Ethical?" in this volume.)

These standards don't include things like the golden rule.

> The golden rule, for all its value as an ideal for society, is simply not feasible as a guide for business. A good part of the time the businessman is trying to do unto others as he hopes others will not do unto him. (See article by Carr.)

Carr then describes the rules of business competition.

> The basic rules of the game have been set by the government, which attempts to detect and punish business frauds. But as long as a company does not transgress the rules of the game set by law, it has the legal right to shape its strategy without reference to anything but its profits. (See article by Carr.)

So government sets the basic rules and profit defines the winners and losers. As one writer put it in a way that Carr would probably approve: "Business must fight as if it were at war. And, like a good war, it should be fought gallantly, daringly, and above all not morally."[1]

Strictly speaking Carr doesn't say that profits should be maximized, but I think the following rules capture the spirit of his understanding of business competition:

1. Follow government laws and regulations.
2. Make as much profit as possible consistent with rule 1.
3. There are no other rules.

These rules imply that in business there is no ethical obligation to tell the truth, keep promises, or avoid harming the innocent. These things should be done only if the law requires it or it enhances profits. Fortunately telling the truth and keeping promises often do contribute to profit. But when lying or breaking a promise is both legal and profitable, then from a business point of view there is no ethical reason not to go ahead and do it. As Carr puts it, "decisions in this area are, in the final test, decisions of strategy, not of ethics." (See article by Carr.)

An example of how the rules might work is this. Suppose you are getting ready to market a product that meets all government safety regulations. You plan to sell it for $10 and make a profit of 10%. Then your engineers tell you that for an extra $2 in manufacturing costs they could make the product much safer. The problem is that if you sell it for $12 you lose market share and your total profits go down. What do you do?

Carr's advice is simple: sell it for $10. It could be safer, but if you make it safer you will make less profit and in any conflict between profit and safety, profit always wins as long as safety regulations are met. That's the way the game works. In business there are no ethical obligations to make safe products. There are only legal obligations to follow government rules.

If Carr is right, then complaints about the lack of ethics in business are entirely wrongheaded. It's like complaining to chess players that they aren't following the rules of checkers. The rules of checkers don't apply to chess, nor, Carr would say, do the rules of ethics apply to business.

But is Carr right? Is business exempt from ethics? If he is, then those who say things like "it was wrong of Enron to try to manipulate the market for electricity in California" are like the checkers players complaining about the chess players. Since the rules of ethics don't apply in business, they must be either ignorant or confused, or both. Otherwise they would not say such outlandish things.

Yet if they are confused they can take comfort in the fact that many businesses suffer from the same malady. Read any code of ethics or business conduct published by a large corporation. It will invariably refer to things like integrity, rights, and ethics. Here's an example from General Electric's code of conduct.

> No matter how high the stakes, no matter how great the challenge, GE will do business only by lawful and ethical means. When working with customers and suppliers in every aspect of our business, we will not compromise our commitment to integrity. (See http://www.geaviation.com/aboutgeae/doingbusinesswith/docs/GE_integrity_guide.pdf.)

Another from Shell Oil.

> Shell employees share a set of core values – honesty, integrity and respect for people. We also firmly believe in the fundamental importance of trust, openness, teamwork and professionalism, and pride in what we do. (See http://retailindustry.about.com/od/retailbestpractices/ig/Company-Mission-Statements/Shell-Group-Mission–Values–Principles.htm.)

And a third from IBM.

> IBM is committed to principles of business ethics and lawful conduct. It is IBM's policy to conduct itself ethically and lawfully in all matters and to maintain IBM's high standards of business integrity. (See http://www.ibm.com/ibm/responsibility/ibm_policies.shtml#business.)

Further, thousands of corporations have signed documents such as the UN Global Compact, the first principle of which is,

> Businesses should support and respect the protection of internationally proclaimed human rights. (See http://www.unglobalcompact.org.)

In short, many businesses take ethics very seriously. They don't think that business is an ethics-free zone. Moreover, I suggest that much of the public feels the same. Recall that not too long ago things like sexual harassment and racial discrimination were not illegal in business, nor was it illegal to pay men and women differently for the same job. Not much further back child labor in deplorable conditions was common, labor strikes were met with armed violence, and workers in general were sometimes treated with brutality that is hard to imagine now. Why did these things change?

A main reason is that a collective social judgment was made, often against fierce business opposition, that the practices in question were ethically unacceptable. Take industrial pollution as an example. Once it was virtually uncontrolled and caused great damage in many communities. It was (partly) stopped, amid dire predictions of economic collapse from many business leaders, because most people came to believe that it was wrong, that the harm caused by pollution was not justified by profit. Because businesses would not voluntarily stop pollution, laws were passed against it. These laws codified an ethical judgment about business behavior.

Since Carr believes ethics doesn't apply in business, he must deny that ethical judgments about business behavior are either appropriate or applicable. Thus he must deny that collective social judgments about the ethics of business behavior are appropriate. Yet they certainly seem appropriate. Sexual harassment and racial discrimination are as ethically repugnant in business as they are in private life. Using young children as laborers in mines and factories is hardly worthy of ethical indifference or acquiescence. Carr's views have consequences that intuitively are extremely implausible. Without some very powerful reason to put aside these intuitions, a reason Carr does not provide, we are justified in rejecting the notion that ethical judgments about business actions are inappropriate.

How might Carr respond to the use of ethics codes in business and public judgments about the ethics of business practices? I think he has to insist that businesses and the public are simply mistaken about ethics in business. He isn't making a factual point about what the public or businesses actually do or believe about ethics in business. His claim is more theoretical, something like: in virtue of some characteristic X that business has (or lacks), ordinary ethics does not apply in business. Therefore, we ought not think and behave as if it does. So, what characteristic might it be?

Carr doesn't say much about this, so let me propose a couple of possibilities. One is that if the sole function of business is to create profit within the bounds of law, then if ethics interferes with that function, ethics has to go. However, a number of people believe that the function of business is more complex than simply making profit. For example, Michael Porter, whose credentials as a capitalist are rock solid, believes it ought to be creating he calls "shared value," not maximizing profit. Porter, with his co-author Mark Kramer, explains shared value as follows:

> The concept of shared value can be defined as policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates.[2]

Porter argues that "The purpose of the corporation must be redefined as creating shared value, not just profit per se." As he puts it,

> A narrow conception of capitalism has prevented business from harnessing its full potential to meet society's broader challenges. The opportunities have been there all along but have been overlooked. Businesses acting as businesses, not as charitable donors, are the most powerful force for addressing the pressing issues we face. The moment for a new conception of capitalism is now; society's needs are large and growing, while customers, employees, and a new generation of young people are asking business to step up.[3]

The basic idea is to "create economic value by creating social value," which is a long way from merely making profits. Hence, at best the idea that the sole function of business is to create profit is questionable. Furthermore, as I mentioned earlier, there is little reason to believe that ethics necessarily reduces profits over the long run. Even granted that "the businessman is trying to do unto others as he hopes others will not do unto him," this need not be understood as anything other than honest competition. It need not imply underhanded, devious, or dishonest business behavior. Game players try to win according to the rules, and for business some of those are the rules of ethics.

A second possibility centers around Carr's claim that when people walk through the office door in the morning they cease to be private citizens subject to ordinary ethical rules. They become what we might call "business citizens" and are subject to the rules of business competition. Now, as private citizens they are "not indifferent to ethics," so presumably in their lives as business citizens they are indifferent to ethics. Hence, there is something about the business environment, some X factor, that causes this change. Yet as far as I can see there is no reason to believe this is true. When people walk through the office door they don't suddenly develop sociopathic tendencies; they still care about rights, justice, and fairness, and corporate codes of conduct encourage them to do so. There is no magical force in business that deprives people of their ethical sensibilities. Of course, people do not always do the ethical thing in business. The annals of business history are littered with sometimes spectacular ethical failures. But the point is that everybody in business and out recognizes them as ethical failures, not simply business as usual.

Carr might reply that even if people remain "not indifferent" to ethics in the business environment, they ought to be indifferent. Why? Well, because otherwise people might feel they should follow ethical rules instead of the rules of business competition, and that might reduce profits. For example, from an excess of ethical zeal a business might decide to contribute to a charity, say, a homeless shelter, with no real expectation of any positive impact on the bottom line. Thus, profit would be reduced and rule 2 violated. A "business wrong" would have been committed.

But why is it wrong to violate the rules of competition? It's illegal to break the law and immoral to break the rules of ethics, but in what sense is it wrong to violate the rules of business competition? It isn't against the law or morality for businesses to donate to charities, make safer products, or provide safer working conditions than the law requires. What could it mean, then, to claim that it would be wrong for businesses to violate the rules of competition by, e.g., contributing to a charity? Why should anyone care?

I can think of only one answer that does not appeal to considerations far beyond the argument I made on Carr's behalf. The reason the game players care that the rules are violated is because they agreed, at least implicitly, to abide by the rules. It would be breaking an agreement – breaking a promise – to violate the rules. But breaking a promise is a violation of ethical rules, not the rules of competition. Thus in the end there is no escaping ethics. Although Carr denies that ethics applies to business, it is only by appealing to ethics that we can explain what is wrong with violating the rules of competition. Otherwise there is no reason to care if the rules are violated, and if there is no reason to care, then there is no reason to pay them any mind. With ethics, we have an answer, but Carr can't accept it because his position then becomes inconsistent. He would have to both deny that ethics applies to business behavior, and then appeal to ethics to explain why it's wrong to break the rules of business competition. For Carr, an inconvenient result.

Carr seems to conceive of business as apart from society, as something self-sufficient and independent, and thus unconnected to larger social concerns. That is why he thinks business is not subject to the ethical rules of society. This is a mistake. Business has a distinct function in society – an economic function – but that does not make it separate from society. Medical, religious, educational, and governmental institutions also have distinct functions in society, but they are not separate from society nor are their members, in their official capacities, immune from ordinary ethical judgments. Business is no different. There is nothing special about business that grants its practitioners ethical immunity.

Carr does not succeed in showing that in their business dealings businesspeople have no ethical responsibilities. Yet it is still possible that the ethical responsibilities of businesspeople are severely limited. That is a possibility we must now consider.

The Skeptic's Challenge: Part 2

In a famous article on the social responsibility of business, Milton Friedman concludes that:

> [T]here is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud. (See article by Friedman "The Social Responsibility of Business is to Increase its Profits" in this volume.)

Since Friedman believes that "only people have responsibilities," suppose that by "business" in the above quote Friedman means "businesspeople." Thus the only social responsibility of businesspeople is to make a profit. This seems to imply that businesspeople have an ethical duty or obligation to society. But earlier in the article Friedman argues that businesspeople should make a profit because they have direct responsibilities to a much different group.

> In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom. … [T]he key point is that, in his capacity as corporate executive, the manager is the agent of the individuals who own the corporation . . . and his primary responsibility is to them. (See article by Friedman.)

Thus, businesspeople have direct or primary responsibilities not to society, but to the owners of the business, which for modern public corporations Friedman takes to be the stockholders. These responsibilities are quite limited. Businesspeople are supposed to do what the owners (stockholders) desire, and nothing else. This gives us another set of rules for businesspeople to follow. They are different from the rules of business competition, so call them "Friedman's rules."

1. Do what the stockholders of the business desire.
2. There are no other rules.

Since Friedman thinks he knows what stockholders desire, his rules can be supplemented as follows:

Supplementary rule 1: stockholders desire that businesspeople (a) follow government laws and regulations, (b) follow customary ethical rules, and (c) make as much money as possible consistent with (a) and (b).

Stockholders' desires, then, form the link between a businessperson's social responsibilities and direct responsibilities. By fulfilling their direct responsibilities to make a profit for stockholders, businesspeople also fulfill their social responsibilities. Nothing complicated about that, and not much room for ethics. Just do what stockholders desire and you'll be fine, ethically speaking.

But suppose Friedman is wrong about what stockholders desire. Suppose, contrary to his expectations, that they desire that businesspeople (managers) break the law to increase profit, or that they demand a level of profit that managers believe can only be achieved by illegal acts. Are managers obligated to follow their wishes? No, it's very unlikely that Friedman means to say that. Managers may have a responsibility to do what stockholders desire, but they also have a responsibility to obey the law. This responsibility takes precedence over the desires of stockholders, so we need another supplementary rule.

Supplementary rule 2: Managers have a responsibility to follow the law regardless of stockholders' desires to make a profit. Therefore, the desire of stockholders to make profit does not obligate managers to break the law.

Just as everyone should obey the law, so everyone should fulfill their ethical obligations. But what if stockholders want managers to break customary ethical rules to increase profit, or that they demand a level of profit that managers believe can only be achieved by violating customary ethical rules? Should managers violate ethical rules to make a profit? Or should there be another supplementary rule?

Supplementary rule 3: Managers have a responsibility to fulfill their ethical obligations regardless of stockholders' desires to make a profit. Therefore, the desire of stockholders to make profit does not obligate managers to violate customary ethical rules.

If this rule is added, then managers' ethical obligations take precedence over stockholders' desires to make a profit. Managers should make a profit, but only if they first make certain that they follow the law and fulfill their ethical obligations.

The longer quote from Friedman seems to imply that managers should follow the law and customary ethical rules because stockholders desire it, not because they are obligated to do so independently of stockholders' desires. In my opinion Friedman would agree that managers have an independent obligation to follow the law, an obligation that does not depend on stockholders' wishes. Would he also agree that managers have an independent obligation to follow ethical rules? In other words, would he accept supplementary rule 3? Or would he argue that the responsibility to make a profit for stockholders takes precedence over managers' ethical responsibilities?

To answer this question, consider what Friedman's rules might mean in practice. For example, it might seem that if managers are supposed to do what stockholders desire, they would take the time and spend the money to find out exactly what they desire in specific cases. Thus in the product pricing example, instead of making an independent decision to sell the product at either $10 or $12, managers would poll the stockholders to learn their desires. If they desired to sell a safer product and make less profit, then managers would sell it at $12. If they wanted more profit and less safety, then it would sell at $10. This polling procedure would guarantee that managers do what (most) stockholders want. It would be used in all major business decisions, such as product development, plant location, investments, employment policy, and so on.

Friedman would not go along with this polling procedure, and for good reason. If business decisions were made by taking polls, then little else would get done. Managers would spend most of their time counting votes instead of managing the business. Furthermore, as a matter of law, in modern corporations the stockholders have no power to control either day to day business operations or many major business decisions, such as moving a plant, downsizing, or introducing a new product. Those decisions are left to senior managers, and they are supervised by the board of directors, not the stockholders. But if managers need not always follow the stockholders' wishes in these cases, what does it mean to say that they should do what stockholders desire?

Maybe it means that managers should be loyal to stockholders. Because stockholders allegedly own the corporation, in an attenuated sense they are, as Friedman says, management's employers. Employees should be loyal to employers. This implies doing what employers desire. Thus loyalty requires that managers do what stockholders desire, if not specific cases such as the ones mentioned, then in the broader sense of supplementary rule 1.

I agree that employees should be loyal to employers. However, loyalty has limits. It does not require managers to break the law if stockholders wish it. It is unreasonable to demand or expect this. That is the point of supplementary rule 2. Therefore, the duty of loyalty does not obligate managers to fulfill all desires stockholders might have.

Loyalty does not require managers to break the law, but might it require them to break customary ethical rules if stockholders wish it? Or is it just as unreasonable to demand that managers break customary ethical rules as it is to demand that they break the law?

Reflect on the concept of loyalty for a moment. In the ordinary sense to be loyal is to be faithful in carrying out one's normal obligations, either the obligations that derive from involuntary relationships or the obligations assumed when one voluntarily takes on certain roles. For example, to be loyal to one's country is faithfully to fulfill the normal obligations of citizenship; to be loyal to one's spouse is faithfully to fulfill the normal obligations one takes on when one gets married. Since managers voluntarily assume their roles, managers are loyal to stockholders provided they faithfully carry out the obligations they assumed when they accepted employment in the corporation.

The question is whether those obligations include acting unethically if the stockholders wish it. It seems clear to me that they do not. Employees are not obligated to act unethically merely because employers wish it, nor can an employee justly be accused of disloyalty if he or she refuses to act unethically. Moreover, acting unethically cannot be considered part of the "normal" duties of any ethically permissible voluntary relationship. Only in associations that are already, so to speak, beyond the ethical pale, can unethical acts be considered a normal part of what one is expected to do. For instance, if you were to join a gang of criminals, then you would routinely be expected to act in ethically unacceptable ways toward those not in the gang. But corporations are not criminal gangs. They are not formed for unethical purposes, nor can the owners of the corporation legitimately demand that employees use unethical means to achieve what would otherwise be an ethical end. Consequently the loyalty managers owe stockholders does not obligate them to act unethically. Sometimes stockholders may desire that managers act unethically to increase profit, but the loyalty managers owe stockholders does not oblige them to do so.

Friedman might respond that managers can be obligated to act unethically if stockholders wish it, not because it would be disloyal to refuse, but because ownership gives stockholders special rights that managers, as agents of the stockholders, must respect. For instance, it gives them the right to have the business managed according to their desires, even if managers have to act unethically to do it.

It is true that property owners, including stockholders, have broad rights to use what they own as they please, or to demand that their agents manage it in a way that pleases them. Homeowners, for instance, have extensive legal rights to use their property as they wish. And stockholders have rights at common law to have the business managed in a way that benefits them. However, the rights of owners are limited. Neither the law nor ethics recognizes the right of owners to use what they own to damage unduly the interests or welfare of other people. For instance, if you own a house in the suburbs, you do not automatically have the right to raise pigs in the backyard. That imposes an unreasonable burden on your neighbors – it reduces the value of their property, not to mention causing an odor that has to be experienced to be believed. Similarly, stockholders have neither the legal or nor the ethical right to expect that the corporation will be managed in a way that unreasonably damages the interests or welfare of individuals or groups affected by corporate actions. The law on these matters is complex, but the ethical argument is plain. It depends on a "customary" ethical principle with a very long history, the principle that one should "do no harm." For present purposes the principle can be stated as follows:

Harm principle: Without good reason, it is always morally wrong for one individual or group to act in a way that harms the interests or welfare of another individual or group.

Since the principle states that no one can harm others without good reason, it has the following implication:

Implication of harm principle: Therefore, without good reason, it is always wrong for corporate managers to act in a way that harms the interests or welfare of another individual or group.

If the harm principle is a true or correct ethical principle, then, unless they have good reason, corporate managers are ethically bound to avoid harming any individual or group affected by corporate action. This is so irrespective of the wishes of stockholders. Stockholders may own the corporation, but ownership is not a license to demand that managers be heedless of the consequences of corporate action. Moreover, even if managers have good reason to harm someone, an extension of the harm principle shows that there are ethical limitations on what they can do.

Harm principle extension: If one individual or group A has good reason to act in a way that harms the interests or welfare of another individual or group B, then B has the ethical right to demand and expect that A will cause no more harm to B's interests or welfare than is absolutely necessary.

An implication of the extension is:

Implication of extension: Therefore, if corporate managers have good reason to act in a way that harms the interests or welfare of some individual or group, then that individual or group has the ethical right to demand and expect that managers cause no more harm to their interests or welfare than is absolutely necessary.

If this is correct, then even if managers have good reason to harm someone's interests or welfare, they are ethically required to minimize that harm. Again, this is true irrespective of the wishes of stockholders.

Is the harm principle a true or correct ethical principle? It is not easy to show that it is because it is a basic a rule of ethics. In its way it is as basic to ethics as the rule $a + b = b + a$ is basic to ordinary arithmetic. However, suppose it isn't correct; that is, suppose one does have the ethical right, if it still makes sense to use these words, to harm others for no good reason. In that case there would be few ethical limits on behavior. No harmful act – no matter how gratuitous – would be ethically wrong as long as someone wanted to do it, not theft, torture, rape, murder or anything else. And no one would have ethical grounds for complaint if they were harmed by another. But this, clearly, is an unacceptable consequence. To suppose that needlessly harmful acts are not wrong is completely at odds with our considered judgments about right and wrong. So we are justified in rejecting the supposition, and accepting the harm principle. It is one of the foundations of ethics.

When is someone harmed? This can turn out to be a surprisingly difficult question. Sometimes what one person regards as harm another will take to be a benefit. Yet in spite of this there are clear cases in which almost everyone would agree that harm has been caused. For example, when one person or group of persons unjustifiably causes another to suffer death, disability, physical or mental pain, loss of freedom or opportunity, economic loss, or violation of commonly accepted political or ethical rights, then that person or group of persons has caused harm. In addition, when someone lies to other people, or deceives or exploits them, or treats them unjustly, then he or she causes harm.

To return to Friedman, there are many groups other than stockholders whose interests and welfare can be harmed or helped by the actions of corporate managers. These groups are usually called "stakeholders." For example, bondholders, suppliers, employees and local communities are stakeholders. Managers may have legal obligations to these groups, but, as noted earlier, Friedman appears to deny that they have ethical obligations to stakeholders except as a consequence of the stockholders' desires. If the arguments above are correct, however, this view is mistaken. Managers have ethical obligations to stakeholders, obligations that derive from the harm principle, that are not dependent in any way on the desires of stockholders. Therefore, in addition to their legal obligations, managers are ethically obligated to consider stakeholders' interests and welfare in all cases in which the potential for harm exists, to prevent the harm if at all possible, and minimize it should it occur. The wishes of stockholders cannot relieve managers of these ethical responsibilities. Things are not as easy as that.

Supplementary rule 3 states that managers should fulfill their ethical obligations even if stockholders desire otherwise. However, the rule says nothing about what those obligations are. Given the harm principle, we are in a position to remedy that defect, at least partially.

Business ethics rule 1: Managers have an ethical responsibility not to harm the interests and welfare of stakeholders without good reason. If there is good reason, then managers have an ethical obligation to minimize the harm they cause.

I suggest that just as the harm principle is basic to ethics as a whole, the above rule is basic to business ethics. It is not the whole story of business ethics by any means, but it is a good beginning.

How might Friedman respond to business ethics rule 1? Since it's grounded in the harm principle it would be hard to argue that it's false without also claiming that the harm principle is false. I doubt that Friedman would do this. Surely it is one of the "customary ethical rules" that he mentions. But he does have a way out. He could argue that in any conflict between the desires of stockholders and the interests and welfare of the stakeholders, the ownership rights of the stockholders are always good enough reason to do what they want.Therefore, the desires of the stockholders automatically win.

Yet as we have seen, ownership rights do not automatically win in other areas. Both legally and ethically, the rights of owners to use their property as they please must be balanced against the interests and welfare of others. So why should they always win in this one?

I suggest that there is no answer to this question that appeals solely to the ownership rights of stockholders. Other considerations must be brought to bear. For example, one might argue that managers' self-interest is the reason that they must do what stockholders desire. Stockholders have the right to elect the board of directors, and so might pressure the board to replace senior management unless their wishes are followed. Or one might argue that the good of the corporation dictates that managers should follow stockholders' desires. If stockholders are dissatisfied they will not invest in the corporation, thus making it unlikely that the corporation will do well in the long term. Finally, one might argue that overall social welfare will be enhanced if the wishes of stockholders prevail. If stockholders want to make as much money as they can, and assuming that the wealthier one is the better off one is, if corporations make a lot of money, many people will be better off. Thus, social welfare will increase.

In each of these cases the interests and welfare of one group – managers, the corporation as a whole, society – is said to be the factor that should motivate managers to follow the desires of stockholders.That is, the reason the stockholders' wishes should prevail is because fulfilling their desires is a means to the end of protecting the interests or welfare of managers, the corporation, or society.To show that this is true one would have to show that the interests and welfare of these groups is more important, or more valuable, or more worthy in some way, than the interests and welfare of other stakeholders such as employees or local communities. If this can be done at all, it can only be done by appealing to ethics and ethical theory. No theory of science or economics will do the job because no scientific or economic theory can tell us whose interests ought to prevail in cases in which the interests or welfare of one group is enhanced or protected at the expense of the interests or welfare of another group.That is the task of ethics, not of science or economics.Thus if any of the three reasons mentioned above are used to justify or explain why the interests and welfare of a particular class of stakeholders do not prevail, then ethics and ethical theory must be a central part of that justification or explanation.

Let us consider how this might work by looking at the third reason in more detail – the claim that managers should do what stockholders desire because it increases overall social welfare.Again, notice that the reason managers are supposed to do what stockholders desire is not because stockholders desire it, but because it increases overall social welfare. Increasing social welfare is the goal, not merely doing what stockholders want.

The idea that we should try to increase social welfare is fundamental to the ethical theory of utilitarianism.This theory attempts to justify actions on the basis of the overall amount of good they cause. If we judge that the theory – utilitarianism – is a true or correct theory, and if it turns out doing what stockholders want actually does increase overall social welfare, then Friedman has a very powerful argument for managers to do what stockholders want. But the argument has a cost. Utilitarianism obligates everyone to increase social welfare. No one is excused, not managers, not stockholders, not anyone. Thus if Friedman appeals to utilitarianism to bolster his claim that the only social responsibility of business is to make profit, he places on managers the ethical obligation to increase social welfare. This makes his first rule, "do what owners desire," irrelevant for managers. It doesn't matter what owners desire because managers have an overriding ethical obligation to increase social welfare. If that means making a profit, then they should make a profit. If it means doing something else, then they should do that other thing. So we can eliminate Friedman's rules altogether. Now only one rule is needed: Do what is required by the ethical theory of utilitarianism.

The Skeptic's Real Worry?

Both Carr and Friedman seem to want to exempt businesspeople from general ethical obligations, Carr because he thinks of business as a game with its own special rules and Friedman because he wants managers to be directly responsible solely to owners.Why do they want to do this? Why not admit that ethical rules apply in business just as in all other human activities? What is gained by claiming otherwise?

The uncharitable answer is that what is gained is freedom from the burden of ethical restraints and responsibilities. Ethics places limits on behavior. It says that some behaviors are unacceptable, e.g., harming other people without a very good reason. It says that people are responsible for what they do, and thus answerable for it. Without these restraints and responsibilities life in business would be much simpler. For Carr, the golden rule would not be a hindrance – only law would restrict business activity. For Friedman, managers could concentrate on taking care of stockholders and not have to worry about balancing the interests and welfare of so many different stakeholders. Ours is a system of free enterprise. Perhaps part of what free enterprise means for Carr and Friedman is "freedom from ethical restraints."

But is it really possible for free enterprise to be free from ordinary ethics? I believe a moment's reflection shows it is not. Business could not operate unless most businesspeople were fair, honest, and trustworthy. Business transactions could not efficiently occur unless the parties to the transaction could count on each other to tell the truth, keep commitments and honor contracts. Without a shared social context of ethical values, assumptions, and understandings, business as we know it would be impossible.

The charitable answer to the questions raised above is that Carr and Friedman know that free enterprise can't long exist without ethics. They know that along with freedom goes responsibility, that with the freedom to do business goes the responsibility to be fair, trustworthy, and honest in business dealings. They know that without ethics, business would be reduced to economically inefficient adversarial relationships in which everyone spent most of their time and energy, not doing business, but trying to protect themselves from everyone else. They know this, but they worry that ethics requires more. They think that ethics places on businesspeople not ordinary or "customary" ethical demands such as being fair, telling the truth, and avoiding harm, but extraordinary ones. And they worry that these extraordinary demands would make it impossible to carry out everyday business transactions. Are they right?

The arguments they give, or rather the arguments I attributed to them, are not strong enough to show that they are right, but neither do my rebuttals show that they are wrong. It is possible that the demands of ethics are extraordinary, that they are too stringent for routine business operations. If that is so, then some big decisions need to be made. But to see whether this is so we need to know a lot more about what those demands are, and the only way to do that is to look and see – to study ethics in the context of business and arrive at rational and defensible conclusions about what it might require. And there is no better group to work on these issues than graduate and undergraduate students in business programs. It is they, after all, who will bear the brunt of implementing any conclusions reached about the role and requirements of ethics in business.

Business Ethics in the Business Curriculum

Dealing with ethical problems, like dealing with other sorts of problems, requires several steps. The first is recognizing something as an ethical problem. The second is deciding what to do about it. The third is resolving to do it; and finally, actually doing it. These steps are independent in the sense that the first can be done without the second, the second without the third, and the third without the fourth. Ethics in the business curriculum is useful for the first and second steps, much less so for third, and not much at all for the fourth. Consequently, as I see it, the goal of ethics in the business curriculum is primarily to help students recognize ethical problems and decide what ought to be done about them.

Ethical problems are often about conflicts or apparent conflicts among the rights, interests, and welfare of different individuals or groups. Recognizing these problems is not always as easy since they do not necessarily come with the familiar labels supplied by everyday moral experience. For example, in the business world recognizing an ethical problem requires an understanding of what is at stake for stakeholders when corporations are considering consequential actions. In a globalized economy, stakeholders may be far distant, have unfamiliar concerns, or require unusual interventions to respect their interests. The knowledge necessary to see what is at stake for them, to recognize what they believe to be their interests and welfare, may be hard to come by, difficult to comprehend, and awkward to employ. And even if corporate stakeholders are local and familiar, their interests are not always simple, nor are conflicts always apparent. The distance between the executive suite and the factory floor can be immense, as history abundantly shows. Getting students to understand all this, and to see how it all can be interrelated, is a vital first step in ethics education.

The second step is no less important. Even if one sees that there is a problem, what ought to be done about it, and on what basis the decision ought to be made, may be far from obvious. This is especially true if we abandon the idea that ethics doesn't apply in business, or that managerial responsibilities apply only to stockholders. For example, suppose the corporation decides that moving an operation overseas would save money, but at the cost of the jobs of many people. Since this decision will affect the welfare and/or rights of these people, what the decision ought to be, and on what grounds it ought to be made, are matters for ethical analysis. There is no other way as long as we take our ethical responsibilities seriously. How to begin to go about this is the second step in ethics education.

Does it work? Does ethics education help when it comes to actual decisions that need to be made and implemented in the real world of business? Sometimes it doesn't, as we know all too well. But consider the alternative: managers in an increasingly complex and globalized business world who have no formal training in either recognizing ethical problems or thinking about how to deal with them. This is a recipe for disaster, so we need to find a way to make it work, both for the sake of business and for the myriads of people whose lives are affected by business decisions. That is a main task of ethics in business school curriculums.

Notes

[1] Theodore Levitt, "The Dangers of Social Responsibility," *Harvard Business Review*, vol. 36, no. 5 (September–October 1958), p. 50.

[2] Michael E. Porter and Mark R. Kramer, "Creating Shared Value," *Harvard Business Review* (January–February 2011), pp. 62–77 at p. 66.

[3] Michael E. Porter and Mark R. Kramer, "Creating Shared Value," *Harvard Business Review* (January–February 2011), p. 62–77 at p. 64.

Commentary on the Social Responsibility of Corporate Entities

Bad and Not-so-Bad Arguments for Shareholder Primacy

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In 1932, the *Harvard Law Review* published a debate between two preeminent corporate scholars on the subject of the proper purpose of the public corporation. On one side stood the renowned Adolph A. Berle, coauthor of the classic *The Modern Corporation and Private Property*.[1] Berle argued for what is now called "shareholder primacy" – the view that the corporation exists only to make money for its shareholders.[2] According to Berle, "all powers granted to a corporation or to the management of a corporation, or to any group within the corporation … [are] at all times exercisable only for the ratable benefit of all the shareholders as their interest appears."[3]

On the other side of the debate stood esteemed Professor Merrick Dodd of Harvard Law School. Dodd disagreed vehemently with Berle's shareholder primacy thesis. He argued for "a view of the business corporation as an economic institution which has a social service as well as a profit-making function."[4] Dodd claimed that the proper purpose of the corporation (and the proper goal of corporate managers) was not confined to making money for shareholders. It also included more secure jobs for employees, better quality products for consumers, and greater contributions to the welfare of the community as a whole.

As can be seen from Delaware Vice Chancellor Leo E. Strine's essay in the preceding pages of this journal, the debate over the social role of the corporation remains unresolved.[5] Does the firm exist only to increase shareholder wealth (a view that Strine dubs the "property" theory)? Or, should managers also seek to serve the interests of employees, creditors, customers, and the broader society (the "entity" view)? [6] After reading Strine's account of the current state of scholarly disagreement, and a similar account in another article he has coauthored, forthcoming in the *University of Chicago Law Review*,[7] one might be tempted to throw up one's hands and conclude that academics have not lent much more insight into this question since the original Berle–Dodd debate.

In this essay, however, I would like to suggest that we have made at least some intellectual progress over the intervening decades on the question of the proper role of the corporation. In particular, we have learned that some of the most frequently raised arguments for shareholder primacy are, not to put too fine a point on it, bad arguments. By "bad" arguments, I do not mean arguments that are somehow morally offensive or normatively unattractive. Rather, I mean arguments that are, as a positive matter, inaccurate, incorrect, and unpersuasive to the careful and neutral observer.

I. The Shareholder Ownership Argument for Shareholder Primacy

Consider first what is probably the most common, and the worst, of the standard arguments for shareholder primacy. This is the argument – really, the naked assertion – that the public corporation "belongs" to its shareholders.[8] This assertion is frequently employed by commentators in the popular media and business press to justify shareholder primacy. A classic example can be found in Milton Friedman's famed 1970 essay in the *New York Times*, in which he argued that, because the shareholders of the corporation are "the owners of the business," the only "social responsibility of business is to increase its profits."[9]

Milton Friedman is a Nobel Prize-winning economist, but he obviously is not a lawyer. A lawyer would know that the shareholders do not, in fact, own the corporation. Rather, they own a type of corporate security commonly called "stock." As owners of stock, shareholders' rights are quite limited. For example, stockholders do not have the right to exercise control over the corporation's assets. The corporation's board of director's holds that right.[10] Similarly, shareholders do not have any right to help themselves to the firm's earnings; the only time they can receive any payment directly from the corporation's coffers is when they receive a dividend, which occurs only when the directors decide to declare one.[11] As a legal matter, shareholders accordingly enjoy neither direct control over the firm's assets nor direct access to them. Any influence they may have on the firm is indirect, through their influence on the board of directors. And (as Berle himself famously argued) in a public corporation with widely dispersed shareownership, shareholder influence over the board is often so diluted as to be negligible.[12] Thus, while it perhaps is excusable to loosely describe a closely held firm with a single controlling shareholder as "owned" by that shareholder, it is misleading to use the language of ownership to describe the relationship between a public firm and its shareholders.

From an intellectual perspective, matters have only gotten worse for the "ownership" argument in the years since Friedman published his essay. Three years after Friedman made his argument in the *New York Times*, Fischer Black and Myron Scholes published their famous paper on options pricing.[13] This work, which provides the foundation for modern options theory, demonstrates that it is not only misleading to say that dispersed shareholders "own" a public corporation, but that it is even questionable, from an economic perspective, to say that a single controlling shareholder "owns" a closely held firm after the firm has issued debt. Options theory teaches us that once a firm has issued debt (as almost all firms do), it makes just as much sense to say that the debtholders "own" the right to the corporation's cash flow but have sold a call option to the shareholder, as it does to say that the shareholder "owns" the right to the corporation's cash flow but has bought a put option from the debtholders.[14] Put differently, options theory demonstrates that bondholders and equity holders each share contingent control and bear residual risk in firms.

How, then, can one describe a publicly held corporation that has issued debt as being owned by its shareholders? The short answer is that one cannot – at least not if one is interested in accurately describing the legal and economic structure of the firm. From both a legal and an economic perspective, the claim that shareholders own the public corporation simply is empirically incorrect. The time has come to lead the "shareholder ownership" argument for shareholder primacy to the back of the barn, and to put it out of its misery.

II. The Residual Claimants Argument for Shareholder Primacy

Thus, I would like to turn to what is arguably the second most frequently raised, and the second worst, of the standard arguments for shareholder primacy. This is the argument (again, one might say the naked assertion) that while shareholders may not be the owners of the corporation, they are at least its sole residual claimants.

A classic example of the use of this argument can be found in the influential work of Frank Easterbrook and Daniel Fischel of the "Chicago School" of law and economic analysis.[15] Adopting the notion that the corporation can be thought of as a nexus of contracts between and among the shareholders of the firm and other corporate participants, Easterbrook and Fischel argue that the contracts entered into by nonshareholder groups such as employees, managers, and creditors are explicit contracts that entitle them to fixed payments, such as salaries and interest payments.[16] In contrast, shareholders rely on an implicit contract that entitles them to whatever remains after the firm has met its explicit obligations and paid its fixed claims.[17] Thus, Easterbrook and Fischel describe shareholders as the sole "residual claimants" and sole "residual risk bearers" in public firms,[18] and argue that in accord with shareholders' implicit "contractual" rights, firms should be run with an eye toward maximizing shareholder wealth.[19]

The idea that shareholders are the sole residual claimants in firms has had a tremendous influence on contemporary scholarly thought regarding the advantages of shareholder primacy.[20] Nevertheless, there remains a fundamental flaw in the residual claimants argument. Like the ownership argument, the residual claimants argument for shareholder primacy is a naked assertion, and an empirically incorrect one at that.[21]

To understand this point, it is essential to recognize that the only time that corporate law comes close to treating shareholders like residual claimants is when the firm *is actually in bankruptcy*.[22] When the firm is not in bankruptcy, it is grossly misleading to suggest that the firm's shareholders are somehow entitled to – much less actually expect to receive – everything left over after the firm's explicit contractual obligations have been met. To the contrary, corporate law allows shareholders to receive payments from firms only when two conditions are met. First, the firm must be doing well enough financially (must have enough retained earnings or enough profits) to permit the directors to declare a dividend.[23] Second, the directors must actually decide to declare a dividend.[24]

Neither contingency can be met unless the directors want it to be met. "Retained earnings" and "profits" are accounting concepts over which directors have considerable control, because both depend not only on the firm's earnings, but also on its expenses. If a firm is doing well in the product market, its directors have the option of allowing reported profits to increase. But they also have the option of using some or all of the firm's new wealth to raise managers' salaries, start an on-site childcare center, improve customer service, beef up retirees' pensions, or make donations to charity. Thus, even when the firm is making money hand-over-fist, it remains for the directors to decide whether and to what extent that wealth will show up in the financial statements in a form that can be paid out to shareholders. Also, even when a firm's balance sheet or earnings statement permits a dividend, directors are not required to declare one, and often they do not. It is standard operating practice among many U.S. firms to pay either small dividends or no dividends to shareholders, while retaining the lion's share of earnings for future projects. If this practice boosts stock prices, shareholders ultimately enjoy an economic benefit. That benefit, however, is indirect, and dependent on the board of directors' decisions. If the board decides to run the firm with an eye primarily to serving the interests of its executives, employees, or customers – or if they simply run it into the ground – shareholders' rights to sell their shares on the open market are of little value.

Accordingly, as a legal matter, shareholders of a public corporation are entitled to receive nothing from the firm *unless and until the board of directors decides that they should receive it*. Moreover, shareholders who become dissatisfied with the manner in which the board treats them have only limited practical ability to change things. A proxy battle to remove the board would be both expensive and unlikely to succeed. Similarly, while disgruntled shareholders can always hope that a takeover bidder will appear on the horizon to rescue them, takeovers are also expensive and uncertain, and rescue may come too late, if at all.

Consequently, it is grossly inaccurate as a positive matter to describe the shareholders of a public corporation as the "sole residual claimants" of a firm while that firm is a going concern. To the contrary, shareholders are only one of several groups that can be described as "residual claimants" or "residual risk bearers," in the sense that they expect to enjoy benefits (and sometimes to endure burdens) beyond those provided in their explicit contracts. When the firm is doing well, for example, employees receive raises and enjoy greater job security, managers get use of a company jet, and bondholders enjoy increased protection from corporate insolvency. Conversely, these groups suffer along with shareholders when times are bad, as employees face "reductions in force," managers are told to fly coach, and debtholders face increased risk. Directors use their control over the firm to reward many groups with larger slices of the corporate pie when that pie is growing, and to spread the loss among many when the pie is shrinking. A corollary to this reality is that we cannot rely on the empirically false claim that shareholders are the "sole residual claimants" of firms in order to justify shareholder primacy.

Of course, one might still argue that if shareholders are not in fact the sole residual claimants of most modern firms, that they ought to be. In other words, one might argue that while shareholders do not actually enjoy all the firm's wealth after its fixed claims have been paid, this is the very problem to be remedied by the rule of shareholder primacy. This argument treats shareholders' supposed status as sole residual claimants as a normative desideratum rather than as a positive description of the state of the world.

At this point, however, the argument for shareholder primacy becomes a tautology: corporate law *ought* to incorporate shareholder primacy (or so the argument goes) because shareholders *ought* to be the firm's sole residual claimants. This approach simply begs the fundamental question: if shareholders are not, in fact, the sole residual claimants of the public firm, why should we want them to be?

This is the question that lies at the heart of the Berle–Dodd debate, and the answer to it is not obvious. Below, I explore what may be the only good argument (meaning the only empirically sound and logically consistent argument) that can be advanced in favor of shareholder primacy. Yet to understand that argument, we must begin by considering an important argument against shareholder primacy. This is the argument based on the contracting problems associated with team production.[25]

III. The Team Production Argument Against Shareholder Primacy

Team production analysis of the corporation begins by recognizing that corporate production often requires inputs from a number of different groups. Shareholders alone cannot make a firm – creditors, employees, managers, and even local governments often must make contributions in order for an enterprise to succeed. Why do these groups make such contributions?

To some extent, nonshareholder groups participate in and contribute to corporations because they expect to be compensated in accordance to their explicit contracts. For example, employees work, in part, because they are entitled to wages. Yet as labor economists have long argued, in a world of complexity and uncertainty, nonshareholder groups often rely on implicit contracts as well. Thus, for example, junior executives or employees might expect that if they do good work and remain loyal to the firm, and if the firm does well, they will receive not only the wages specified in their contracts but also, eventually, raises, job security, and the prospect of promotion.

Why is this expectation not reduced to writing, to a formal contract? In brief, because the resulting document would be inches thick and would raise more problems than it solved. For example, how is a court to decide how much, exactly, employees' salaries should be raised in light of the firm's profits, or to judge reliably the quality and importance of their relative contributions?[26] Instead, employees, managers, creditors, and even governments often prefer to contribute to firms on the basis of bare-bones formal contracts or no formal contract at all, relying on the understanding that they will be treated considerately and allowed to share some of the bounty if the firm does well. What's more, it can be in the shareholders' interest to encourage such expectations, because those expectations encourage managers to be loyal, employees to be committed, creditors to be patient, and governments to be supportive.

This observation offers important insights into the nature of the relationship between shareholder and nonshareholder participants in corporations. First, it suggests how it is possible to increase the value of shareholders' economic interest in the firm (shareholders' supposedly "residual claim") without increasing the economic value of the firm itself. Put differently, a board of directors focused solely on shareholder wealth can often make shareholders better off by simply taking wealth from other corporate constituencies.

This possibility is nicely illustrated by Strine's hypothetical. Consider the dilemma faced by James Trains' board of directors. It can maximize shareholder wealth by selling the firm to the highest bidder – a bidder that would pink-slip James Train's executives, fire its rank-and-file employees, and shut down its manufacturing plants (built and maintained with the help of tax breaks and financing from state and local governments). Alternatively, for a slightly lower price, the board can sell James Trains to a reputable firm that would both keep the plants operational and retain most of the firm's employees. One cannot help but suspect that much of the additional wealth that would go into the shareholders' pockets if the firm were sold to the first bidder would be counterbalanced by monetary losses (not to mention nonmonetary losses) to the James Trains managers, employees, and the local community. Indeed, the one-time gains to the James Trains shareholders can easily be outweighed by the losses to other groups.[27]

Strine's hypothetical consequently demonstrates how a rule of shareholder primacy that requires the James Trains directors to sell to the highest bidder can be inefficient ex post. This potential for inefficiency becomes even greater when we consider the ex ante effects of such a rule. If the employees and managers of James Trains really believed that the firm's directors not only could sell, but were required to sell the company to the highest bidder whenever the board received an offer of even a penny above market price, would the firm's executives have been as willing to commit their careers to James Trains? Would the rank-and-file have made the same effort to acquire firm-specific skills? Would state and local governments have been so willing to provide tax breaks and financing? A priori, one cannot exclude the possibility (indeed, probability) that the answer to these questions is "no." In other words, as Margaret Blair and I have argued at length elsewhere, strict shareholder primacy of the sort described by Strine in his James Trains hypothetical may inefficiently discourage nonshareholder constituents from making the types of firm-specific investments that can be essential to a company's success.[28]

Once one takes account of the corporation's need for firm-specific investments by many groups, and of the difficulties of drafting complete contracts under conditions of complexity and uncertainty, one cannot avoid the conclusion that shareholder primacy easily can produce results that are inefficient from both ex post and ex ante perspectives. It also becomes clear that the ideal rule for corporate directors to follow is not to require them to focus solely on maximizing shareholders' current wealth. Rather, the ideal rule of corporate governance, at least from an efficiency perspective, is to require corporate directors to maximize the sum of all the risk-adjusted returns enjoyed by all of the groups that participate in firms.[29] These groups include not only shareholders, but also executives, employees, debtholders, and possibly even suppliers, consumers, and the broader community.

Because this ideal rule efficiently encourages firm-specific investment, it can be argued that it is consistent with shareholder primacy from an ex ante perspective. That is, it is in the best interests of shareholders as a class over the long run. But in the short run, it also allows directors discretion to refuse to maximize the wealth of the shareholders of a particular firm at a particular time in order to protect the extracontractual expectations of essential nonshareholder groups. For example, it allows the James Trains directors to refuse to sell to the highest bidder. Thus, shareholders as a class may be served best not by shareholder primacy, but by what Stephen Bainbridge has called "director primacy."[30]

The superior efficiency, at least in theory, of a corporate governance rule that allows directors to take account of the interests of all of the corporations' constituents is increasingly acknowledged both in corporate scholarship[31] and in corporate case law.[32] Nevertheless, it remains common practice for even sophisticated commentators to assume that shareholder primacy is somehow preferable. Why?

IV. Counterbalancing Team Production Concerns: The Agency Cost Argument for Shareholder Primacy

So we come to the third, and arguably the best, of the standard arguments for shareholder primacy. This argument begins by acknowledging that, in theory, the ideal rule for corporate governance is a rule that grants directors discretion to balance the interests of all the firm's constituents. But we do not live in an ideal world. Corporate directors are only human. Accordingly, they are imperfect agents. They worry not only about the interests of the firms to which they owe fiduciary duties, but also about their own interests. As a result, they may sometimes allow self-interest to prevail over duty, and shirk or even steal from the firm. Economists frequently refer to this problem as the problem of "agency costs."[33]

Agency costs can be reduced when one can monitor and measure an agent's performance. This need to measure and monitor agent performance provides the foundation for the best of the standard arguments for shareholder primacy. If we ask directors to consider the interests of all the firm's constituents, we are asking them to maximize the joint welfare function of happy consumers, secure employees, self-actualized managers, and wealthier shareholders. How are we to tell when they are doing a good job? Although it may be simple enough, at least in theory, to determine how directors' decisions affect the market price of the firm's stock and even some of its bonds, measuring the value of employee security, manager self-actualization, and consumer satisfaction (to give only a few examples) is far more difficult.

In contrast, it is easy to measure stock price. As a result, a shareholder primacy rule leaves directors with far less leeway to claim that they are doing a good job for the firm when, in fact, they are doing well mostly for themselves. As Mark Roe has put it, shareholder wealth maximization may be the best rule of corporate governance because "a stakeholder measure of managerial accountability could leave managers so much discretion that managers could easily pursue their own agenda, one that might maximize neither shareholder, employee, consumer, nor national wealth, but only their own."[34]

So we have learned in the decades following the Berle–Dodd debate that the issue really boils down to this: which is worse? To require directors to maximize shareholder wealth, even in cases, like Strine's James Trains, where shareholder wealth maximization is inefficient? Or to allow directors to look at the interests of nonshareholder "stakeholders," recognizing that they may use their enhanced discretion to serve themselves? Put differently, the best argument for shareholder primacy does not rest on its benefits for shareholders alone. Rather, it rests on the notion that shareholder primacy is a second-best solution that is good for *all* the stakeholders in the firm, because it limits what might otherwise be the runaway agency costs that might be incurred by *all* if directors were not held to a clear and easily observed metric of good corporate governance.

In this short essay, I do not attempt to address which of these two economic evils – increased agency costs from a rule of director primacy or the ex post and ex ante inefficiencies that flow from shareholder primacy – is worse. Instead, I point out that the question ultimately cannot be answered *except on the basis of empirical evidence*. Before we know whether social wealth is best promoted by a rule of shareholder primacy or a rule that allows directors discretion to consider other stakeholders, we must actually know the costs and the benefits that flow from each rule. We must somehow measure and weigh such matters as the importance of firm-specific human capital, the incompleteness of formal contracts, the value of a good corporate "reputation," and the risks of director self–interest. Put differently, the Berle–Dodd debate cannot be resolved by armchair theorizing.

V. Some Empirical Evidence: Which Rule Do Lawmakers, Managers, and Shareholders Actually Choose?

How, then, might it be resolved? Where can we search for empirical evidence on the question of whether shareholder primacy (the property model) or director primacy (the entity model) is the best approach to corporate governance?

For now, at least, I doubt that academics can provide a definitive answer. Whether the social losses from shareholder primacy outweigh the social losses from allowing greater director discretion is an extraordinarily complex question. Moreover, the answer is likely to vary from firm to firm and from one historical period to another. Case studies, and even large longitudinal studies, may be of limited value.

There is, however, another potential source of evidence to consider. This is the collective opinion of the business world itself – the opinion of the executives, directors, shareholders, and employees who actually participate in corporations, as well as the opinion of the judges and legislators who regulate them. These are the people in the trenches, the ones who experience business life as a day-to-day reality, or at least directly observe how America does business. They are also the people (as Strine reminds us) who are faced with the necessity of choosing between strategies and rules that favor shareholders, and strategies and rules that favor a broader range of corporate constituencies.[35] While academics debate the relative merits of the property and the entity theory, businesspeople must actually choose between them, and must live with the consequences if they do not choose wisely.

Which approach do they choose? If we focus only on rhetoric, the answer is not clear. At different times and at different places, lawmakers and business leaders can be found giving lip service to both shareholder primacy and the need to consider stakeholder interests.[36]

Thus, it may be more useful to focus on actual behavior – what economists call "revealed preferences" – to discern the business world's beliefs about the relative merits of shareholder versus director primacy. If one adopts this approach, an interesting pattern emerges. It appears that when forced to choose, managers and shareholders alike – as well as most judges and legislators – generally opt for rules that favor director primacy over rules that favor shareholder primacy. In other words, the business world itself seems to favor the entity model.

As an example of this behavioral pattern, let us consider first the choices of lawmakers and, in particular, the choices (as opposed to the rhetoric) of the Delaware judges whose decisions affect half of all publicly traded companies.[37] As Strine observes, Delaware case law generally follows the entity model.[38] For example, Delaware gives directors free rein to pursue strategies that reduce shareholder wealth while benefiting other constituencies.[39] Thus, directors can use earnings to raise employees' wages rather than to declare a dividend; they can "reprice" executive stock options even when share prices are falling; they can retroactively increase retirees' pension benefits; and they can donate corporate funds to charity.[40]

Such discretion seems inconsistent (to put it mildly) with shareholder wealth maximization, at least if we are focusing on the wealth of the shareholders who own stock in that particular firm at that particular time. Nevertheless, corporate law in Delaware, like corporate law elsewhere, generally allows directors to redirect wealth from shareholders to other stakeholders. In the process, courts sometimes employ the language of shareholder primacy, suggesting that actions that appear to reduce current shareholder wealth might nevertheless offer some hope of a long-run shareholder benefit.[41] Such rhetoric may reflect what has been described as judicial "elision" – the tendency for courts to blur distinctions between contradictory ideas in order to decide cases while avoiding broad issues of public policy.[42] Alternatively, it may reflect an intuitive recognition of the team production problem and the possibility that allowing directors discretion to consider the interests of stakeholder groups can encourage firm-specific investment, and so be in the ex ante interests of shareholders as a class, even if not always in the ex post interests of the shareholders of a particular firm.[43] Whatever the explanation, the rhetoric does not change the reality. The courts have chosen between the property and the entity models of the public firm, and they have opted for the latter.

There is, of course, one notable exception to this rule – the case of *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*[44] (It is no coincidence that, in his hypothetical, Strine has chosen a situation similar to that in Revlon to illustrate the supposed clash between the property and the entity approaches in Delaware law.) In Revlon, the Delaware Supreme Court held that in an "end-game" situation where the directors of a publicly traded firm had decided to sell the firm to a company with a controlling shareholder – in brief, had decided to turn their publicly held company into a privately held one – the board had a duty to maximize shareholder wealth by getting the best possible price for the firm's shares.[45] Revlon thus defines the one context in which Delaware law mandates shareholder primacy.

This is a very limited context, however. Subsequent Delaware cases have dramatically reduced *Revlon*'s significance by making clear that if the directors of the firm decide not to sell, or if they prefer a stock-for-stock exchange with another public firm, *Revlon* is irrelevant.[46] Accordingly, directors can avoid Revlon duties when they want to.[47] All this suggests that *Revlon* may prove to be an evolutionary dead end in corporate law, doctrinal deadwood that the courts have already pruned back and, eventually, may remove entirely.

The end result is that, if we judge their beliefs from their behavior, Delaware courts seem to have come down rather firmly on Dodd's side of the Berle–Dodd debate. This is even more true in the case of legislatures asked to address the merits of shareholder primacy. Although Delaware pruned back Revlon by case law rather than by statute, in the wake of Revlon, over thirty other states have passed "constituency" laws that expressly permit corporate directors to sacrifice shareholders' interests to serve other stakeholders.[48] As a group, lawmakers seem to have a rather strong revealed preference for the entity model.

Of course, one might argue that lawmakers' revealed preferences are suspect. For example, a shareholder primacy advocate might assert that even if Delaware judges are renowned for their sophistication and knowledge of corporate matters, they still fail to choose socially optimal corporate rules because they are subject to interest group pressures and other influences that lead them to favor unduly the interests of corporate managers or corporate lawyers (the so-called "race to the bottom" thesis).[49] Thus, in addition to considering the revealed preferences of lawmakers, it is perhaps more useful to consider the revealed preferences of corporate promoters and of shareholders themselves.

In assessing these preferences, it is important to distinguish between what the shareholders of a particular firm might favor ex post, and what shareholders as a class seem to prefer ex ante. In an ex post situation, such as Strine's James Trains hypothetical, one should not be surprised to hear at least some shareholders clamor for shareholder primacy. At this point in the game, many nonshareholder constituents – including, most obviously, the firm's employees and managers – have already made the firm-specific investments that promote efficient team production. Shareholders accordingly may be tempted to exploit those investments opportunistically and to line their own pockets at the expense of other stakeholders.[50] Thus, once a firm is a going proposition, it is only to be expected that shareholders might sometimes adopt the position that maximizing shareholder wealth is the only proper goal of corporate governance.[51]

But a team production analysis of the corporation suggests that this sort of approach can be counterproductive if adopted by shareholders ex ante, when the corporation is being formed. When the corporate "contract" is first negotiated, equity investors may have a strong interest in inducing managers, employees, creditors, and even governments to commit resources to corporate production – resources that may be neither easy to recover once invested nor easy to protect by explicit contracts. One way to do this may be to place control of the firm not in the hands of the shareholders themselves, but in the hands of a board of directors that is charged with looking out for the interests of all the firm's stakeholders. Thus, director primacy may be a means for shareholders to benefit themselves by "tying their own hands" in a fashion that encourages firm-specific investments from other corporate stakeholders.[52]

If this analysis is correct, we can expect to see shareholders display a revealed preference for rules that promote director primacy at early stages of a firm's development. Indeed, there is considerable evidence to suggest they do. Recent studies have concluded that states that promote director primacy by providing incumbent boards of directors with relatively strong protections against hostile takeover bids, such as Delaware, are more successful both in attracting new incorporations and in retaining the incorporations of existing firms. In contrast, firms seem to avoid incorporating or reincorporating in states with a strong shareholder primacy bias, such as California.[53]

Similarly, another recent study has concluded that a majority of a sample of firms that have "gone public" in recent years amended their corporate charters before doing so in order to add additional antitakeover protections (for example, a classified board system).[54] This finding is almost impossible to reconcile with the claim that shareholder primacy is efficient. After all, if investors believed that the increase in agency costs associated with greater director protection from takeovers outweighed the benefits of such autonomy in terms of encouraging team production, they presumably would be less willing to buy the firm's shares. Knowing this, the firm's founders should be reluctant to adopt antitakeover provisions. Put differently, at the IPO stage when the corporation's promoters are actually "negotiating" the corporate contract with outside investors, they should have a strong preference for efficient (wealth-maximizing) rules. It would seem that both shareholders and promoters prefer director primacy.

This conclusion is bolstered by a final and related observation: Delaware corporate law, like most corporate law, is an enabling system. This means that most of the rules provided by Delaware are default rules that corporate promoters are free to modify through charter and bylaw provisions. Thus, there is nothing to prevent a promoter who thinks that shareholders actually want shareholder primacy from providing in the firm's articles of incorporation that *Revlon* duties apply to all the board's decisions, not just to cash-out mergers. Put more bluntly, there is nothing to stop corporate promoters from expressly providing for shareholder wealth maximization as a corporate goal in the firm's charter. [55]

If shareholders really valued shareholder primacy rules, one would think at least a few promoters might have thought of inserting such provisions in the corporate charter at the IPO stage. However, I have never heard of, much less seen, such a charter provision. I suspect the reason may be that promoters and investors alike understand that if the firm did mandate shareholder primacy in its charter, it would find it far more difficult to attract qualified, motivated, and loyal employees, managers, and even creditors. Perhaps this suspicion is incorrect – perhaps firms that go public do not put shareholder primacy provisions into their charters simply because it has never occurred to anyone that there might be value in doing so. But if shareholder primacy is indeed clearly the optimal rule of corporate governance, as many academics believe, it seems curious that corporate participants, including shareholders themselves, have overlooked this possibility.

This is not to suggest that such observations alone provide proof that shareholder primacy is inefficient. More work remains to be done before one can reach a sound empirical conclusion about whether the agency costs associated with director primacy are greater or less than the cost of lost opportunities for team production that flow from a shareholder primacy regime. But at a minimum, the findings – that firms seem to prefer to incorporate in states with relatively strong antitakeover laws, that they often insert antitakeover provisions into their charters when going public, and that charter provisions mandating shareholder primacy are notably missing – ought to be enough to make careful and dispassionate observers suspicious. The claim that shareholder primacy is needed to control agency costs is clearly a better argument for the property model of the corporation than either the shareholder ownership argument or the residual claimants argument. Still, without some evidence that shareholders themselves desire shareholder primacy – not only ex post when they can extract wealth from other corporate stakeholders, but also ex ante when they need stakeholders cooperation and investment – it is perhaps a bit of a reach to describe the agency cost argument as a truly "good" argument for shareholder primacy. "Not-so-bad" may be a more precise description.

VI. Conclusion

Since the days of Berle and Dodd, scholars, commentators, lawmakers, and businesspeople have debated the purpose of the corporation. Does it exist only to create wealth for shareholders (the property model)? Or does good corporate governance demand that a firm's board of directors also consider the interests of other stakeholders, including managers, employees, creditors, and the broader society (the entity model)?

If the debate remains unresolved, at least there has been some progress in our understanding of it. In particular, we have learned that two of the most commonly advanced arguments for shareholder primacy – the argument that the shareholders "own" the firm and the argument that shareholders are the firm's sole residual claimants – are bad arguments, in the sense that they are built on empirical claims that are demonstrably false. There is a third argument for shareholder primacy that is much more reasonable. This is the argument that shareholder primacy is necessary to protect not just shareholders, but *all* the firm's stakeholders, by reducing the runaway agency costs that would be incurred if corporate directors were invited to consider the interests of both shareholders and other stakeholders as well. Put differently, shareholders and stakeholders alike are thought to be made better off by a rule that prevents directors from pursuing strategies that reduce share price whenever this can be rationalized as somehow serving the often – intangible interests of other constituencies.

There is one rather awkward and rather significant difficulty with this argument, however. Corporate law, in fact, *does* allow directors to pursue strategies that reduce share price whenever this can be rationalized as somehow serving the often-intangible interests of other constituencies. Put differently, outside the limited context of Revlon, corporate law follows the entity model. Moreover, both corporate managers and shareholders show little interest in departing from that model, even though the enabling nature of corporate law allows them to do so.

Berle himself eventually recognized this reality of modern business life.[56] More than two decades after he first crossed words with the Harvard professor, Berle published *The 20th Century Capitalist Revolution*.[57] In that book, Berle observed that corporate law had evolved in a direction that allowed directors almost total discretion over how to use corporate assets, including even giving them away to charity. He then offered his own view of the outcome of the Berle–Dodd debate:

> Twenty years ago, the writer had a controversy with the late Professor E. Merrick Dodd, of Harvard Law School, the writer holding that corporate powers were powers in trust for shareholders while Professor Dodd argued that these powers were held in trust for the entire community. The argument has been settled (at least for the time being) squarely in favor of Professor Dodd's contention.[58]

Half a century after Berle's concession, academics continue to argue the merits of the property versus the entity model of the firm. The business world continues to prefer the entity model of the firm.

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Notes

1 Adolph A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* (Harvest Books, 1968) (1932).

2 See generally D. Gordon Smith, The Shareholder Primacy Norm, 23 *J. Corp. L.* 277 (1998).

3 Adolph A. Berle, Corporate Powers as Powers in Trust, 44 *Harv. L. Rev.* 1049, 1049 (1931).

4 E. Merrick Dodd, For Whom Are Corporate Managers Trustees?, 45 *Harv. L. Rev.* 1145, 1148 (1932).

5 See Leo E, Strine, Jr., The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is There Any "There" There?, 75 S. *Cal. L. Rev.* 1169, 1170–73 (2002).

6 See William T. Allen, Our Schizophrenic Conception of the Business Corporation, 14 *Cardozo L. Rev*. 261, 264–66 (1992) (discussing property-entity debate).

7 William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., The Great Takeover Debate;A Mediation on Bridging the Conceptual Divide, *U. Chi. L. Rev*. (forthcoming 2002).

8 Although shareholder "ownership" language appears most often as a rhetorical device in the popular press, the assertion that shareholders own the firm also crops up even in contemporary corporate cases and commentary. See, e.g., *Malone* v. *Brincat*, 722 A.2d 5, 10 (Del. 1998) ("The board of directors has the legal responsibility to manage the business of a corporation for the benefit of its shareholder owners."); Lewis D. Solomon, Donald E. Shwartz, Jeffrey D. Bauman, & Elliott J. Weiss, *Corporations: Law and Policy, Cases and Materials 348* (4th ed. 1998) (observing that "shareholders are considered to be the corporation's ultimate owners").

9 Milton Friedman, The Social Responsibility of Business Is to Increase Its Profits, *N.Y. Times Mag*., Sept. 13, 1970, at 32–33, 122–26.

10 Del. Code Ann. tit. 8, 141(a) (2001).

11 Id. at 170(a).

12 Berle & Means, supra note 1, at 78–84,To some extent, the development of the hostile takeover has given public shareholders more power than they enjoyed in Berle's day because they can now sell en masse to a hostile bidder who can overcome the collective action problems faced by dispersed shareholders and can oust the board of directors. Given the expense and uncertainty associated with hostile takeover attempts, however, this remedy is likely to be effective only in extreme cases, leaving directors at most firms a great degree of leeway in pursuing goals other than shareholder wealth. See infra text accompanying notes 22–25.

13 Fischer Black & Myron Scholes, The Pricing of Options and Corporate Liabilities, 81*J. Pol. Econ*. 637 (1973). Myron Scholes subsequently was awarded a Nobel Prize in Economics based on his work in this paper.

14 See Margaret M. Blair & Lynn A. Stout, Director Accountability and the Mediating Role of the Corporate Board, 79 *Wash. U. L.Q.* 403, 411–14 (2001) (describing implications of options theory for ownership arguments).

15 See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* 36–39 (1991).

16 Id. at 36.

17 Id.

18 Id. at 36–37.

19 Id. at 36 ("For most firms the expectation is that the residual risk bearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock.").

20 See, e.g., Peter Coy, High Turnover, High Risk, *Bus. Wk.*, Apr. 11, 2002, at 24 ("Professors teach that in exchange for supplying companies with capital, shareholders are entitled to receive all of a corporation's wealth in excess of what's paid out to contractual claimants – a group that includes customers, bondholders, and salaried employees.").

21 See id. (noting that "theory doesn't match reality").

22 There are reasons to doubt whether shareholders are treated as residual claimants even then. See Blair & Stout, supra note 14, at 417 note 29 (discussing shareholder rights in bankruptcy).

23 See Del. Code Ann. tit. 8, Sec. 170(a) 2001 (describing circumstances under which directors of corporations may declare dividends).

24 See id.

25 See generally Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 *Va. L. Rev*. 247 (1999) (discussing team productions and its implications for corporate governance). See also Blair & Stout, supra note 14, at 418–22 (discussing team production problem).

26 To put the problem in economic terms, contracting is difficult whenever corporate production requires different parties to make contributions that become team specific (meaning that after the resources have been invested in team production, their value cannot

be recovered easily except by waiting to share in the resulting profits) and whenever the output is nonseparable (meaning that it is impossible to determine exactly what portion of the output is attributable to which party's contribution). Consider the example of an entrepreneur and an investor who want to start a joint venture in which the investor provides financial capital and the entrepreneur contributes managerial skills. If the entrepreneur acquires knowledge, skills, and business contacts that are uniquely valuable to the joint venture, she will not be able to recover this investment in team-specific "human capital" by leaving and going to work for another employer. Similarly, after the investor's funds have been spent on salaries or specialized equipment, he cannot simply demand his money back. Thus both team members must wait until the venture turns a profit to recoup their investments. Furthermore, how are they to contract over how that profit will be shared? If they agree ex ante to share the wealth equally, this creates incentives for shirking. In the alternative, if they wait until the venture is a success to decide who gets what portion of the credit and the profits, they are likely to indulge in wasteful squabbling and "rent-seeking." See Blair & Stout, supra note 14, at 420 (discussing this contracting problem); Blair & Stout, supra note 25, at 418–22 (discussing same).

[27] For example, suppose James Trains has encouraged its managers and employees to invest in firm-specific human capital through an informal understanding that so long as the firm is doing well, they will be paid a wage premium of ten percent over what they could expect to earn if forced to abandon their firm-specific investment by seeking employment elsewhere. Assume that the firm has annual sales of $120,000 and pays annual wages totaling $110,000, that wages are the firm's only expense, that annual profits accordingly are $10,000, and that these profits are paid out to shareholders in the form of dividends. If a takeover bidder were to purchase the firm and then renege on the implicit understanding that the firm's employees are to be paid for their firm-specific human capital (which is valueless elsewhere), such an acquirer would be able to reduce or even eliminate the wage premium, bringing annual wage expense down from $110,000 to as low as $100,000. The result would be to double the shareholders' total annual dividend payments from $10,000 to $20,000, and also to double the value of the shareholders stock. This 100% increase in value – much larger than the premium suggested by Strine in his hypothetical – reflects not real wealth gains, but a pure wealth transfer from employees to shareholders. If the shareholders were to sell for less than a 100% premium, the end result would be that their gains are outweighed by the employees' losses.

[28] See Blair & Stout, supra note 25, at 305.

[29] More particularly, from a purely ex post perspective, the most efficient rule would be to require directors to maximize aggregate social wealth, including the wealth of groups that do not make firm-specific investments. From an ex ante team production perspective, the most efficient rule would be the one that does the best job of encouraging efficient investment in team production despite incomplete contracts.

[30] See Stephen P. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, *Nw. U. L. Rev.,* (forthcoming 2003) (discussing how directors and not shareholders control firms). It should be noted that there are justifications for director primacy other than team production, including justifications that are consistent with shareholder wealth maximization as the normative goal of corporate governance. For example, if the stock market does not always accurately price shares, giving directors discretion to turn down a premium offer may serve shareholders' long run interest when directors can recognize that an offering price is "too low" and shareholders cannot. See id. (discussing how director primacy allows directors to hire corporate factors of production in pursuit of goal of shareholder wealth maximization).

[31] See Blair & Stout, supra note 25, at 253; G. Mitu Gulati, William A. Klein & Eric M. Zolt, Connected Contracts, 47 *UCLA L. Rev.* 887, 895 (2000); Frank Partnoy, Adding Derivatives to the Corporate Law Mix, 34 *Ga. L. Rev.* 599, 600, 612–16 (2000); Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers, in Corporate Takeovers: Causes and Consequences* 33, 37–41 (Alan J. Auerbach ed., 1988); Thomas A. Smith, The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty, 98 *Mich. L. Rev.* 214, 218–20 (1999).

[32] For a sophisticated and instructive example, see *Credit Lyonnais Bank Nederland, N.V.* v. *Pathe Communications Corp.*, 17 *Del. J. Corp. L.* 1099, 1155–56 (1991), concerning the economic efficiency of allowing directors to take account of debtholders' interests.

[33] It should be noted that the observation that directors are imperfect agents incorporates both the possibility that directors can be imperfect agents for shareholders (the primary focus of those who adopt the property view of the firm) and the possibility that directors can be imperfect agents for the "firm," envisioned as an agglomeration of all the corporation's constituents (the entity view).

[34] Mark J. Roe, The Shareholder Wealth Maximization Norm and Industrial Organization, 149 *U. Pa. L. Rev.* 2063, 2065 (2001).

[35] See Strine, supra note 5, at 5.

[36] Compare *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) (noting that "a business corporation is organized and carried on primarily for the good profit of the stockholders") and Richard Egan, The Corporation's Responsibility to the Community, *NYSE Mag.*, Jan./Feb., 2002, at 40 (observing that "the company that serves its community best is the one that serves its shareholders first.") with *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (stating that among the concerns directors may consider in managing the firm is "the impact on "constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)") and Jorma Ollila, The Business of Being Responsible, *NYSE Mag.*, Jan./Feb., 2002, at 34 ("Global issues of environment, health, diversity and human rights once at the periphery of management decisionmaking are fast becoming central… .The clear message from rising stakeholder expectations is that companies must contribute more.").

[37] Guhan Subramanian, The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching, 150 *U. Pa. L. Rev.* 1795, 1801 (2002).

[38] Strine, supra note 5, at 1176 (stating that except when a publicly held firm is going to be merged with another private firm and acquire a controlling shareholder, "the entity model prevails"). See also Allen et al., supra note 7, at 21 ("Delaware law inclines toward the entity model").

[39] See *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989) (finding that "a board of directors … is not under any per se duty to maximize shareholder value").

[40] See Smith, supra note 2, at 279–80 (stating that "the shareholder primacy norm is nearly irrelevant to the ordinary business decisions of modern corporations… . Outside the takeover context…, application of the shareholder primacy norm … is muted by the business judgment rule").

[41] See *Shlenskv v., Wrigley,* 237 N.E.2d 776, 780 (III. App. Ct. 1968) (upholding directors' decisions that plaintiff alleged were harmful to shareholders, speculating that they might be in "long run" interests of firm); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) ("A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.").

[42] Allen, et al., supra note 7, at 6–7 (describing judicial elision between entity and property models of corporations).

[43] See supra text accompanying notes 26–32 (discussing benefits of team production).

[44] Revlon, 506 A.2d at 173.

[45] See Revlon, 506 A.2d at 185.

[46] See, e.g., *Paramount Communications, Inc.* v. *Time, Inc.*, 571 A.2d 1140, 1149–51 (Del. 1989).

[47] For example, it is only because the James Train directors are considering a "cash out" merger that they have to worry about Revlon at all. Indeed, it is not uncontestably clear that Revlon would apply even in that situation. Recognizing as much, Strine has directed us to assume for the sake of the discussion that Revlon does apply. See Strine, supra note 5, at 5.

[48] See Subramanian, supra note 37, at 30 tbl.4 (listing thirty-one states as having passed other-constituency statutes).

[49] See Lucian Bebchuk, Alma Cohen & Allen Ferrell, Does the Evidence Favor State Competition in Corporate Law, *Ca. L. Rev.* (forthcoming 2002) (manuscript at 1–4, on file with author) (describing "race-to-the-bottom" thesis); Subramanian, supra note 37, at 8–10 (same).

[50] See supra note 27 (providing example of this).

[51] Similarly, it should not be surprising to find, as some studies have, that the adoption of antitakeover laws sometimes decreases the stock prices of firms incorporated in the state that adopts them, See Subramanian, supra note 37, at 31–33 (discussing studies of stock market reaction to antitakeover statutes). When a legislature imposes an antitakeover law on a corporation "mid-stream," it is changing the rules in the middle of the game. At that point, increasing director autonomy may not do much to encourage team production (for example, it may not do much to encourage human capital investment in firms where managers and employees made that decision years ago). Antitakeover laws may, however, work an immediate transfer of wealth from shareholders to other stakeholders, by providing the latter with even greater protection from shareholder demands than they expected to enjoy.

[52] See Blair & Stout, supra note 25, at 273–87 (describing value of director primacy rules that allow board to serve as "mediating hierarch" of the firm).

[53] See, e.g., Lucian Bebchuk & Alma Cohen, Olin Center, Firms' Decisions Where to Incorporate 10–11 (Feb., 2002) (unpublished manuscript, on file with The Southern California Law School); Bebchuk, Cohen &

Ferrell, supra note 49, at 34–40; Subramanian, supra note 37, at 52–53.

[54] See Robert Daines & Michael Klausner, Do IPO Charters Maximize FirmValue? Antitakeover Protection in IPOs, 17 *J.L. Econ. & Org.* 83, 95–97 (2001).

[55] See Del. Code Ann. tit. 8, 102(b) (2001) (allowing firms to include in their charters "any provision for the management of the business," including "any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders").

[56] Indeed, as Jack Treynor has pointed out, despite the impression given by his argument in the *Harvard Law Review*, Berle's contemporaneous writings with Gardiner Means gave a far more agnostic view of whether the shareholder primacy view could or should eventually prevail in the modern corporation. Jack L. Treynor, Samizdat: The Value of Control, *Fin. Analysts J.* 6 (July-Aug. 1993),

[57] Adolphe A. Berle, *The 20th Century Capitalist Revolution* (1954).

[58] Id. at 169.

Questions for Discussion

1. Goodpaster and Matthews assert that the market (invisible hand) and government (hand of the government) views of the corporation are conceptually similar. In what way are they conceptually similar, if at all? How does their "hand of management" view differ? In what respects are corporations and people similar? Dissimilar?
2. Carr argues that businesspeople must make "impersonal" business decisions. What does it mean to say that a decision is impersonal? Why must business decisions be impersonal? Is it really possible for business decisions to be impersonal, or is an impersonal decision no more than one in which the interests of some persons are given priority over the interests of others?
3. Friedman says that managers are responsible only to stockholders. How do such responsibilities arise? Under what conditions are they fulfilled, or not fulfilled as the case may be? Under what conditions might they change, or might managers have responsibilities to other groups?
4. Frederick claims that the first rule of business ethics is essentially "do no unjustified harm." When might a business be justified in inflicting harm? When would it not be justified? What should it do if harm is inflicted? How might the practice of business change if this rule were strictly followed?
5. Stakeholders, according to Freeman, are groups, such as employees, that bear a certain kind of relationship to the firm. What is the nature of this relationship? What is it about the relationship that creates moral obligations on the part of the firm? Is the relationship reciprocal, i.e. do stakeholders have obligations to the firm as well? If so, what are they?
6. If it is misleading, as Stout says, to claim that stockholders own the firm, then who does own the firm? What is implied by the concept of ownership? Does the concept really apply to modern multinational corporations such as General Electric or Exxon?

4

Corporate Governance and Accountability

Who Rules the Corporation?

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Ralph Nader, Mark Green, and Joel Seligman. "Who Rules the Corporation?" Excerpted from Ralph Nader, Mark Green, and Joel Seligman, *Taming the Giant Corporation* (New York: W. W. Norton & Co., 1976). Reprinted with permission of the Center for the Study of Responsive Law.

All modern state corporation statutes describe a common image of corporate governance, an image pyramidal in form. At the base of the pyramid are the shareholders or owners of the corporation. Their ownership gives them the right to elect representatives to direct the corporation and to approve fundamental corporate actions such as mergers or bylaw amendments. The intermediate level is held by the board of directors, who are required by a provision common to nearly every state corporation law "to manage the business and affairs of the corporation." On behalf of the shareholders, the directors are expected to select and dismiss corporate officers; to approve important financial decisions; to distribute profits; and to see that accurate periodic reports are forwarded to the shareholders. Finally, at the apex of the pyramid are the corporate officers. In the eyes of the law, the officers are the employees of the shareholder owners. Their authority is limited to those responsibilities which the directors delegate to them.

In reality, this legal image is virtually a myth. In nearly every large American business corporation, there exists a management autocracy. One man – variously titled the President, or the Chairman of the Board, or the Chief Executive Officer – or a small coterie of men rule the corporation. Far from being chosen by the directors to run the corporation, this chief executive or executive clique chooses the board

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of directors and, with the acquiescence of the board, controls the corporation.

The common theme of many instances of mismanagement is a failure to restrain the power of these senior executives. A corporate chief executive's decisions to expand, merge, or even violate the law can often be made without accountability to outside scrutiny. There is, for example, the detailed disclosures of the recent bribery cases. Not only do these reports suggest how widespread corporate foreign and domestic criminality has become; they also provide a unique study in the pathology of American corporate management.

At Gulf Corporation, three successive chief executive officers were able to pay out over $12.6 million in foreign and domestic bribes over a 15-year period without the knowledge of "outside" or non-employee directors on the board. At Northrop, chairman Thomas V. Jones and vice president James Allen were able to create and fund the Economic and Development Corporation, a separate Swiss company, and pay $750,000 to Dr. Hubert Weisbrod, a Swiss attorney, to stimulate West German jet sales without the knowledge of the board or, apparently, other senior executives. At 3M, chairman Bert Cross and finances vice president Irwin Hansen ordered the company insurance department to pay out $509,000 for imaginary insurance and the bookkeeper to fraudulently record the payments as a "necessary and proper" business expense for tax purposes. Ashland Oil Corporation's chief executive officer, Orwin E. Atkins, involved at least eight executives in illegally generating and distributing $801,165 in domestic political contributions, also without question.

The legal basis for such a consolidation of power in the hands of the corporation's chief executive is the proxy election. Annually the shareholders of each publicly held corporation are given the opportunity of either attending a meeting to nominate and elect directors or returning proxy cards to management or its challengers signing over their right to vote. Few shareholders personally attend meetings. Sylvan Silver, a Reuters correspondent who covers over 100 Wilmington annual meetings each year, described representative 1974 meetings in an interview: At Cities Service Company, the 77th largest industrial corporation with some 135,000 shareholders, 25 shareholders actually attended the meeting; EI Paso Natural Gas with 125,000 shareholders had 50 shareholders; at Coca Cola, the 69th largest corporation with 70,000 shareholders, 25 shareholders attended the annual meeting; at Bristol Meyers with 60,000 shareholders a like 25 shareholders appeared. Even "Campaign GM," the most publicized shareholder challenge of the past two decades, attracted no more than 3,000 of General Motors' 1,400,000 shareholders, or roughly two-tenths of one percent.

Thus, corporate directors are almost invariably chosen by written proxies. Yet management so totally dominates the proxy machinery that corporate elections have come to resemble the Soviet Union's euphemistic "Communist ballot" – that is, a ballot which lists only one slate of candidates. Although federal and state laws require the annual performance of an elaborate series of rituals pretending there is "corporate democracy," in 1973, 99.7 percent of the directorial elections in our largest corporations were uncontested.

The Best Democracy Money Can Buy

The key to management's hegemony is money. Effectively, only incumbent management can nominate directors – because it has a nearly unlimited power to use corporate funds to win board elections while opponents must prepare separate proxies and campaign literature entirely at their own expense.

There is first management's power to print and post written communications to shareholders. In a typical proxy contest, management will "follow up" its initial proxy solicitation with a bombardment of five to ten subsequent mailings. As attorneys Edward Aranow and Herb Einhorn explain in their treatise, *Proxy Contests for Corporate Control*:

> Perhaps the most important aspect of the follow up letter is its role in the all-important efforts of a soliciting group to secure the *latest-dated* proxy from a stockholder. It is characteristic of every proxy contest that a large number of stockholders will sign and return proxies to one faction and then change their minds and want to have their stock used for the opposing faction.

The techniques of the Northern States Power Company in 1973 are illustrative. At that time, Northern States Power Company voluntarily employed cumulative voting, which meant that only 7.2 percent of outstanding shares was necessary to elect one director to Northern's 14-person board. Troubled by Northern's record on environmental and consumer issues, a broadly based coalition of public interest groups called the Citizens' Advocate for Public Utility Responsibility (CAPUR) nominated Ms. Alpha Snaby, a former Minnesota state legislator, to run for director. These groups then successfully solicited the votes of over 14 percent of all shareholders, or more than twice the votes necessary to elect her to the board.

Northern States then bought back the election. By soliciting proxies a second, and then a third time, the Power Company was able to persuade (or confuse) the shareholders of 71 percent of the 2.8 million shares cast for Ms. Snaby to change their votes.

Larger, more experienced corporations are usually less heavyhanded. Typically, they will begin a proxy campaign with a series of "buildup" letters preliminary to the first proxy solicitation. In Campaign GM, General Motors elevated this strategy to a new plateau by encasing the Project on Corporate Responsibility's single 100-word proxy solicitation within a 21-page booklet specifically rebutting each of the Project's charges. The Project, of course, could never afford to respond to GM's campaign. The postage costs of soliciting GM's 1,400,000 shareholders alone would have exceeded $100,000. The cost of printing a document comparable to GM's 21-page booklet, mailing it out, accompanied by a proxy statement, a proxy card, and a stamped return envelope to each shareholder might have run as high as $500,000.

Nor is it likely that the Project or any other outside shareholder could match GM's ability to hire "professional" proxy solicitors such as Georgeson & Company, which can deploy up to 100 solicitors throughout the country to personally contact shareholders, give them a campaign speech, and urge them to return their proxies. By daily tabulation of returned proxies, professional solicitors are able to identify on a day-by-day basis the largest blocks of stock outstanding which have yet to return a favorable vote.

The State of the Board

But does not the board of directors with its sweeping statutory mandate "to manage the business and affairs of every corporation" provide an internal check on the power of corporate executives? No. Long ago the grandiloquent words of the statutes ceased to have any operative meaning. "Directors," William O. Douglas complained in 1934, "do not direct." "[T]here is one thing all boards have in common, regardless of their legal position." Peter Drucker has written. "*They do not function*." In Robert Townsend's tart analysis. "[M]ost big companies have turned their boards of directors into nonboards. . . . In the years that I've spent on various boards I've never heard a single suggestion from a director (made as a director *at* a board meeting) that produced any result at all."

Recently these views are corroborated by Professor Myles Mace of the Harvard Business School, the nation's leading authority on the performance of boards of directors. In *Directors – Myth and Reality*, Mace summarized the results of hundreds of interviews with corporate officers and directors.

Directors do not establish the basic objectives, corporate strategies or broad policies of large and medium-size corporations, Mace found. Management creates the policies. The board has a right of veto but rarely exercises it. As one executive said, "Nine hundred and ninety-nine times out of a thousand, the board goes along with management. . . ." Or another, "I can't think of a single time when the board has failed to support a proposed policy of management or failed to endorse the recommendation of management."

The board does not select the president or other chief executive officers. "What is perhaps the most common definition of a function of the board of directors – namely, to select the president – was found to be the greatest myth," reported Mace. "The board of directors in most companies, except in a crisis, does not select the president. The president usually chooses the man who succeeds him to that position, and the board complies with the legal amenities in endorsing and voting his election." A corporate president agreed: "The former company president tapped me to be president, and I assure you that I will select my successor when the time comes." Even seeming exceptions such as RCA's 1975 ouster of Robert Sarnoff frequently turn out to be at the instigation of senior operating executives rather than an aroused board.

The board's role as disciplinarian of the corporation is more apparent than real. As the business-supported Conference Board conceded, "One of the most glaring deficiencies attributed to the corporate board . . . is its failure to monitor and evaluate the performance of the chief executive in a concrete way." To cite a specific example, decisions on executive compensation are made by the president – with perfunctory board approval in most situations. In the vast majority of corporations, Professor Mace found, the compensation committee, and the board which approves the recommendations of the compensation committee, "are not decision-making bodies."

Exceptions to this pattern become news events. In reporting on General Motors' 1971 annual shareholders' meeting, the *Wall Street Journal* noted that, "The meeting's dramatic highlight was an impassioned and unprecedented speech by the Rev. Leon Sullivan, GM's recently appointed Negro director, supporting the Episcopal Church's efforts to get the company out of South Africa. It was the first time that a GM director had ever spoken against management at an annual meeting." Now Rev. Sullivan is an unusual outside director, being General Motor's first black director and only "public interest" director. But what makes Leon Sullivan most extraordinary is that he was the first director in *any* major American corporation to come out publicly against his own corporation when its operations tended to support apartheid.

Revamping the Board

The modern corporation is akin to a political state in which all powers are held by a single clique. The senior executives of a large firm are essentially not accountable to any other officials within the firm. These are precisely the circumstances that, in a democratic political state, require a separation of powers into different branches of authority. As James Madison explained in the *Federalist No. 47*:

> The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny. Were the federal constitution, therefore, really chargeable with this accumulation of power, or with a mixture of powers, having a dangerous tendency to such an accumulation, no further arguments would be necessary to inspire a universal reprobation of the system.

A similar concern over the unaccountability of business executives historically led to the elevation of a board of directors to review and check the actions of operating management. As a practical matter, if corporate governance is to be reformed, it must begin by returning the board to this historical role. The board should serve as an internal auditor of the corporations, responsible for constraining executive management from violations of law and breach of trust. Like a rival branch of government, the board's function must be defined as separate from operating management. Rather than pretending directors can "manage" the corporation, the board's role as disciplinarian should be clearly described. Specifically, the board of directors should:

- establish and monitor procedures that assure that operating executives are informed of and obey applicable federal, state, and local laws;
- approve or veto all important executive management business proposals such as corporate by-laws, mergers, or dividend decisions;
- hire and dismiss the chief executive officer and be able to disapprove the hiring and firing of the principal executives of the corporation; and
- report to the public and the shareholders how well the corporation has obeyed the law and protected the shareholders' investment.

It is not enough, however, to specify what the board should do. State corporations statutes have long provided that "the business and affairs of a corporation shall be managed by a board of directors," yet it has been over a century since the boards of the largest corporations have actually performed this role. To reform the corporation, a federal chartering law must also specify the manner in which the board performs its primary duties.

First, to insure that the corporation obeys federal and state laws, the board should designate executives responsible for compliance with these laws and require periodic signed reports describing the effectiveness of compliance procedures. Mechanisms to administer spot checks on compliance with the principal statutes should be created. Similar mechanisms can insure that corporate "whistle blowers" and non-employee sources may communicate to the board – in private and without fear of retaliation – knowledge of violations of law.

Second, the board should actively review important executive business proposals to determine their full compliance with law, to preclude conflicts of interest, and to assure that executive decisions are rational and informed of all foreseeable risks and costs. But even though the board's responsibility here is limited to approval or veto of executive initiatives, it should proceed in as well-informed a manner as practicable. To demonstrate rational business judgment, the directorate should require management "to prove its case." It should review the studies upon which management relied to make a decision, require management to justify its decision in terms of costs or rebutting dissenting views, and, when necessary, request that outside experts provide an independent business analysis.

Only with respect to two types of business decisions should the board exceed this limited review role. The determination of salary, expense, and benefit schedules inherently possesses such obvious conflicts of interest for executives that only the board should make these decisions. And since the relocation of principal manufacturing facilities tends to have a greater effect on local communities than any other type of business decision, the board should require management to prepare a "community impact statement." This public report would be similar to the environmental impact statements presently required by the National Environmental Policy Act. It would require the corporation to state the purpose of a relocation decision; to compare feasible alternative means; to quantify the costs to the local community; and to consider methods to mitigate these costs. Although it would not prevent a corporation from making a profit-maximizing decision, it would require the corporation to minimize the costs of relocation decisions to local communities.

To accomplish this restructuring of the board requires the institutionalization of a new profession: the full-time "professional" director. Corporate scholars frequently identify William O. Douglas' 1940 proposal for "salaried, professional experts [who] would bring a new responsibility and authority to directorates and a new safety to stockholders" as the origin of the professional director idea. More recently, corporations including Westinghouse and Texas Instruments have established slots on their boards to be filled by full-time directors. Individuals such as Harvard Business School's Myles Mace and former Federal Reserve Board chairman William McChesney Martin consider their own thorough-going approach to boardroom responsibilities to be that of a "professional" director.

To succeed, professional directors must put in the substantial time necessary to get the job done. One cannot monitor the performance of Chrysler's or Gulf's management at a once-a-month meeting; those firms' activities are too sweeping and complicated for such ritual oversight. The obvious minimum here is an adequate salary to attract competent persons to work as full-time directors and to maintain the independence of the board from executive management.

The board must also be sufficiently staffed. A few board members alone cannot oversee the activities of thousands of executives. To be able to appraise operating management, the board needs a trim group of attorneys, economists, and labor and consumer advisors who can analyze complex business proposals, investigate complaints, spot-check accountability, and frame pertinent inquiries.

The board also needs timely access to relevant corporate data. To insure this, the board should be empowered to nominate the corporate financial auditor, select the corporation's counsel, compel the forwarding and preservation of corporate records, require all corporate executives or representatives to answer fully all board questions respecting corporate operations, and dismiss any executive or representative who fails to do so.

This proposed redesign for corporate democracy attempts to make executive management accountable to the law and shareholders without diminishing its operating efficiency. Like a judiciary within the corporation, the board has ultimate powers to judge and sanction. Like a legislature, it oversees executive activity. Yet executive management substantially retains its powers to initiate and administer business operations. The chief executive officer retains control over the organization of the executive hierarchy and the allocation of the corporate budget. The directors are given ultimate control over a narrow jurisdiction: Does the corporation obey the law, avoid exploiting consumers or communities, and protect the shareholders' investment? The executive contingent retains general authority for all corporate operations.

No doubt there will be objections that this structure is too expensive or that it will disturb the "harmony" of executive management. But it is unclear that there would be any increased cost in adopting an effective board. The true cost to the corporation could only be determined by comparing the expense of a fully paid and staffed board with the savings resulting from the elimination of conflicts of interest and corporate waste. In addition, if this should result in a slightly increased corporate expense, the appropriateness must be assessed within a broader social context: should federal and state governments or the corporations themselves bear the primary expense of keeping corporations honest? In our view, this cost should be placed on the corporations as far as reasonably possible.

It is true that an effective board will reduce the "harmony" of executive management in the sense that the power of the chief executive or senior executives will be subject to knowledgeable review. But a board which monitors rather than rubber-stamps management is exactly what is necessary to diminish the unfettered authority of the corporate chief executive or ruling clique. The autocratic power these individuals presently possess has proven unacceptably dangerous: it has led to recurring violations of law, conflicts of interest, productive inefficiency, and pervasive harm to consumers, workers, and the community environment. Under normal circumstances there should be a healthy friction between operating executives and the board to assure that the wisest possible use is made of corporate resources. When corporate executives are breaking the law, there should be no "harmony" whatsoever.

Election of the Board

Restructuring the board is hardly likely to succeed if boards remain as homogeneously white, male, and narrowly oriented as they are today. Dissatisfaction with current selection of directors is so intense that analysts of corporate governance, including Harvard Law School's Abram Chayes, Yale political scientist Robert Dahl, and University of Southern California Law School Professor Christopher Stone, have each separately urged that the starting point of corporate reform should be to change the way in which the board is elected.

Professor Chayes, echoing John Locke's principle that no authority is legitimate except that granted "the consent of the governed," argues that employees and other groups substantially affected by corporate operations should have a say in its governance:

> Shareholder democracy, so-called, is misconceived because the shareholders are not the governed of the corporations whose consent must be sought. . . . Their interests are protected if financial information is made available, fraud and overreaching are prevented, and a market is maintained in which their shares may be sold. A priori, there is no reason for them to have any voice, direct or representational, in [corporate decision making]. They are no more affected than nonshareholding neighbors by these decisions. . . .
>
> A more spacious conception of 'membership,' and one closer to the facts of corporate life, would include all those having a relation of sufficient intimacy with the corporation or subject to its powers in a sufficiently specialized way. Their rightful share in decisions and the exercise of corporate power would be exercised through an institutional arrangement appropriately designed to represent the interests of a constituency of members having a significant common relation to the corporation and its power.

Professor Dahl holds a similar view: "[W]hy should people who own shares be given the privileges of citizenship in the government of the firm when citizenship is denied to other people who also make vital contributions to the firm?" he ask rhetorically. "The people I have in mind are, of course, employees and customers, without whom the firm could not exist, and the general public without whose support for (or acquiescence in) the myriad protections and services of the state the firm would instantly disappear. . . ." Yet Dahl finds proposals for interest group representation less desirable than those for worker self-management. He also suggests consideration of codetermination statutes such as those enacted by West Germany and ten other European and South American countries under which shareholders and employees separately elect designated portions of the board.

From a different perspective, Professor Stone has recommended that a federal agency appoint, "general public directors" to serve on the boards of all the largest industrial and financial firms. In certain extreme cases such as where a corporation repeatedly violates the law, Stone recommends that the federal courts appoint "special public directors" to prevent further delinquency.

There are substantial problems with each of those proposals. It seems impossible to design a general "interest group" formula which will assure that all affected constituencies of large industrial corporations will be represented and that all constituencies will be given appropriate weight. Even if such a formula could be designed, however, there is the danger that consumer or community or minority or franchisee representatives would become only special pleaders for their constituents and otherwise lack the loyalty or interest to direct generally. This defect has emerged in West Germany under codetermination. Labor representatives apparently are indifferent to most problems of corporate management that do not directly affect labor. They seem as deferential to operating executive management as present American directors are. Alternatively, federally appointed public directors might be frozen out of critical decision-making by a majority of "privately" elected directors, or the appointing agency itself might be biased.

Nonetheless, the essence of the Chayes-Dahl-Stone argument is well taken. The boards of directors of most major corporation are, as CBS's Dan Rather criticized the original Nixon cabinet, too much like "twelve grey-haired guys named George." The quiescence of the board has resulted in important public and, for that matter, shareholder concerns being ignored.

An important answer is structural. The homogeneity of the board can only be ended by giving to each director, in addition to a general duty to see that the corporation is profitably administered, a separate oversight responsibility, a separate expertise, and a separate constituency so that each important public concern would be guaranteed at least one informed representative on the board. There might be nine corporate directors, each of whom is elected to a board position with one of the following oversight responsibilities:

1. Employee welfare;
2. Consumer protection;
3. Environmental protection and community relations;
4. Shareholder rights;
5. Compliance with law;
6. Finances;
7. Purchasing and marketing;
8. Management efficiency;
9. Planning and research.

By requiring each director to balance responsibility for representing a particular social concern against responsibility for the overall health of the enterprise, the problem of isolated "public" directors would be avoided. No individual director is likely to be "frozen out" of collegial decision-making because all directors would be of the same character. Each director would spend the greater part of his or her time developing expertise in a different area; each director would have a motivation to insist that a different aspect of a business decision be considered. Yet each would simultaneously be responsible for participating in all board decisions, as directors now are. So the specialized area of each director would supplement but not supplant the director's general duties.

To maintain the independence of the board from the operating management it reviews also requires that each federally chartered corporation shall be directed by a purely "outside" board. No executive, attorney, representative, or agent of a corporation should be allowed to serve simultaneously as a director of that same corporation. Directorial and executive loyalty should be furthered by an absolute prohibition of interlocks. No director, executive, general counsel, or company agent should be allowed to serve more than one corporation subject to the Federal Corporate Chartering Act.

Several objections may be raised. First, how can we be sure that completely outside boards will be competent? Corporate campaign rules should be redesigned to emphasize qualifications. This will allow shareholder voters to make rational decisions based on information clearly presented to them. It is also a fair assumption that shareholders, given an actual choice and role in corporate governance, will want to elect the men and women most likely to safeguard their investments.

A second objection is that once all interlocks are proscribed and a full-time outside board required, there will not be enough qualified directors to staff all major firms. This complaint springs from that corporate mentality which, accustomed to 60-year-old white male bankers and businessmen as directors, makes the norm a virtue. In fact, if we loosen the reins on our imagination, America has a large, rich, and diverse pool of possible directorial talent from academics and public administrators and community leaders to corporate and public interest lawyers.

But directors should be limited to four two-year terms so that boards do not become stale. And no director should be allowed to serve on more than one board at any one time. Although simultaneous service on two or three boards might allow key directors to "pollinize" directorates by comparing their different experiences, this would reduce their loyalty to any one board, jeopardize their ability to fully perform their new directorial responsibilities, and undermine the goal of opening up major boardrooms to as varied a new membership as is reasonable.

The shareholder electoral process should be made more democratic as well. Any shareholder or allied shareholder group which owns .1 percent of the common voting stock in the corporation or comprises 100 or more individuals and does not include a present executive of the corporation, nor act for a present executive, may nominate up to three persons to serve as directors. This will exclude executive management from the nomination process. It also increases the likelihood of a diverse board by preventing any one or two sources from proposing all nominees. To prevent frivolous use of the nominating power, this proposal establishes a minimum shareownership condition.

Six weeks prior to the shareholders' meeting to elect directors, each shareholder should receive a ballot and a written statement on which each candidate for the board sets forth his or her qualifications to hold office and purposes for seeking office. All campaign costs would be borne by the corporation. These strict campaign and funding rules will assure that all nominees will have an equal opportunity to be judged by the shareholders. By preventing directorates from being bought, these provisions will require board elections to be conducted solely on the merit of the candidates.

Finally, additional provisions will require cumulative voting and forbid "staggered" board elections. Thus any shareholder faction capable of jointly voting approximately 10 percent of the total number of shares cast may elect a director.

A New Role for Shareholders

The difficulty with this proposal is the one that troubled Juvenal two millennia ago: *Quis custodiet ipsos custodes*, or Who shall watch the watchmen? Without a full-time body to discipline the board, it would be so easy for the board of directors and executive management to become friends. Active vigilance could become routinized into an uncritical partnership. The same board theoretically elected to protect shareholder equity and internalize law might instead become management's lobbyist.

Relying on shareholders to discipline directors may strike many as a dubious approach. Historically, the record of shareholder participation in corporate governance has been an abysmal one. The monumental indifference of most shareholders is worse than that of sheep; sheep at least have some sense of what manner of ram they follow. But taken together, the earlier proposals – an outside, full-time board, nominated by rival shareholder groups and voted on by beneficial owners – will increase involvement by shareholders. And cumulative voting insures that an aroused minority of shareholders – even one as small as 9 or 10 percent of all shareholders – shall have the opportunity to elect at least one member of the board.

But that alone is hardly sufficient. At a corporation the size of General Motors, an aggregation of 10 percent of all voting stock might require the allied action of over 200,000 individuals – which probably could occur no more than once in a generation. To keep directors responsive to law and legitimate public concerns requires surer and more immediate mechanisms. In a word, it requires arming the victims of corporate abuses with the powers to swiftly respond to them.

For only those employees, consumers, racial or sex minorities, and local communities harmed by corporate depredations can be depended upon to speedily complain. By allowing any victim to become a shareholder and by permitting any shareholder to have an effective voice, there will be the greatest likelihood of continuing scrutiny of the corporation's directorate.

Shareholders are not the only ones with an incentive to review decisions of corporate management; nor, as Professors Chayes and Dahl argue, are shareholders the only persons who should be accorded corporate voting rights. The increasing use by American corporations of technologies and materials that pose direct and serious threats to the health of communities surrounding their plants requires the creation of a new form of corporate voting right. When a federally chartered corporation engages, for example, in production or distribution of nuclear fuels or the emissions of toxic air, water, or solid waste pollutants, citizens whose health is endangered should not be left, at best, with receiving money damages after a time-consuming trial to compensate them for damaged property, impaired health, or even death.

Instead, upon finding of a public health hazard by three members of the board of directors or 3 percent of the shareholders, a corporate referendum should be held in the political jurisdiction affected by the health hazard. The referendum would be drafted by the unit triggering it – either the three board members or a designate of the shareholders. The affected citizens by majority vote will then decide whether the hazardous practice shall be allowed to continue.This form of direct democracy has obvious parallels to the initiative and referendum procedures familiar to many states – except that the election will be paid for by a business corporation and will not necessarily occur at a regular election.

This type of election procedure is necessary to give enduring meaning to the democratic concept of "consent of the governed." To be sure, this proposal goes beyond the traditional assumption that the only affected or relevant constituents of the corporation are the shareholders. But no longer can we accept the Faustian bargain that the continued toleration of corporate destruction of local health and property is the cost to the public of doing business. In an equitable system of governance, the perpetrators should answer to their victims.

Power and Accountability The Changing Role of the Corporate Board of Directors

Irving S. Shapiro

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The proper direction of business corporations in a free society is a topic of intense and often heated discussion. Under the flag of corporate governance there has been a running debate about the performance of business organizations, together with a flood of proposals for changes in the way corporate organizations are controlled.

It has been variously suggested that corporate charters be dispensed by the Federal Government as distinct from those of the states (to tighten the grip on corporate actions); that only outsiders unconnected to an enterprise be allowed to sit on its board of directors or that, as a minimum, most of the directors should qualify as "independent"; that seats be apportioned to constituent groups (employees, women, consumers and minorities, along with stockholders); that boards be equipped with private staffs, beyond the management's control (to smoke out facts the hired executives might prefer to hide or decorate); and that new disclosure requirements be added to existing ones (to provide additional tools for outside oversight of behavior and performance).

Such proposals have come from the Senate Judiciary Committee's antitrust arm; from regulatory agency spokesmen, most notably the current head of

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the Securities and Exchange Commission, Harold Williams, and a predecessor there, William Cary; from the professoriat in schools of law and business; from the bench and bar; and from such observers of the American scene as Ralph Nader and Mark Green.[1]

Suggestions for change have sometimes been offered in sympathy and sometimes in anger. They have ranged from general pleas for corporations to behave better, to meticulously detailed reorganization charts. The span in itself suggests part of the problem: "Corporate Governance" (like Social Responsibility before it) is not a subject with a single meaning, but is a shorthand label for an array of social and political as well as economic concerns. One is obliged to look for a way to keep discussion within a reasonable perimeter.

There appears to be one common thread. All of the analyses, premises, and prescriptions seem to derive in one way or another from the question of accountability: Are corporations suitably controlled, and to whom or what are they responsible? This is the central public issue, and the focal point for this paper.

One school of opinion holds that corporations cannot be adequately called to account because there are systemic economic and political failings. In this view, nothing short of a major overhaul will serve. What is envisioned, at least by many in this camp, are new kinds of corporate organizations constructed along the lines of democratic political institutions. The guiding ideology would be communitarian, with the needs and rights of the community emphasized in preference to profit-seeking goals now pursued by corporate leaders (presumably with Darwinian abandon, with natural selection weeding out the weak, and with society left to pick up the external costs).

Boards Changing for Better

Other critics take a more temperate view. They regard the present system as sound and its methods of governance as morally defensible. They concede, though, that changes are needed to reflect new conditions. Whether the changes are to be brought about by gentle persuasion, or require the use of a two-by-four to get the mule's attention, is part of the debate.

This paper sides with the gradualists. My position, based on a career in industry and personal observation of corporate boards at work, is that significant improvements have been made in recent years in corporate governance, and that more changes are coming in an orderly way: that with these amendments, corporations are accountable and better monitored than ever before; and that pat formulas or proposals for massive "restructuring" should be suspect. The formula approach often is based on ignorance of what it takes to run a large enterprise, on false premises as to the corporate role in society, or on a philosophy that misreads the American tradition and leaves no room for large enterprises that are both free and efficient.

The draconian proposals would almost certainly yield the worst of all possibilities, a double-negative tradeoff: They would sacrifice the most valuable qualities of the enterprise system to gain the least attractive features of the governmental system. Privately owned enterprises are geared to a primary economic task, that of joining human talents and natural resources in the production and distribution of goods and services. That task is essential, and two centuries of national experience suggest these conclusions: The United States has been uncommonly successful at meeting economic needs through reliance on private initiative; and the competitive marketplace is a better course-correction device than governmental fiat. The enterprise system would have had to have failed miserably before the case could be made for replacing it with governmental dictum.

Why should the public have any interest in the internal affairs of corporations? Who cares who decides? Part of the answer comes from recent news stories noting such special problems as illegal corporate contributions to political campaigns, and tracking the decline and fall of once-stout companies such as Penn Central. Revelations of that kind raise questions about the probity and competence of the people minding the largest stores. There is more to it than this, though. There have always been cases of corporate failures. Small companies have gone under too, at a rate far higher than their larger brethren.[2] Instances of corruption have occurred in institutions of all sizes, whether they be commercial enterprises or some other kind.

Corporate behavior and performance are points of attention, and the issue attaches to size, precisely because people do not see the large private corporation as entirely private. People care about what goes on in the corporate interior because they see themselves as affected parties whether they work in such companies or not.

There is no great mystery as to the source of this challenge to the private character of governance. Three trends account for it. First is the growth of very large corporations. They have come to employ a large portion of the workforce, and have become key factors in the nation's technology, wealth and security. They have generated admiration for their prowess, but also fear of their imputed power.

The second contributing trend is the decline of owner-management. Over time, corporate shares have been dispersed. The owners have hired managers, entrusted them with the power to make decisions, and drifted away from involvement in corporate affairs except to meet statutory requirements (as, for example, to approve a stock split or elect a slate of directors).

That raises obvious practical questions. If the owners are on the sidelines, what is to stop the managers from remaining in power indefinitely, using an inside position to control the selection of their own bosses, the directors? Who is looking over management's shoulder to monitor performance?

The third element here is the rise in social expectations regarding corporations. It is no longer considered enough for a company to make products and provide commercial services. The larger it is, the more it is expected to assume various obligations that once were met by individuals or communities, or were not met at all.

With public expectations ratcheting upward, corporations are under pressure to behave more like governments and embrace a universe of problems. That would mean, of necessity, that private institutions would focus less on problems of their own choice.

If corporations succumbed to that pressure, and in effect declared the public's work to be their own, the next step would be to turn them into institutions accountable to the public in the same way that units of government are accountable.

But the corporation does not parallel the government. The assets in corporate hands are more limited and the constituents have options. There are levels of appeal. While the only accountability in government lies within government itself – the celebrated system of checks and balances among the executive, legislative, and judicial branches – the corporation is in a different situation: It has external and plural accountability, codified in the law and reinforced by social pressure. It must "answer" in one way or another to all levels of government, to competitors in the marketplace who would be happy to have the chance to increase their own market share, to employees who can strike or quit, and to consumers who can keep their wallets in their pockets. The checks are formidable even if one excludes for purposes of argument the corporation's initial point of accountability, its stockholders (many of whom do in fact vote their shares, and do not just use their feet).

The case for major reforms in corporate governance rests heavily on the argument that past governmental regulation of large enterprises has been impotent or ineffectual. This is an altogether remarkable assertion, given the fact that the nation has come through a period in which large corporations have been subjected to an unprecedented flood of new legislation and rule making. Regulation now reaches into every corporate nook and cranny – including what some people suppose (erroneously) to be the sanctuary of the boardroom.

Market competition, so lightly dismissed by some critics as fiction or artifact, is in fact a vigorous force in the affairs of almost all corporations. Size lends no immunity to its relentless pressures. The claim that the largest corporations somehow have set themselves above the play of market forces or, more likely, make those forces play for themselves, is widely believed. Public opinion surveys show that. What is lacking is any evidence that this is so. Here too, the evidence goes the other way. Objective studies of concentrated industries (the auto industry, for instance) show that corporate size does not mean declining competitiveness, nor does it give assurance that the products will sell.

Everyday experience confirms this. Consider the hard times of the Chrysler Corporation today, the disappearance of many once-large companies from the American scene, and the constant rollover in the membership list of the "100 Largest," a churning process that has been going on for years and shows no signs of abating.[3]

If indeed the two most prominent overseers of corporate behavior, government and competition, have failed to provide appropriate checks and balances, and if that is to be cited as evidence that corporations lack accountability, the burden of proof should rest with those who so state.

The basics apply to Sears Roebuck as much as to Sam's appliance shop. Wherever you buy the new toaster, it should work when it is plugged in. Whoever services the washing machine, the repairman should arrive at the appointed time, with tools and parts.

Special expectations are added for the largest firms, however. One is that they apply their resources to tasks that invite economies of scale, providing goods and services that would not otherwise be available, or that could be delivered by smaller units only at considerable loss of efficiency. Another is that, like the elephant, they watch where they put their feet and not stamp on smaller creatures through clumsiness or otherwise.

A second set of requirements can be added, related not to the markets selected by corporations individually, but to the larger economic tasks that must be accomplished in the name of the national interest and security. In concert with others in society, including big government, big corporations are expected to husband scarce resources and develop new ones, and to foster strong and diverse programs of research and development, to the end that practical technological improvements will emerge and the nation will be competitive in the international setting.

Beyond this there are softer but nonetheless important obligations: To operate with respect for the environment and with careful attention to the health and safety of people, to honor and give room to the personal qualities employees bring to their jobs, including their need to make an identifiable mark and to realize as much of their potential as possible; to lend assistance in filling community needs in which corporations have some stake; and to help offset community problems which in some measure corporations have helped to create.

This is not an impossible job, only a difficult one. Admitting that the assignment probably is not going to be carried out perfectly by any organization, the task is unlikely to be done even half well unless some boundary conditions are met. Large corporations cannot fulfill their duties unless they remain both profitable and flexible. They must be able to attract and hold those volunteer owners; which is to say, there must be the promise of present or future gain. Companies must have the wherewithal to reinvest significant amounts to revitalize their own capital plants, year after year in unending fashion. Otherwise, it is inevitable that they will go into decline versus competitors elsewhere, as will the nation.

Flexibility is no less important. The fields of endeavor engaging large business units today are dynamic in nature. Without an in-and-out flow of products and services, without the mobility to adapt to shifts in opportunities and public preferences, corporations would face the fate of the buggywhip makers.

Profitability and flexibility are easy words to say, but in practice they make for hard decisions. A company that would close a plant with no more than a passing thought for those left unemployed would and should be charged with irresponsibility; but a firm that vowed never to close any of its plants would be equally irresponsible, for it might be consigning itself to a pattern of stagnation that could ultimately cost the jobs of the people in all of its plants.

The central requirement is not that large corporations take the pledge and bind themselves to stated actions covering all circumstances, but that they do a thoughtful and informed job of balancing competing (and ever changing) claims on corporate resources, mediating among the conflicting (also changing) desires of various constituencies, and not giving in to any one-dimensional perspective however sincerely felt. It is this that describes responsible corporate governance.

Certainly, corporations do not have the public mandate or the resources to be what Professor George Lodge of the Harvard Business School would have them be, which is nationally chartered community-oriented collectives.[4] Such a mission for corporations would be tolerable to society only if corporations were turned into mini-governments – but that takes us back to the inefficiency problem noted earlier. The one task governments have proven they almost always do badly is to run production and distribution organizations. The only models there are to follow are not attractive. Would anyone seriously argue that the public would be ahead if General Motors were run along the lines of Amtrak, or Du Pont were managed in the manner of the U.S. Postal System?

Once roles are defined, the key to success in running a large corporation is to lay out a suitable division of labor between the board and the management, make that division crystal clear on both sides, and staff the offices with the right people. Perhaps the best way to make that split is to follow the pattern used in the U.S. Constitution, which stipulates the powers of the Federal Government and specifies that everything not covered there is reserved to the states or the people thereof. The board of directors should lay claim to five basic jobs, and leave the rest to the paid managers.

The duties the board should not delegate are these:

1. The determination of the board policies and the general direction the efforts of the enterprise should take.
2. The establishment of performance standards – ethical as well as commercial – against which the management will be judged, and the communication of these standards to the management in unambiguous terms.
3. The selection of company officers, and attention to the question of succession.
4. The review of top management's performance in following the overall strategy and meeting the board's standards as well as legal requirements.
5. The communication of the organization's goals and standards to those who have a significant stake in its activities (insiders and outsiders both) and of the steps being taken to keep the organization responsive to the needs of those people.

The establishment of corporate strategy and performance standards denotes a philosophy of active stewardship, rather than passive trusteeship. It is the mission of directors to see that corporate resources are put to creative use, and in the bargain subjected to calculated risks rather than simply being tucked into the countinghouse for safekeeping.

That in turn implies certain prerequisites for board members of large corporations which go beyond those required of a school board member, a trustee of a charitable organization, or a director of a small, local business firm. In any such assignments one would look for personal integrity, interest and intelligence, but beyond these there is a dividing line that marks capability and training.

The stakes are likely to be high in the large corporation, and the factors confronting the board and management usually are complex. The elements weighing heavily in decisions are not those with which people become familiar in the ordinary course of day-to-day life, as might be the case with a school board.

Ordinarily the management of a corporation attends to such matters as product introductions, capital expansions, and supply problems. This in no way reduces the need for directors with extensive business background, though. With few exceptions, corporate boards involve themselves in strategic decisions and those involving large capital commitments. Directors thus need at least as much breadth and perspective as the management, if not as much detailed knowledge.

If the directors are to help provide informed and principled oversight of corporate affairs, a good number of them must provide windows to the outside world. That is at least part of the rationale for outside directors, and especially for directors who can bring unique perspective to the group. There is an equally strong case, though, for directors with an intimate knowledge of the company's business, and insiders may be the best qualified to deliver that. What is important is not that a ratio be established, but that the group contain a full range of the competences needed to set courses of action that will largely determine the long-range success of the enterprise.

Boards Need Windows

The directors also have to be able and willing to invest considerable time in their work. In this day and age, with major resources on the line and tens of thousands of employees affected by each large corporation, there should be no seat in the boardroom for people willing only to show up once a month to pour holy water over decisions already made. Corporate boards need windows, not window dressing!

There are two other qualities that may be self-evident from what has been said, but are mentioned for emphasis. Directors must be interested in the job and committed to the overall purpose of the organization. However much they may differ on details of accomplishment, they must be willing to work at the task of working with others on the board. They ought to be able to speak freely in a climate that encourages open discussion, but to recognize the difference between attacking an idea and attacking the person who presents it. No less must they see the difference between compromising tactics to reach consensus and compromising principles.

Structures and procedures, which so often are pushed to the fore in discussions of corporate governance, actually belong last. They are not unimportant, but they are subordinate.

Structure follows purpose, or should, and that is a useful principle for testing some of the proposals for future changes in corporate boards. Today, two-thirds to three-quarters of the directors of most large corporations are outsiders, and it is being proposed that this trend be pushed still farther, with the only insider being the chief executive officer, and with a further stipulation that he not be board chairman. This idea has surfaced from Harold Williams, and variations on it have come from other sources.

The idea bumps into immediate difficulties. High-quality candidates for boards are not in large supply as it is. Conflicts of interest would prohibit selection of many individuals close enough to an industry to be familiar with its problems. The disqualification of insiders would reduce the selection pool to a still smaller number, and the net result could well be corporate boards whose members were less competent and effective than those now sitting.

Experience would also suggest that such a board would be the most easily manipulated of all. That should be no trick at all for a skillful CEO, for he would be the only person in the room with a close, personal knowledge of the business.

The objective is unassailable: Corporate boards need directors with independence of judgment; but in today's business world, independence is not enough. In coping with such problems as those confronting the electronics corporations beset by heavy foreign competition, or those encountered by international banks which have loans outstanding in countries with shaky governments, boards made up almost entirely of outsiders would not just have trouble evaluating nuances of the management's performance; they might not even be able to read the radar and tell whether the helmsman was steering straight for the rocks.

If inadequately prepared individuals are placed on corporate boards, no amount of sincerity on their part can offset the shortcoming. It is pure illusion to suppose that complex business issues and organizational problems can be overseen by people with little or no experience in dealing with such problems. However intelligent such people might be, the effect of their governance would be to expose the people most affected by the organization – employees, owners, customers, suppliers – to leadership that would be (using the word precisely) incompetent.

It is sometimes suggested that the members of corporate boards ought to come from the constituencies – an employee-director, a consumer-director, an environmentalist-director, etc. This Noah's Ark proposal, which is probably not to be taken seriously, is an extension of the false parallel between corporations and elected governments. The flaw in the idea is all but self evident: People representing specific interest groups would by definition be committed to the goals of their groups rather than any others; but it is the responsibility of directors (not simply by tradition but as a matter of law as well) to serve the organization as a whole. The two goals are incompatible.

If there were such boards they would move at glacial speed. The internal political maneuvering would be Byzantine, and it is difficult to see how the directors could avoid an obvious challenge of accountability. Stockholder suits would pop up like dandelions in the spring.

One may also question how many people of ability would stand for election under this arrangement. Quotas are an anathema in a free society, and their indulgence here would insult the constituencies themselves – a woman on the board not because she is competent but only because she is female; a black for black's sake; and so on ad nauseam.

A certain amount of constituency pleading is not all bad, as long as it is part of a corporate commitment.

There is something to be said for what Harold Williams labels "tension," referring to the divergence in perspective of those concerned primarily with internal matters and those looking more at the broader questions. However, as has been suggested by James Shepley, the president of Time, Inc., "tension" can lead to paralysis, and is likely to do so if boards are packed with groups known to be unsympathetic to the management's problems and business realities.

As Shepley commented, "The chief executive would be out of his mind who would take a risk-laden business proposition to a group of directors who, whatever their other merits, do not really understand the fine points of the business at hand, and whose official purpose is to create 'tension.'"[5]

Students of corporate affairs have an abundance of suggestions for organizing the work of boards, with detailed structures in mind for committees on audit, finance, and other areas; plus prescriptions for membership. The danger here is not that boards will pick the wrong formula – many organization charts could be made to work – but that boards will put too much emphasis on the wrong details.

The idea of utilizing a committee system in which sub-groups have designated duties is far more important than the particulars of their arrangement. When such committees exist, and they are given known and specific oversight duties, it is a signal to the outside world (and to the management) that performance is being monitored in a no-nonsense fashion.

It is this argument that has produced the rule changes covering companies listed on the New York Stock Exchange, calling for audit committees chaired by outside directors, and including no one currently active in management. Most large firms have moved in that direction, and the move makes sense, for an independently minded audit committee is a potent instrument of corporate oversight. Even a rule of that kind, though, has the potential of backfiring.

Suppose some of the directors best qualified to perform the audit function are not outsiders? Are the analytical skills and knowledge of career employees therefore to be bypassed? Are the corporate constituencies well served by such an exclusionary rule, keeping in mind that all directors, insiders or outsiders, are bound by the same legal codes and corporate books are still subject to independent, outside audit? It is scarcely a case of the corporate purse being placed in the hands of the unwatched.

Repeatedly, the question of structure turns on the basics: If corporations have people with competence and commitment on their boards, structure and process fall into line easily; if people with the needed qualities are missing or the performance standards are unclear, corporations are in trouble no matter whose guidebook they follow. Equally, the question drives to alternatives: The present system is surely not perfect, but what is better?

By the analysis presented here the old fundamentals are still sound, no alternative for radical change has been defended with successful argument, and the best course appears to be to stay within the historical and philosophical traditions of American enterprise, working out the remaining problems one by one.

Notes

[1] U.S. Senate, Committee on the Judiciary Subcommittee on Antitrust, Monopoly & Business Rights; Address by Harold M. Williams, *Corporate Accountability*, Fifth Annual Securities Regulation Institute, San Diego, California (January 18, 1978); W. Cary, *A Proposed Federal Corporate Minimum Standards Act*, 29 Bus. Law. 1101 (1974) and W. Cary, *Federalism & Corporate Law: Reflections Upon Delaware*, 83 Yale L. J., 663 (1974); D. E. Schwartz, *A Case for Federal Chartering of Corporations*, 31 Bus. Law. 1125 (1976); M. A. Eisenberg, *Legal Modes of Management Structure in the Modern Corporation; Officers, Directors & Accountants*, 63 Calif. L. Rev. 375 (1975); A. J. Goldberg, *Debate on Outside Directors, New York Times*, October 29, 1972 (§3, p. 1); Ralph Nader & Mark Green, *Constitutionalizing the Corporation: The Case for Federal Chartering of Giant Corporations* (1976).

[2] *See* "Sixty Years of Corporate Ups, Downs & Outs," *Forbes*, September 15, 1977, p. 127 et seq.

[3] *See* Dr. Betty Bock's Statement before Hearings on S.600, Small and Independent Business Protection Act of 1979, April 25, 1979.

[4] G. Lodge, *The New American Ideology* (1975).

[5] Shepley, *The CEO Goes to Washington*, Remarks to Fortune Corporation Communications Seminar, March 28, 1979.

Who Should Control the Corporation?

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Who should control the corporation? How? And for the pursuit of what goals? Historically the corporation was controlled by its owners – through direct control of the managers if not through direct management – for the pursuit of economic goals. But as shareholding became dispersed, owner control weakened; and as the corporation grew to very large size, its economic actions came to have increasing social consequences. The giant, widely held corporation came increasingly under the implicit control of its managers, and the concept of social responsibility – the voluntary consideration of public social goals alongside the private economic ones – arose to provide a basis of legitimacy for their actions.

To some, including those closest to the managers themselves, this was accepted as a satisfactory arrangement for the large corporation. "Trust it" to the goodwill of the managers was their credo; these people will be able to achieve an appropriate balance between social and economic goals.

But others viewed this basis of control as fundamentally illegitimate. The corporation was too large, too influential, its actions too pervasive to be left free of the direct and concerted influence of outsiders. At the extreme were those who believed that legitimacy could be achieved only by subjecting managerial authority to formal and direct external control. "Nationalize it," said those at one end of the political spectrum, to put ultimate control in the hands of the government so that it will pursue public social goals. No, said those at the other end, "restore it" to direct share holder control, so that it will not waiver from the pursuit of private economic goals.

Other people took less extreme positions. "Democratize it" became the rallying cry for some, to open up the governance of the large, widely held corporation to a variety of affected groups – if not the workers, then the customers, or conservation interests, or minorities. "Regulate it" was also a popular position, with its implicit premise that only by sharing their control with government would the corporation's managers attend to certain social goals. Then there were those who accepted direct management control so long as it was tempered by other, less formal types of influence. "Pressure it," said a generation of social activists, to ensure that social goals are taken into consideration. But others argued that because the corporation is an economic instrument, you must "induce it" by providing economic incentives to encourage the resolution of social problems.

Finally, there were those who argued that this whole debate was unnecessary, that a kind of invisible hand ensures that the economic corporation acts in a socially responsible manner. "Ignore it" was their implicit conclusion.

This article is written to clarify what has become a major debate of our era, *the* major debate revolving around the private sector: Who should control the corporation, specifically the large, widely held corporation, how, and for the pursuit of what goals? The answers that are eventually accepted will determine what kind of society we and our children shall live in. . . .

As implied earlier, the various positions of who should control the corporation, and how, can be laid out along a political spectrum, from nationalization at one end to the restoration of shareholder power at the other. From the managerial perspective, however, those two extremes are not so far apart. Both call for direct control of the corporation's managers by specific outsiders, in one case the government to ensure the pursuit of social goals, in the other case the shareholders to ensure the pursuit of economic ones. It is the moderate positions – notably, trusting the corporation to the social responsibility of its managers –

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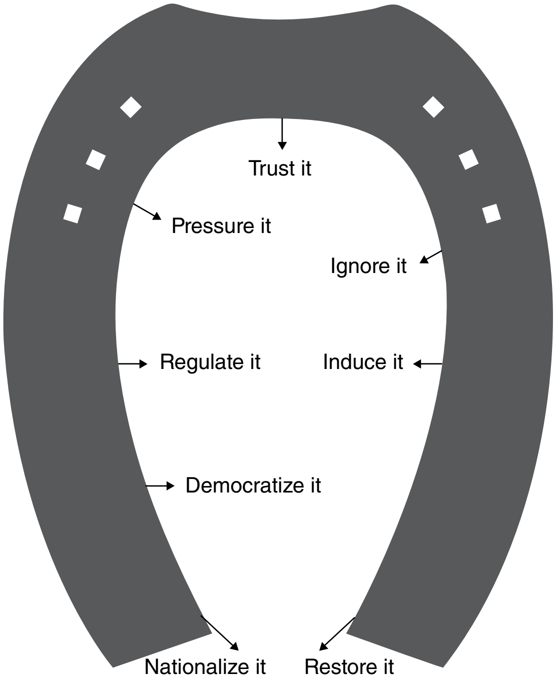

Figure 1 The conceptual horseshoe.

that are farthest from the extremes. Hence, we can fold our spectrum around so that it takes the shape of a horseshoe.

Figure 1 shows our "conceptual horseshoe," with "nationalize it" and "restore it" at the two ends. "Trust it" is at the center, because it postulates a natural balance of social and economic goals. "Democratize it," "regulate it," and "pressure it" are shown on the left side of the horseshoe, because all seek to temper economic goals with social ones. "Induce it" and "ignore it," both of which favor the exclusive pursuit of economic goals, are shown on the right side.

This conceptual horseshoe provides a basic framework to help clarify the issues in this important debate. We begin by discussing each of these positions in turn, circling the horseshoe from left to right. Finding that each (with one exception) has a logical context, we conclude – in keeping with our managerial perspective – that they should be thought of as forming a portfolio from which society can draw to deal with the issue of who should control the corporation and how.

"Nationalize It"

Nationalization of the corporation is a taboo subject in the United States – in general, but not in particular. Whenever a major corporation runs into serious difficulty (i.e., faces bankruptcy with possible loss of many jobs), massive government intervention, often including direct nationalization, inevitably comes up as an option. This option has been exercised: U.S. travellers now ride on Amtrak; Tennessee residents have for years been getting their power from a government utility; indeed, the Post Office was once a private enterprise. Other nations have, of course, been much more ambitious in this regard.

From a managerial and organizational perspective, the question is not whether nationalization is legitimate, but whether it works – at least in particular, limited circumstances. As a response to concerns about the social responsibility of large corporations, the answer seems to be no. The evidence suggests that social difficulties arise more from the size of an organization and its degree of bureaucratization than from its form of ownership.[1] On the other hand, contrary to popular belief in the United States, nationalization does not necessarily harm economic efficiency. Over the years, Renault has been one of the most successful automobile companies outside Japan; it was nationalized by the French government shortly after World War II. . . . When people believe that government ownership leads to interference, politicization, and inefficiency, that may be exactly what happens. However, when they believe that nationalization has to work, then state-owned enterprises may be able to attract the very best talent in the country and thereby work well.

But economic efficiency is no reason to favor nationalization any more than is concern about social responsibility. Nationalization does, however seem to make sense in at least two particular circumstances. The first is when a mission deemed necessary in a society will not be provided adequately by the private sector. That is presumably why America has its Amtrak, and why Canada created its Canadian National. . . . The second is when the activities of an organization must be so intricately tied to government policy that it is best managed as a direct aim of the state. The Canadian government created Petrocan to act as a "window" and a source of expertise on the sensitive oil industry.

Thus, it is not rhetoric but requirement that should determine the role of this position as a solution to who should control the corporation. "Nationalize it" should certainly not be embraced as a panacea, but neither should it be rejected as totally inapplicable.

"Democratize It"

A less extreme position – at least in the context of the American debate – is one that calls for formal devices to broaden the governance of the corporation. The proponents of this position either accept the legal fiction of shareholder control and argue that the corporation's power base is too narrow, or else they respond to the emergent reality and question the legitimacy of managerial control. Why, they ask, do stockholders or self-selected managers have any greater right to control the profound decisions of these major institutions than do workers or customers or the neighbors downstream.

This stand is not to be confused with what is known as "participative management." The call to "democratize it" is a legal, rather than ethical one and is based on power, not generosity. Management is not asked to share its power voluntarily; rather, that power is to be reallocated constitutionally. That makes this position a fundamental and important one, *especially* in the United States with its strong tradition of pluralist control of its institutions.

The debate over democratization of the corporation has been confusing, in part because many of the proposals have been so vague. We can bring some order to it by considering, in organizational terms, two basic means of democratization and two basic constituencies that can be involved. As shown in Table 1, they suggest four possible forms of corporate democracy. One means is through the election of representatives to the board of directors, which we call *representative democracy*. The other is through formal but direct involvement in internal decision making processes, which we call *participatory democracy*. Either can focus on the workers – either all the employees or just those in operating tasks – or else on a host of outside interest groups, the latter giving rise to a *pluralistic* form of democracy. These are basic forms of corporate democracy in theory. With one exception, they have hardly been approached – let alone achieved – in practice. But they suggest where the "democratize it" debate may be headed. . . .

Critics . . . have pointed out the problems of defining constituencies and finding the means to hold elections. "One-person, one-vote" may be easily applied to electing representatives of the workers, but no such simple rule can be found in the case of the consumer or environmental representatives, let alone ones of the "public interest." Yet it is amazing how quickly things become workable in the United States when Americans decide to put their collective mind to it. Indeed, the one case of public directors that I

Table 1 Four basic forms of corporate democracy.

		Groups involved	
		Internal employees	*External interest groups*
Focus of attention	*Board of Directors*	Worker Representative Democracy (European style, e.g., "co-determination" or worker ownership)	Pluralistic Representative Democracy (American style, e.g., "public interest" directors)
	Internal decision-making process	Worker Participatory Democracy (e.g., works councils)	Pluralistic Participatory Democracy (e.g., outsiders on new product committees)

came across is telling in this regard. According to a Conference Board report, the selection by the Chief Justice of the Supreme Court of New Jersey of 6 of the 24 members of the board of Prudential Insurance as public directors has been found by the company to be "quite workable."[2]

Despite its problems, representative democracy is crystal clear compared with participatory democracy. What the French call "auto-gestion" (as opposed to "co-gestion," or co-determination) seems to describe a kind of bottom-up, grassroots democracy in which the workers participate directly in decision making (instead of overseeing management's decisions from the board of directors) and also elect their own managers (who then become more administrators than bosses). Yet such proposals are inevitably vague, and I have heard of no large mass production or mass service firm – not even one owned by workers or a union – that comes close to this.

What has impeded worker participatory democracy? In my opinion, something rather obvious has stood in its way; namely, the structure required by the very organizations in which the attempts have been made to apply it. Worker participatory democracy – and worker representative democracy too, for that matter – has been attempted primarily in organizations containing large numbers of workers who do highly routine, rather unskilled jobs that are typical of most mass production and service – what I have elsewhere called Machine Bureaucracies.[3] The overriding requirement in Machine Bureaucracy is for tight coordination, the kind that can only be achieved by central administrators. For example, the myriad of decisions associated with producing an automobile at Volvo's Kalmar works in Sweden cannot be made by autonomous groups, each doing as it pleases. The whole car must fit together in a particular way at the end of the assembly process. These decisions require a highly sophisticated system of bureaucratic coordination. That is why automobile companies are structured into rigid hierarchies of authority, not because their managers lust for power (though lust for power some of them no doubt do)....

Participatory democracy is approached in other kinds of organizations. These are not the large, mass output corporations, but rather the autonomous professional institutions such as universities and hospitals, which have very different needs for central coordination. . . . But the proponents of democracy in organizations are not lobbying for changes in hospitals or universities. It is the giant mass producers they are after, and unless the operating work in these corporations becomes largely skilled and professional in nature, nothing approaching participative democracy can be expected.

In principal, the pluralistic form of participatory democracy means that a variety of groups external to the corporation can somehow control its decision-making processes directly. In practice, of course, this concept is even more elusive than the worker form of participatory democracy. To fully open up the internal decision-making processes of the corporation to outsiders would mean chaos. Yet certain very limited forms of outside participation would seem to be not only feasible but perhaps even desirable. . . . Imagine telephone company executives resolving rate conflicts with consumer groups in quiet offices instead of having to face them in noisy public hearings.

To conclude, corporate democracy – whether representative or participatory in form – may be an elusive and difficult concept, but it cannot be dismissed. It is not just another social issue, like conservation or equal opportunity, but one that strikes at the most fundamental of values. Ours has become a society of organizations. Democracy will have decreasing meaning to most citizens if it cannot be extended beyond political and judicial processes to those institutions that impinge upon them in their daily lives – as workers, as consumers, as neighbors. This is why we shall be hearing a great deal more of "democratize it."

"Regulate It"

In theory, regulating the corporation is about as simple as democratizing it is complex. In practice, it is, of course, another matter. To the proponents of "regulate it," the corporation can be made responsive to social needs by having its actions subjected to the controls of a higher authority – typically government, in the form of a regulatory agency or legislation backed up by the courts. Under regulation, constraints are imposed externally on the corporation while its internal governance is left to its managers....

To some, regulation is a clumsy instrument that should never be relied upon; to others, it is a panacea for the problems of social responsibility. At best, regulation sets minimum and usually crude standards of acceptable behavior; when it works, it does not make any firm socially responsible so much as stop some from being grossly irresponsible. Because it is inflexible, regulation tends to be applied slowly and conservatively, usually lagging public sentiment. Regulation often does not work because of difficulties in enforcement. The problems of the regulatory agencies are legendary – limited resources and information compared with the industries they are supposed to regulate, the cooptation of the regulators by industries, and so on. When applied indiscriminately, regulation either fails dramatically or else succeeds and creates havoc.

Yet there are obvious places for regulation. A prime one is to control tangible "externalities" – costs incurred by corporations that are passed on to the public at large. When, for example, costly pollution or worker health problems can be attributed directly to a corporation, then there seems to be every reason to force it (and its customers) to incur these costs directly, or else to terminate the actions that generate them. Likewise, regulation may have a place where competition encourages the unscrupulous to pull all firms down to a base level of behavior, forcing even the well-intentioned manager to ignore the social consequences of his actions. Indeed, in such cases, the socially responsible behavior is to encourage sensible regulation. "Help us to help ourselves," businessmen should be telling the government.

Although the public has generally been sympathetic to it, "regulate it," even in highly limited form, has hardly been the position of businessmen. . . Most discouraging is Theodore Levitt's revelation some years ago that business has fought every piece of proposed regulatory or social legislation throughout this century, from the Child Labor Act on up. In Levitt's opinion, much of that legislation has been good for business – dissolving the giant trusts, creating a more honest and effective stock market, and so on. Yet, "the computer is programmed to cry wolf."[4] One reason why so much legislation has been excessive and ineffective may be because it has been enacted with the support of the general public but over the obstinate resistance of businessmen.

In summary, regulation is a clumsy instrument but not a useless one. Were the business community to take a more enlightened view of it, regulation could be applied more appropriately, and we would not need these periodic housecleanings to eliminate the excesses.

"Pressure It"

"Pressure it" is designed to do what "regulate it" fails to do: provoke corporations to act beyond some base level of behavior, usually in an area that regulation misses entirely. Here, activists bring ad hoc campaigns of pressure to bear on one or a group of corporations to keep them responsive to the activists' interpretation of social needs. . . .

"Pressure it" is a distinctively American position. While Europeans debate the theories of nationalization and corporate democracy in their cafes, Americans read about the exploits of Ralph Nader et al. in their morning newspapers. Note that "pressure it," unlike "regulate it," implicitly accepts management's right to make the final decisions. Perhaps this is one reason why it is favored in America.

While less radical than the other positions so far discussed, "pressure it" has nevertheless proved far more effective in eliciting behavior sensitive to social needs. . . .

Activist groups have pressured for everything from the dismemberment of diversified corporations to the development of day care centers. Of special note is the class action suit, which has opened up a whole new realm of corporate social issues. But the effective use of the pressure campaign has not been restricted to the traditional activist. President Kennedy used it to roll back U.S. Steel price increases in the early 1960s, and business leaders in Pittsburgh used it in the late 1940s by threatening to take their freight-haulage business elsewhere if the Pennsylvania Railroad did not replace its coal burning locomotives to help clean up their city's air.

"Pressure it" as a means to change corporate behavior is informal, flexible, and focused; hence, it has been highly successful. Yet it is irregular and ad hoc, with different pressure campaigns sometimes making contradictory demands on management. Compared to the positions to its right on the horseshoe, "pressure it," like the other positions to its left, is based on confrontation rather than cooperation.

"Trust It"

To a large and vocal contingent, which parades under the banner of "social responsibility," the corporation has no need to act irresponsibly, and therefore there is no reason for it to either be nationalized by the state, democratized by its different constituencies, regulated by the government, or pressured by activists. This contingent believes that the corporation's leaders can be trusted to attend to social goals for their own sake, simply because it is the noble thing to do. (Once this position was known as *noblesse oblige*, literally "nobility obliges.")

We call this position "trust it," or, more exactly, "trust the corporation to the goodwill of its managers," although looking from the outside in, it might just as well be called "socialize it." We place it in the center of our conceptual horseshoe because it alone postulates a natural balance between social and economic goals – a balance which is to be attained in the heads (or perhaps the hearts) of responsible businessmen. And, as a not necessarily incidental consequence, power can be left in the hands of the managers; the corporation can be trusted to those who reconcile social and economic goals.

The attacks on social responsibility, from the right as well as the left, boil down to whether corporate managers should be trusted when they claim to pursue social goals; if so, whether they are capable of pursuing such goals; and finally, whether they have any right to pursue such goals.

The simplest attack is that social responsibility is all rhetoric, no action. E.F. Cheit refers to the "Gospel of Social Responsibility" as "designed to justify the power of managers over an ownerless system.. . .

Others argue that businessmen lack the personal capabilities required to pursue social goals. Levitt claims that the professional manager reaches the top of the hierarchy by dedication to his firm and his industry; as a result, his knowledge of social issues is highly restricted.[5] Others argue that an orientation to efficiency renders business leaders inadept at handling complex social problems (which require flexibility and political finesse, and sometimes involve solutions that are uneconomic).. . .

The most far reaching criticism is that businessmen have no right to pursue social goals. "Who authorized them to do that?", asks Braybrooke, attacking from the left.[6] What business have they – self-selected or at best appointed by shareholders – to impose *their* interpretation of the public good on society. Let the elected politicians, directly responsible to the population, look after the social goals.

But this attack comes from the right, too. Milton Friedman writes that social responsibility amounts to spending other people's money – if not that of shareholders, then of customers or employees. Drawing on all the pejorative terms of right-wing ideology, Friedman concludes that social responsibility is a "fundamentally subversive doctrine," representing "pure and unadulterated socialism," supported by businessmen who are "unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades." To Friedman, "there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game."[7] Let businessmen, in other words, stick to their own business, which is business itself.

The modern corporation has been described as a rational, amoral institution – its professional managers "hired guns" who pursue "efficiently" any goals asked of them. The problem is that efficiency really means measurable efficiency, so that the guns load only with goals that can be quantified. Social goals, unlike economic ones, just don't lend themselves to quantification. As a result, the performance control systems – on which modern corporations so heavily depend – tend to drive out social goals in favor of economic ones. As Robert Ackerman concluded in a study of performance control systems:

> The financial reporting system may actually inhibit social responsiveness. By focusing on economic performance . . . such a system directs energy and resources to achieving results measured in financial terms. It is the only game in town, so to speak, at least the only one with an official scorecard.[8]

In the contemporary large corporation, professional amorality turns into economic morality. When the screws of the performance control systems are turned tight – as they were, for example, in the General Electric price fixing scandal of the early 1960s – economic morality can turn into social immorality. And it happens often: A *Fortune* writer found that "a surprising number of [big companies] have been involved in blatant illegalities" in the 1970s, at least 117 of 1,043 firms studied.[9]

Even when the chief executive is personally committed to social goals, the control systems he must rely upon to manage far flung operations may preclude him from doing anything about them. Thus, while he sings the praises of social responsibility, his employees are forced to march to the tune of economic performance. And then they respond to questionnaires with complaints about having to compromise their ethics.

How, then, is anyone to "trust it"?

The fact is that we have to trust it, for two reasons. First, the strategic decisions of large organizations inevitably involve social as well as economic consequences that are inextricably intertwined. The neat distinction between economic goals in the private sector and social goals in the public sector just doesn't hold up in practice. Every important decision of the large corporation – to introduce a new product line, to close an old plant, whatever – generates all kinds of social consequences. There is no such thing as purely economic decisions in big business. Only a conceptual ostrich, with his head deeply buried in the abstractions of economic theory, could possibly use the distinction between economic and social goals to dismiss social responsibility.

The second reason we have to "trust it" is that there is always some degree of discretion involved in corporate decision making, discretion to thwart social needs or to attend to them. Things could be a lot better in today's corporation, but they could also be an awful lot worse. It is primarily our ethics that keep us where we are. If the performance control systems favored by diversified corporations cut too deeply into our ethical standards, then our choice is clear: to reduce these standards or call into question the whole trend toward diversification.

To dismiss social responsibility is to allow corporate behavior to drop to the lowest level, propped up only by external controls such as regulation and pressure campaigns. Solzhenitsyn, who has experienced the natural conclusion of unrestrained bureaucratization, warns us (in sharp contrast to Friedman) that "a society with no other scale but the legal one is not quite worthy of man . . . A society which is based on the letter of the law and never reaches any higher is scarcely taking advantage of the high level of human possibilities."[10]

This is not to suggest that we must trust it completely. We certainly cannot trust it unconditionally by accepting the claim popular in some quarters that only business can solve the social ills of society. Business has no business using its resources without constraint in the social sphere – whether to support political candidates or to dictate implicitly through donations how non-profit institutions should allocate their efforts. But where business is inherently involved, where its decisions have social consequences, that is where social responsibility has a role to play: where business creates externalities that cannot be measured and attributed to it (in other words, where regulation is ineffective); where regulation would work if only business would cooperate with it; where the corporation can fool its customers, or suppliers, or government through superior knowledge; where useful products can be marketed instead of wasteful or destructive ones. In other words, we have to realize that in many spheres we must trust it, or at least socialize it (and perhaps change it) so that we can trust it. Without responsible and ethical people in important places, our society is not worth very much.

"Ignore It"

"Ignore it" differs from the other positions on the horseshoe in that explicitly or implicitly it calls for no change in corporate behavior. It assumes that social needs are met in the course of pursuing economic goals. We include this position in our horseshoe because it is held by many influential people and also because its validity would preempt support for the other positions. We must, therefore, investigate it alongside the others.

It should be noted at the outset that "ignore it" is not the same position as "trust it." In the latter, to be good is the right thing to do; in the present case, "it pays to be good." The distinction is subtle but important, for now it is economics, not ethics, that elicits the desired behavior. One need not strive to be ethical; economic forces will ensure that social needs fall conveniently into place. Here we have moved one notch to the right on our horseshoe, into the realm where the economic goals dominate. . . .

"Ignore it" is sometimes referred to as "enlightened self-interest," although some of its proponents are more enlightened than others. Many a true believer in social responsibility has used the argument that it pays to be good to ward off the attacks from the right that corporations have no business pursuing social goals. Even Milton Friedman must admit that they have every right to do so if it pays them economically. The danger of such arguments, however – and a prime reason "ignore it" differs from "trust it" – is that they tend to support the status quo: corporations need not change their behavior because it already pays to be good.

Sometimes the case for "ignore it" is made in terms of corporations at large, that the whole business community will benefit from socially responsible behavior. Other times the case is made in terms of the individual corporation, that it will benefit directly from its own socially responsible actions. A popular claim in the 1960s, for example, was that satisfied workers lead to greater productivity. "Treat them well, get them involved, and you will make money," we were told by a generation of industrial psychologists. This particular claim has been largely discredited, but many others have taken its place – for example, that companies that are good neighbors by polluting less are more profitable. Others make the case for "ignore it" in "social investment" terms, claiming that socially responsible behavior pays off in a better image for the firm, a more positive relationship with customers, and ultimately a healthier and more stable society in which to do business.

Then, there is what I like to call the "them" argument: "If we're not good, *they* will move in" – "they" being Ralph Nader, the government, whoever. In other words, "Be good or else." The trouble with this argument is that by reducing social responsibility to simply a political tool for sustaining managerial control of the corporation in the face of outside threats, it tends to encourage general pronouncements instead of concrete actions (unless, of course, "they" actually deliver with pressure campaigns). . . .

The "ignore it" position rests on some shaky ground. It seems to encourage average behavior at best; and where the average does not seem to be good enough, it encourages the status quo. In fact, ironically, "ignore it" makes a strong case for "pressure it," since the whole argument collapses in the absence of pressure campaigns. Thus while many influential people take this position, we question whether in the realities of corporate behavior it can really stand alone.

"Induce It"

Continuing around to the right, our next position drops all concern with social responsibility per se and argues, simply, "pay it to be good," or, from the corporation's point of view, "be good only where it pays." Here, the corporation does not actively pursue social goals at all, whether as ends in themselves or as means to economic ends. Rather, it undertakes socially desirable programs only when induced economically to do so – usually through government incentives. If society wishes to clean up urban blight, then let its government provide subsidies for corporations that renovate buildings; if pollution is the problem, then let corporations be rewarded for reducing it.

"Induce it" faces "regulate it" on the opposite side of the horseshoe for good reason. While one penalizes the corporation for what it does do, the other rewards it for doing what it might not otherwise do. Hence these two positions can be direct substitutes: pollution can be alleviated by introducing penalties for the damage done or by offering incentives for the improvements rendered.

Logic would, however, dictate a specific role for each of these positions. Where a corporation is doing society a specific, attributable harm – as in the case of pollution – then paying it to stop hardly seems to make a lot of sense. If society does not wish to outlaw the harmful behavior altogether, then surely it must charge those responsible for it – the corporation and, ultimately, its customers. Offering financial incentives to stop causing harm would be to invite a kind of blackmail – for example, encouraging corporations to pollute so as to get paid to stop. And every citizen would be charged for the harm done by only a few.

On the other hand, where social problems exist which cannot be attributed to specific corporations, yet require the skills of certain corporations for solution, then financial incentives clearly make sense (so long, of course, as solutions can be clearly defined and tied to tangible economic rewards). Here, and not under "trust it," is where the "only business can do it" argument belongs. When it is true that only business can do it (and business has not done it to us in the first place), then business should be encouraged to do it.. . .

"Restore It"

Our last position on the horseshoe tends to be highly ideological, the first since "democratize it" to seek a fundamental change in the governance and the goals of the corporation. Like the proponents of "nationalize it," those of this position believe that managerial control is illegitimate and must be replaced by a more valid form of external control. The corporation should be restored to its former status, that is, returned to its "rightful" owners, the shareholders. The only way to ensure the relentless pursuit of economic goals – and that means the maximization of profit, free of the "subversive doctrine" of social responsibility – is to put control directly into the hands of those to whom profit means the most.

A few years ago this may have seemed to be an obsolete position. But thanks to its patron saint Milton Friedman . . . it has recently come into prominence.. . .

Friedman has written:

> In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.[11]

Interestingly, what seems to drive Friedman is a belief that the shift over the course of this century from owner to manager control, with its concerns about social responsibility, represents an unstoppable skid around our horseshoe. In the opening chapter of his book *Capitalism and Freedom*, Friedman seems to accept only two possibilities – traditional capitalism and socialism as practiced in Eastern Europe. The absence of the former must inevitably lead to the latter.

> The preservation and expansion of freedom are today threatened from two directions. The one threat is obvious and clear. It is the external threat coming from the evil men in the Kremlin who promise to bury us. The other threat is far more subtle. It is the internal threat coming from men of good intentions and good will who wish to reform us.[12]

The problem of who should control the corporation thus reduces to a war between two ideologies – in Friedman's terms, "subversive" socialism and "free" enterprise. In this world of black and white, there can be no middle ground, no moderate position between the black of "nationalize it" and the white of "restore it," none of the grey of "trust it." Either the owners will control the corporation or else the government will. Hence: " 'restore it' or else." Anchor the corporation on the right side of the horseshoe, Friedman seems to be telling us, the only place where "free" enterprise and "freedom" are safe.

All of this, in my view, rests on a series of assumptions – technical, economic, and political – which contain a number of fallacies. First is the fallacy of the technical assumption of shareholder control. Every trend in ownership during this century seems to refute the assumption that small shareholders are either willing or able to control the large, widely held corporation. The one place where free markets clearly still exist is in stock ownership, and that has served to detach ownership from control. When power is widely dispersed – among stockholders no less than workers or customers – those who share it tend to remain passive. It pays no one of them to invest the effort to exercise their power. Hence, even if serious shareholders did control the boards of widely held corporations (and one survey of all the directors of the *Fortune 500* in 1977 found that only 1.6% of them represented significant shareholder interests),[13] the question remains open as to whether they would actually try to control the management.

The economic assumptions of free markets have been discussed at length in the literature. Whether there exists vibrant competition, unlimited entry, open information, consumer sovereignity, and labor mobility is debatable. Less debatable is the conclusion that the larger the corporation, the greater is its ability to interfere with these processes. The issues we are discussing center on the giant corporation.. . .

Those who laid the foundation for conventional economic theory – such as Adam Smith and Alfred Marshall – never dreamed of the massive amounts now spent for advertising campaigns, most of them designed as much for affect as for effect; of the waves of conglomeration that have combined all kinds of diverse businesses into single corporate entities; of chemical complexes that cost more than a billion dollars; and of the intimate relationships that now exist between giant corporations and government, as customer and partner not to mention subsidizer. The concept of arm's length relationships in such conditions is, at best, nostalgic. What happens to consumer sovereignty when Ford knows more about its gas tanks than do its customers? And what does labor mobility mean in the presence of an inflexible pension plan, or commitment to a special skill, or a one-factory town? It is an ironic twist of conventional economic theory that the worker is the one who typically stays put, thus rendering false the assumption of labor mobility, while the shareholder is the mobile one, thus spoiling the case for owner control.

The political assumptions are more ideological in nature, although usually implicit. These assumptions are that the corporation is essentially amoral, society's instrument for producing goods and services, and, more broadly, that a society is "free" and "democratic" so long as its governmental leaders are elected by universal suffrage and do not interfere with the legal activities of businessmen. But many people – a large majority of the general public, if polls are to be believed – seem to subscribe to one or more assumptions that contradict these "free enterprise" assumptions.

One assumption is that the large corporation is a social and political institution as much as an economic instrument. Economic activities, as noted previously, produce all kinds of social consequences. Jobs get created and rivers get polluted, cities get built and workers get injured. These social consequences cannot be factored out of corporate strategic decisions and assigned to government.

Another assumption is that society cannot achieve the necessary balance between social and economic needs so long as the private sector attends only to economic goals. Given the pervasiveness of business in society, the acceptance of Friedman's prescriptions would drive us toward a one-dimensional society – a society that is too utilitarian and too materialistic. Economic morality, as noted earlier, can amount to a social immorality.

Finally, the question is asked: Why the owners? In a democratic society, what justifies owner control of the corporation any more than worker control, or consumer control, or pluralistic control? Ours is not Adam Smith's society of small proprietors and shopkeepers. His butcher, brewer, and baker have become Iowa Beef Packers, Anheuser-Busch, and ITT Continental Baking. What was once a case for individual democracy now becomes a case for oligarchy. . . .

I see Friedman's form of "restore it" as a rather quaint position in a society of giant corporations, managed economies, and dispersed shareholders – a society in which the collective power of corporations is coming under increasing scrutiny and in which the distribution between economic and social goals is being readdressed.

Of course, there are other ways to "restore it." "Divest it" could return the corporation to the business or central theme it knows best, restoring the role of allocating funds between different businesses to capital markets instead of central headquarters. Also, boards could be restored to positions of influence by holding directors legally responsible for their actions and by making them more independent of managers . . . We might even wish to extend use of "reduce it" where possible, to decrease the size of those corporations that have grown excessively large on the basis of market or political power rather than economies of scale, and perhaps to eliminate certain forms of vertical integration. In many cases it may prove advantageous, economically as well as socially, to have the corporation trade with its suppliers and customers instead of being allowed to ingest them indiscriminately.[14]

I personally doubt that these proposals could be any more easily realized in today's society than those of Friedman, even though I believe them to be more desirable. "Restore it" is the nostalgic position on our horseshoe, a return to our fantasies of a glorious past. In this society of giant organizations, it flies in the face of powerful economic and political forces.

Conclusion: If The Shoe Fits . . .

I believe that today's corporation cannot ride on any one position any more than a horse can ride on part of a shoe. In other words, we need to treat the conceptual horseshoe as a portfolio of positions from which we can draw, depending on circumstances. Exclusive reliance on one position will lead to a narrow and dogmatic society, with an excess concentration of power. We have learned about the dangers of unrestrained government ownership. No less menacing is the unrestrained pursuit of the economic interests of the shareholders, or of the oligarchy of ostensibly "socially responsible" managers. Lord Acton taught us that absolute power corrupts absolutely. In contrast, the use of a variety of positions can encourage the pluralism I believe most of us feel is necessary to sustain democracy. If the shoe fits, then let the corporation wear it.

I do not mean to imply that the eight positions do not represent fundamentally different values and, in some cases, ideologies as well. Clearly they do. But I also believe that anyone who makes an honest assessment of the realities of power in and around today's large corporations must conclude that a variety of positions have to be relied upon. Anyone can tilt to the left, right, or center of our horseshoe, favoring popular, shareholder, or managerial control, along with social or economic goals or both in balance. But even the most devoted adherent of conventional economic theory cannot, for example, dismiss regulation totally, any more than the most flaming radical can deny the place of economic goals in the corporation.

I tilt to the left of center, as has no doubt been obvious in my comments to this point. Let me summarize my own prescriptions as follows, and in the process provide some basis for evaluating the relevant roles of each of the eight positions.

First "Trust It" or at Least "Socialize It." Despite my suspicions about much of the rhetoric that passes for social responsibility and the discouraging evidence about the behavior of large contemporary organizations (not only corporations), I remain firmly convinced that without honest and responsible people in important places, we are in deep trouble. We need to trust it because, no matter how much we rely on the other positions, managers will always retain a great deal of power. And that power necessarily has social no less than economic consequences. The positions on the right side of our horseshoe ignore these social consequences while some of those on the left fail to recognize the difficulties of influencing these consequences in large, hierarchical organizations. Sitting between these two sets of positions, managers can use their discretion to satisfy or to subvert the wishes of the public. Ultimately, what managers do is determined by their sense of responsibility as individual members of society.

Although we must "trust it," we cannot *only* "trust it." As I have argued, there is an appropriate and limited place for social responsibility – essentially to get the corporation's own house in order and to encourage it to act responsibly in its own sphere of operations. Beyond that, social responsibility needs to be tempered by other positions around our horseshoe.

Then "Pressure It," Ceaselessly. As we have seen, too many forces interfere with social responsibility. The best antidote to these forces is the ad hoc pressure campaign, designed to pinpoint unethical behavior and raise social consciousness about issues. . . .

In fact, "pressure it" underlies the success of most of the other positions. Pressure campaigns have brought about necessary new regulations and have highlighted the case for corporate democracy. As we have seen, the "ignore it" position collapses without "pressure it." Indeed, what if not a pressure campaign is the media blitz of Milton Friedman to "restore it."

After That, Try to "Democratize It." A somewhat distant third in my portfolio is "democratize it," a position I view as radical only in terms of the current U.S. debate, not in terms of fundamental American values. Democracy matters most where it affects us directly – in the water we drink, the jobs we perform, the products we consume. How can we call our society democratic when many of its most powerful institutions are closed to governance from the outside and are run as hierarchies of authority from within?

As noted earlier, I have no illusions about having found the means to achieve corporate democracy. But I do know that Americans can be very resourceful when they decide to resolve a problem – and this is a problem that badly needs resolving. Somehow, ways must be found to open the corporation up to the formal influence of the constituencies most affected by it – employees, customers, neighbors, and so on – without weakening it as an economic institution. At stake is nothing less than the maintenance of basic freedoms in our society.

Then, Only Where Specifically Appropriate, "Regulate It" and "Induce It." Facing each other on the horseshoe are two positions that have useful if limited roles to play. Regulation is neither a panacea nor a menace. It belongs where the corporation can abuse the power it has and can be penalized for that abuse – notably where externalities can be identified with specific corporations. Financial inducements belong, not where a corporation has created a problem, but where it has the capability to solve a problem created by someone else.

Occasionally, Selectively, "Nationalize It" and "Restore It," but Not in Friedman's Way. The extreme positions should be reserved for extreme problems. If "pressure it" is a scalpel and "regulate it" a cleaver, then "nationalize it" and "restore it" are guillotines.

Both these positions are implicitly proposed as alternatives to "democratize it." One offers public control, the other "shareholder democracy." The trouble is that control by everyone often turns out to be control by no one, while control by the owners – even if attainable – would remove the corporation even further from the influence of those most influenced by it.

Yet, as noted earlier, nationalization sometimes makes sense – when private enterprise cannot provide a necessary mission, at least in a sufficient or appropriate way, and when the activities of a corporation must be intricately tied in to government policy.

As for "restore it," I believe Friedman's particular proposals will aggravate the problems of political control and social responsibility, strengthening oligarchical tendencies in society and further tilting what I see as the current imbalance between social and economic goals. In response to Friedman's choice between "subversive" socialism and "free" enterprise, I say "a pox on both your houses." Let us concentrate our efforts on the intermediate positions around the horseshoe. … I stand with Friedman in wishing to see competitive markets strengthened; it is just that I believe his proposals lead in exactly the opposite direction.

Finally, Above All, Don't "Ignore It." I leave one position out of my portfolio altogether, because it contradicts the others. The one thing we must not do is ignore the large, widely-held corporation. It is too influential a force in our lives. Our challenge is to find ways to distribute the power in and around our large organizations so that they will remain responsive, vital, and effective.

Notes

1 E. M. Epstein, for example, finds the social record of nationalized firms in the U.K. not much better than the private ones, a conclusion reinforced by C. Jenkins, who advocates nationalization. E. M. Epstein, "The Social Role of Business Enterprise in Britain: An American Perspective; Part II," *The Journal of Management Studies* (1977), pp. 281–316; and C. Jenkins, *Power at the Top* (Westport, CT: Greenwood Press, 1976).

2 From J. Bacon and J. K. Brown, *Corporate Directorship Practices: Role, Selection and Legal Status of the Board* (The Conference Board and the American Society of Corporate Secretaries, Inc., 1975), p. 48.

3 See Henry Mintzberg, *Structure in Fives: Designing Effective Organizations* (Englewood Cliffs, NJ: Prentice Hall, 1983).

4 T. Levitt, "Why Business Always Loses," *Harvard Business Review* (March/April 1968), p. 83.

5 Levitt, op. cit.

6 D. Braybrooke, "Skepticism of Wants, and Certain Subversive Effects of Corporations on American Values," in S. Hook, ed., *Human Values and Economic Policy* (New York, NY: New York University Press, 1967), p. 224.

7 Milton Friedman, "A Friedman Doctrine: The Social Responsibility of Business is to Increase its Profits," *The New York Times Magazine*, September 13 1970, pp. 33, 126.

8 Robert W. Ackerman, *The Social Challenge to Business* (Cambridge, MA: Harvard University Press, 1975), p. 56.

9 I. Ross, "How Lawless are the Big Companies?" *Fortune*, December 1, 1980, p. 57.

10 Aleksander Solzhenitsyn, from "Why The West Has Succumbed to Cowardice," *The Montreal Star News and Review*, June 10, 1978, p. Bl.

11 Friedman, op. cit., p. 33.

[12] Milton Friedman, *Capitalism and Freedom*. (Chicago, IL: University of Chicago Press, 1962), p. 20.

[13] L. Smith, "The Boardroom Is Becoming a Different Scene," *Fortune*, May 8, 1978, pp. 150–154, 158, 162, 166, 168.

[14] A number of these proposals would be worthwhile to pursue in the public and parapublic sectors as well, to divide up overgrown hospitals, school systems, social service agencies, and all kinds of government departments.

Tone at the Top
An Ethics Code for Directors?

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Introduction: Where Were the Directors?[1]

The number and extent of recent corporate scandals (e.g., Enron and their auditor Arthur Andersen, WorldCom, Tyco International, Global Crossing, Adelphia, Fannie Mae, HealthSouth, and the New York Stock Exchange, with the number growing steadily), have provoked interest in corporate governance on the part of the media, shareholders, legislators, regulators, creditors, mutual funds and pension funds. "...(T)oday, [directors] are under the microscope as everyone from bondholders to the smallest retail investor looks to boards of directors to restore confidence in a shaken market" (Gray, 2003, p. 59). The growing interest and concern is not surprising, given the significant financial and social harm these scandals have caused society.

As noted by U.S. President George W. Bush (Guardian, 2002):

> [These] high-profile acts of deception have shaken people's trust. Too many corporations seem disconnected from the values of our country. These scandals have hurt the reputations of many good and honest companies. They have hurt the stock market. And worst of all, they are hurting millions of people who depend on the integrity of businesses for their livelihood and their retirement, for their peace of mind and their financial well-being.

According to U.S. Federal Reserve Chairman Alan Greenspan (2002), "infectious greed" had simply "gripped the business community." The magnitude of these 21st century scandals, in contrast to earlier ones limited to specific industries (i.e., savings and loan firms, defense contractors) or activity (i.e., insider trading) is reflected in their variety across industries and the type of fraud perpetrated. Corporate agents at the most senior levels, including several CEOs and chairs of boards of directors,[2] have been accused of being key players in the corporate malfeasance.

Enron and WorldCom symbolize the ways in which greed penetrated corporate governance. Enron involved ". . .a systematic and pervasive attempt by Enron's management to misrepresent the company's financial condition. . .self-enrichment by employees, inadequately designed controls, poor implementation, inattentive oversight, simple and not-so-simple accounting mistakes, and overreaching in a culture that appears to have encouraged pushing the limits" (Cohan, 2002, p. 277). In the case of WorldCom the drivers included (Directors' Report, 2003): ". . . a perceived need to meet unrealistic securities market expectations" (p. 35); a culture "...emphasizing making the numbers above all else" (p. 18); the keeping of ". . . financial information hidden from those who needed to know" (p. 18); "...a systematic attitude

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conveyed from the top down that employees should not question their superiors, but simply do what they were told" (p. 21); and the provision of few "...outlets through which employees believed they could safely raise their objections" (p. 18).

It is instructive that these scandals might have been reduced or avoided but for board failures. In the case of Enron, the U.S. Senate's Permanent Subcommittee on Investigations found that "while the primary responsibility for the financial reporting abuses... lies with Management...those abuses could and should have been prevented or detected at an earlier time had the Board been more aggressive and vigilant" (Senate Report, 2002, p. 13). In the case of WorldCom, the Special Investigative Committee of the Board of Directors found that "WorldCom's collapse reflected not only a financial fraud but also a major failure of corporate governance...although the Board, at least in form, appeared to satisfy many checklists of the time, it did not exhibit the energy, judgment, leadership or courage that WorldCom needed" (Directors' Report, 2003, p. 29). In other words, the failures were not merely the result of senior executives engaging in inappropriate activity, but the fact that boards and directors responsible for monitoring senior management appear to have failed in their responsibilities. A defining question is: "Where were the directors?" (Nofsinger and Kim, 2003, p. 89).

The Enron board included many highly competent and accomplished individuals. In fact, shortly before its collapse, Enron was ranked by *Chief Executive* magazine as having one of the nation's five best boards in 2000 (NACS, 2002). The board included among others John Duncan, who held "extensive corporate and Board experience," Herbert Winokur, Jr., who held "...two advanced degrees from Harvard University [with] extensive corporate, Board and investment experience," Dr. Robert Jaedicke, Dean emeritus of the Stanford Business School and a former accounting professor, and Dr. Charles LeMaistre, former President of the Anderson Cancer Center, "a large and well respected and complex medical facility in Texas" (Senate Report, 2002, p. 2). The U.S. Senate Subcommittee found that the Directors possessed "...a wealth of sophisticated business and investment experience and considerable expertise in accounting, derivatives, and structured finance"(Senate Report, 2002, p. 8).

Yet at the end of the day, according to the U.S. Senate Subcommittee:

> The Enron Board of Directors failed to safeguard Enron shareholders and contributed to the collapse of the seventh largest public company in the United States, by allowing Enron to engage in high risk accounting, inappropriate conflict of interest transactions, extensive undisclosed off-the-books activities, and excessive executive compensation. The Board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders, employees and business associates. (Senate report, 2002, p. 3)

WorldCom's board also appeared highly competent: "Before WorldCom Inc.'s fall, its board of directors included a seasoned group of leaders, members such as the former head of the National Association of Securities Dealers, several company chief executives, the chairman of Moody's Corp., even the dean of the Georgetown University Law Center." Yet despite the apparent quality and competence of the board: "An investigative report...concluded that while its top executives mismanaged the company disastrously, WorldCom's directors 'served as passive observers' and 'did not exert independent leadership'" (Hilzenrath, 2003).

Even the venerable New York Stock Exchange, an organization charged with regulatory oversight for member broker-dealer firms and companies with listed securities, fell victim to charges of inadequate internal corporate governance. Its Board of Directors included many of the most sophisticated and experienced financial executives in the country. Yet they were criticized for inadequate performance of their fiduciary duties. The issue that received the most publicity and outcry was the disclosure that the former CEO, Richard A. Grasso, had an unprecedented generous retirement plan that dwarfed retirement plans for CEO's of many of the largest companies in the world.

In order to examine and better understand the underlying reasons for the various corporate governance failures, in particular Enron and WorldCom, and to potentially work towards avoiding such scandals in the future, we argue that the legal system underlying corporate governance, although necessary, is inherently insufficient as a means of ensuring essential levels of ethical behavior on the part of corporate directors. The identification of, and adherence to, ethical obligations constitute a critical complementary responsibility for corporate directors.

Much has been written on the legal obligations of directors (Akula, 2000; Fairfax, 2002; Iwan and Watts, 2002; Schreurs, 1999; Wade, 2002; Walsh, 2003), as well as board "best practices" (Daily et al., 2003; Westphal, 1999; Zahra and Pearce, 1989). Surprisingly little however has been written specifically on the ethical obligations of directors. Other than descriptive studies that have been conducted on directors and their involvement in their firms' ethics programs (e.g., Felo, 2001), a review of ABI/Inform and LexisNexis using the search terms "ethics" and "directors" did not reveal any formal normative study dedicated to the subject of directors' ethical obligations. One text on corporate governance neglects to explicitly discuss the ethical obligations of directors (Monks and Minow, 2001). Another corporate governance text which lists "Business, Legal and Ethical Challenges Faced by Boards of Directors" on its cover, devotes only a few pages to a discussion of the ethical obligations of directors (Colley, Doyle, Logan and Stettinus, 2003). In terms of practical application, a review (as of August 1, 2003) of several national directors' associations including the United States' National Association of Corporate Directors (NACD), Britain's Institute of Directors (IoD), and Canada's Institute of Corporate Directors (ICD), did not find any offering training that specifically addressed the ethical as opposed to legal obligations of directors. These findings might appear surprising given the extensive literature discussing the ethical obligations of other non-professional groups including: marketing managers (O'Boyle and Dawson, 1992); public relations managers (Bivins, 1993; Pratt, 1991, 1994); project managers (Nixon, 1987); scientists (Rapoport, 1989; Schinin, 1989); bank managers (Rideout, 1989); real estate agents (Allmon, 1990); property managers (Sharplin et al., 1992); purchasing professionals (Forker, 1990); property/liability underwriters (Cooper and Frank, 1990); financial managers (Ang, 1993; Freeman et al., 1992; Nemes, 1992); and computer professionals (Oz, 1993).

To address the paucity of research in the literature on the explicit ethical obligations of directors, we begin by exploring whether directors have unique ethical obligations and, if so, what these obligations might be comprised of. In part one of our paper we argue that the legal framework for directors, while necessary, is insufficient as a means of encouraging appropriate levels of ethical behavior on the part of directors. To do this, we: (a) summarize the current state of the U.S. legal framework for directors and discuss limitations restricting enforcement the law; and (b) examine the current corporate scandals as illustrations of ethical failures. Part two discusses the key bases for the ethical role of directors. Directors have overall responsibility for the ethics and compliance programs of the corporation. The tone at the top that they set by example and action is central to the overall ethical environment of their firms. This role is reinforced by their legal responsibilities to provide oversight of the financial performance of the firm. Underlying this analysis is the critical assumption that ethical behavior, especially on the part of corporate leaders, leads to the best long-term interests of the corporation. Part three examines formal sources that can be used to derive ethical obligations for directors, including: (a) corporate codes of ethics for employees; (b) corporate codes of ethics for directors; (c) companies' corporate governance principles or guidelines; (d) ethical standards from national corporate directors' associations; (e) national and international corporate governance codes or principles; and (f) generally recognized business ethics principles. Part four proposes a basic framework for a firm-based "Code of Ethics for Directors" based upon a convergence of the formal ethical standards discussed in part three into six core ethical values. Part five discusses specific issues that would have to be addressed in any firm-based code of ethics for directors.

Part One – Corporate Governance Law, Necessary But Inherently Insufficient

Our basic claim is that the U.S. law of corporate governance has proven insufficient to encourage appropriate ethical behavior on the part of corporate directors. We believe this is the case in spite of the apparently widely held impression that there is significant personal liability for individual directors. Although there may be contexts in which directors' potential liability becomes a motivator, in fact it is only for the most extreme malfeasance, leaving the law impotent as a means of encouraging day-to-day ethical behavior. To clarify our argument, we are not claiming that the failure of boards was the sole, or even necessarily the most significant factor in the perfect storm that brought down so many firms. We agree with Coffee (2002) that the failure of other, also inadequately deterred gatekeepers such as auditing and law firms was also important. We disagree, however, with Coffee's (2002, p. 1419) claim that "Enron is more about gatekeeper failure than board failure." Instead, we see corporate boards as the gatekeeper of last resort when it comes to preventing massive ethical failure.

Limitations of ability of law to ensure director's performance of duty

Corporate governance has been defined as (Weil et al., 2002, p. 28):

> . . . the mechanisms by which a business enterprise, organized in a limited liability corporate form, is directed and controlled. It usually concerns mechanisms by which corporate managers are held accountable for corporate conduct and performance.

The mechanism by which companies are ultimately directed and controlled is through the actions of the board of directors, as elected by the corporation's shareholders. As detailed in the U.S. Senate Subcommittee Report on Enron:

> [T]he Board of Directors sits at the apex of a company's governing structure. A typical Board's duties include reviewing the company's overall business strategy; selecting and compensating the company's senior executives; evaluating the company's outside auditor; overseeing the company's financial statements; and monitoring overall company performance. According to the Business Roundtable, the Board's 'paramount duty' is to safeguard the interests of the company's shareholders.
>
> (Senate Report, 2002, p. 5)

To help ensure that directors carry out these critical duties, national legal systems around the world have established specific obligations for directors. The legal responsibilities "...date from the introduction of publicly traded companies in the 19th century" (Vinten, 1998, p. 37). They often impose individual liability upon directors who breach their legal obligations. Directors can be sued by many parties including: "...the company itself, liquidators, shareholders, creditors, third parties, and government authorities" (Iwan and Watts, 2002, p. 67). Legal obligations for directors derive from the principle that "all corporate affairs must be managed under the direction of the board of directors" (Fairfax, 2002, p. 2).

The U.S. Senate Subcommittee examining Enron summarized directors' legal obligations as follows:

> Directors operate under state laws which impose fiduciary duties on them to act in good faith, with reasonable care, and in the best interest of the corporation and its shareholders. Courts generally discuss three types of fiduciary obligations. . .namely, the duties of obedience, loyalty, and due care. The duty of obedience requires a director to avoid committing. . .acts beyond the scope of the powers of a corporation as defined by its charter or the laws of the state of incorporation... the duty of loyalty dictates that a director must act in good faith and must not allow his personal interest to prevail over the interests of the corporation. [T]he duty of care requires a director to be diligent and prudent in managing the corporation's affairs.
>
> (Senate Report, 2002, p. 5)

The breach of these essential duties would appear to address most of the improper conduct on the part of directors involved in the recent scandals. The question thus arises why the legal regulatory scheme proved insufficient to bring about proper behavior and oversight on the part of boards. The following phenomena contributed to the failure of the potential for legal liability to sufficiently motivate boards and individual directors: (i) the business judgment rule; (ii) corporate constituency statutes; and (iii) charter/by-law limitations/elimination of liability. Due to these provisions, and despite what many suggest is ever broader potential legal liability for directors (Olijnyk, 2003, p. 51), it is still very difficult to enforce the law against directors. The result is that directors may not have sufficient motivation in terms of potential legal liability to engage in appropriate (or avoid inappropriate) behavior. The limitations to the law and liability are as follows:

Business judgment rule. The New Jersey Business Corporation Act (the "NJBCA") is representative of modern state corporate statutes that have endeavored to define an objective standard for business judgment. The NJBCA provides the following: "Directors and members of any committee designated by the board shall discharge their duties in good faith and with that degree of diligence care and skill which ordinarily prudent people would exercise under similar circumstances in like positions"[3] [s. 14A: 6–14].

However, this type of relatively simple statutory construction of the standard for conduct of directors has been modified in many states in recent years, often to broaden the protections for directors and provide for considerable flexibility in their permissible actions.

The business judgment rule provides an important limitation of liability with respect to a director's duty of care. The rule establishes a presumption that: ". . .the directors acted on an informed basis, in good faith and in honest belief that the action was taken in the best interest of the corporation" (Iwan and Watts, 2002, p. 68). In other words, courts are not permitted to "second-guess" boards (Akula, 2000, p. 33), and are only able to consider the board's decision-making process and not the substance of the decision (Hanewicz, 2003, Winter, p. 217).

Under the business judgment exception, the oft-invoked claim of "ignorance" by directors or their reliance on the honesty of the executives reporting to them or on the opinions provided by their auditors or lawyers appears to be a major obstacle to finding directors liable for their actions or inaction (Hanewicz, 2003).

> For example, the Delaware General Corporation Law ("DGCL") provides the following: A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation [s. 141(e)].

Similar provisions are contained in the Pennsylvania Business Corporation Law ("PBCL") [s. 512(a)] and the NJBCA [s. 14A: 6–14].

Corporate Constituency statutes. In recent years a number of states, such as New Jersey, have enacted provisions designed to give directors greater latitude in carrying out their fiduciary duties by allowing them to consider a wider range of statutorily-sanctioned factors in making decisions. The expansion allows directors to justify their actions on more ambiguous grounds such as acting on behalf of stakeholders when they are attacked by shareholders or others. For example, the NJBCA provides the following:

> In discharging his duties to the corporation and in determining what he reasonably believes to be in the best interest of the corporation, a director may, in addition to considering the effects of any action on shareholders, consider any of the following: (a) the effects of the action on the corporation's employees, suppliers, creditors and customers; (b) the effects of the action on the community in which the corporation operates; and (c) the long term as well as the short-term interests of the corporation and its shareholders, including the possibility that these interests may best be served by the continued independence of the corporation [s. 14A: 6–1(2)].

This New Jersey provision in effect acts to redefine and expand the meaning of "best interests of the corporation" and the "effects of any actions on the shareholders" with the effect of providing greater protection for directors from liability for decision-making. This gives directors much greater latitude setting corporate policy by permitting them to consider factors that were not traditionally deemed to be within the scope of determination. It is at least mildly ironic that the corporate constituency statutes that have been favored by many business ethicists (e.g., Fort, 1997, O'Connor, 1991, Van Wezel Stone, 1991) may have contributed to a more permissive legal environment resulting in ethical lapses by boards.

Charter/by-law limitations/elimination of liability. In recent years a number of states have gone even further to authorize exoneration of directors from personal liability to the extent that the articles of incorporation or bylaws adopted by the shareholders specifically so provide. For example the PBCL (s. 513) adopted in 1990 provides the following:

> (a) General rule. – If a bylaw adopted by the shareholders entitled to vote or members entitled to vote of a domestic corporation so provides, a director shall not be personally liable, as such, for monetary damages for any action taken unless:
> (1) the director has breached or failed to perform the duties of his office under this subchapter [which includes the provisions described above relative to Section 512(a) of the PBCL]; and
> (2) the breach or failure to perform constitutes self-dealing, willful misconduct or recklessness.

Although New Jersey also permits elimination or limitation of the personal liability of a director [NJBCA s. 14A: 2–7(3) and s. 14A: 6–14(3)], such provisions must be contained in the certificate of incorporation (which automatically requires share-holder approval), rather than the bylaws of the corporation as in Pennsylvania. As a result, it is extremely difficult to find directors liable.

In addition to the defenses and liability limitations identified above, many states "*. . .*permit corporations to indemnify their directors from liabilities associated with civil, criminal or administrative proceedings against the company" (Senate Report, 2002, p. 5)[4]. As a further protection, "... most U.S. publicly traded corporations, purchase directors' liability insurance that pays for a director's legal expenses and other costs in the event of such proceedings" (Senate Report, 2002).[5]

Beyond these limitations and protections from civil liability, other difficulties exist in order to find directors criminally liable. The standard of proof required is to prove criminal intent beyond a reasonable doubt. This often necessitates the need to find a whistle-blower willing to testify against his or her superiors, which is not an easy task. If directors are prosecuted, they tend to have access to high quality, legal counsel (France and Carney, 2002, p. 34). Although additional criminal penalties with respect to fines and jail sentencing have bepp imposed through the enactment of the *Sarbanes-Oxley Act of 2002*, whether the *Act* will have any effect on changing the behavior of executives or directors is yet to be seen:

> So does this mean that the rogue's gallery of irresponsible execs who have populated the business pages over the past several months will finally go to jail? Will the little guy finally be avenged? Don't count on it. While there will certainly be more prosecutions – and some of them will bear fruit – criminal enforcement is a risky game. The laws regulating companies are ambiguous, juries have a hard time grasping abstract financial concepts, and well-counseled executives have plenty of tricks for distancing themselves from responsibility.
>
> (France and Carney, 2002, p. 34)

Ethical failures were key to most of the major scandals

Closer attention to ethical concerns should have short-circuited some of the behaviors that ultimately brought down entire firms in the recent scandals. The Enron disaster occurred in the face of Board ratification of waivers of the firm's Code of Ethics and its conflict of interest rules on three separate occasions. Jennings (2003) suggests that the firm's auditor had requested the board's action in the belief that the board would step up, refuse to go along, and thereby save the audit team. As is well known, the board did not do so. As Jennings notes (Id.) "another important safety tip for directors emerges: if the CEO asks you to waive provisions in the Code of Ethics, you perhaps, have a problem."

The directors involved in Enron did not appear to believe that they were doing anything that was legally problematic.

As noted above, Enron's board of directors voted three times to suspend the conflict of interest provisions in Enron's code of ethics to permit CFO Andrew Fastow to establish and operate entities that transacted business with Enron and profited at Enron's expense. The Senate Committee found that the waiver of the code was "highly unusual and disturbing [as it] allowed inappropriate conflict of interest transactions" (Senate Report, 2002, p. 24). Two other senior financial officers were able to profit from the entities, neither of whom obtained a waiver of the code of conduct (Senate Report, 2002, p. 28). Yet, during the congressional hearings, the directors indicated that they believed they were acting in the best interests of Enron, that there were sufficient safeguards in place, and that they would make the same decision again in the future (Senate Report, 2002, p. 29). Although the new *Sarbanes-Oxley Act* will now require disclosure of code waivers, at the time, disclosure of the waiver by Enron's board was not legally necessary.

Many directors appeared to have had direct or indirect conflicts of interest. Two directors received payment for consulting services to Enron (Senate Report, 2002, p. 55). One director was a CEO of a company that had engaged in tens of millions of dollars of transactions with Enron (Senate Report, 2002, p. 55; Shmitt and Barnett, 2002). Other directors were directly associated with organizations that received substantial charitable donations from Enron (Berenbeim, 2002, p. 3). Even if technically legal, such actions were viewed by the Subcommittee as ethically inappropriate in terms of creating potential conflicts of interest and thus affecting the board's independent judgment vis-a-vis Enron management (Senate Report, 2002, p. 56).

Enron's board simply did not sufficiently probe into the financial situation (Cohan, 2002, p. 277). The egregious falsification of financial data leads one to ask: "Were there times that Enron directors noticed an anomaly but chose to ignore it because it conformed to GAAP and did not violate securities laws?" (NACS, 2002, p. 4).

Despite all of the above concerns, Enron's directors "...explicitly rejected any share of responsibility for Enron's collapse." They argued that "the Board worked hard" and "asked probing questions." The directors all viewed their actions as appropriate and legal in nature and blamed Enron management and the auditors, Arthur Andersen, for "not telling the truth" (Senate Report, 2002, p. 14).

WorldCom's directors also appear to have engaged in a number of acts that while technically legal, are arguably unethical through an appearance of impropriety.

Two directors, Bernie Ebbers and Scott Sullivan, gave significant financial gifts and loans of hundreds of thousands of dollars to other managers at WorldCom, creating ". . .conflicting loyalties and disincentives to insist on proper conduct" (Directors' Report, 2003, p.24). The board of directors authorized significant loans and guarantees ($400 million) to CEO Bernie Ebbers (Directors' Report, 2003, p. 32) so that he could avoid selling his own WorldCom stock to meet his personal financial obligations. Nobody on the board challenged Ebbers with respect to his use of WorldCom stock. The investigative committee felt that these loans and guarantees, although legal, were "...a major failure of corporate governance" (Directors' Report, 2003, p. 32). The board also approved one of WorldCom's airplanes being leased by one of the directors, potentially affecting his independence (Directors' Report, 2003, p. 34). The board did not seriously question Bernie Ebbers in relation to his extensive outside business interests. According to the investigative committee: "We do not believe most properly run Boards of Directors would permit a Chief Executive Officer to pursue an array of interests such as these, certainly not without careful examination of the time and energy commitments they would require" (Directors' Report, 2003, p. 32). According to the Bankruptcy Examiner's Report of WorldCom, the board appeared to "rubber stamp" management's decisions, in one case spending only 35 minutes during a telephone meeting reviewing the take-over of a company worth $6 billion that ultimately cost WorldCom billions in losses. No documents were provided to the board (Business Times, 2002). Many other steps could have been taken by the board "…to increase the chances of detecting acts of corporate wrongdoing including: maintaining enough involvement in the Company's business to enable the Board to exert some control over the agenda, ensuring the presence of strong 'control' functions within the company; communicating throughout the Company the value of high ethical standards; having some familiarity and direct contact with people throughout the Company (as well as suppliers and customers); and keeping a close and open relationship with the outside auditors" (Directors' Report, 2003, p. 283).

In summary, the law as it presently stands remains insufficient to encourage appropriate behavior on the part of directors. While more stringent corporate governance laws regulating director behavior along with enhanced enforcement and potential penalties might help improve the situation somewhat, we argue that the law is inherently insufficient. Experience has demonstrated that potential loopholes will always exist in the legal framework for corporate governance, providing one with the opportunity to merely comply with the letter as opposed to the spirit of the law. Part two will now further develop the rationale for emphasizing the ethical obligations of directors.

Part Two – The Need for Emphasis on the Ethical Obligations of Directors

Directors' ethical obligations derive from the nature of their role and are reinforced by their primary legal obligation to provide oversight of the financial performance of the firm and their secondary obligation to ensure an effective corporate compliance program. Directors truly set the "tone at the top" for their organizations.

The critical role of directors

As professionals and fiduciaries, boards are ultimately responsible for the protection of corporate assets. Directors hold ultimate responsibility for the selection, retention, and discipline of senior management, they help ensure the accuracy of financial reports, and they decide whether to approve major organizational changes such as mergers and acquisitions. A high degree of trust is placed in the hands of directors by shareholders. As a result, directors of companies might be considered to be some of the most important fiduciaries in society. They are subject to formal expectations concerning their knowledge and their responsibilities to others. In that sense, they are similar to doctors, lawyers and accountants who are subject to professionally prescribed ethical responsibilities. By undertaking a formal commitment to enter into this professional role, and often being paid substantial compensation, individuals serving as directors should be considered bound by professional ethical obligations beyond mere compliance with the law.

Although directors have not yet been recognized as a professional group, this may be changing as education, training, and director certification courses are beginning to be offered in several jurisdictions (e.g., Britain and Canada). Companies are becoming much more concerned about the level of competence (including financial expertise) of their board members and appear to be increasing the level of due diligence used in the screening process of potential board members (Olihnyk, 2003, p. 52). Such due diligence includes:". . .reference checks, criminal checks, and education verification" (Olihnyk, 2003, p. 52). Establishing financial expertise for the audit committee's "financial expert" has become a legal requirement under the *Sarbanes-Oxley Act* (s. 407).

Failure by directors to fulfill their role properly for companies of all sizes can lead to disastrous consequences for many stakeholder groups, and potentially affect thousands of people. In some cases, decisions (or inaction) by boards can involve life or death consequences (e.g., non-recall of the Ford Pinto, non-recall of Goodrich tires, Dow Corning and breast implants, Union Carbide in Bhopal India), or involve significant financial harm, (e.g., Barings Bank, Enron, WorldCom). Based on the moral duty of non-malfeasance, or the avoidance of unnecessary harm, as well as based on utilitarian arguments, the potential negative consequences of directors' actions or inaction suggests that reference to the law alone for standards is simply not sufficient. The Directors' Report (2002) on WorldCom reflects this by emphasizing that had the Board been concerned with communicating the value of high ethical standards throughout the company, it might have detected and/or forestalled the financially disastrous scandal.

One might respond that unlike other professional groups, the role of a director is part-time in nature and therefore not comparable to lawyers or accountants. According to one Enron director, Herbert Winokur, the former Chairman of the Finance Committee, Enron's catastrophe was "a cautionary reminder of the limits of a director's role" which is by nature "a part-time job" (Senate Report, 2002, p. 14). When one considers the substantial responsibility that directors have in monitoring their corporations, however, it is hard to imagine that directors should not be considered professionals without additional ethical obligations, regardless of the part-time nature of their role. One would not argue that a part-time lawyer or accountant is any less a professional. In addition, despite the part-time nature of directors, their significance is emphasized due to the fact that directors are required to "… be available to drop everything for any special situation or crises" (Olijnyk, 2003, p. 53).

Setting the tone at the top; ensuring effective compliance and ethics programs

Boards sit at the top of the corporate hierarchy. Along with senior management, directors set by their words and deeds the ethical tone for the organizations (Schroeder, 2002). All others involved with the firm look to the top for guidance. Whether or not they actively seek the responsibility, boards serve as role models for ethical tone. The organizational literature documents the importance of the role of senior executives (Treviño and Weaver, 2003) and board members in influencing the ethical behavior of lower level employees. For example, large accounting organizations have long emphasized "tone at the top" as a means of ensuring that their members act ethically and professionally (McGrath et al., 2001).

Beyond the general role of directors in setting the tone at the top, recent changes in law and practice are expanding the responsibility of boards for their firms' corporate compliance and ethics programs. Boards are increasingly being asked to ensure that their companies have implemented compliance or ethics programs. Under the U.S. Federal Sentencing Guidelines for Organizations (1991), a company found to have an "effective compliance program" in place prior to a violation of federal law may have fines reduced substantially. An effective compliance program includes, among other elements, a code of conduct or ethics, ethics training, an ethics officer, and a reporting system. The guidelines were bolstered by the case, *Caremark International* (1996). While referring to the Federal Sentencing Guidelines' minimum requirements for an effective compliance program, the court emphasized the board's responsibility to adopt systems that help keep it adequately informed of compliance problems (Akula, 2000). 'Directors' responsibilities with respect to a firm's compliance and ethics program as outlined in *Caremark* appears to have been enhanced by recent amendments to the Sentencing Guidelines (2004). The Sentencing Guidelines now require organizations to "…promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law." In addition, the Sentencing Guidelines require the organization's "governing authority" (i.e., directors) to be: "… knowledgeable about the content and operation of the compliance and ethics program and …exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program."

Following along legal trends, the U.S. National Association of Corporate Directors recommends that: "Boards should review the adequacy of their companies' compliance and reporting systems at least annually. In particular, boards should ensure that management pays strict attention to ethical behavior and compliance with laws and regulations…" (NACD, 2002, p. 2). The *Sarbanes-Oxley Act* [s. 406(a)] requires companies to adopt a code of ethics for senior financial officers, or to indicate the reasons why one does not exist. Directors must also disclose whether they have waived any provision in their codes [s. 406(b)], and can be held liable for any retaliation against whistleblowers (s. 1107).

Corporate practice is changing in a manner congruent with these trends. Some corporate codes of ethics specifically indicate that the code has been adopted by the firm's board of directors: The Code of Business Conduct of Halliburton Company specifically notes, "Policies *adopted by the Board of Directors*" [emphasis added]. Board adoption of a code surely creates an expectation on the part of all employees that individual directors themselves will at a minimum meet relevant ethical obligations set forth therein.

Boards often have special responsibilities relating to the enforcement of existing ethics codes and programs. For example, corporate codes of ethics typically indicate that employees have an obligation to report wrongdoing by others. Morgan Stanley's code indicates: "If your concerns relate to the conduct of the Chief Executive Officer, any other senior executive or financial officer, or a member of the Board of Directors, you may also report your concerns to the Chief Legal Officer. The Chief Legal Officer will notify the Board of Directors if the allegations of unlawful or unethical conduct have merit. Similar concerns involving the Chief Legal Officer should be reported to the Board of Directors." The firm is stating that the board of directors is the final authority even when other board members are acting improperly. As the employees' final resort to potentially address employees' raised concerns over wrongdoing (e.g., code violations), directors can and should be expected to set the ethical tone for the firm.

Acting in the best interests of the corporation

Research suggests that the ethical behavior of a corporation's leaders, including whether actions are taken against unethical behavior, has an impact on the ethical behavior of other corporate agents (Akaah and Riordan, 1989; Baumhart, 1961; Brenner and Molander, 1977; Posner and Schmidt, 1987; Soutor et al., 1994). Potential harm to the company increases if corporate agents view their directors as acting unethically and then become more likely to act illegally or unethically. Manager or employee perceptions of their directors' ethical behavior may also affect the likelihood that illegal or unethical, behavior is disclosed through internal whistle-blowing, which would provide the company with a potential opportunity to avoid a scandal. In the case of WorldCom, the Special Investigative Committee found that "one of the serious adverse consequences was the message that [the loans and guarantees to CEO Bernie Ebbers] conveyed. Employees will not believe that the Board can be approached with concerns about the Chief Executive Officer or his top management when they see the Board using shareholder funds to bail the Chief Executive Officer out of his financial distress" (Directors' Report, 2003, p. 291). At Enron, Sherron Watkins indicated in her testimony to the U.S. Senate that the company's corporate culture made it difficult for her to come forward (CNN Watkins, 2002).

The ethical behavior of boards of directors can influence both the ethical behavior of corporate agents, and the ability to have unethical behavior disclosed and addressed. In both cases, the likelihood of a corporate scandal causing significant harm to the company only increases if directors are perceived as acting unethically. There may be all sorts of additional costs that can be avoided if corporate directors fulfill their ethical obligations (Dunfee, 1999). For example, in addition to legal and public relations costs, corporate scandals that occur due to directors' ethical lapses can affect a company's ability to retain and attract talented managers and employees. Corporate governance practices perceived as being problematic may also affect the firm's ability to raise capital from ethically sensitive investors or lenders (Baue, 2002; CalPERS, 2003; Gray, 2003). If it is accepted that directors have an obligation to act in the best interests of their companies, then based on the evidence, directors have an obligation to behave ethically.

In summary, directors need to emphasize their ethical obligations because: (1) recent corporate scandals involved serious ethical failures at the board level; (2) the nature of boards requires observance of ethical obligations; (3) boards, charged with the ultimate responsibility of ensuring the ethics of their organizations, are thereby obligated to act as ethical role models themselves; and (4) it is simply good for corporate business success for directors to be ethical. Part three will now examine the formal sources available for establishing the parameters of ethical obligations for boards and directors.

Part Three – Formal Sources of Directors' Ethical Obligations

We have seen that ethical dimensions are critical to the operation of boards and in the performance of individual directors. This is reflected in trends in corporate practice with more firms explicitly recognizing the need for ethical standards and guidance for directors. At the same time, complementary principles of emerging corporate law either actively encourage consideration of ethical dimensions by directors, or are open to such considerations (Dunfee, 1999).

The multiple sources of standards that exist or potentially exist complicate the process of determining which ethical principles are relevant for a particular board and its constituent directors. The potential sources for ethical obligation for directors and/or boards include: (a) corporate codes of ethics; (b) director-specific corporate codes of ethics; (c) company corporate governance principles; (d) ethical codes for members of national director associations; (e) international and national corporate governance principles; and (f) generally recognized principles of business ethics. Each has its own focus and purpose.

Taken together they point the way toward core principles for directors' ethical obligations.

Corporate codes of ethics

Directors of companies having a code of ethics for their employees may be explicitly required to comply with relevant portions of their corporation's code of ethics. For example, AT&T Corp. indicates that: "The Company's Code of Conduct applies to *all directors* and employees of the Company…" [emphasis added]. Even if directors are not specifically mentioned, they may implicitly be required to abide by the code if the code defines "employees" as including all directors.

Companies' director-specific codes of ethics

A number of companies have established codes of ethics specifically for their directors in addition to their codes of ethics for their employees. For example, Pitney Bowes (2003) has a "Code of Business Conduct and Ethics for Members of the Board of Directors." The topics covered include: conflict of interest; corporate opportunities; confidentiality; compliance with laws, rules, and regulations; fair dealing; encouraging the reporting of any illegal or unethical behavior; and compliance procedures.

Companies' corporate governance principles

Many companies, rather than establishing a distinct code of ethics for their directors, have developed firm-specific corporate governance principles or guidelines. This phenomenon should continue as, on November 4, 2004, the SEC approved changes (SEC Release 34–48745) to the listing standards of the New York Stock Exchange (the "Listing Standards") and the NASDAQ that impose greatly increased governance, business conduct and ethics requirements on listed companies and their officers, directors and employees. The new Listing Standards require a code of business conduct and ethics for directors, officers and employees. They further require listed companies to disclose any waivers of the code for directors of executive officers. It remains to be seen the extent to which the Exchange's approach will serve as a model for all United States companies or the extent to which it will encompass ethical considerations. Although corporate governance guidelines typically are intended to provide "guidance" concerning governance procedures and the operation of boards, some guidelines go beyond and mention ethical expectations. For example, AT&T Corp.'s guidelines indicate that: "Each member of the *Board of Directors* shall at all times exhibit high standards of integrity and ethical behavior" [emphasis added].

National director associations' codes of conduct

A number of countries have national director associations, some of which have developed codes of ethics for their members. These codes tend to emphasize ethical principles as opposed to general corporate governance principles. For example, the U.K. Institute of Directors (IoD) has a "Code of Professional Conduct" (2003) which indicates that: "This Code has been written in order to help directors simultaneously meet high standards of professionalism and ethics." The code demands that a director avoid conflicts of interest, respect confidentiality of information, observe "a duty to respect the truth and act honestly" in business dealings, and "exercise responsibilities to employees, customers, suppliers, and other relevant stakeholders, including the wider community."

International and national corporate governance principles

A number of countries or international organizations around the world have established their own corporate governance standards for their corporations. These standards have been referred to as governance "codes," "principles," or "guidelines" (Weil et al., 2002). As one example, the OECD Principles of Corporate Governance (1999) discuss the following topics: rights of shareholders; equitable treatment of shareholders; role of stakeholders in corporate governance; disclosure and transparency; and the responsibilities of the board. The OECD Principles mention the importance of various ethical values such as honesty, responsibility, rights, and equitable treatment.

General principles of business ethics

Increasingly, scholars and managers alike recognize the existence of core standards of business ethics applying to all commercial activities. They encompass factors such as acting honestly and in good faith. They stress avoidance of conflicts of interest, require the exercise of due care, and emphasize fairness and just results. Senior managers speak time and time again of their importance. The major media stress their centrality to capitalism. Corporate codes make general reference to them. Legal principles embrace them. Scholars seek to document and justify specific examples. Across the active domain of business ethics, one dimension is crystal clear; these general principles of business ethics apply to everyone, including all constituents of the corporation. They are not just the concern of lower-level employees or of those who belong to formal professional associations. They apply to senior managers and directors with full force.

Part Four – Elements of a Code of Ethics for Directors

As we have seen, codes may either be internal to a firm or they may, instead, derive from an external source that is intended to guide directors in general. Firm-specific directors' codes need to cover topics and issues unique to the firm's operations, nature, and history. Although there are many aspects of operation and performance expectations common to all boards, boards may also differ substantially depending on the structure of the firm and the nature of the business. Those differences need to be covered in firm specific codes.

If one were to attempt to construct a firm-based code of ethics for directors, what would it encompass? Fortunately, one does not need to start from scratch. Building on the vast array of sources of ethical standards and principles, discussed in part three, a basic framework for a directors' code of ethics can be developed. We recognize that a one-size fits all, "cookie cutter" approach is impractical. Instead, we seek to determine the basic core values and critical issues that should guide the adoption of individualized codes of ethics by specific corporations. We envision that those responsible for developing corporate codes would use the framework as a pattern for the development of the design for their specific code. This framework or pattern should be capable of serving as a broad outline and also as a checklist for developing a code reflecting the special history and experience of the firm and its board.

We first seek to identify the general values that should guide and be reflected throughout a code of ethics of directors and boards. Significantly, we could only identify one prior attempt to establish a code for directors in the literature. Siebens (2002) proposes five principles for an "ethical code for directors." These principles include: the duty of loyalty; the duty of care; the duty to formulate its ultimate goal; openness of direction (transparency); and the duty to give account of all actions taken (accountability). Driscoll (1995), while not setting out an actual code of ethics for directors, does suggest four activities that lead to an ethical director: acting with diligence (e.g., meeting attendance, reviewing materials); providing oversight (e.g., oversee procedures, test assumptions); making policy (e.g., setting standards, engaging in self-assessment, acting with candor); and remaining educated.

If one attempts to converge the various ethical standards currently in existence, as well as the primary legal obligations for directors, one finds that six core ethical values emerge. They include: honesty; integrity; loyalty; respect; responsibility; fairness; and citizenship. The values are consistent with those universal core ethical values identified by others (Josephson, 1997, pp. 26–27; Schwartz, 2002).

These six core ethical values then become the organizing framework for any legal or ethical obligations for directors. Table 1 below provides an illustration of how the standards converge.

Based on the convergence of the various sources of ethical standards, the values that should underpin every code of ethics for directors can be constructed. These values should be relevant anywhere around the world, for all corporate boards. We identify six core ethical values, which then lead to the more specific ethical principles to be followed.

(1) *Honesty*: Directors have an ethical obligation to act with honesty. The hallmark of honesty is truthfulness and forthrightness. It requires speaking up frankly when required to prevent a false impression.

The honest director eschews half-truths and other linguistic devices intentionally used to create misunderstandings.

Commentary: Honesty can affect all actions of directors, including the provision of accurate reports of the companies activities. The importance of honesty has been commented on: ". . . honest corporate directors acting in good faith are the key to proper corporate governance and stockholder welfare" (Veasey, 2003, p. 450).

(2) *Integrity*: Directors have an obligation to act with integrity.

Commentary: The obligation to act with integrity requires that directors act with honor, always ensuring that they are acting in accordance with their firms' espoused principles and values. Virtually every corporate code of ethics mentions the importance of acting with integrity, indeed some codes include the word integrity in their titles (e.g., EDS – "Acting with Integrity: Code of Business Conduct"). Associations such as the Institute of Directors in Southern Africa and the U.S. NACD include the notion of integrity in their core values. According to Siebens (2002, p. 112): "Corporate governance, in short, is based on integrity; the integrity to be expected from each individual director and the integrity expected from the board as a whole. Integrity means constantly being inviolable, which makes decision making and acting predictable and certain."

(3) *Loyalty*: Directors have an obligation to act with loyalty, in the best interests of the corporation as opposed to one's personal interests.

Commentary: In order to be considered acting with loyalty, directors should avoid: self-dealing; taking advantage of corporate opportunities; engaging in potential or apparent conflict of interest transactions; and insider trading. They should maintain objectivity in decision-making and protect confidential and proprietary information.

(4) *Responsibility*: Directors must fulfill their responsibilities as established by the company and corporate law in a transparent manner by which they can be held accountable.

Commentary: Being responsible involves the fulfillment of a number of designated roles as a director. It is based on the legal principle of duty of care. It involves regular attendance at meetings, being informed and maintaining an appropriate level of competence (e.g., continuing education), and expressing dissent when necessary. It requires appropriate supervision of management without micro-management of the firms operations. It also involves being accountable, which requires an adequate degree of transparency and disclosure. It furthermore requires self-assessment of whether one is properly doing one's duties as a director, as well as disclosure of any failures to abide by any other provision in the code.

Being accountable is often referred to in the various standards of corporate governance. According to William Patterson (2003), Director of the Office of Investment for the AFL-CIO, "...good governance hangs on the independence and *accountability* of directors" (Murray, 2003, p. R. 8, emphasis added). Being responsible goes beyond merely showing up at meetings, but expressing dissent when appropriate. For example: "...directors at many companies touched by scandals, including Tyco International Ltd. and WorldCom Inc., followed most of the accepted standards for boards, such as showing up regularly for meetings and establishing codes of ethics. But they failed to question enough and to think of dissent as an obligation" (Hymowitz, 2003, p. R. 1). In other words, directors should not be "a rubber stamp." In terms of disclosure, one question directors might ask is: "Do you have procedures in place to disclose all material information, information whose omission or misstatement could influence the decisions taken by the users?" (management, shareholders, creditors, etc.) (International Chamber of Commerce, 2003). In addition, there is a world-wide movement supporting corporate disclosure of the societal, environmental, and ethical consequences of decisions (Weil et al., 2002, p. 49). Self-assessment is also an important component of responsibility. For example, Raymond Troubh, appointed Chairman of Enron Corp. following the scandal, believes that boards ". . .should conduct thorough *performance reviews* of individual directors and disclose them in companies' proxy statements (Lublin, 2003, p. R. 8, emphasis added). Both Enron and WorldCom's boards clearly did not live up to their responsibilities, rather, they blamed everyone else.

(5) *Fairness*: Directors must treat others and make decisions on the basis of fairness.

Table 1 Convergence of core ethical values for directors.

Source	*Examples*	*(1) Honesty*	*(2) Integrity*	*(3) Loyalty*	*(4) Responsibility*	*(5) Fairness*	*(6) Citizenship*
Law	U.S. system	Business Judgment Rule: Presumption directors acted in honest belief action taken was in best interest of corporation.	Obligation as fiduciary to act consistently	Duty of loyalty	Duty of care Duty of disclosure	Stakeholder statutes: Fairly take into account interests of other constituencies	Duty of obedience Ensure legal compliance
Corporate Codes for Employees	BellSouth	"We will deal with customers honestly." (p. 4)	"We interact with our customers, our employees and our shareholders with… integrity." (p. 4)	Avoid "conflicts of interest" (p. 4)	"Each person at BellSouth is responsible for his or her own behavior… When we err, we will make things right."	"Vendors and suppliers must know we will be fair." (p. 5)	Comply ". . .with all laws and regulations." (p. 4) "Strive to make our communities better places to live, work and grow."(p. 4)
Corporate Codes for Directors	Pitney Bowes, Bank of Ann Arbor, Amgen	"Help foster a culture of honesty…" (P-B, intro)	"... integrity will not be compromised by Amgen [Directors] anywhere at any time." (Amgen, 2003 p. 1)	"avoid any conflicts of interest. . ." (P-B) "Loyalty, fidelity, and good morals are assumed qualities [of the] Board of Directors. . ." (BAA, p. 2)	Accountability (P-B)	"Directors should endeavor to deal fairly with the Company's customers, suppliers, competitors and employees." (P-B, s. 4)	Compliance with laws (P-B, s. 4) "Community activities by directors is encouraged. . ." (BAA, p. 2)

Corporate Governance Principles	Colgate-Palmolive, AT&T, Sara Lee, Pinnacle West Capital Corp. (2003)	“The Board shall seek to foster a culture of honesty…” (Sara Lee, s. 6)	“Each member of the Board of Directors shall at all times exhibit high standards of integrity. . .” (AT&T)	Independence (C-P)	Functions of board to be fulfilled (C-P)	Shareholder rights CEO Evaluation (C-P)	“The Board recognizes the importance of the Company operating as an ethical and law-abiding company.” (PWest, s. 2)
Director Associations	Singapore Southern Africa	“a director shall at all times act honestly” (Sing.)	“This Code embraces the value of.. .integrity. . .” (Sing.)	“a director shall... avoid placing himself in a position of conflict… (Sing.)	“A director shall act with due diligence in the discharge of his office as director.” (Sing.)	“directed by people of fairness” (SA)	“A director shall ensure...he and the company he serves observe all laws…” (Sing.)
National Governance Codes	OECD (1999) Common-wealth Principles (1999)	“Directors have a duty to act honestly…” (Common-wealth, principle 5)	“The board should exercise integrity…” (Commonwealth, 1999)	Avoid potential conflict of interest “Exercise objective judgment” (OECD, Part V. Section E)	Responsibility of boards (OECD, p.24) Disclosure and transparency (OECD, p. 23)	Equitable treatment of shareholders (OECD, Part II)	Role of stakeholders’ “awareness of environmental and society interests” (OECD, Preamble)
Business Ethics Principles	Josephson Institute of Ethics	Honesty	Integrity	Loyalty	Responsibility	Fairness	Citizenship

Commentary: Fairness involves balancing the interests involved in all decision-making including any decisions related to hiring, firing (including the investigatory process), and executive compensation. It also implies ensuring that all classes of shareholders are treated fairly: "Does your board have standards and procedures to ensure equitable treatment of all shareholders, including access to information and the ability of the shareholders to exercise their rights?" (International Chamber of Commerce, 2003). This core value also reflects concerns expressed in the OECD code to: "…deal fairly with stakeholder interests." Enron's board appeared to ignore fairness in terms of its decisions regarding executive compensation which were considered by the Senate Subcommittee to be "excessive" (Senate Report, 2002, p. 3).

(6) *Citizenship*: Directors must act as good citizens, which includes ensuring that they and their companies are complying with laws and regulations and the standards of the communities in which they operate.

Commentary: Acting as a good citizen means not only individual compliance with the law, but as a director, ensuring that mechanisms are in place, so that all of the company's agents are in compliance with the law and acting ethically. This necessitates ensuring that an effective compliance or ethics program is in place, including a reporting system free from retaliation, and taking appropriate action if wrongdoing is reported or discovered. Citizenship also involves decision-making that protects the environment, and does not involve unnecessary harm to the community.

This core ethical value is emphasized by all of the various sources of ethical standards. It also reflects legislation (e.g., Federal Sentencing Guidelines, the *Caremark* case, and the *Sarbanes-Oxley Act*) putting a focus on the compliance of corporate agents. Bernie Ebbers of WorldCom demonstrated his lack of concern for this core ethical value when he reportedly indicated that the proposed code of ethics was a "colossal waste of time" and never demanded ethical business practices (Directors' Report, 2003, p. 19). The directors also failed to create a safe channel to blow the whistle (Directors' Report, 2003, p. 18). The problem may go beyond WorldCom, as a 1998 Conference Board study found that nearly one quarter of directors were not involved in developing their firm's ethics codes (Barry, 2002).

These six core values should permeate the code and be reflected in all aspects and components of the code. Their presence must extend beyond just a general mention. In the next section, we note some of the specific issues that should be dealt with in the code.

Part Five – Specific Issues to Deal With in a Director's Code

If a firm were to institute a formal code of ethics for its directors, a number of additional specific issues would need to be addressed. The following will discuss these concerns.

Definition of independence for independent directors

Developments such as the *Sarbanes-Oxley Act* and the proposed NYSE rules have extended the traditional definition of independence for so-called "outside" directors. The role of independent directors is being given greater emphasis, particularly in regard to compensation and nomination committees. Because of the growing role for independent directors, firms should consider whether they need to extend the meaning of independence beyond extant legal requirements. Some firms have adopted the concept of a 'lead director' and even provide for the independent directors to retain their own counsel. The circumstances under which independent directors are required to meet independently of management should also be indicated. Explicit rules concerning board compensation and stock holdings/options must be provided. The method and level of compensation for independent directors must be scrutinized so that they have incentives to perform at a high level without making the compensation itself an issue for independence.

Role of the board in the corporate ethics program

Building on the legal obligation to ensure an effective corporate compliance program, the director's code of ethics should specify this obligation in sufficient detail. For example, reporting lines among the ethics officer (or other senior staff responsible for the ethics program), the GEO, senior management, chief corporate counsel outside counsel, and the board of directors must be clarified. Explicit rules pertaining to whistle-blowing options for employees and for the process of response by the board and by individual directors must be specified. A clear process must be established in advance to deal with the situation in which an employee alleges to a board member that a senior executive is acting unethically. The code must indicate how the board member must respond, such as a mandatory reporting requirement to the lead director or other person who chairs the independent members of the board. Protections for whistle-blowers against retaliation by the board itself must be clearly set out.

Policies relating to transparency/accountability

The code must establish policies concerning the board's provision of information to the public. For example, what reports will the board give to shareholders and/or the public? Will there be regular reviews of the ethics program and its operation? Annual reports relating to the overall operation of the board including the number of meetings of the audit and ethics committees should be provided. In the case of multi-nationals, there may be a special need for monitoring and policies relating to foreign payments and the threat of corruption. Consideration should be given to annual reports on the operation of the anti-corruption policies and on audits to ensure no improper payments have been made.

Ethics training for board members

Board members should be required to be aware of the firm's ethical programs and codes and should engage in appropriate ethics training. Reports on the ethics and compliance activities of the firm should be provided at least annually to the board. These involvements are essential in order for the board to carry out its ultimate responsibility for the ethics of its company. A study by the Ethics Officer Association of its members found that while 96 percent of those companies surveyed require their management employees to certify that they have read their companies' code of ethics, only 33 percent require certification from their directors that they have read the code (EGA, 2001). Another study (U.S. Conference Board, 2003) found that the vast majority of U.S. directors have never received training in ethics or compliance issues:"While 81% of firms have conducted ethics and compliance training among their employees, only 27% have held any training sessions for their directors. About 55% of those surveyed say their boards are 'not engaged enough' in major ethical issues involving the company." A U.K. study found that two-thirds of non-executive directors had not received any training or development of any kind, let alone compliance or ethics training (Schmukler, 2003). According to Alexander Keyserlingk of the World Bank Group "Everyone gets trained at companies but directors. . . They train the lowest bookkeeper and the lowest truck driver, but they don't spend any time training directors." (Schmukler, 2003, p. R. 6). Ethics training specifically for directors will provide directors with an opportunity to ensure that they understand their own ethical responsibilities, as well as those of their firm's employees.

Sufficient budget and staff

In order to properly carry out the board's ethical responsibilities, a separate budget and staff should be dedicated specifically for this purpose. Budgetary independence will enable the board to have its own set of consultants and advisors critical to assessing issues such as compensation and reported ethical violations. The board should also ensure that adequate resources and staff are in place to effectively implement the firm's ethics program for employees.

This set of critical issues is intended as a *de minimus* list. All codes for corporate boards should deal with these. There are many others, such as whether there should be specialized codes for senior executives, e.g. the CEO and CFO, that should be considered as well and dealt with if they are relevant to the firm implementing the code.

Conclusion

Boards and Directors play a critical role in overseeing the ethical performance of their organizations. Vigilant boards should be capable of preventing ethical disasters involving their firms. Instead, in the recent scandals there were too many examples where boards were "sleepy-eyed sentries." Much of the focus on reform has been to strengthen and extend legal regulation and liability. Although there is merit to many of the reforms, it is also important to reform critical behavioral and organizational factors.

One of the possible answers is for firms to develop and implement a code of ethics specifically for directors. According to Sempra Energy's Chairman and CEO Steve Baum, boards of directors should be required to have "ethics guidelines for all members" (Baum, 2003). Of course, a code of ethics for directors is not a panacea, and will certainly not guarantee ethical behavior on the part of directors. Enron's code of ethics, referred to on numerous occasions by board members such as Kenneth Lay (1999), did not appear to prevent unethical behavior. A code of ethics and ethics training specifically for directors, based on their unique role in setting the"tone at the top," is, however, one important component of a "portfolio" of initiatives in which companies should engage to help establish an ethical corporate culture.

Ethics, by its very nature, has the ability to capture those activities that the law is unable to address. Ethical values and principles, if formally set out, can also help provide the moral justification for the law, which might lead to greater compliance with the law. Adoption of greater ethical obligations also provides for the ability to anticipate changes in the law. Ethical principles have the ability to cut across national boundaries, in ways beyond the scope of legislation. What is important to note is that we are not proposing that additional ethical obligations for directors are "*in lieu of*" their legal obligations. They should be considered "in addition to" one's legal obligations. Rather than being in conflict with legal obligations, ethical obligations and legal obligations are not mutually exclusive, but reinforce each other.

To date, definitions of an "effective" board of directors appear to focus on those boards that are able to maximize firm performance through effective decision making while complying with their legal obligations. In our view, the definition of a "good" or "effective" corporate board of directors should no longer simply focus on a board that is able to maximize firm performance. If there is anything that the current corporate scandals should have taught us, it is that only those boards that fulfill heir ethical obligations will ensure long term financial success. To put it bluntly, a board that must cut ethical corners in order to help its firm maximize financial performance (e.g., Enron's board or WorldCom's board) should not be considered an "effective" board. Corporate governance should no longer be considered distinct from ethics, but instead should be seen as built on an ethical foundation.

Notes

1 We thank Jennifer Huang for her able research assistance.

2 For example, Bernie Ebbers of WorldCom, John Rigas of Adelphia Communications, Sam Waksal of ImClone Systems, Dennis Koslowski of Tyco International, Martha Stewart of Martha Stewart Living Omnimedia, Richard Scrushy of HealthSouth, Philip Anschutz of Qwest, Gary Winnick of Global Crossing, and Alfred Taubman of Sotheby's (CNN, 2003; Corporate Library, 2003).

3 A similar but more expansive provision on the duty of directors is contained in Section 512(a) of the Pennsylvania Business Corporation Law ("PBCL") at Section 512(a) as follows:

> Directors. – A director of a domestic corporation shall stand in a fiduciary relation to the corporation and shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances.

4 For example Section 145(a) of the DGCL provides the following:

> A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the

> person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person’s conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reason-able cause to believe that the person’s conduct was unlawful. Similar provisions are contained in Section 14A: 3–5 of the NJBCA and Section 1741 of the PBCL.

5 Section 512(g) of the DGCL contains the following language:

> A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person’s status as such, whether or not the corporation would have the power to indemnify such person against such liability under this section.

Similar provisions that authorize a corporation to purchase insurance for protection of directors are contained in Section 14A: 3-5(9) of the NJBCA and Section 1747 of the PBCL.

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Do CEOs Get Paid Too Much?

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America's corporate executives get paid huge sums of money. According to a study by the Economic Policy Institute, in 2011, CEOs of the 350 largest publicly-traded U.S. companies received – in salary, bonus, grants of restricted stock and stock options, and payouts from long-term incentive plans -$11.1 million on average. This is 209 times as much as the typical worker in these companies was paid (Mishel & Sabadish, 2012a).[1] CEO pay is not at its peak. In 2000, CEOs of the 350 largest U.S. companies were paid $20 million on average, or 411 times as much as their workers (Mishel & Sabadish, 2012a). But the trend over the past few decades has been undeniably upward. Adjusted for inflation, from 1978 to 2011, CEOs' compensation packages increased by 725%, while workers' pay increased by only 5.7%. The ratio of CEO to worker pay has gone from 26.5-to-1 to 209-to-1 over the same period (Mishel & Sabadish, 2012a). What, if anything, is wrong with this?

Although it has received a great deal of attention in business and economics journals and in the popular press, the topic of executive compensation has been virtually ignored by philosophers. As a result, its normative dimensions have been neglected. Organizational theorists and economists tend to be more interested in what the determinants of CEO pay *are* than in what they *should be*. What is needed, I suggest, is a general ethical framework for thinking about justice in pay. After elaborating this framework, I will argue that CEOs get paid too much.

1. Three Views of Justice in Wages

To determine whether CEOs get paid too much, we first need to consider what, in general, makes a wage just. In this section, I will sketch three views of justice in wages, each of which is based on a widely recognized moral value. I do not claim that these are the only views of justice in wages possible. But the values from which they derive are the ones most frequently appealed to in debates about CEO pay. It is unlikely that any other view would be as attractive.

According to what I will call the "agreement view," just prices for goods are obtained through arm's-length negotiations between informed buyers

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and informed sellers. In our case, the good is the CEO's services, the seller is the CEO, and the buyer(s) is (are) the company's owner(s). Provided there are no imperfections (e.g., fraud, coercion) in the bargaining process, the agreement view says, the wage that comes out of it is just. Owners are free to do what they want with their money, and CEOs are free to do what they want with their services.

The "desert view" appeals to independent standards for justice in wages. It says that people deserve certain wages for performing certain jobs, whatever they might agree to accept for performing them. The wages people deserve may depend on facts about their jobs (e.g., their difficulty or degree of responsibility), people's performances in them (e.g., how much effort they expend, how much they contribute to the firm), or both. According to the desert view, the CEO should be paid $11.1 million per year if and only if he deserves to be paid $11.1 million per year.

What I will call the "utility view" conceives of wages not as rewards for past work, but as incentives for future work. The purpose of wages on this view is to maximize firm wealth by attracting, retaining, and motivating talented workers. If, in our case, the CEO's position is not compensated adequately, few talented candidates will apply or remain on the job for long, and the company as a whole will suffer. On the other hand, an expensive CEO can easily earn his keep through even small increases in the price of the company's stock. According to the utility view, then, a compensation package of $11.1 million per year is just if and only if it maximizes firm wealth by attracting, retaining, and optimally motivating a talented CEO.[2]

Too often in discussions of executive compensation, the separateness of these views is overlooked. But if we do not distinguish among them, we run the risk of talking past each other. One person's belief that CEOs do not deserve, by any standard of deservingness, $11.1 million per year may lead him to the conclusion that CEOs make too much money. Another person's belief that the pay negotiations between CEOs and owners are fair may lead her to conclusion that CEOs do not make too much money. In fact, both people may agree that CEOs do not deserve $11.1 million per year and that the pay negotiations between CEOs and owners are fair. They may simply disagree about what is morally more important: deserts or agreements. Understanding this, of course, does not solve the debate. But it does help to clarify what it might be about.

To solve the debate about CEO pay, we must determine which view of justice in wages is correct. It is unlikely (for reasons given below) that agreement-theorists, desert-theorists, and utility-theorists will all come to the same conclusion about how much CEOs should be paid. I will not try to do this here. There is deep disagreement about the relative importance of these values. A full defense of one of them against the others is beyond the scope of this paper. Fortunately, it is not necessary to determine which view of justice in wages is correct to draw *any* conclusions about CEO pay. Below I will argue that its current level cannot be justified by the agreement view, the desert view, or the utility view. No matter which one is correct, I suggest, CEOs get paid too much. It is possible that new theories of justice in wages will be developed. But the theories we have sketched are based on the most common considerations deployed in discussions of the ethics of executive compensation, and it is not at all clear what these new theories would look like. Until it is, we have reason to believe that the current level of CEO pay cannot be justified *simpliciter*.

2. The Agreement View

According to the agreement view of justice in wages, a just price for the CEO's services is one that results from an arm's-length negotiation between an informed CEO and informed owners. I will show that these negotiations are not, in general, conducted at arm's-length. If they were, CEOs would be paid on average less than $11.1 million per year.[3]

The problem occurs mainly on the "buy" side of the equation, so we will focus our attention there. Traditionally, shareholders are represented in negotiations with the CEO by a subset of the members of the company's board of directors. This may seem promising to those who would appeal to the agreement view to justify the current level of CEO compensation. Since directors are elected by shareholders, they might say, it is likely that the directors who negotiate with the CEO – those who form the board's "compensation committee" – are in fact independent and informed. If shareholders did not elect independent and informed directors, they would risk paying too much to an incompetent CEO, or too little to an exceptional one.

This hope is unfounded. It is well-known that shareholders do not, in fact, elect directors in any meaningful way. When a seat on the board opens up, usually there is just one person who "runs" in the "election." Once a candidate is nominated, her election is a formality (typically, she needs just one vote to win). The group that controls the nomination process, then, controls the board's membership. In most cases this is not the shareholders but the board itself, whose chairman in 84% of American firms is the firm's own CEO (Shivdasani & Yermack, 1999). While there has been a trend away from direct CEO involvement in the nominating process in recent years, most CEOs still wield considerable informal influence over it (Main, O'Reilly, & Wade, 1995).

This is worrisome. Whereas shareholders may elect, out of apathy or ignorance, directors who are unfamiliar with the industry and friendly with the CEO, CEOs can encourage the appointment of such directors. Do they? The fact that CEOs who are appointed *before* the appointment of their compensation committee chairs are paid more, on average, than CEOs who are appointed *after* suggests that they do (Main et al., 1995). Examining the composition of boards of directors more carefully, we see that directors may be informed, but they are not independent.

Three factors compromise directors' independence from their CEOs. The first is gratitude. The board member's job is prestigious, lucrative, and relatively undemanding. In 2009, the average board member of an S&P 500 company was paid $213,000 for participating in nine meetings (Eder, 2003). Directors may also be given life and medical insurance, retirement benefits, and the use of company property such as automobiles and vacation homes. In addition – and perhaps most importantly, since many corporate directors are independently wealthy – there is the considerable "social capital" they acquire in the form of connections with influential people. Thus getting an appointment to a board is like getting a large gift. This is problematic, for it is natural for gift-recipients to feel grateful to gift-givers. The larger the gift is, the more grateful, and more inclined to "return the favor," the gift-recipient will be. Since CEOs have a great deal of influence over who gets appointed to the board, the directors will feel grateful to him. To represent properly shareholders' interests, then, they will have to fight against this feeling. There is reason to believe they have not been successful. Recent research shows a positive correlation between director and CEO pay (Boyd, 1994).

Self-interest is the second factor compromising the independence of directors in pay negotiations with CEOs. To determine how much to pay their CEO, the board will usually find out how much CEOs of comparable firms are being paid. The more those CEOs make, the more the board will pay their CEO (Ezzamel & Watson, 1998). The problem is that many boards have members who are CEOs of comparable firms (Main et al., 1995). This is good from the point of view of having knowledgeable directors. But CEO-directors have a self-interested reason to increase the pay of the CEO on whose board they sit. Suppose CEO P sits on CEO Q's board, and P and Q run comparable firms. P knows that, the more he agrees to pay Q, the more pay he (P) may later receive. For, when it comes time to determine P's pay package, Q's may be used as one of the reference points.

The third factor is not a reason directors have to favor CEOs; it is the absence of a reason directors should have to favor shareholders. Since they are paying with their own money, shareholders have a powerful incentive not to overpay the CEO. The more they pay the CEO, the less they have for themselves. Directors, by contrast, are not paying with their own money. Although they are often given shares in the company as compensation, directors are rarely required to buy them. So their incentive not to overpay the CEO is less powerful than shareholders'. It might be wondered whether shareholders can make it more powerful by threatening to recall overly generous directors. They cannot. Shareholders in most firms lack this power. In fact, not only will directors have nothing to fear if they *do* overpay the CEO, they will have something to fear if they *do not*. Shareholders cannot recall overly generous directors, but CEOs can use their power to force them out.

Let me sum up. According to the agreement view, a wage of $11.1 million per year is just if and only if it results from an arm's-length negotiation between an informed CEO and an informed group of owners. We argued that these negotiations are not, in general, conducted at arm's-length. It follows that $11.1 million per year is not a just (average) wage. Because the independence condition is violated in a way that favors the CEO, we can be confident that the just average wage on this view is less than $11.1 million per year. Speculation about how much less, however, would be premature. A different view of justice in wages may be correct, and it may justify the current level of CEO pay. In the next section I will examine the desert view.

3. The Desert View

A familiar complaint about CEO pay is that it has increased in years when firms have performed badly. This complaint is grounded in the desert view of justice in wages. It assumes that a CEO should get the wage he deserves, that the wage a CEO deserves is determined by his economic contribution to the firm, and that the proper measure of contribution is firm performance. If the firm performs worse in year two than in year one, the argument goes, the CEO deserves to make less, and therefore should make less, in year two than in year one. The agreement and utility views of justice in wages cannot account, except indirectly, for this intuition.

Determining how much pay CEOs deserve raises two difficulties. The first is identifying the standard(s) for deservingness. Economic contribution is often assumed to be the desert-base for wages. But a variety of others have been offered, including (i) the physical effort exerted by the worker, (ii) the amount of ability, skill, or training his job requires, (iii) its dangerousness, difficulty, stress, or unpleasantness, and (iv) its degree of responsibility or importance. Desert may be determined by one or more of these factors. The second difficulty is connected to the first. Once we identify the desert-base(s) for wages, then we must find a way of matching desert levels to pay levels. Suppose contribution is the basis of desert, and suppose, as a direct result of key decisions by the CEO, the firm's profits increase 20% in a year. We might think that the CEO's desert-level has increased by 20%, and thus that he deserves a 20% raise. But what should his initial salary have been? If we cannot match desert levels to pay levels, we cannot answer this question. However, from the point of view of desert, the absolute amount of the CEO's pay matters as much as its percentage increase.

For the purposes of this paper, both of these problems can be avoided. The first questions our ability to identify the base(s) of desert. In response, I will assume, as most parties to the debate about CEO pay do, that the basis for desert of pay is contribution. Indeed, of all the desert-bases mentioned above, this is the one most likely to justify the current level of CEO pay. The second questions our ability to identify what it is exactly that people deserve. In response, I will not argue that CEOs deserve to make less than $11.1 million per year *absolutely*. Instead, I will argue that that they deserve to make less than $11.1 million per year *given that* their employees make on average $55,400 per year. CEOs are not on average 209 times as deserving as their employees.

Under the assumption that contribution is the sole desert-base for pay, the CEO deserves to be paid 209 times what the average worker is paid if and only if his contribution is 209 times as valuable as the worker's. For every $1 in revenue the worker generates, the CEO must generate $209. If the worker generates $100,000 in a year, the CEO must generate $20.9 million. Does this happen?

Some will deny that this question can be answered. They will say that employees are not Robinson Crusoes, each at work on their own self-contained projects. Instead, many people work together on the same complex projects. As a result, it is difficult or impossible to tell where one person's contribution ends and another's begins.

This is not, of course, an objection that will be advanced by those who appeal to the desert view to justify the current level of CEO pay. They need a way to measure contribution accurately. If the stronger form of this objection is true, however, and we cannot tell how much each employee contributes to the firm, then we cannot tell how much each deserves to be paid. So this conclusion is not unwelcome; it suggests that the desert-view cannot be used to justify the current level of CEO pay. But it is weak. A thoroughgoing skepticism about the accuracy of contribution measurements yields the conclusion that we *cannot tell* whether CEOs deserve to make 209 times as much as their employees, not that they *do not* deserve to make this much. As far as this view is concerned, CEOs may deserve to make *more* than 209 times as much as their employees.

This kind of skepticism about the accuracy of contribution measurements is, I suggest, unwarranted. Although it may be impossible to determine exactly how much each employee contributes to the firm, rough estimates are possible. How do CEOs stack up? The popular view is that CEOs matter enormously to their firms. The CEOs of successful corporations are glorified in news stories and biographies. Witness, for example, the flurry of books written by and about Jack Welch, the former chief executive of General Electric. If we accept this view, then we will conclude that CEOs' contributions are at least 209 times as valuable as their employees'.

But we should not. To be sure, some scholars endorse the popular view, but an increasing number reject it. Summarizing the current state of the debate, Khurana says the "overall evidence" points to "at best a contingent and relatively minor cause-and-effect relationship between CEOs and firm performance" (2002: 23). He explains: "a variety of internal and external constraints inhibit CEOs' abilities to affect firm performance .. . [including] internal politics, previous investments in fixed assets and particular markets, organizational norms, and external forces such as competitive pressures and barriers to exit and entry" (2002: 22). It cannot be denied that CEOs' decisions at times make a difference to firm performance. These leaders may deserve bonuses for strategic thinking. But, if Khurana is right, cases such as these are exceptions to the rule. Factors outside of the CEO's control normally "contribute" more to the firm's success than the CEO does.

Some will reject the research on which this result is founded. Others will point out that it is compatible with the claim that CEOs contribute 209 times as much to their firms as their employees. These claims are not irrational. No theorist is willing to say exactly how much, compared to the average employee, the average CEO contributes. But they are unreasonable. There is mounting evidence that CEOs are not as important as they were once thought to be, and average employees are far from useless. We have ample evidence for a negative conclusion, i.e., the claim that CEOs deserve to be paid 209 times as much as their employees is *unjustified*. But I think the evidence licenses a tentative positive conclusion as well, viz., that CEOs are *less* than 209 times as deserving as their employees, and so deserve *less* than 209 times as much pay. The desert view clearly does not support, and probably condemns, the current level of CEO pay.

4. The Utility View

Having considered the agreement and desert views of justice in wages, let us now turn to the utility view. To recall, this view says that a just wage for a CEO is one that maximizes firm wealth by attracting, retaining, and motivating a talented leader. This is perhaps the most important of the three views of justice in wages. Boards of directors frequently appeal to utility-based arguments to defend the pay packages they give to their CEOs. I will argue that these defenses fail. I begin by discussing pay as a tool of attraction and retention. I then consider its role in motivation.

4.1 Attraction and retention

Several of the desert-bases discussed above might be cited as reasons an employer has to pay more to fill a certain job. The most important of these are effort, skill, and difficulty (including stress, dangerousness, and unpleasantness). Since, other things equal, an employee will choose an easier job over a harder job, employers will have to make other things unequal, by offering higher wages for the harder job. Similarly, employers will offer higher wages for jobs that require rare and valuable skills or long periods of training, and for jobs that are comparatively difficult.[4]

The CEO's job has some of these characteristics. It does not require much physical effort, but it takes a lot of time, it requires skill and training, and it is difficult and stressful. The question, of course, is not *if* the CEO's job has these characteristics, but *to what degree* it has them. Does the CEO's job take so much time, does it require so much skill and training, and is it so difficult and stressful, that offering $11.1 million per year is necessary to get talented people to become CEOs? Those convinced by my argument that CEOs do not deserve to be paid 209 times what their employees are paid may think not. But notice we are now asking a different question: not what people deserve for performing the CEO's job, but what would make them willing to perform it.

The answer, however, is similar. There is no evidence that offering $11.1 million per year is necessary to get talented people to become CEOs. Indeed, we have reason to believe that much less will do. Consider the jobs of university presidents and US military generals. They require no less time, are no less difficult, and require no less skill and training, than the jobs of CEOs. But the wages offered to presidents and generals are many times lower than the wages offered to CEOs. In 2010–2011, the average compensation of presidents of private doctoral universities – the type of educational institution arguably most similar in size and complexity to a large corporation – was $583,000 per year (Chronicle of Higher Education, 2011); US military generals earn $185,000 per year (Bureau of Labor Statistics, 2012b). Despite this, there seems to be no shortage of talented university presidents and military generals. The fact that people can be attracted to time-consuming, high-skill, and difficult managerial jobs that pay "only" several hundred thousand dollars per year suggests that talented people will still want to become CEOs even if they are paid less than $11.1 million per year.

Three objections might be advanced against this conclusion. It might be admitted that the CEO's job is about as difficult and time-consuming, and requires about as much skill and training, as the university president's job or the military general's job. But, it might be said, the CEO's job is in one important way more unpleasant than these jobs. Military generals get, in addition to a paycheck, the satisfaction of knowing that they are protecting their country. University presidents get, in addition to a paycheck, the satisfaction of knowing that they are helping to increase human understanding. There is no comparable benefit, according to this objection, for CEOs.

I suspect that many CEOs find their jobs immensely intrinsically rewarding, and would find this suggestion mildly insulting. But let us grant, for the sake of argument, that CEOs' jobs are less intrinsically rewarding than university presidents' and military generals' jobs. Are they *that* much less rewarding – as many as 19 (in the case of university presidents) or even 60 (in the case of military generals) times less rewarding? For the objection to succeed, they would have to be. But it is implausible to suppose that they are. While the extra unpleasantness of the CEO's job may make it necessary to offer more than $185,000 or $583,000 per year to attract talented candidates, it does not seem necessary to offer as much as $11.1 million.

The second objection grants that talented people would still be attracted to the CEO's job even if they were offered less than $11.1 million per year. But, it says, when this much pay is offered, truly exceptional people become interested. Analogously, the people who are now university presidents are talented, but truly exceptional people would become university presidents if they were offered, instead of several hundred thousand dollars per year, several million dollars per year.

Pay does matter to people when they are choosing a profession. So it is reasonable to assume that the people who become CEOs because corporations offer $11.1 million per year are, on average, more talented than the people who would become CEOs if corporations offered, say, $3.1 million per year. But there are two reasons to think that they are not *that much* more talented, and so not worth the extra pay. First, the spectrum of managerial talent is only so wide. And $3.1 million per year is more than enough to attract a talented person to a difficult and important managerial job, as is demonstrated, by the high talent level found among military generals and university presidents. Thus the $11.1 million-per-year CEO simply *cannot be* that much more talented than the $3.1 million-per-year CEO. Second, as seen, firms' performances do not usually depend heavily on the contributions of their CEOs. So it is unlikely that the modest difference in talent between the $11.1-million-per-year-CEO and the $3.1-million-per-year-CEO will translate into a $8 million difference in firm performance. In support of this, note that while American CEOs significantly outearn Japanese and British CEOs, American firms do not generally outperform Japanese and British firms (Abowd & Kaplan, 1999).

It might be said – as a third objection – that I am missing the point. The fact is that the going rate *now* for CEOs is $11.1 million per year. In this market, it is necessary for any one firm to offer $11.1 million per year to get a talented person to become its CEO. This argument defies free market economic sense. It says, in effect, that the market cannot correct itself. This is pessimistic.

Our discussion has focused on attraction; we have said nothing about retention. Could it be the case that, while $11.1 million per year is not necessary to *attract* talented people to the CEO's job, it is necessary to *retain* them in the face of competing offers? The answer is no. In the first place, it is unlikely that there will be that many competing offers. According to a study by Challenger, Gray and Christmas, Inc., of the 1178 CEO departures in 2011, in only 126 cases was "new position in another company" given as the reason for the departure.[5] If CEOs were paid less, this number might increase. But even if it did, firms should not be alarmed. The difficulty of retention is a function of the difficulty of attraction. If it is not difficult to get a qualified person to take the CEO's job in the first place, it will not be difficult – or, more to the point, necessary – to retain him in the face of competing offers. The company can simply hire a new one.[6]

4.2 Motivation

Attraction and retention are not the only utility-based reasons for paying employees certain wages. There is also motivation. Employees who are talented *and* motivated create more wealth for their firms than employees who are only talented. There are three ways paying CEOs $11.1 million per year might be thought – mistakenly, I will argue – to maximize firm wealth through motivation.

First, it might motivate the CEO himself. The CEO knows that, if he does not do an excellent job, he will be fired. Since he wants to keep making $11.1 million per year, he will work as hard as he can. If CEOs were paid less money, they would work less hard, and firms would be worse off.

In this respect also, pay matters. It motivates people to work hard. It is thus arguable that the CEO who is paid $11.1 million per year will work harder than the CEO who is paid $3.1 million per year. But this, as we know, is not what needs to be shown. What needs to be shown is that the extra amount of hard work put in by the $11.1-million-per-year CEO is worth an extra $8 million. It is unlikely that it is. There is no guarantee that extra hard work will translate into extra revenue, and there is only so hard an executive can work. One might think that an extra $11.1 million per year would be worth it if one thought that CEOs would put in very little effort if they were paid only $3.1 million per year. But this takes a pessimistic view of CEOs' characters, as if only money – and only a lot of it – could get them to do anything. There is no empirical evidence to support this view. To the contrary, studies show that money is not the only, or even the primary, reason people work hard (Annis & Annis, 1986). Instead of trying to further motivate their CEOs with more money, then, firms would do better to use the extra money to increase revenue in other ways, such as advertising more.

The second motivation-based reason for paying CEOs $11.1 million per year is, in effect, a slightly different version of the first. It has been said that CEOs' compensation packages should be structured so that CEOs' and owners' interests are *aligned* (Jensen & Murphy, 1990). Owners want the stock price to go up. So CEOs should be paid in a way that makes them want the stock price to go up. This is typically achieved by paying CEOs mostly in restricted stock and stock options. Since, it is assumed, the CEO wants to make more money rather than less, this will give him an incentive to try to make the company's stock price go up. The idea is not just to make sure that CEOs do what investors want; it is to make sure that they do *only* what investors want. If the CEO is paid mostly in stock, he has little to gain from pursuing alternative courses of action.

Let us grant, for the sake of argument, that CEOs' interests should be aligned exclusively with investors' interests. Let us also grant that offering CEOs about $5.5 million per year in restricted stock and stock options accomplishes this. (To arrive at this figure, I use

Mishel and Sabadish's (2012a) estimate of 2011 CEO compensation and assume – conservatively – that CEOs receive about half of their total pay in grants of restricted stock and stock options. On the composition of CEO pay, see Bebchuk and Grinstein (2005).) Does this prove that CEOs should be paid $5.5 million in stock? It does only if there is no cheaper way of achieving this goal. But there does seem to be: monitoring and dismissal. The interests of most employees are aligned with investors' interests this way. Employees are monitored, if they promote interests other than those (ultimately) of the investors, they are dismissed. Would anyone seriously propose, as an alternative to this practice, giving each employee several million dollars in stock? To be sure, doing so would align their interests with investors' interests. But it is expensive and unnecessary. The same seems to be true of paying CEOs $5.5 million in stock. There is no reason to give away so much of the firm's wealth when the CEO can be fired for poor performance. Owners could secure the same level of loyalty at a fraction of the price.

We have examined two ways that paying CEOs $11.1 million per year might maximize firm wealth through motivation. Both focus on the effects of high pay on the CEO. The third focuses on the effects of high pay on other employees. According to some writers, a firm's job hierarchy can be seen as a tournament, with the CEO's job as top prize. Many of the firm's employees, they say, want this prize and will work hard to get it. The better the prize is, the harder they will work. If the CEO is paid $11.1 million per year, the rest of the employees will work very hard indeed. The consequent increase in productivity will be good for the firm as a whole. Ehrenberg and Bognanno (1990) find evidence for this hypothesis in the field of professional golf. They observe that golfers' scores are negatively correlated (i.e., improve) with potential earnings. The larger the tournament's purse is, and hence the more money the golfers in the tournament could win, the lower the average score is.

This is the most sophisticated of the utility-based attempts to justify the current level of CEO pay. Still, the argument in its present form has several problems. In the first place, not every employee wants to be CEO, no matter how much the job pays. So paying the CEO $11.1 million per year provides an incentive to work hard to only some of the firm's employees. Second, there is evidence that this practice has unintended negative effects. Since there is only one CEO's job, employees must compete with each other to get it. The more the job pays, the more intense the competition will be. This is problematic, for competition fosters jealousy and hostility, which can hinder communication and cooperation (Annis & Annis, 1986). This will not matter to golfers; they play alone. But employees often work together. A decline in communication and cooperation may lead to a decline in productivity. In support of this, Cowherd and Levine (1992) find that pay inequality between workers and managers is negatively correlated with product quality. Thus, while paying CEOs $11.1 million per year may increase hard work, it may also increase competition. The benefit of the former may be outweighed by the cost of the latter. Even if it is not, this does not suffice to prove that CEOs should be paid $11.1 million per year. My objection is familiar. That is, while paying CEOs $11.1 million per year might be an effective motivational tool, it is likely not a *cost*-effective one. Above we said that the $11.1-million-per-year CEO is likely to be only slightly more productive than the $3.1-million-per-year CEO. Similar reasoning suggests that $11.1-million-per-year CEO hopefuls are likely to be only slightly more productive than $3.1-million-per-year CEO hopefuls. From the point of view of utility, then, firms would do better to use the extra $8 million to increase revenue in other ways.

5. Conclusion

To structure the debate about executive compensation, I distinguished three views of justice in wages: the agreement view, the desert view, and the utility view. No matter which one is right, I argued, CEO pay is too high. Owners may agree to pay CEOs $11.1 million per year, but the negotiations are not conducted at arm's-length. If they were, CEOs would be paid less. The evidence suggests also that CEOs do not deserve to make 209 times what workers make, and that paying CEOs $11.1 million per year does not maximize firm wealth. New empirical evidence (e.g., about the value of CEOs' contributions) may emerge that challenges these conclusions. Or new theories of justice in wages may be devised that draw different conclusions about the justice of executive pay from the existing evidence. Until then, it is reasonable to believe that CEO pay is too high.

This result is important. It supports the popular suspicion that CEOs are overpaid. But our inquiry leaves an important question unanswered, namely, exactly how much should CEOs be paid? Answering this question requires an interdisciplinary effort. First, we must determine what the correct view of justice in wages is. That is, we must determine which of these values, in this context, is most important. Here the writings of moral and political philosophers will be relevant. Second, we must apply the correct theory of justice in wages to the problem of CEO pay. That is, we must identify the wage that maximizes firm wealth, gives the CEO what he deserves, or would be the result of an arm's-length negotiation between the CEO and the owners. Here the writings of economists and organizational theorists will be relevant. Each of these tasks will be difficult and will require a full discussion of its own. In the meantime, what should be done? CEO pay should be kept from increasing; ideally, it should decrease. Space considerations prevent a detailed discussion of how this can be accomplished. I conclude, however, with two preliminary suggestions.

First, CEOs should be removed from the director election process. Directors feel obligated to those who put them on the board. If this is the CEO, they will feel obligated to him, and be more inclined to overpay him. Directors should feel obligated to the people that they are actually representing: the shareholders. Giving shareholders real power to elect and recall them will help to create this feeling. It may also make being a director a more demanding job. It may end the era in which an individual can serve on several corporate boards and still hold a full time job. This would be a good thing. Being a director is an important job: directors oversee entities whose actions can impact the welfare of thousands or even millions of people. It should feel like one.

Second, directors should be required to make meaningful investments in the firms that they direct. They need not all own a certain percentage of the firm's total stock. What matters is that they own an amount that is meaningful for them. This promotes the first objective: directors will feel more obligated to shareholders if they are themselves shareholders. It is useful for another reason as well. Above we said that a problem with the pay negotiations between directors and CEOs is that directors feel as if they are not paying with their own money. Making them buy stock would help to ameliorate this problem. An implication of this view is that other kinds of compensation that seem "free" to directors should be eliminated. This includes stock options insofar as they are not counted against firm earnings. If options are given as compensation, they should be expensed.[7]

Notes

[1] Mishel and Sabadish attempt to estimate the pay of CEOs compared to the pay of workers *in these CEOs' firms*. The closest they come is an estimation of the pay of CEOs compared to the pay of workers *in the key industries in which these CEOs' firms operate*. They arrive at an amount of $55,400 per year, inclusive of pay *and* benefits. (The fact that Mishel and Sabadish include benefits in worker compensation makes their ratio of CEO to worker compensation lower than is commonly reported.) Now it might be observed that $55,400 multiplied by 209 does not equal $11.1 million. This is because, to arrive at a ratio of CEO to worker pay, Mishel and Sabadish do not compute a "ratio of averages," i.e., they do not divide average CEO pay ($11.1 million) by average worker pay ($55,400). Instead, they compute an "average of ratios," i.e., they compute a ratio of CEO to worker pay for each firm in their sample, and average those ratios. A more detailed discussion of their methodology can be found in Mishel & Sabadish (2012b).

[2] Some might deny that it makes sense to speak of an "agreement view" or "utility view" of *justice* in wages. We can talk about whether utility or agreements should determine the wages workers get all-things-considered. But, according to this objection, the just wage, *by definition*, is the wage the worker deserves. This is merely a

terminological objection and can be set aside. What the objector would describe as a debate about the wages workers should get all-things-considered *just* is what I describe as a debate about justice in wages.

3 It is possible that some CEOs are not overpaid according to any of the three views of justice in wages. But even if some - or as I suspect, most - are, it follows that average CEO pay is too high.

4 Nichols and Subramanian (2001) suggest that high CEO pay is justified, in part, because CEOs' jobs are risky. When the company performs poorly, CEOs are more likely than average workers to be fired. But this ignores the fact that CEOs have less to fear from job loss than average workers. CEOs are wealthy, whereas most employees cannot afford to be out of work for long.

5 The study is available at http://www.challengergray.com/press/press.aspx.

6 This is not to suggest that companies should make *no* effort to keep their CEOs. There is debate about whether CEO succession events disrupt organizational performance, but most writers agree that they tend to lower the price of the firm's stock, at least for a time.

7 At the time this article was written, U.S. corporations were not required to expense stock options. Now they are, according to the Financial Accounting Standards Board's (FASB) Statement No. 123 (revised 2004). A summary of this statement is available at http://www.fasb.org/summary/stsuml23r.shtml.

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Questions for Discussion

1. Nader, Green, and Seligman are quite skeptical about the effectiveness of boards of directors. What are the traditional functions of the board? According to Nader *et al.*, how do boards sometimes fail to fulfill those functions? How would the authors like to see the board changed to make it function more effectively? Would these changes be sufficient?
2. Mintzberg discusses a number of ways that corporations might be controlled. Which do you think is most likely to succeed? Why? Is it plausible to suppose that all of them (except "ignore it") should and can be used depending on the circumstances? Can you think of any other ways in which corporations might be controlled?
3. Schwartz, Dunfee, and Kline propose a code of ethics for directors. What might be some specific rules contained in the code? How would the rules be monitored and enforced? What would happen if the rules were violated?
4. Moriarty claims that none of the usual ways to justify appropriate compensation in fact justifies the amount of compensation top executives often receive. If this is correct, then many executives are overpaid, perhaps even grossly overpaid in some cases. If so, what is the explanation for this? How did it happen? What responsibility do boards of directors have here? What action, if any, should be taken to correct the problem?

Cases for Part 2

Introduction

The two mini-cases in Part 2, "Stuart Howser" and "Deborah Wilson," focus on the social responsibilities of corporations. The articles on social responsibility in Chapter 3 can be used as background for resolving the dilemmas faced in each case.

The cases for Part 2 are intended to assist further reflection on the ideas and articles presented in Chapters 3 and 4. The first case, "Fire Destroys Malden Mills," discusses the actions of the owner of Malden Mills, a garment factory that burned down and put at risk the jobs of hundreds of employees. Articles in Chapter 3 applicable to this case are those by Goodpaster and Matthews, Friedman, and Freeman. The same articles are relevant to the next case, "Merck & Co., Inc.," which describes Merck's decision to provide an important drug to remote and poverty-stricken locations in developing countries. The next case, "Bailouts and Bonuses on Wall Street," discusses bonuses and other forms of compensation on Wall Street in the aftermath of the 2008 financial crisis. It can be analyzed using articles from both Chapter 3 and 4, including Friedman, Freeman, Stout, and Moriarty. Also appropriate here are articles by Nader, Green, and Seligman; Shapiro; and Schwartz, Dunfee, and Kline. The final case, "Citigroup's Chief Rebuffed on Pay by Shareholders," can be discussed using articles by Moriarty; Stout; Nader, Green, and Seligman; Shapiro; and Mintzberg.

Mini-Cases

Stuart Howser

Stuart Howser works for the US subsidiary of a German company. During lunch break, he notices that a group of people have gathered outside the head office. On the huge open courtyard of the extravagant building, people are marching back and forth, waving their placards with comments such as "We still remember" and "You profited from our grandparents' pain." Stuart goes outside to learn more about the protest. He enters into the following dialogue with one of the protestors:

STUART: Can you please tell me why are you protesting against the company?

PROTESTOR: Because during World War II this company employed slave labor. It profited from the sweat and pain of my father, a survivor of the Holocaust, and we demand compensation.

STUART: I understand you're upset, but it wasn't the company's fault. If anyone is to blame, it was the Nazi government of the time, which demanded that companies use slave labor. If what you ask for is compensation for pain and suffering, shouldn't you be asking the current German government?

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PROTESTOR: No, I blame the company, they made the decision to use the slave labor, not all German companies did so.

STUART: But wasn't it because of such work that many avoided dying in the concentration camps?

PROTESTOR: You really think that even if that were true, that this exonerates the company from its moral responsibility?

STUART: But this took place more than half a century ago. Almost all of the people who were responsible for slave labor are now dead. I don't even think that many of the former shareholders are still alive. Isn't there a point in time at which a company is no longer responsible for previous actions?

PROTESTOR: As long as the company still exists, even if in name only, it is still responsible for its actions of the past.

STUART: Well, if my father had been a Nazi involved in terrible crimes, would you hold me morally accountable for the past actions of my dead father?

PROTESTOR: No, I would not hold you accountable, other than your obligation to be aware of your father's actions and to help ensure that such things don't happen again. But companies are different. You are not your father, but the company, despite the turnover in employees and shareholders, is the same company.

STUART: But only in name! The company doesn't even sell many of the same products! And we are merely the US subsidiary!

Discussion questions

1. Who has the stronger arguments, the protestor or Stuart? Why?
2. Are corporations capable of moral responsibility? Or are only human beings responsible?
3. Is there a certain point in time at which companies are no longer responsible for actions in the past? If so, what is that point?

Deborah Wilson

Deborah Wilson is the CEO of a small manufacturing firm which specializes in baked goods and specialty sauces. The firm has grown significantly over its first three years, and in order to raise funding for further expansion, Deborah decides that it is time for her firm to go public through an IPO. Deborah believes that her firm's success is primarily due to the support she has received from her local community, her local suppliers, and her employees. As a result, she has decided that before going public the firm should officially adopt a number of new policies. One of her policies would be to place a salary limit for any employee of the firm, including herself as CEO, at 10 times the salary of the lowest paid employee. She also wants to dedicate 5 percent of the firm's pre-tax profits to local charities which would be selected each year on the basis of a vote by the firm's employees. She also wants to institute a policy of using only local or state suppliers as long as they meet the firm's quality standards, regardless of whether a cheaper supplier exists out of state. She knows that such policies might have a negative long-term impact on the firm's bottom line, but believes that such policies are in keeping with her own personal views regarding her firm's obligations toward society.

While discussing such policies with the lead investment broker, Deborah is surprised by their reaction. In attempting to resist Deborah's efforts, they argue that such actions will not necessarily produce any short-term or even long-term financial gains for the firm, and that they may discourage a number of investors from buying shares during the IPO. Even the employees are raising some concerns about how the policies will affect the financial prosperity of the firm. Deborah must consider whether she must drop or tone down her new policies in order to gain the lead investor's support for the IPO.

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Discussion questions

1. As CEO of a public company, is Deborah entitled to use shareholder money in order to implement her new policies?
2. Do Deborah's new policies have any ethical justification?
3. In what respects might Deborah's policies be good long-term business?

MBA Student Mini-Dilemmas

Ethical Crisis for the Community

You manage a performing-arts center that has featured events from theater to corporate retreats to comedy and music events. One night, an all-ages electronic music dance party takes place. The center was one of the only venues left for such parties, which otherwise would be held in illegal and unsafe locations. While there was heavy security for the event, you receive a panicked phone call following the event. Six people, including several teenagers, are reported dead, in addition to the suicidal shooter. No names have yet been released. The media is contacting you asking for quotes. A colleague in the industry as well as your legal counsel have advised silence and non-action to avoid liability. The media has already begun to call for legal action. You need to decide whether to "lie low" and do nothing, or step up and get involved in the process. By lying low, it might be possible to avoid undue attention and ride out the story, since the shooting had not taken place at the center, but at a house party following the event. What do you do?

Profiting from Catastrophe Bonds?

You work for an insurance firm. While sitting in your New York office, you hear that Hurricane Katrina has hit New Orleans. You are from New Orleans, and while you know your immediate family was evacuated at the last moment, you have not heard from any of your extended family or friends. As you wait anxiously to hear that everyone is OK, you are listening to your co-workers' excitement over how well catastrophe bonds were now doing due to the hurricane. You discover that catastrophe bonds are insurance-linked financial instruments meant to raise money for catastrophic events, but can also be used to legally make profits when there is a disaster. Basically, one makes money by betting on the lives of others. You are infuriated with the insensitivity of your colleagues. You wonder if it is acceptable for your colleagues to be so excited when there's a tragedy, given that they have a fiduciary duty to maximize the financial interests of their clients. Is it OK to make emotionless bets on the well-being of other human beings? Do you say anything, or keep quiet?

Fire Destroys Malden Mills

Anonymous

On This Day …

… in 1995, a massive, wind-whipped fire completely destroyed three buildings at Malden Mills in Lawrence, where the company's signature Polartec fabric was produced. Just two weeks before Christmas, thousands of workers faced unemployment and the fear that the mill's owner would take the insurance money and follow other textile companies south. The next day, company president Aaron Feuerstein announced that he would rebuild in Lawrence, and he promised to keep his employees on the payroll during the time it would take to reconstruct the plant. Venerated as "a man of his word" and "extremely compassionate," Feuerstein became a national folk hero. Sadly, the millions he spent to keep his pledges eventually cost him control of the company his family had owned for three generations.

Background

The fire that reduced Malden Mills to rubble on the evening of December 11, 1995 was one of the worst in the state's history. Seven hundred people were at work in the factory when, at a little past 8:00 p.m., a boiler

"Fire Destroys Malden Mills," *Mass Moments*, December 11, 1995,http://www.massmoments.org/moment.cfm?mid=355. Reprinted with permission of the Massachusetts Foundation for the Humanities.

exploded in one of the mill buildings. The explosion was so powerful that it ruptured gas mains; fire quickly engulfed the buildings. Employees fled into the streets; 33 were injured, four of them critically.

Fueled by the chemicals and flammable materials used in textile production, the six-alarm fire gutted the mill complex. More than 200 firefighters from as far away as New Hampshire and Boston's South Shore battled 50-foot walls of flame. Strong, gusty winds and temperatures near zero degrees hampered the effort. The fire raged out of control for much of the night, forcing nearby residents to evacuate. By morning, the once-busy textile complex was a scene of utter devastation.

The fire was a catastrophe for Methuen and Lawrence, the struggling factory towns that were home to many of the mill's immigrant workers. Malden Mills was not just one of the largest employers in the area, it was also one of the best. Owned by the Feuerstein family for three generations, the company had a longstanding reputation for being good to its employees and committed to its community. When most other textile mills moved south to benefit from lower labor costs, the Feuersteins continued to invest in their Lawrence operation. Aaron Feuerstein believed that his father had left him to care for the family business and for the local synagogue; he devoted himself to keeping both afloat.

From the time he took over the company in 1957, Feuerstein became an active player in the community. He extended credit to struggling local businesses, sponsored English classes for immigrant employees, and offered training for textile workers. He took special care of his own workers, making sure they had a safe and comfortable work environment and paying higher wages than most of his competitors. Even union leaders praised him, calling him "a man of his word" and "extremely compassionate." One union official said, "He believes in the process of collective bargaining and he believes that if you pay people a fair amount of money, and give them good benefits to take care of their families, they will produce for you."

Malden Mills was not immune to the hard times that afflicted the New England's textile industry in the mid-1900s, but in 1981 Aaron Feuerstein and his management team found an innovative solution to the company's problems. With the development of Polartec, a synthetic fleece, Malden Mills was able to expand its workforce to 2,300. Clothing made from lightweight and fast-wicking Polartec fleece, worn next to the skin, keeps wearers warm and dry; *Time Magazine* named Polartec one of the greatest inventions of the 20th century. It has been in high demand by active and outdoor wear marketers such as L.L. Bean, Eddie Bauer, and Patagonia, and has also been adopted for military uses.

But with the mill in ruins, people who did not know Aaron Feuerstein predicted that he would take the $300,000,000 insurance money and re-locate or dissolve the business. His announcement the day after the fire that he intended to rebuild in Lawrence and to continue paying his workers during reconstruction made news all over the country. His generosity brought him international attention and admiration. In January of 1996, with Feuerstein sitting in the presidential box, Bill Clinton acknowledged his actions in the State of the Union address.

Feuerstein, a devout Orthodox Jew, explained that he drew on Jewish tradition when faced with the crisis: "When all is moral chaos, this is the time for you to be a mensch," the Yiddish word for an honorable, decent, compassionate person who embodies justice and strives for righteousness.

It would cost Aaron Feuerstein $25,000,000 to keep his employees on the payroll. The long-term costs were eventually greater than the company could bear. He invested $100,000,000 in addition to the insurance settlement to build a state-of-the-art factory, the first new textile mill in New England in more than 100 years. In 2001 the cost of financing the project forced him into bankruptcy.

Feuerstein struggled to maintain family control of the company. He needed to raise $92,000,000 by August of 2003 to satisfy his creditors. He told reporters, "We insist the business must be profitable … But we also insist a business must have responsibility for its workers, for the community and the environment. It has a social obligation to figure out a strategy, which will be able to permit workers to make a living wage. There's a responsibility to the workforce, to this community."

Feuerstein's efforts fell short, and he lost control of the company. In July of 2004, Malden Mills Industries, now owned by its creditors, announced that a new CEO had been hired to replace 78-year-old Aaron Feuerstein.

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Merck & Co., Inc. (A)

David Bollier and Stephanie Weiss

In 1978, Dr. P. Roy Vagelos, then head of the Merck research labs, received a provocative memorandum from a senior researcher in parasitology, Dr. William C. Campbell. Dr. Campbell had made an intriguing observation while working with ivermectin, a new antiparasitic compound under investigation for use in animals.

Campbell thought that ivermectin might be the answer to a disease called river blindness that plagued millions in the Third World. But to find out if Campbell's hypothesis had merit, Merck would have to spend millions of dollars to develop the right formulation for human use and to conduct the field trials in the most remote parts of the world. Even if these efforts produced an effective and safe drug, virtually all of those afflicted with river blindness could not afford to buy it. Vagelos, originally a university researcher but by then a Merck executive, had to decide whether to invest in research for a drug that, even if successful, might never pay for itself.

David Bollier and Stephanie Weiss, "Merck & Co., Inc. (A)," The Business Enterprise Trust, Harvard Business School Publishing, 1991. Case Number 9-991-021. Reprinted with permission of Act III Communications.

River Blindness

River blindness, formally known as *onchocerciasis*, was a disease labeled by the World Health Organization (WHO) as a public health and socioeconomic problem of considerable magnitude in over 35 developing countries throughout the Third World. Some 85 million people in thousands of tiny settlements throughout Africa and parts of the Middle East and Latin America were thought to be at risk, "The cause: a parasitic worm carried by a tiny black fly which bred along fast-moving rivers. When the flies bit humans – a single person could be bitten thousands of times a day – the larvae of a parasitic worm, *Onchocerca volvulus*, entered the body.

These worms grew to more than two feet in length, causing grotesque but relatively innocuous nodules in the skin. The real harm began when the adult worms reproduced, releasing millions of microscopic offspring, known as microfilariae, which swarmed through body tissue. A terrible itching resulted, so bad that some victims committed suicide. After several years, the microfilariae caused lesions and depigmentation of the skin. Eventually they invaded the eyes, often causing blindness.

The World Health Organization estimated in 1978 that some 340,000 people were blind because of onchocerciasis, and that a million more suffered from varying degrees of visual impairment At that time, 18 million or more people were infected with the parasite, though half did not yet have serious symptoms. In some villages close to fly-breeding sites, nearly all residents were infected and a majority of those over age 45 were blind. In such places, it was said, children believed that severe itching, skin infections and blindness were simply part of growing up.

In desperate efforts to escape the flies, entire villages abandoned fertile areas near rivers, and moved to poorer land. As a result, food shortages were frequent Community life disintegrated as new burdens arose for already impoverished families.

The disease was first identified in 1893 by scientists and in 1926 was found to be related to the black flies. But by the 1970s, there was still no cure that could safely be used for community-wide treatment Two drugs, diethylcarbamazine (DEC) and Suramin, were useful in killing the parasite, but both had severe side effects in infected individuals, needed close monitoring, and had even caused deaths. In 1974, the Onchocerciasis Control Program was created to be administered by the World Health Organization, in the hope that the flies could be killed through spraying of larvacides at breeding sites, but success was slow and uncertain, The flies in many areas developed resistance to the treatment, and were also known to disappear and then reinfest areas.

Merck & Co., Inc.

Merck & Co., Inc. was, in 1978, one of the largest producers of prescription drugs in the world. Headquartered in Rahway, New Jersey, Merck traced its origins to Germany in 1668 when Friedrich Jacob Merck purchased an apothecary in the city of Darmstadt. Over three hundred years later, Merck, having become an American firm, employed over 28,000 people and had operations all over the world.

In the late 1970s, Merck was coming off a 10-year drought in terms of new products. For nearly a decade, the company had relied on two prescription drugs for a significant percentage of its approximately $2 billion in annual sales: Indocin, a treatment for rheumatoid. arthritis, and Aldomet, a treatment for high blood pressure. Henry W. Gadsden, Merck's chief executive from 1965 to 1976, along with his successor, John J. Horan, were concerned that the 17-year patent protection on Merck's two big moneymakers would soon expire, and began investing an enormous amount in research.

Merck management spent a great deal of money on research because it knew that its success ten and twenty years in the future critically depended upon present investments. The company deliberately fashioned a corporate culture to nurture the most creative, fruitful research. Merck scientists were among the best-paid in the industry, and were given great latitude to pursue intriguing leads. Moreover, they were inspired to think of their work as a quest to alleviate human disease and suffering world-wide. Within certain, proprietary constraints, researchers were encouraged to publish in academic journals and to share ideas with their scientific peers. Nearly a billion dollars was spent between 1975 and 1978, and the invest ment paid off. In that period, under the direction of head, of research, Dr. P. Roy Vagelos, Merck introduced Clinoril, a painkiller for arthritis; a general antibiotic called Mefoxin; a drug for glaucoma named Timoptic; and Ivomec (ivermectin, MSD), an antiparasitic for cattle.

In 1978, Merck had sales of $1.98 billion and net income of $307 million. Sales had risen steadily between 1969 and 1978 from $691 million to almost $2 billion. Income during the same period rose from $106 million to over $300 million. (See Exhibit 1 for a 10 year summary of performance.)

At that time, Merck employed 28,700 people, up from 22,200 ten years earlier. Human and animal health products constituted 84% of the company's sales, with environmental health products and services representing an additional 14% of sales. Merck's foreign sales had grown more rapidly during the 1970s than had domestic sales, and in 1978 represented 47% of total sales. Much of the company's research operations were organized separately as the Merck Sharp & Dohme Research Laboratories, headed by Vagelos. Other Merck operations included the Merck Sharp & Dohme Division, the Merck Sharp & Dohme International Division, Kelco Division, Merck Chemical Manufacturing Division, Merck Animal Health Division, Calgon Corporation, Baltimore Aircoil Company, and Hubbard Farms.

The company had 24 plants in the United States, including one in Puerto Rico, and 44 in other countries. Six research laboratories were located in the United States and four abroad.

While Merck executives sometimes squirmed when they quoted the "unbusinesslike" language of George W. Merck, son of the company's founder and its former chairman, there could be no doubt that Merck employees found the words inspirational. "We try never to forget that medicine is for the people,"

Exhibit 1 10 Year summary of financial performance of Merck &. Co., Inc. and subsidiaries (dollar amounts in thousands except per-share figures).

Results for Year:	1978	1977	1976	1975	1974	1973	1972	1971	1970	1969
Sales	$1,981,440	$1,724,410	$1,561,117	$1,401,979	$1,260,416	$1,104,035	$942,631	$832,416	$761,109	$691,453
Materials and production costs	744,249	662,703	586,963	525,853	458,837	383,879	314,804	286,646	258,340	232,878
Marketing/administrative expenses	542,186	437,579	396,975	354,525	330,392	304,807	268,856	219,005	201,543	178,593
Research/development expenses	161,350	144,898	133,826	121,933	100,952	89,155	79,692	71,619	69,707	61,100
Interest expenses	25,743	25,743	26,914	21,319	8,445	6,703	4,533	3,085	2,964	1,598
Income before taxes	507,912	453,487’	416,439	378,349	361,890	319,491	274,746	252,061	228,555	217,284
Taxes on income	198,100	173,300	159,100	147,700	149,300	134,048	121,044	118,703	108,827	109,269
Net income	307,534	277,525	255,482	228,778	210,492	182,681	151,180	131,381	117,878	106,645
Per common share	$4.07	$3.67	$3.38	$3.03	$2.79	$2.43	$2.01	$1.75	$1.57	$1.43
Dividends declared on common stock	132,257	117,101	107,584	105,564	106,341	93,852	84,103	82,206	76,458	75,528
Per common share	$1.75	$1.55	$1.42½	S1.40	$1.40	$1.23½	$1.12	$1.10	$1.02½	$1.02½
Gross plant additions	155,353	177,167	153,894	249,015	159,148	90,194	69,477	67,343	71,540	48,715
Depreciation	75,477	66,785	58,198	52,091	46,057	40,617	36,283	32,104	27,819	23,973
Year-End Position:										
Working capital	666,817	629,515	549,840	502,262	359,591	342,434	296,378	260,350	226,084	228,296
Property, plant, and equipment (net)	924,179	846,784	747,107	652,804	459,245	352,145	305,416	274,240	239,638	197,220
Total assets	2,251,358	1,993,389	1,759,371	1,538,999	1,243,287	988,985	834,847	736,503	664,294	601,484
Stockholders' equity	1,455,135	1,277,753	1,102,154	949,991	822,782	709,614	621,792	542,978	493,214	451,030
Year-End Statistics:										
Average number of common shares outstanding (in thousands)	75,573	75,546	75,493	75,420	75,300	75,193	75,011	74,850	74,850	74,547
Number of stockholders	62,900	63,900	63,500	63,500	61,400	60,000	58,000	54,300	54,600	53,100
Number of employees	28,700	28,100	26,800	26,300	26,500	25,100	24,100	23,200	23,000	22,200

*The above data are as previously reported, restated for poolings-of-interests and stock splits.

**Net income for 1977 and related per-share amounts exclude gain on disposal of businesses of $13,225 and 18c, respectively.

Merck said. "It is not for the profits. The profits follow, and if we have remembered that, they have never failed to appear. The better we have remembered it, the larger they have been," These words formed the basis of Merck's overall corporate philosophy.

The Drug Investment Decision

Merck invested hundreds of millions of dollars each year in research. Allocating those funds amongst various projects, however, was a rather involved and inexact, process. At a company as large as Merck, there was never a single method by which projects were approved or money distributed.

Studies showed that, on the average, it took 12 years and $200 million to bring a new drug to market. Thousands of scientists were continually working on new ideas and following new leads. Drug development was always a matter of trial and error; with each new iteration, scientists would close some doors and open others. When a Merck researcher came across an apparent breakthrough – either in an unexpected direction, or as a derivative of the original lead – he or she would conduct preliminary research. If the idea proved promising, it was brought to the attention of the department heads.

Every year, Merck's research division held a large review meeting at which all research programs were examined. Projects were coordinated and consolidated, established programs were reviewed and new possibilities were considered. Final approval on research was not made, however, until the head of research met later with a committee of scientific advisors. Each potential program was extensively reviewed, analyzed on the basis of the likelihood of success, the existing market, competition, potential safety problems, manufacturing feasibility and patent status before the decision was made whether to allocate funds for continued experimentation.

The Problem of Rare Diseases and Poor Customers

Many potential drugs offered little chance of financial return. Some diseases were so rare that treatments developed could never be priced high enough to recoup the investment in research, while other diseases afflicted only the poor in rural and remote areas of the Third World. These victims had limited ability to pay even a small amount for drugs or treatment.

In the United States, Congress sought to encourage drug companies to conduct research on rare diseases. In 1978 legislation had been proposed which would grant drug companies tax benefits and seven-year exclusive marketing rights if they would manufacture drugs for diseases afflicting fewer than 200,000 Americans. It was expected that this "orphan drug" program would eventually be passed into law.

There was, however, no U.S. or international program that would create incentives for companies to develop drugs for diseases like river blindness which afflicted millions of the poor in the Third World. The only hope was that some Third World government, foundation, or international aid organization might step in and partially fund the distribution of a drug that had already been developed.

The Discovery of Ivermectin

The process of investigating promising drug compounds was always long, laborious and fraught with failure. For every pharmaceutical compound that became a "product candidate," thousands of others failed to meet the most rudimentary pre-clinical tests for safety arid efficacy. With so much room for failure, it became especially important for drug companies to have sophisticated research managers who could identify the most productive research strategies.

Merck had long been a pioneer in developing major new antibiotic compounds, beginning with penicillin and streptomycin in the 1940s. In the 1970s, Merck Sharp & Dohme Research Laboratories were continuing this tradition. To help investigate for new microbial agents of potential therapeutic value, Merck researchers obtained 54 soil samples from the Kitasato Institute of Japan in 1974. These samples seemed novel and the researchers hoped they might disclose some naturally occurring antibiotics.

As Merck researchers methodically put the soil through hundreds of tests, Merck scientists were pleasantly surprised to detect strong antiparasitic activity in Sample No. OS3153, a scoop of soil dug up at a golf course near Ito, Japan. The Merck labs quickly brought together an interdisciplinary team to try to isolate a pure active ingredient from the microbial culture. The compound eventually isolated – avermectin – proved to have an astonishing potency and effectiveness against wide range of parasites in cattle, swine, horses and other animals. Within a year, the Merck team also began to suspect that a group of related compounds discovered in the same soil sample could be effective against many other intestinal worms, mites, ticks and insects.

After toxicological tests suggested that ivermectin would be safer than related compounds, Merck decided to develop the substance for the animal health market. In 1978 the first ivermectin-based animal drug, Ivomec, was nearing approval by the U.S. Department of Agriculture and foreign regulatory bodies. Many variations would likely follow: drugs for sheep and pigs, horses, dogs, and others. Ivomec had the potential to become a major advance in animal health treatment.

As clinical testing of ivermectin progressed in the late 1970s, Dr. William Campbell's ongoing research brought him face-to-face with an intriguing hypothesis. Ivermectin, when tested in horses, was effective against the microfilariae of an exotic, fairly unimportant gastrointestinal parasite, *Onchocerca cervicalis*. This particular worm, while harmless in horses, had characteristics similar to the insidious human parasite that causes river blindness, *Onchocerca volvulus*.

Dr. Campbell wondered: Could ivermectin be formulated to work against the human parasite? Could a safe, effective drug suitable for community-wide treatment of river blindness be developed? Both Campbell and Vagelos knew that it was very much a gamble that it would succeed. Furthermore, both knew that even if success were attained, the economic viability of such a project would be nil. On the other hand, because such a significant amount of money had already been invested in the development of the animal drug, the cost of developing human formulation would be much less than that for developing a new compound. It was also widely believed at this point that ivermectin, though still in its final development stages, was likely to be very successful.

A decision to proceed would not be without risks. If a new derivative proved to have any adverse health effects when used on humans, its reputation as a veterinary drug could be tainted and sales negatively affected, no matter how irrelevant the experience with humans. In early tests, ivermectin had had some negative side effects on some specific species of mammals. Dr. Brian Duke of the Armed Forces Institute of Pathology in Washington, D.C. said the cross-species effectiveness of antiparasitic drugs are unpredictable, and there is "always a worry that some race or subsection of the human population" might be adversely affected.

Isolated instances of harm to humans or improper use in Third World settings might also raise some unsettling questions: Could drug residues turn up in meat eaten by humans? Would any human version of ivermectin distributed to the Third World be diverted into the black market, undercutting sales of the veterinary drug? Could the drug harm certain animals in unknown ways?

Despite these risks, Vagelos wondered what the impact might be of turning down Campbell's proposal. Merck had built a research team dedicated to alleviating human suffering. What would a refusal to pursue a possible treatment for river blindness do to morale?

Ultimately, it was Dr. Vagelos who had to make the decision whether or not to fund research toward a treatment for river blindness.

Note

[1] This case was researched and written by David Bollier and adapted by Stephanie Weiss, under the supervision of Kirk O. Hanson, senior lecturer at the Stanford Graduate School of Business.

Bailouts and Bonuses on Wall Street

Kirsten Martin and Michael Scotto

> "They want Wall Street to pay … They think we're overpaid assholes."[1]
>
> Jamie Dimon,
> CEO JP Morgan Chase

The $100-Million-Dollar Problem

Matt, a top level executive at Goldman Sachs, never figured that how he paid his employees would be one of his most pressing issues – not after having watched his entire industry turned on its head for the past two years and the world economy shaken to its core. But as of January 2010, all that was on Matt's mind was how to deal with his own group of highly-paid traders who had been promised generous compensation packages and had made Goldman Sachs between $1.5 and $3.0B in 2008 and 2009.

Matt knew the financial services industry was still stinging from a seemingly outrageous pay package bestowed upon an individual at Citigroup – a trader who became known as the $100-Million-Dollar-Man. This commodities trader received a $100 million bonus just a few months previous based on his contract with the company; he had earned Citigroup $2 billion with bets against the oil market and contractually was owed the money. Citigroup, however, had received $45 billion in taxpayer funds and, at the time of the bonus payments, had yet to pay back the funds to the US government. As word leaked out to the press, calls for pay reform reverberated throughout the industry.[2]

In the midst of a recession, this pay problem was industry-wide, and executives like Matt were dealing with the same issue: how big should employee paychecks be?[3] Matt needed to make a decision about how to pay *his* employees and was not sure how to factor in the industry and economic public perceptions. His task was difficult. On one hand, Matt had to pay his eight employees a total of $125 M owed under contract, yet Goldman Sachs had received more than $10B in taxpayer aid from a federal bailout. In addition, this particular trading group played an unusual role in the financial crisis due to its relationship with AIG Financial Products (FP) group – considered by many to be the epicenter of the crisis.

Financial Crisis

Compensation decisions within the financial industry had become a public debate in the wake of one of the worst financial crises to ravage Wall Street and send the rest of the global economy into a downward spiral. A combination of factors such as a lack of liquidity, overleveraged balance sheets, and a heavy reliance on financial instruments tied to the housing markets, also known as *mortgage-backed securities*, created a domino effect within the financial industry. When these mortgage-backed securities dropped in value due to the collapse of the housing bubble, the overextended Wall Street firms could not absorb the loss in asset value and increase in short term liabilities. See Figure 1 for leverage over time.

As banks took major write-downs of the assets on their books due to their huge stakes on the housing market, concerns spread over whether certain banks could remain solvent. The first domino to fall was that of investment bank Bear Stearns. Only a year after its stock was trading at $133 per share, Bear Stearns was forced to sell to JP Morgan Chase in March 2008, at $2 per share,[4] due to a lack of investor confidence in Bear's ability to cover obligations it held with its trading partners. See Figure 2 for profit margin.

Key to this transaction was that the federal government had stepped in to guarantee up to $30 billion of Bear Stearns' assets. This action set a precedent wherein the US government – in the form of the Federal Reserve, the Treasury Department, and eventually

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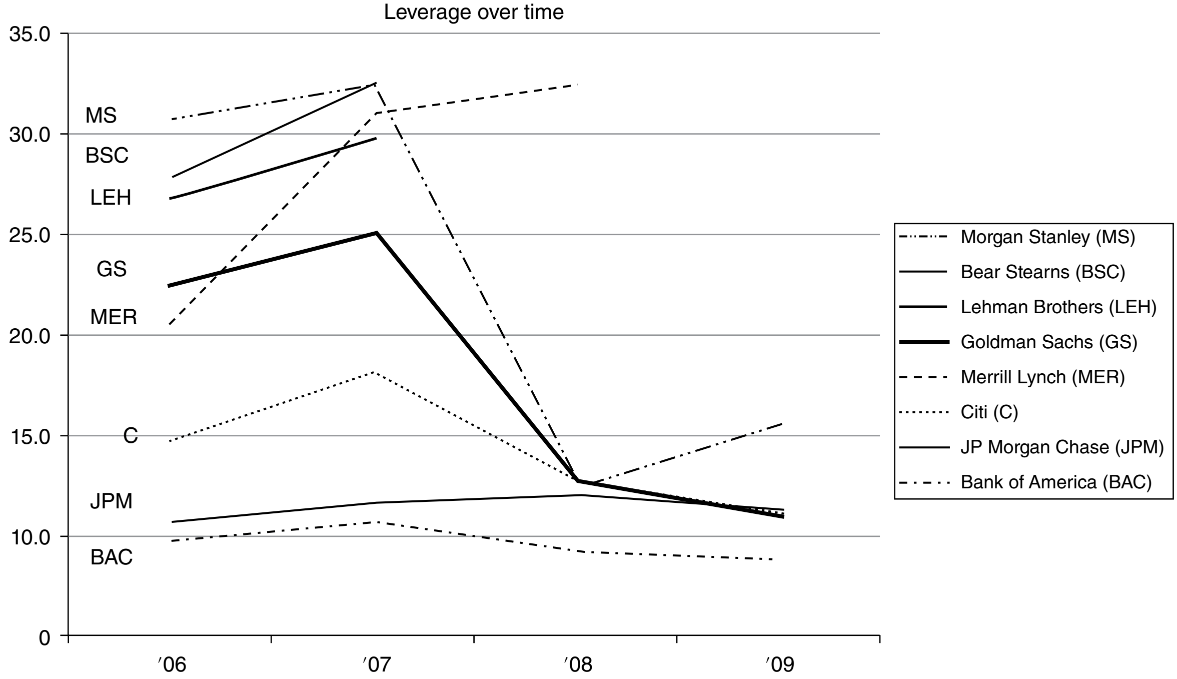

Figure 1 Leverage.

the US Congress – acted to bailout banks and securities firms. Some banks would survive with the help of the government, whereas others would collapse due to a lack of government assistance.[5]

One of the major players in the financial crisis was insurance giant American International Group (AIG).[6] One of its products – the credit default swap (CDS)[7] – was an insurance contract (or bet) on the value of bonds based on subprime mortgages.[8] It was sold by AIG's FP group.[9] The CDS market looked particularly attractive because the underlying bonds historically did not go bankrupt. Companies such as AIG that sold CDSs were able to profit by selling the swaps and collecting premiums, with a low risk of pay out on claims.[10] Problems arose when homeowners began defaulting on their subprime mortgages and all the bonds associated with mortgage-backed securities fell in value. AIG had sold CDSs that insured more than $440B in bonds, yet AIG did not have the assets to back these risky swaps or insurance policies. AIG FP had taken on responsibility for $20B in mortgage bonds through deals with Goldman Sachs' trading desk alone.[11] Customers, trading partners, and credit rating agencies lost faith in AIG's ability to cover its promises.[12] The federal government then stepped in to bailout AIG on September 17, 2008, by extending an emergency $85 billion line of credit to the company.[13]

On October 3, 2008, Congress set aside over $700B to invest in the US economy through the Troubled Asset Relief Program (TARP). CEOs from nine banks – JP Morgan Chase, Goldman Sachs, Bank of America, Merrill Lynch, Morgan Stanley, Citigroup, Wells Fargo, State Street, and Bank of New York Mellon – were called to a meeting on Monday, October 13, 2008, and told they each would be taking between $10B and $25B in government assistance in the form of TARP funds. This original TARP proposal was written on three pages with no requirements on capital, leverage, compensation, or profit-sharing for those receiving the money.[14] All banks were expected to take money no matter how financially solvent

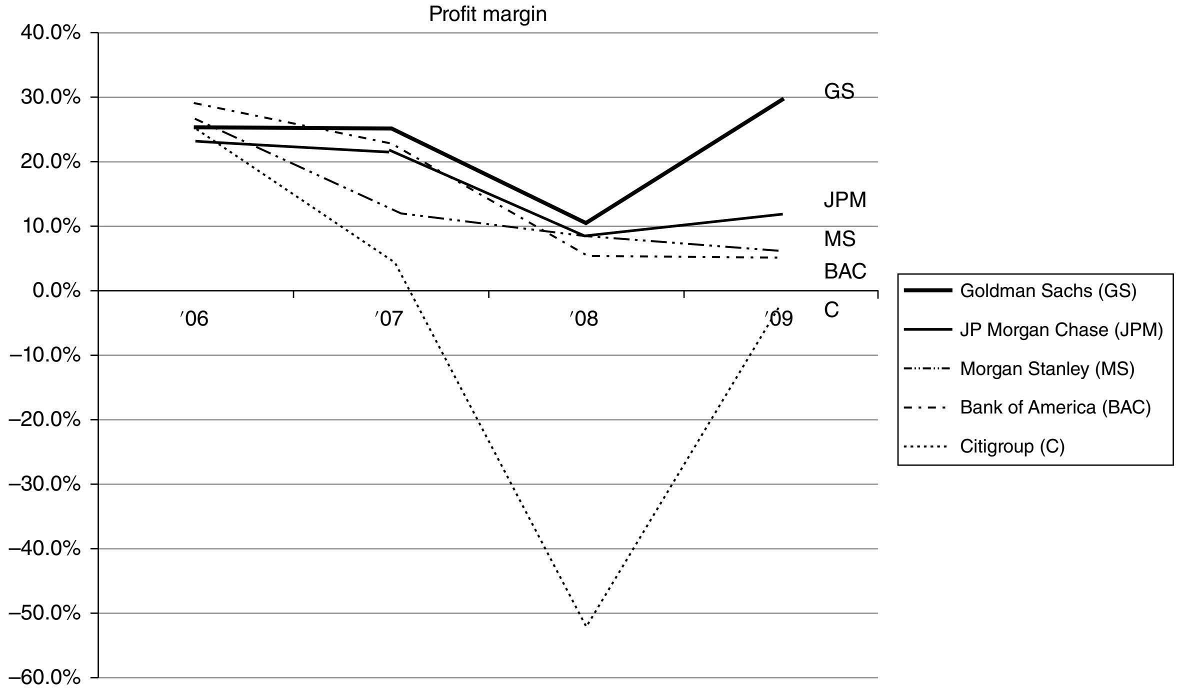

Figure 2 Profit margin.

they believed themselves to be. See Appendix for detailed breakdown of companies receiving TARP funds.

TARP had in effect stabilized the economy, but when Wall Street's 'bonus season' came around only four months later in the spring of 2009, AIG was ready to hand its employees a total of $165 M in bonuses, including those in its Financial Products division – the largest recipient of taxpayer money and the same division that sold the credit default swaps that every other financial institution relied upon to 'insure' its collateralized debt obligation (CDO). When the underlying assets – those subprime mortgages – first fell in value in 2008, AIG's trading in credit-default swaps began to cost the company billions of dollars. AIG offered its FP employees more than $400 million in retention pay, with lump sums due in March 2009 and March 2010.[15] See Exhibit 1 for a timeline of financial activities.

When AIG's retention bonus plan became public in March 2009, President Obama vowed to "pursue every single legal avenue to block" the bonuses, and lawmakers backed a bill that would have taxed the payments to Financial Products' employees at 90%.[16] The New York Attorney General threatened to publicize the recipients' names, thus prompting executives at AIG FP to hastily agree to return about $45 million in bonuses by the end of 2009.[17] Matt's decision to pay his employees was increasingly complicated by these two highly publicized scandals: the $100-Million-Man at Citigroup and the AIG FP bonuses.

Compensation in Financial Services

Wall Street executives and employees have historically been awarded a mix of stock and cash bonuses as a percent of revenue. Prior to the financial crisis, however, bonuses had become cash heavy – compensation was not tied to the long-term performance of the companies, and executives were able to walk away from a company at any time. Since the financial crisis,

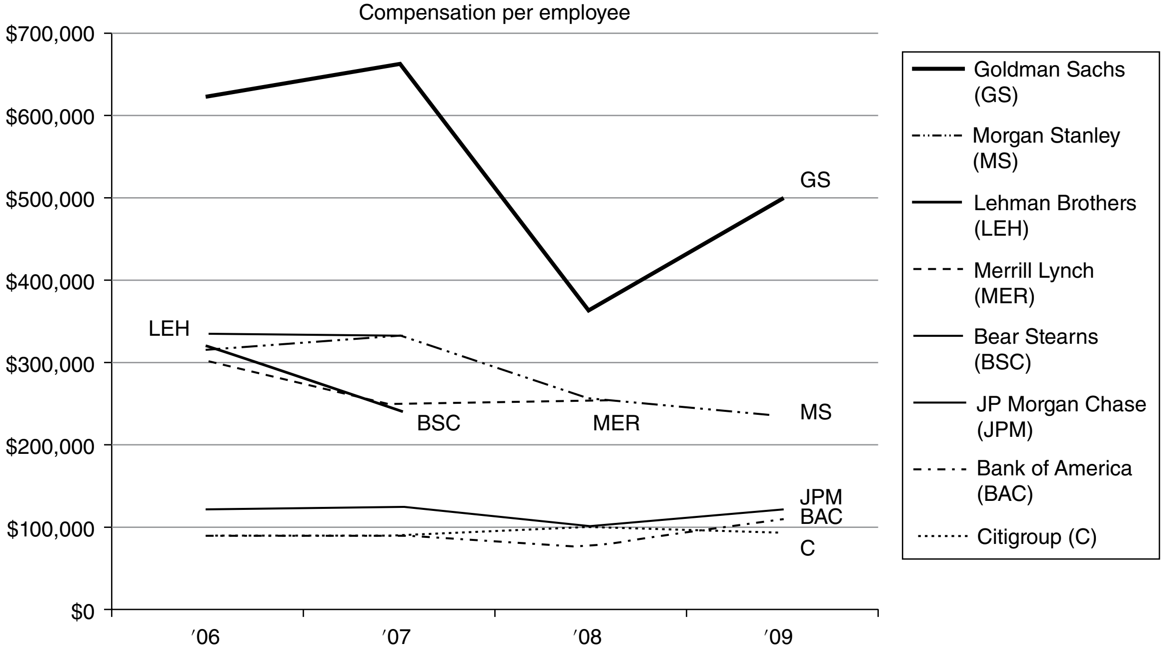

Figure 3 Compensation.

companies began to shift the focus of their bonuses to stock with provisions to prevent executives from the option of quickly selling their shares.[18] An emphasis on bonuses rather than salary was not new for Wall Street, where the bulk of bankers' and traders' pay was tied up in year-end performance bonuses. See Figure 3 for Wall Street compensation history.

Government assistance to the financial industry opened the door to public scrutiny on pay practices that had gone unchallenged for decades. But both the role of the financial industry in the larger economy and the structure of financial organizations had changed. First, the financial industry became a larger part of the overall economy. From 1929 through 1988, financial industry profits averaged 1.2% of GDP. Starting in the 1990s, however, profits increased rapidly and peaked at 3.3% of GDP in 2005.[19] In addition, the industry was more concentrated: the 10 largest financial institutions had 10% of financial assets in the United States in 1990, yet in 2009, the top 10 institutions owned over 60% of the US financial assets.[20]

Finally, the structure of the organizations changed. Until the 1970s, many Wall Street firms were private partnerships, where the partners' capital supported the firms' operations, and compensation was a form of profit sharing. Profits from firm activities were divided at year-end among the partners of the firm as a percent of revenue. As such, compensation was a negotiation among partners and generally tracked the amount of ownership in the firm and the ability of a partner to add value to the firm.[21] When many financial firms went public – including the companies at the center of the financial crisis – the compensation structure did not change. Executives were still paid as if they were in a partnership without the same risk profile. Some were concerned that the rewards were out of balance with the risk. According to Peter J. Solomon Company's founder and chairman, "If securities traders could lose their capital as well as their income, the public might be less upset about their gains."[22]

Banks' Post-Crisis Activities

The landscape of Wall Street was completely changed, from the largest profits ever in the fall of 2007, to the lows in March of 2009. Lehman Brothers, Bear Stearns, and Merrill Lynch – all once staples of a thriving sector – were either liquidated or sold at depressed prices. The surviving players on Wall Street included Goldman Sachs, Morgan Stanley, Bank of America, JP Morgan Chase, and Citigroup. All received aid from the Troubled Asset Relief Program (TARP), and as of January 2010, only Citigroup had yet to repay its bailout funds.

These Wall Street survivors saw a revival in revenue and profitability in 2009. During the first nine months of 2009, five of the largest banks that had received federal aid – Citigroup, Bank of America, Goldman Sachs, JP Morgan Chase, and Morgan Stanley – together set aside $90 billion for compensation. That figure included salaries, benefits, and bonuses, but at several companies, bonuses made up more than half of compensation.[23] While average bonuses for the industry were expected to be around half a million dollars for 2009, the amount was not evenly distributed throughout the companies. Bond and currency traders, as well as investment bankers, received a disproportionate amount of the bonuses.[24] Surprising to many, the traders making the most money were not at hedge funds but rather at the investment banks – firms who received TARP money and were not considered traditional places for trading activity.[25] See Exhibit 2 for a breakdown of the financial results of each bank.

Public and Government Reactions to Bonuses

On May 20, 2009, President Obama signed the Fraud Enforcement and Recovery Act of 2009, creating the Financial Crisis Inquiry Commission (FCIC). The Commission was established to "examine the causes, domestic and global, of the current financial and economic crisis in the United States"[26] and report the findings to the President, to Congress, and to the American people. In addition, "Pay Czar" Ken Feinberg was named Special Master for TARP executive compensation for those firms that had not paid back TARP funds. Feinberg determined the compensation for the top 30 executives at those firms.

Even with additional controls, a tremendous amount of public backlash against Wall Street over the 'bonus culture' persisted. One school of thought was that bonuses themselves led to the meltdown of the global financial system. Because executive pay was tied to short-term success, excessive risks were taken in the form of CDOs and CDSs. According to this line of reasoning, the packages for executives were structured to encourage a get-rich-quick mentality and led to extremely risky behavior, which helped bring the financial markets crashing down and wipe out the profits of multiple companies.[27] Jean-Claude Trichet, president of the European Central Bank, noted that the "so-called bonus culture is one of the many factors that can drive the financial system in the wrong direction." He added that it encouraged "self-referential speculation," discouraged medium-term stability, and drove banking "away from being a service sector to being a self-serving sector."[28]

To add fodder to this argument, most compensation analysis did not take into account the executives who left the firms before the financial crisis.[29] For example, during the 11 years before the crisis, Merrill Lynch paid its three CEOs more than $240 million in performance-based compensation.[30]

In addition, the US Treasury required banks that had not paid back TARP funds to pay executives almost entirely in stock. For example, 19 executives at Citigroup could split $113 million in stock for 2009.[31] If Citigroup's stock returned to levels just 24 months prior, however, the executives' shares would be worth more than $800 million.[32] This trend toward stock compensation was not limited to those holding TARP money due to the heavy influence of the Pay Czar, who was charged with the task of rebuilding how employees were compensated on Wall Street.

The emphasis on stock also complicated matters. Bankers were predicted to make large gains on stock compensation due to the depressed stock prices at the time stocks were issued. For example, 2008 compensation was considered low at the time, yet increased in value when the entire financial system began to mend and banks' stock prices climbed.[33] As noted by Jesse M. Brill, chairman of the CompensationStandards.com trade publication, "People have to look at the sizable gains that have been made since stock and options were granted last year, and the fact is this was, in many ways, a windfall … This had nothing to do with people's performance. These were granted at market lows."[34] Matt's trading group at Goldman

Sachs was profitable because it was trading through the market lows in 2008 and 2009.

Finally, some grew frustrated that not enough lending was taking place with the investment of TARP funds into financial institutions – firms were more interested in trading their own money rather than lending money to companies or individuals. Goldman Sachs and JP Morgan Chase were so highly profitable in proprietary trading and taking large risks "that weaker rivals were unable or unwilling to shoulder – a benefit of less competition after the failure of some investment firms last year."[35] Yet, the lack of lending to large and small businesses impacted business expansion and new company start-ups – steps which are integral for economic recovery.[36]

The Financial Industry's Response

Financial institutions at the middle of the storm made their own arguments, defending their business and compensation practices.

Strong versus weak institutions

While some found the competitive advantage of Goldman Sachs and JP Morgan Chase distasteful, others saw it as a natural consolidation of power in an industry with tremendous upheaval. The collapse of competitors such as Lehman Brothers, Bear Stearns, and Merrill Lynch concentrated financial power in a few hands that were able to take stronger, more risky positions in the market place.[37] "They are able to charge more for all kinds of services because companies need banks and investment banks more now, and there are fewer strong ones to help them," said Douglas J. Elliott of the Brookings Institution.[38]

Conforming to standards

As stated by a Bank of America spokesperson, "We're paying for results, and there were some areas of the company that had terrific results, and they will be compensated for that."[39] In this manner, the financial institutions were conforming to the standards set out by the Pay Czar and Congress in structuring compensation payments to align with results. In fact, even the original $100 Million-Dollar-Man within Citigroup could be seen as exemplifying the new pay structure espoused by the Pay Czar and lawmakers. James Forese, Citigroup's co-head of global markets indicated that the $100 Million-Dollar-Man's pay-for-performance contract was one of which the Pay Czar would approve. "We're confident in the value these types of profit-sharing arrangements bring to the company and its shareholders," Mr. Forese wrote in a statement, "as they directly align compensation with performance." [40] In Matt's case, his trading group had made money for Goldman Sachs the past two years. Paying his people for their performance was in-line with industry standards.

Unintended consequences

In an op-ed in the *Washington Post*, staff writer Brady Dennis noted that sweeping indictments actually punished healthy banks – those that survived the crisis intact and were currently thriving – for the mismanagement by the failed banks. According to this argument, we may, in fact, tie the hands of the healthy banks when we need them to provide financial resources to consumers and businesses. Vilifying all bankers creates a climate where excessive regulations are more likely. Banks will act more conservatively and lend less, "thereby crimping expansion by small business and shutting down start-ups" leading to slower economic recovery.[41]

We're getting better

As the CEO of Bank of America Merrill Lynch noted during congressional testimony in front of the FCIC, his institution had paid back all TARP funds plus dividends; his employees were working hard and deserved to be paid competitively.[42] He was not alone, as banking executives reportedly thought they had made enough concessions to the growing anti-Wall-Street sentiment. Collectively, the banks – Goldman Sachs, Morgan Stanley, JP Morgan Chase, Citigroup, and Bank of America – announced lower than expected compensation totaling $114 billion for 2009.[43] While this constituted a 4% increase over $109 billion in 2008, this compensation was based on revenues that jumped 63% to produce combined profits of $31 billion.[44]

In addition, these banks performed as expected – paying back TARP funds with interest, changing pay practices, reducing the use of borrowed money, and clearing bad assets from their balance sheets.[45] As noted by John Mack, CEO of Morgan Stanley, "I think in the past…we've taken it too far… [However,] I think the structure of compensation has changed."[46]

Recent Events

> Throughout the country, the anger at bankers is palpable. This isn't a narrow populist phenomenon; rather, it reflects widespread mistrust in the nation's financial institutions. A 'Bank Anger' tour has percolated across the blogosphere. 'I Hate Banks' yields 70,000 Google Index results.[47]

While US Treasury Secretary Timothy Geithner was calling for an end to "an era of irresponsibly high bonuses,"[48] European Central Bank President Trichet suggested profitable banks use their cash to "strengthen their capital positions, rather than to distribute a large part of their profits or to pay out unwarranted levels of compensation or bonuses."[49]

As such, Europe was tackling the compensation issue differently by applying a large 'windfall' tax to executives' bonuses. Such a tax was not unprecedented in the United States either. A windfall profits tax was used during wartime when certain industries benefited from an unusual macroeconomic shock. A similar tax was imposed on US oil producers when they profited from an increase in the price of oil due to an embargo.[50] Other regulations were also considered in the United States such as (1) forcing banks to hold more capital or (2) dividing the banks' roles by risk: one side would contain conventional lending and relationship-oriented business and another side would hold more risky, transaction-oriented capital markets activities.[51]

In January 2010, Goldman Sachs CEO John Mack made the statement, "As long as unemployment in the US is in the 10% range… [then as a citizen] I'm angry when I see the compensation bankers are getting."[52] Unfortunately, unemployment was 10.2% and underemployment was at 17.5%.[53] Housing had not yet rebounded and a second wave of mortgages was expected to enter foreclosure.

In an effort to stem the growing sentiment against bankers in general, Goldman Sachs considered working with a philanthropy consultant to set up a charitable program, paying a special dividend to shareholders, reinvesting in its bonus pool, or paying the scheduled bonus payouts for 2009.[54] Two pension funds, however, sued Goldman Sachs over its 2009 compensation plan, which they charged "vastly overcompensated management and constituted corporate waste."[55] In addition, a civil lawsuit was filed requesting that Goldman's charitable contributions be the responsibility of the CEO and management team rather than Goldman Sachs' shareholders.[56]

The FCIC – charged with identifying the factors that led to the financial crisis and possible remedies to avoid a repeat – held a hearing on February 13, 2010, where the CEOs of JP Morgan Chase, Goldman Sachs, Morgan Stanley, and Bank of America Merrill Lynch were asked to testify. During the hearing, Phil Angelides, chairman of the FCIC, summarized the popular sentiment toward all bankers with a question for Goldman Sachs' CEO Lloyd Blankfein:

> At your firm, you tripled your assets, almost, from about 403 billion to 1.1 trillion from 2003 to 2007. That's an annual compounded growth rate of 29 percent when GDP was growing at 1 to 3 percent. Your leverage ratio, when measured against tangible equity, was 26 to 1. By some analysts' measures, 32 to 1 against common – tangible common equity.
>
> In the end of the day – and I'm going to press you on this – it seems to me that you survived with extraordinary government assistance. There was $10 billion in TARP funds, $13.9 billion as a counterparty via the AIG bailout.
>
> By your own Form 10-K, you said that you issued $28 billion in debt guaranteed by the FDIC, which you could not have done in the market but for that. You were given access to the Fed window and the ability to borrow at next to nothing. You became a bankholding company over the weekend. You had access to TALF. You benefited from a ban on short selling, which you initially opposed, which Mr. Mack had advocated. And you got relief – some relief from mark-to-market rules even though I understand you were assiduous about marking to market.
>
> … do you really believe that your risk management in the big picture was sufficient to have allowed you to survive but for that government assistance which I laid out?[57]

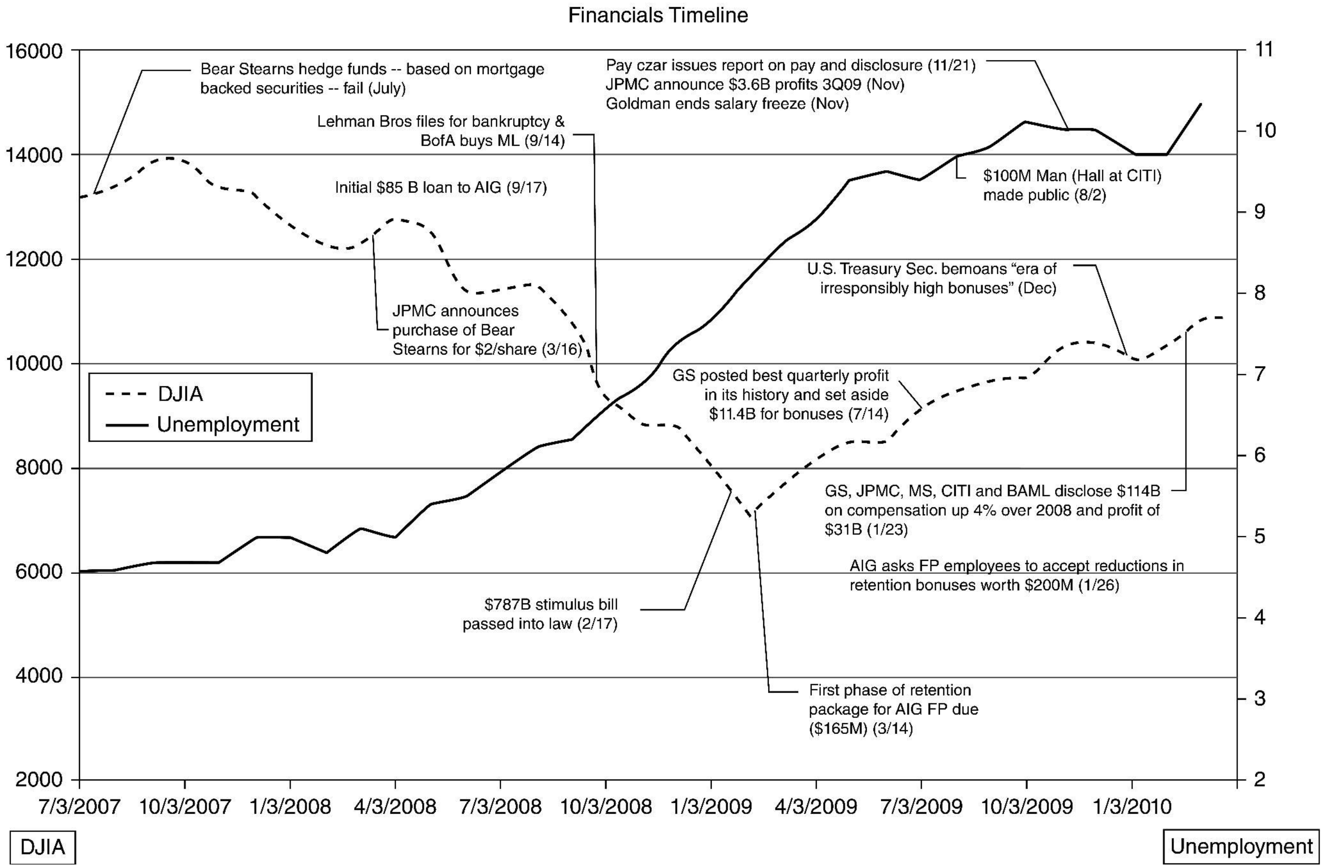

Exhibit 1 Bailouts and bonuses on Wall Street.

Exhibit 2 Bailouts and bonuses on Wall Street.

Financials Breakdown (all from banks' SEC Form 10-K)

	Citigroup				*Goldman Sachs*				*JP Morgan Chase*			
	'06	'07	'08	'09	'06	'07	'08	'09	'06	'07	'08	'09
Revenue in billions	$86	$81	$53	$80	$38	$46	$22	$45	$62	$71	$67	$100
Compensation	$30	$34	$32	$25	$17	$20	$11	$16	$21	$23	$23	$27
as % of rev	35%	42%	61%	31%	44%	44%	50%	36%	34%	32%	34%	27%
Income	$22	$4	($28)	($2)	$10	$12	$2	$13	$14	$15	$6	$12
as % of rev	24.9%	4.4%	−52.3%	−2.0%	25.3%	25.1%	10.5%	29.6%	23.3%	21.4%	8.4%	11.7%
Employees	327,000	374,000	322,800	265,300	26,467	30,522	30,067	32,500	174,360	180,667	224,961	222,316
Compensation/ee	$91,131	$90,642	$100,372	$94,233	$623,418	$661,818	$362,524	$498,462	$121,588	$125,646	$100,906	$120,999
Leverage (debt/ equity)	14.7	18.2	12.6	11.0	22.4	25.2	12.7	11.0	10.7	11.7	12.0	11.3

	Morgan Stanley				*Bank of America*				*Merrill Lynch*			
	'06	'07	'08	'09	'06	'07	'08	'09	'06	'07	'08	'09
Revenue in billions	$28	$27	$22	$23	$73	$66	$74	$121	$34	$11	$13	n/a
Compensation	$14	$l6	$12	$14	$18	$19	$18	$32	$17	$16	$15	n/a
as % of rev	48%	61%	54%	62%	25%	28%	25%	26%	50%	141%	117%	
Income	$7	$3	$2	$1	$21	$15	$4	$6	$7	($9)	($28)	n/a
as % of rev	25.5%	12.3%	8.1%	60%	28.8%	22.7%:	5.4%	5.0%,	22.2%	−76.8%	−219.3%	
Employees	43,124	48,256	46,964	61,388	203,425	210,000	243,000	284,000	56,200	64,200	59,000	n/a
Compensation/ee	$315,370	$333,637	$253,386	$234,574	$89,468	$89,524	$75,720	$110,915	$300,125	$247,710	S250,220	n/a
Leverage (debt/ equiry)	30.7	32.4	12.5	5.5	9.8	10.7	9.3	8.6	20.6	30.9	32.4	

Matt's Dilemma

Given the hostile climate toward his industry, Matt knew something had to change. Talk of compensation reform had spread to the public forum. Even his favorite sports columnist had taken up the cause in the middle of dissecting the National Football League playoffs.[58] The fact that someone who studies and writes about the NFL was lamenting the disproportionate pay of any industry indicated to Matt that the $100-Million-Problem had gotten out of control. There were congressional hearings and articles on the front page of the papers every day about compensation, unemployment, and the overall recession.

While change may be needed, should it affect Mart's company and his employees? Even the $100-Million-Dollar-Man had made money for Citigroup – the kind of profits taxpayers would want to see in a company they partly owned – and had said that he would take his business to a competitor if Citigroup was unable to pay him the money.[59] What if Matt's star employees left?

Although his firm had paid back its share of the TARP, Matt wasn't sure that a single individual or even eight traders should be given a $125 million bonus when unemployment numbers were over 10%. Any decision was going to need to go past the COO, CEO, and public relations department in a meeting tomorrow. Matt did not see any good options at the moment.

Notes

1 Andrew Ross Sorkin, *Too Big to Fail* (New York: Viking Penguin, 2009), 335.

2 David Segal, "$100 Million Payday Poses Problem for Pay Czar," *The New York Times*, 1 August 2009.

3 Louise Story and Eric Dash, "Banks Prepare for Big Bonuses, and Public Wrath," *The New York Times*, 9 January 2010.

4 Eventually was negotiated to $10/share.

5 Peter J. Solomon, "Another View: Unintended Consequences on Wall St.," *The New York Times*, 19 November 2009.

6 David Segal, "$100 Million Payday Poses Problem for Pay Czar," *The New York Times*, 1 August 2009.

7 Some felt that the credit default swap not only insured against the underlying mortgage backed securities, but the CDS actually created and spread the subprime housing crisis by creating a demand for collateralized debt obligations, which, in turn, increased demand for the underlying subprime mortgages.

8 A CDO – collateralized debt obligation – is a pyramid structure with levels of debt with stair-step credit ratings and associated yields. Some levels are of higher quality with a lower risk of default. Other levels are of lower quality with higher risk of default. Problems arose when companies did not hedge their bets on CDOs sufficiently in the event that they lost value. Even those firms who did buy 'insurance' against the possibility of loss in CDO value – the purchase of credit default swaps (CDSs) – were in trouble. AIG and other issuers of CDSs did not put aside enough cash in the event that they needed to pay out on such 'insurance' claims.

9 Adam Davidson, "How AIG Fell Apart," *Reuters*, 18 September 2008.

10 Adam Davidson, 18 September 2008.

11 Michael Lewis, *The Big Short* (New York: W.W. Norton and Company, 2010), 72.

12 Adam Davidson, 18 September 2008.

13 Kirk Shinkle, "AIG: The Biggest Bailout," *US News and World Report*, 17 September 2008.

14 Stephen Castle and Katrin Bennhold, "European Bank President Joins Critics of Bonuses," *The New York Times*, 12 December 2009.

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23 Louise Story and Eric Dash, 9 January 2010.
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25 Cyrus Sanati, "Big Poker Bet Falls Short for Former Bear Executive," *The New York Times*, 9 November 2009.
26 Financial Crisis Inquiry Commission Web Site, http://www.fcic.gov/about/ (accessed April 2010).
27 Steve Eder, "Goldman, Morgan Stanley Payouts Hog the Spotlight," *Reuters*, 19 January 2010.
28 Stephen Castle and Katrin Bennhold, "European Bank President Joins Critics of Bonuses," *The New York Times*, 11 December 2009.
29 Gretchen Morgenson, "Gimme Back Your Paycheck," *The New York Times*, 22 February 2009.
30 Gretchen Morgenson, 22 February 2009.
31 Dan Fitzpatrick, "BofA's Banker-Pay Pool: $4 Billion," *The Wall Street Journal*, 3 February 2010.
32 Dan Fitzpatrick 3 February 2010.
33 Louise Story, 7 November 2009.
34 Louise Story, 7 November 2009.
35 Graham Bowley, "Bailout Helps Fuel a New Era of Wall Street Wealth," *The New York Times*, 16 October 2009.
36 Brady Dennis, 23 December 2009.
37 Graham Bowley, 16 October 2009.
38 Graham Bowley, 16 October 2009.
39 Louise Story and Eric Dash, 9 January 2010.
40 David Segal, 1 August 2009.
41 Brady Dennis, 23 December 2009.
42 The Official Transcript of the Financial Crisis Inquiry Commission (FCIC), 13 January 2010, http://fcic.gov/hearings/pdfs/2010-0113-Transcript.pdf (accessed 4 April 2010).
43 Tomoeh Murakami Tse, "Banks Stung By Criticism Over Pay Despite Recent Changes," *The Washington Post*, 23 January 2010.
44 Tomoeh Murakami Tse, 23 January 2010.
45 Tomoeh Murakami Tse, 23 January 2010.
46 Becky Quick, Interview with John Mack, "Davos 2010: Road to Recovery," CNBC, 28 January 2010.
47 Brady Dennis, 23 December 2009.
48 Robert Schmidt, "Geithner Slams Bonuses, Says Banks Would Have Failed (Update2)," *Bloomberg*, Dec. 4, 2009.
49 Stephen Castle and Katrin Bennhold, 11 December 2009.
50 Peter J. Solomon, 19 November 2009.
51 Peter J. Solomon, 19 November 2009.
52 Becky Quick, Interview with John Mack, 28 January 2010.
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54 Tomoeh Murakami Tse, 23 January 2010.
55 Jonathan Stempel and Steve Eder, "Goldman Sachs Sued By Big Pension Fund Over Pay," *Reuters,* 9 March 2010.
56 Jonathan Stempel and Steve Eder, 9 March 2010.
57 FCIC Chairman during congressional hearing, FCIC Transcript, 13 January 2010.
58 Gregg Easterbrook, *Sonic Boom: Globalization at Mach Speed* (New York: Random House: 2010).
59 David Segal 1 August 2009.

Appendix

Companies receiving TARP money

The following is a breakdown of the major players in Wall Street's financial crisis and bonus controversy.

AIG[1] [Received $40B in TARP] After AIG received over $180 billion[2] in taxpayer aid, it was virtually owned by the government, with taxpayers taking 85% share of the company. AIG's Financial Products division, at the heart of the financial crisis and the compensation controversy, was to receive $168 million in March 2009, when a fury of public outcry resulted in Financial Products' current and former employees taking 10% to 20% less money than AIG had initially promised.[3] As part of this renegotiated pay package, AIG employees were due $100 million in March 2010. AIG and Pay Czar Ken Feinberg, however, sought to extract the $26 million that Financial Products' employees had said they would return in 2009, but did not.[4] Financial Products shrunk steadily during 2009, winding down the number of derivatives trades on its books to about 16,000 at the end of 2009, from 44,000 before the bailout. It closed offices in Hong Kong and Tokyo and reduced its staff to 237 employees from 428.[5]

Morgan Stanley[6] [Received $10B in TARP] Morgan Stanley took a number of steps to secure its business after taking TARP funds. First, Morgan Stanley converted to a bank-holding company, providing it with access to funds from the Federal Reserve.[7] This enabled it to use the Fed's capital and guarantees to buy higher yielding securities, as well as protect itself under the FDIC. In addition, Morgan Stanley reduced leverage from 33-to-l in 2007, to 16-to-l by 3Q09;[8] raised $14 billion in capital from private sources, including $9 billion from Mitsubishi, as part of a broader strategic alliance;[9] and diversified its revenue through the acquisition of Citigroup's Smith Barney wealth management division.[10]

While Morgan Stanley repaid its TARP funds, providing taxpayers a 20% annualized return,[11] James Gorman, who took over as CEO of Morgan Stanley in January 2010, recommended to his board that he receive no bonus in 2009, due to the "unprecedented environment in which we are operating and the government's extraordinary financial support to our industry."[12] The company, however, was criticized for paying out 62% of its 2009 revenue as compensation and benefits, though many of its internal divisions struggled. In comparison, rival Goldman Sachs, with record net income, had a compensation ratio of 36% of revenue.[13] Morgan Stanley, however, revised its compensation structure to emphasize deferred cash with clawbacks[14] – up to three years if investments or trading positions produced subsequent losses[15] – as well as stock and salaries rather than bonuses.

Goldman Sachs[16] [Received $10B in TARP] Goldman Sachs received $10 billion in TARP funds. Similar to many in the industry, Goldman reduced its balance sheet by 25% while increasing the amount of cash on hand.[17] Goldman's total bonus pool in 2008 was $4.82 billion but was worth $7.8 billion by November 2009 because 50% was paid in stock.[18] In December 2009, however, Goldman announced that the management committee would receive all of its discretionary compensation – non-salary compensation or bonus – in the form of shares at risk that could not be sold for five years. Further, these shares could be 'recaptured' or clawed-back if an employee did not effectively manage risk[19] and shareholders had an advisory vote on the firm's compensation at the shareholder meeting in 2010.[20] Goldman Sachs was expected to pay its employees an average of $595,000 apiece for 2009, one of the most profitable years in its 141-year history.[21]

While Goldman repaid its $10 billion bailout allotment of TARP funds, many pointed to additional taxpayer support in the form of 'counterparty' agreements with AIG. In receiving billions in bailout funds, AIG was able to fulfill its contractual obligations with its counterparties; Goldman was a primary beneficiary of these fulfilled agreements and was paid $12.9 billion through A1G.[22]

Bank of America Merrill Lynch[23] [Received $45B in TARP] Bank of America received $45B in TARP funds and in fall 2008, bought Merrill Lynch in a deal partially arranged by the Treasury.[24] Merrill Lynch was one of the largest CDO issuers on Wall Street and garnered lucrative fees by creating and selling CDOs. Merrill was heavily invested in the housing market and even acquired mortgage services companies including the largest subprime mortgage lender in late 2006 and continued to increase its position in mortgage-backed securities through the first seven months of 2007.[25] Merrill's losses as a result of the credit crisis – $35.8 billion in 2007 and 2008 – effectively offset 11 years of earnings.[26] Bonuses in 2006 and 2007 were triggered by the $700 M in fees generated by creating and trading the CDOs – despite not all of them being sold.[27]

In response to the backlash and receipt of TARP funds, neither the current nor previous CEO, nor any of the top leaders of Bank of America Merrill Lynch, received a bonus for 2008, and bonuses were cut more than 80% for the executives just below the top leadership.[28] For 2009, however, Bank of America approved more than $4 billion in pay for its investment bankers and traders, which equals an average of $300,000 to $500,000 per employee;[29] this represents about 19% of the roughly $23 billion in revenue generated by investment-banking and capital-markets activities, and is close to what Bank of America paid during its peak compensation year of 2006, when the ratio of bonuses to total revenue was 27%.[30]

Bank of America Merrill Lynch paid back the $45 billion in TARP funds in addition to nearly $3 billion in dividends and other payments.[31]

JP Morgan Chase[32] [Received $25B in TARP] JP Morgan received $25 billion in TARP funds, yet JP Morgan posted profits throughout 2008 and 2009 and was able to pay back its TARP funds on June 17 2009. Workers in the investment bank of JP Morgan Chase collected an average of $463,000 in bonuses for 2009.[33]

JP Morgan Chase became an active acquirer during the financial crisis. The March 2008 purchase of Bear

Stearns, with the guidance and assistance of the federal government was, perhaps, its most public activity at the height of the crisis. During the period when Bear Stearns' stock reached a height of $162.78 per share in 2007,[34] CEO Jimmy Cayne received compensation totaling $39.6 million.[35] Bear Stearns had become increasingly reliant upon mortgage-related properties leading to a massive mortgage-related write down of $854 million and the collapse of two large hedge funds created to invest in subprime mortgages in 2007.[36] J. P. Morgan Chase stepped in to buy the company with backing from the federal government for a final sale price of $10/share.

Citigroup[37] [Received $45B in TARP] In total, Citigroup received $45 billion in TARP funds because it was deemed 'too big to fail.' Citigroup's size – it manages nearly 200 million customer accounts across six continents in more than 100 countries[38] – in addition to untenable balance sheet positions including CDOs[39] resulted in the federal government taking a strong ownership position through TARP funds. On December 23, 2009, Citigroup paid back a portion of the TARP funds ($20 billion), yet the US treasury still owned 27% of Citigroup's common stock[40] and, therefore, Citigroup was still required to comply with the US government's standards for executive compensation. All compensation arrangements for the top 30 most highly compensated employees were subject to review by the Federal Reserve Board and other regulators.[41] Vikram S. Pandit, Citigroup's CEO, stated he would take a salary of $1 and would receive no bonuses until his troubled bank turned a profit. As of February 2009, he had not received any performance pay since taking over the top job at Citigroup in late 2007.[42]

Notes to Appendix

1 American International Group Corporation (AIG) with two divisions of business, the first is the insurance agency, which provides general and life insurance options. The second is the financial services division, which includes retirement savings and asset management.

2 AIG was awarded $40 Billion in TARP money, but has also received other capital infusions from the Government with its total equaling over $180 Billion in tax payer aid.

3 Brady Dennis, "AIG plans to pay $100 million."

4 Brady Dennis, "AIG plans to pay $100 million."

5 Brady Dennis, "AIG plans to pay $100 million."

6 Morgan Stanley was one of the two remaining investment banks left after the crisis. Although both Morgan Stanley and Goldman Sachs were converted to bank holding companies, they did not lend in the classic banking sense. Morgan Stanley was a financial services company whose principal activity was to provide products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

7 The Official Transcript of the Financial Crisis Inquiry Commission (FCIC), 13 January 2010, http://fcic.gov/hearings/pdfs/2010-0113-Transcript.pdf (accessed 4 April 2010).

8 FCIC Transcript.

9 FCIC Transcript.

10 FCIC Transcript.

11 FCIC Transcript.

12 FCIC Transcript.

13 Aaron Lucchetti, "Morgan Stanley Compensation Ratio to Decline this Year," *The Wall Street Journal*, 3 February 2010.

14 "Clawbacks" is a strategy being considered by many firms to make sure that the decisions made by executives will be for long term purposes and not for simply short term gain. Executives will be awarded bonuses based on performance, but if the decisions they make turn sour in the future the company holds the option to "clawback" the bonus money.

15 FCIC Transcript.

16 Goldman Sachs is one of two remaining investment banks since the financial crisis. Although it is now a bank holding company, it is still a global investment banking and securities firm specializing in investment banking, trading and principal investments, asset management, and securities services.

17 FCIC Transcript.

18 Louise Story, "Takeouts: College Football, Wall St. Pay, Listeners on Religion," The Take Away (WNYC Radio), 9 November 2009.

19 FCIC Transcript.

20 FCIC Transcript.

21 Louise Story and Eric Dash, "Banks Prepare for Big Bonuses, and Public Wrath," *The New York Times,* 9 January 2010.

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23 Bank of America Merrill Lynch was formed in on September 15, 2008, when Bank of America bought Merrill Lynch for $50 billion in an all-stock transaction. Bank of America accepts deposits and offers banking, investing, asset management, and other financial and risk-management products and services. The company has a mortgage lending subsidiary and an investment banking and securities brokerage subsidiary. Merrill Lynch is now a subsidiary of Bank of America and is a leader in wealth management services.

24 Gretchen Morgenson, "Gimme Back Your Paycheck," *The New York Times*, 22 February 2009.

25 Andrew Ross Sorkin, *Too Big to Fail* (New York:Viking Penguin, 2009), 335.

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27 Andrew Ross Sorkin, 145.

28 FCIC Transcript.

29 Dan Fitzpatrick, "BofA's Banker-Pay Pool: $4 Billion," *The Wall Street Journal*, 3 February 2010.

30 Dan Fitzpatrick, 3 February 2010.

31 FCIC Transcript, Bank of America.

32 JP Morgan Chase is one of the largest and oldest financial services firms in the world, with operations in 60 countries, assets of $2 trillion, the largest market capitalization, and the third largest deposit base in U.S. banking behind Wells Fargo and Bank of America. The firm was formed in 2000, when Chase Manhattan Corporation merged with J.P. Morgan & Co.

33 Louise Story and Eric Dash, 9 January 2010.

34 Russ Britt, "Gauging Plight of Bear Sterns' Staffs Investments: Stock's Swift Tumble Gave Brokerage Employees Little Time to React," MarketWatch, 18 March 2008.

35 Bear Sterns Case Study, AFL-CIO Web Site, http://www.aflcio.org/corporatewatch/paywatch/retirementsecurity/casebearstearns.cfm#ftn5 (accessed April 2010).

36 These two hedge funds based were invested in CDOs based on subprime mortgages. Their failure is considered by many to be the beginning of the financial crisis.

37 Citi is one of the largest and most diversified financial services companies to act as one to deliver solutions to clients throughout the world.

38 Citi Web Site, http://www.citigroup.com/citi/business/brands.htm (accessed April 2010).

39 Barbara Kiviat, "Five Questions (and Answers) About Citi's Bailout," *TIME*, 25 November 2008.

40 Citigroup Inc. Annual Report Form 10-K, December 2009, http://www.sec.gov/Archives/edgar/data/831001/000I20677410000406/citi 10k.htm (accessed April 2010).

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Citigroup's Chief Rebuffed on Pay by Shareholders

Jessica Silver-Greenberg and Nelson D. Schwartz

Jessica Silver-Greenberg and Nelson D. Schwartz, "Citigroup's Chief Rebuffed on Pay by Shareholders," *The New York Times*, April 17, 2012. Reprinted with permission of Pars International.

In a stinging rebuke, Citigroup shareholders rebuffed on Tuesday the bank's $15 million pay package for its chief executive, Vikram S. Pandit, marking the first time that stock owners have united in opposition to outsized compensation at a financial giant.

The shareholder vote, which comes amid a rising national debate over income inequality, suggests that anger over pay for chief executives has spread from Occupy Wall Street to wealthy institutional investors like pension fund and mutual fund managers. About 55 percent of the shareholders voting were against the plan, which laid out compensation for the bank's five top executives, including Mr. Pandit.

"C.E.O.s deserve good pay but there's good pay and there's obscene pay," said Brian Wenzinger, a principal at Aronson Johnson Ortiz, a Philadelphia money management company that voted against the pay package. Mr. Wenzinger's firm owns more than 5 million shares of Citigroup.

While the vote at Tuesday's annual meeting in Dallas is not binding, it serves as a warning shot to other banks that have increased the pay of their top executives this year despite middling performance.

After the vote, Richard D. Parsons, who is retiring as Citigroup chairman, said that he takes the vote seriously and Citi's board will carefully consider it.

Mike Mayo, an analyst with Credit Agricole Securities, said: "This is a milestone for corporate America. When shareholders speak up about issues on which they've been complacent, it's definitely a wake-up call. The only question is what took so long?"

Shareholders rarely vote against compensation plans. The votes are part of the Dodd-Frank financial overhaul that mandates that public companies include "say on pay" votes for shareholders to express opinions about compensation. Last year, only 2 percent of compensation plans were voted against, according to ISS Proxy Advisory Services. In some instances, boards responded by reducing executives' pay.

In Citigroup's case, ISS itself recommended that shareholders vote against the pay proposal, citing concerns that the compensation package lacked "rigorous goals to incentivize improvement in shareholder value." At Tuesday's meeting, 75 percent of the shareholders voted.

Excessive pay has been a long-running problem at Citigroup, dating to well before Mr. Pandit became chief executive in 2007, analysts said. Citigroup has had the worst stock price performance among large banks over the last decade but ranked among the highest in terms of compensation for top executives, Mr. Mayo said.

Citi shares closed at $35.08 Tuesday, up 3.18 percent amid a market rally. Citigroup shares remain down more than 80 percent since the financial crisis.

Last year, Mr. Pandit's compensation included a $1.67 million salary and a $5.3 million cash bonus. In addition, he received a retention package valued at $40 million, to be awarded through 2015. In 2009 and 2010, as Mr. Pandit struggled, to pull the bank back from the brink, he accepted only a $1 annual salary.

Still, investors say that it is too soon for the bank to start giving out generous pay packages again. "The company has been flatlining," said Mike McCauley, a senior officer at the Florida State Board of Administration, which voted its 6.4 million shares against the plan. "The plan put forth reveals a disconnect between pay and performance."

Calpers, the California state pension fund, also voted against the plan. The issue was whether pay was linked to performance and whether those targets were spelled out and sustainable over the long term, said Anne Simpson, director of corporate governance for Calpers, which owns 9.7 million Citigroup shares.

"Citi was found wanting on both," she said. "If you reward them for focusing on high-risk, short-term profits, that's what you get, and that's how the financial crisis caught fire."

Not all institutional investors are unhappy. Bill Ackman, the head of Pershing Square Capital Management, which owns more than 26 million shares, said he thinks that "Vikram Pandit is doing an excellent job and the bank has made tremendous progress during his tenure."

Noting that Mr. Pandit received just $1 a year in 2009 and 2010, Mr. Ackman called the current package "an appropriate level of compensation."

In justifying the pay package, the company noted in its proxy filing that Citigroup net income was $11.1 billion in 2011, up 4 percent from 2010 and that it paid back the federal government billions in bailout loans and deferred cash awards to "limit incentives to take imprudent or excessive risks.

Even as Citigroup's earnings and capital cushion have improved, the bank has struggled to make up for lackluster revenue. Citi was dealt a further blow in March when the Federal Reserve rejected the bank's proposal to buy back shares and increase its dividend. While Citi intends to submit a revised plan to the central bank this year, shareholders say that with a quarterly dividend of one cent, Citi's top executives shouldn't be rewarded.

"Citigroup was terribly managed and whatever could be done wrong, they did wrong," said David Dreman, whose money management firm owns about $400,000 worth of Citigroup shares. While many of those mistakes predated Mr. Pandit, he said, it was way too early to start handing out generous pay packages.

"Shareholders have finally done something constructive on the whole C.E.O. pay problem," he said.

Mr. Pandit's compensation is higher than some more successful rivals, according to proxy filings. Lloyd C. Blankfein, the chief executive of Goldman Sachs, received $3 million less than Mr. Pandit's $15 million, while James P. Gorman, the chief of Morgan Stanley, had a pay package of $10.5 million.

Still, disapprovals are rare. Last year, shareholders at 42 companies – out of more than 3,000 firms – voted against pay plans. In one of the most visible renunciations, shareholders at Hewlett-Packard, which has struggled with lackluster returns, voted against the pay for the technology company's top executives, including the chief executive, Meg Whitman.

Companies should brace for more shareholder denunciations, said. James D. C. Barrall, an executive compensation lawyer at Latham & Watkins. The nation's other major banks have their annual meetings in the coming weeks.

Bank of America, whose shares have also struggled, could be the next bank to feel shareholders' wrath when it holds its annual meeting May 9, executive compensation consultants said. Its chief executive, Brian T. Moynihan, received $7 million for 2011, down from $10 million the previous year.

"There could be a real disconnect between pay and performance at Bank of America," said Frank Glassner, a partner with Meridian Compensation Partners, an executive consulting firm.

Part 3

Work in the Corporation

Introduction

In Part 2 we examined the notion that business organizations have obligations not only, or even primarily, to their shareholders, but also to other stakeholders in the firm. One of the most important of these groups of stakeholders is the corporation's employees. They provide the productive and decision-making power of the business. In a very real sense, they are the corporation.

What obligations hold between a company and its employees? The traditional view of the relation between employer and employee has been that it is a free agreement or contract between the two parties for their mutual benefit. According to this contract, the primary responsibility of the employer is to pay fair wages. In return, employees owe the company loyalty, obedience, and satisfactory job performance. Either party can terminate the contract at any time, and traditionally, this power to terminate has been thought sufficient to protect the interests of both employers and employees. Like the traditional understanding of the corporation itself, however, this simple model of employer–employee relations has been challenged. Some thinkers argue that the employee's interests are not sufficiently protected by the right to quit. In the past two decades, a strong interest has emerged in securing more extensive rights for employees to protect them from potential abuses of power in the workplace. In Chapter 5, we examine the rights and duties of employees, with an initial focus on worker health and safety. The rights of free speech and dissent in the workplace have also received increasing attention, as "whistleblowing" incidents – cases in which employees go above their supervisors or to the public to reveal corporate wrongdoing – have become more and more common. The next two articles in Chapter 5 are devoted to the ethical issues raised by the practice of whistleblowing. The last two articles include a discussion of two of the more prevalent ethical issues in the workplace, conflicts of interest and insider trading.

In Chapter 6 we turn to a variety of other workplace issues, including the meaning of work, business and family, discrimination, harassment, and romance in the workplace. These issues have been the subject of much controversy and legislative action, particularly in the case of discrimination and sexual harassment. The elimination of harassment and discrimination is essential both to a truly free society and to a truly efficient market. As a major social institution, business has a significant role to play in the termination of harassment and discrimination. But how should business exercise this role? How should corporations regulate interactions between men and women in the workplace? And what policies should business have about family life? How should businesses

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handle the increasing level of romance taking place in the workplace? All of these issues are examined in our selections.

Employee Rights and Duties

Until recently employee rights have been restricted to those specified in the contract between employee and employer. Generally these had to do with wages, job description, hours, pension, and other benefits. If an employee did not like the treatment he or she received at the hands of an employer, did not wish to carry out an order, or disagreed with company policy, he or she could leave the job. Conversely, employers were permitted to fire employees for any reason or for no reason at all. Both parties, then, were free to terminate their contract at any time. But because jobs have usually been harder to find than employees, many felt that employers held the power and that employees were relatively powerless and required protection.

Today corporations are subject to laws governing minimum wages and maximum hours, health and safety standards, and forbidding discrimination in hiring, firing, and promotion. For example, an employer cannot fire an employee for union activity. But what exactly are the additional ethical rights, if any, held by employees? Ronald Duska, in his article "Employee Rights," explores more fully the nature of rights and their application in the workplace. After outlining the various means by which rights can be morally justified, Duska attempts to clarify and delimit the "right to work," and the "right to meaningful work." According to Duska, one would probably only have a right to work in a socialist society, as opposed to a free-market state. In terms of the right to meaningful work, Duska argues that, at best, what can be claimed is a right to a job which is made as meaningful as possible. He then discusses the extent to which a number of employee rights are justified. Based on the asymmetries of power in the employer–employee relationship, employees have a right to a safe and healthy work environment. This right would even override the right of shareholders to profit maximization. Although there is no right to job security, employees do have a right of due process regarding the decision to fire or demote the employee. Other employee rights discussed by Duska include the right to privacy, the right to compensation for injury, the right to equal treatment without regard to race or gender, freedom from harassment, and the right to a living wage.

Tibor Machan, in his article "Human Rights, Workers' Rights, and the 'Right' to Occupational Safety," takes a different approach, by arguing that there is no such thing as special workers' rights. Workers do possess rights, but as human beings, not as workers. This implies that there are no special rights which need government protection or duties of employers toward employees which need government enforcement. Would a completely free labor market necessarily lead to exploitations such as child labor or a neglect of health and safety at the workplace? Machan thinks not. He discusses the example of a not so prosperous coal mine advertising for jobs. At the present time, the employer is not equipped to provide completely safe work conditions when compared to its competitors. Should we be concerned? Machan argues that as long as prospective employees are made aware of the safety hazards, taking a more paternalistic approach is inappropriate. Workers have options. They can reject the job, bargain on their own, organize and insist on safer conditions, or pool resources, borrow, and purchase the firm. If employers are required by law to spend the firm's funds to meet safety requirements, less funds will be available for additional wages or to purchase additional sites. More importantly, the liberty of the employer–employee relation would have been intruded upon.

In the next two articles in Chapter 5, we consider the dilemma of disclosing corporate wrongdoing or misconduct. For example, occasionally an employee discovers, or is asked to participate in, an activity he or she believes to be unethical or illegal. In such a situation the employee may choose to "blow the whistle" or reveal the activity, either to someone higher up within the corporation (usually called "internal" whistleblowing) or to the public ("external" whistleblowing).

Do employees have the right, or perhaps even the obligation, to blow the whistle on corporate wrongdoing? Should they receive legal protection from such retaliations by their employer as firing, blackballing, or attacks on professional integrity? Some, such as Ralph

Nader, recommend not only that whistleblowing receive protection but that it be actively encouraged as a means of improving corporate responsibility. Others are violently opposed to whistleblowing, feeling that it violates the duties of employees to their employer. James M. Roche, former chairman of General Motors Corporation, states:

> Some of the enemies of business now encourage an employee to be disloyal to the enterprise. They want to create suspicion and disharmony and pry into the proprietary interests of the business: However this is labeled – industrial espionage, whistle-blowing, or professional responsibility – it is another tactic for spreading disunity and creating conflict.

Legally, an employee is regarded as the agent of the corporation for which he or she works. Agency law states that employees have a duty to obey the directions of their employers, to act solely in their employers' interests in all matters related to their employment, and to refrain from disclosing confidential information that, if revealed, might harm their employers. The law does not require employees to carry out commands that are illegal or immoral, but neither does it authorize them to reveal such commands to the public or (for the most part) protect them from reprisals if they do so.

In his article "Whistle-Blowing," Richard De George argues that because it is a form of disloyalty, and because it can cause harm to the firm, whistleblowing needs moral justification. De George believes that whistleblowing is only morally permissible under certain conditions: when serious (physical) harm is threatened and when the employee has already exhausted channels within the corporation in an attempt to correct the problem. De George regards whistleblowing as a supererogatory, self-sacrificing, or heroic act and believes that employees very rarely have an obligation to blow the whistle. For such an obligation to be present, De George believes, an employee must have documented evidence of serious potential harm and have good reason to believe that blowing the whistle will actually succeed in averting the harm. The best solution to the problem of whistleblowing in the workplace, claims De George, is to encourage channels of communication and response inside the corporation so that employees are not forced to be "moral heroes."

In response, W. Michael Hoffman and Mark Schwartz in their article "The Morality of Whistleblowing: A Commentary on Richard T. De George" believe that some of De George's criteria are too strict and should be revised. In addition to serious harm, violations of the law or a firm's code of conduct would also entitle one to blow the whistle internally. In addition to potential serious physical harm, Hoffman and Schwartz believe that other actions that would lead to serious psychological or financial harm, serious infringement of basic moral rights, or a serious injustice would also justify external whistleblowing. While the need for reasonable evidence and attempts to report internally all the way up to the board of directors are still required, as they are by De George, they disagree with De George's requirement that a reasonable belief must exist that blowing the whistle will lead to changes in the firm's practices. Instead, Hoffman and Schwartz suggest that one is required to blow the whistle internally if the other criteria are met and an effective written anti-retaliation policy exists at the firm, and externally if effective legal protections for employees exist. These additional requirements then place an ethical obligation on firms to ensure that they possess effective retaliation policies, and on governments to ensure that employees are legally protected against retaliation as well. For illustrative purposes, Hoffman and Schwartz then apply their revised whistleblowing criteria to three well-known business ethics cases: the Ford Pinto, Sherron Watkins at Enron, and Jeffrey Wigand at the tobacco firm Brown & Williamson.

In the final two articles, two central ethical issues related to employees are examined. The first article, "Conflicts of Interest," is by Thomas Carson. After reviewing several possible definitions of conflict of interest, Carson proposes his own: "A conflict of interest exists in any situation which an individual has difficulty discharging [one's official duties due to] an actual or potential conflict between [one's own personal interests and those] of the party to whom one owes those duties." Carson also includes actions which involve a desire to promote or thwart the interests of another when there is an actual or potential conflict of interest. After discussing each of the elements of his definition, Carson describes how conflicts of interest can arise. For example, operating within bureaucracies can lead to an individual possessing a conflict of interest in terms of advancing one's career by increasing the size of the bureaucracy. Hiring situations can lead to conflicts when one can prevent others from being hired who might then interfere with one's own job security. Self-regulation in the professions can prevent one from taking a position against one's professional colleague. The desire to avoid new technological changes can prevent one from adopting more efficient processes. In some cases, there are intangible interests involved, for instance one does not want to support new policies to replace those one has been responsible for developing, leading to a conflict of interest. Carson concludes his discussion by examining the moral status of various conflicts of interest, including what one should do to avoid the conflict, why one should try to avoid conflicts, when it might be permissible to engage in a conflict of interest, and when one must report conflicts of interest.

In the last article, "The Moral Problem in Insider Trading," the more specific conflict of interest issue of insider trading is discussed by Alan Strudler. In the article, Strudler examines and critiques the standard criticisms leveled against insider trading. First he raises the "harm" argument, which claims that insider trading causes harm to the marketplace. He concludes that this argument is not clearly supported by the evidence. He then discusses the deontological argument against insider trading, in that it involves theft, breach of trust, and unfair dealing but concludes that this argument is unpersuasive. Strudler is also concerned that any arguments against insider trading have greater difficulty being applied with respect to "tippees," meaning those who trade based on tips from insiders. After rejecting all of the standard moral arguments raised against insider trading, Strudler concludes by suggesting that legally permitting insider trading would lead to unconscionable contracts, which involve morally wrongful deceit, and on this basis insider trading should be considered ethically unacceptable.

The Modern Workplace: Obligations and Limits

For many years in the United States work in the corporation was dominated by one group – white males. Middle and upper-level management were the exclusive preserve of white males. Lower-level jobs were all that women, African-Americans, and other minorities could hope for. There was no real possibility of advancement for women and minorities. They were excluded, sometimes subtly, sometimes callously, from full participation in corporate life.

This is gradually changing. As a consequence of legislation and different social realities and attitudes, management is no longer composed solely of white males. This, we hope and anticipate, will continue in the future. However, it brings with it many new problems for corporations and those who run them. Many of these problems are discussed in the articles in Chapter 6.

The first article in Chapter 6 discusses the issue of meaningful work. Norman Bowie in "A Kantian Theory of Meaningful Work" uses Kantianism to reveal six characteristics of meaningful work. Meaningful work involves work that is freely entered into, allows the worker to exercise her autonomy and independence, develop her rational capacities, provides a sufficient wage for physical welfare, supports the moral development of employees, and is not paternalistic in terms of interfering with the worker's conception of how to obtain happiness. All of these characteristics are based on Kant's categorical imperative, and more specifically on treating workers with respect, that is, as an end and never merely as a means to an end. Bowie then goes on to link various practices for managing people successfully with Kantian philosophy, such as providing high wages, incentive pay, employee ownership, participation and empowerment, and promotion from within.

The next article, by Domènec Melé, "Organization of Work in the Company and Family Rights of the Employees," addresses the fact that the traditional view of work and family – the man at work and the woman at home – no longer applies. Changing demographics and new attitudes toward work are bringing more and more women into the workplace. But with both parents working, and with the increasing number of single parents in the workforce, dependant care becomes a major issue for workers. Melé argues in his article that this new reality must be recognized by employers. In other words, employees have legitimate family responsibilities which employers must respect. He provides a list of key family rights including: the right to find the necessary social support to consolidate the unity and stability of the family; the right to socio-economic conditions with respect to raising children; the right to working hours and periods necessary to devote to one's spouse and children and to just being together; the right to a quality of work life allowing for necessary attention to one's family; and the right to sufficient compensation to start and maintain a family. He presents a number of scenarios connected to the above rights in which company policy can attack the family's unity and stability.

In the next article, "Workplace Wars: How Much Should *I* be Required to Meet the Needs of *Your* Children?" Claudia Mills takes a different view on family and work. The key questions she asks include: "Are the special needs of parents the ones we should be seeking to meet? If so, who is the 'we' – the government, employers, fellow workers? What policies in the workplace are most fair to parents and non-parents alike?" Her answer is that employees without children should not be obligated to subsidize the "family-friendly" policies of their firms to benefit those employees with children. Parents voluntarily choose to have children, and should therefore be prepared to carry some of the responsibility for the implications in doing so. Mills does argue that children being properly taken care of by working parents is a good thing for everyone, and therefore the enlightened self-interest of even non-parents should lead to such individuals supporting "family-friendly" workplaces. Mills, however, would prefer for this objective to be served by government assistance, rather than by the employer. If the employer was to create improved workplace policies, then it should according to Mills offer benefits to all employees through a "mix-and-match" menu from which all employees can choose.

The article by Myrtle Bell, Mary McLaughlin, and Jennifer Sequeira, "Discrimination, Harassment, and the Glass Ceiling: Women Executives as Change Agents," discusses three inter-related issues and the relationship between them: discrimination; harassment; and the glass ceiling, which collectively prevent women from occupying executive and managerial positions. The glass ceiling refers to the invisible barriers that prevent women from advancing in the workplace. After discussing the relevant legislation, the authors discuss the influence of gender inequality on sexual harassment. They then provide recommendations for firms seeking to minimize sexual harassment, including the need for organizational support of gender equity, as well as strong sexual harassment policies.

In the final article of the chapter, "The Debate Over the Prohibition of Romance in the Workplace," Colin Boyd explores the increasingly important workplace issue of romance among employees. Boyd initially describes the matter as one of balancing the need to protect female employees from harassment against employee rights to privacy and freedom of association. He then suggests that the reality may be that firms ban dating not to protect female employees from harassment, but rather to protect employers from sexual harassment liability claims. Boyd ultimately uses a consequentialist approach to the problem, suggesting that because most romances in the workplace end up in marriage or long-term partnerships, this beneficial outcome outweighs any concerns over an increase in the incidence of sexual harassment. Boyd then concludes the article by providing examples of various firms that actually encourage romance, demonstrating that it is possible to manage any resulting issues arising within the firm's existing sexual harassment or conflict of interest policies.

5

Employee Rights and Duties

Employee Rights

Ronald Duska

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Does drug testing violate an employee's right to privacy? Should companies be able to fire employees without cause? Is there a right to a safe workplace? All of these questions revolve around the notion of employee rights, one of the most important in business ethics. Much recent legislation has been passed which specifies employees' rights and which regulates working conditions, hiring and firing procedures, harassment and a host of other areas. There has been so much regulation and so many assertions of rights, recently, that some critics bemoan what they see as an unwarranted proliferation of rights. Sometimes, rights seem to be created out of thin air. Opponents of those critics, however, are not concerned about a proliferation of rights, but rather see the articulations of new rights as an inevitable product of a society's concern for preserving and protecting human dignity. Defenders of the expansion of rights follow the lead of Judge Blackstone (1941) who in Book I of his famous *Commentaries on the Law*, asserts that "The principal aim of society is to protect individuals in the enjoyment of those absolute rights, which were vested in them by the immutable laws of nature, but which could not be preserved in peace, without the mutual assistance and intercourse of social communities. The primary end of human laws is to maintain and regulate these absolute rights of individuals."

From Blackstone's perspective, our human laws, rather than proliferating rights arbitrarily, are doing exactly what they are supposed to be doing – identifying and specifying human rights which were never before articulated, particularly in the workplace and particularly for the employee.

The purpose of this essay is to examine the nature of rights and their application in the workplace.

A right can be defined as either a capacity, possession, or condition of existence which entitles either an individual or group to the enjoyment of some object or state of being. For example, the right to free speech is a condition of existence which entitles one

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to express one's thoughts as one sees fit. Of course, if someone has a right, someone else must have an obligation to respect that right. Hence, a right is a relational entity. In the case of employee rights, there are correlative employer obligations. However, employers have rights too, so that there are also employee duties. However, in this essay we will concentrate on employee rights, rather than the rights of other groups. First, though, we need a clearer idea about what rights are.

Quite simply, rights are entitlements by virtue of which one person justifiably lays claim to an object or state of being against another person, who has an obligation to respect that claim. One respects a claim either by providing the object claimed, assisting in the achievement of the state of being claimed, or, at the very least, not standing in the way of the obtaining of the object or the achieving of the state of being. We add the qualification that the claim is justified, for one could claim a right that was not justified, and, in that case, it would not be a right. Thus, asserting a right carries with it the belief that the entitlement claim is justified. Thus, if an employee has a right to a safe workplace, that employee is justified in claiming that right, and in expecting and demanding that his or her employer meet certain standards in setting up the employee's work area.

Rights are secured either by nature, human laws or societal conventions, including a grant or a purchase. That being so, we can distinguish between three possible types of rights: natural, conventional or civil (legal). Philosophers and jurists split on the issue of whether nature secures any rights. Positivists who deny the existence of natural rights and reduce moral law to the ethos and customs of various societies, necessarily claim that there are only customary (conventional) rights or legal rights, rights which are the result of legislation. Hence, rights apply only to those whom the laws or traditions designate. The difficulty with this positivist position is that, if it were true, every system of rights would be self-legitimating and there could be no claims of natural rights or objective moral rights by which one can evaluate the soundness of the laws or the conventions. Hence, there would be no framework of rights with which to criticize a regime that took away rights from one or another group, e.g. gays, women, Jews.

Those who claim that there are universal rights and that some legal systems such as those which permit slavery are immoral and violate moral rights, must maintain that rights are grounded somehow in the nature of things, or in some sort of objective moral code. Most people implicitly recognize or appeal to such a higher set of rights, called moral rights or natural rights.

But what would those natural rights be grounded in? The most basic grounding would be in the needs of human beings. One is entitled, or has a right, to those things which are necessary for a quality existence. This was the method of philosophically grounding rights in western cultures from the time of Socrates to the modern era, called Natural Law theory. For example, Aquinas, in the thirteenth century, with respect to the right of property asserted that "Whatever is held in superabundance is owed by natural right to those in need." John Locke (1960) in the seventeenth century echoed Aquinas, and argued for the natural rights to life, liberty and property. In line with the theories of Locke, the writers of the American Declaration of Independence claimed basic rights to life, liberty and the pursuit of happiness. For them, as for Locke, these rights were grounded in the fact that our dignity arises from our being children of God. Further, the existence of these rights, and the equality of all men, was thought to be a self-evident truth.

However, Locke added to the right to property argument a consideration of fairness. It is only fair that people be entitled to that for which they work. The notion of a right to property based on need begins to fade with the development of Capitalism, and the later enlightenment figures such as David Hume are skeptical of the self-evidence claim and attempt to ground rights without an appeal to God or Nature. This leads to a more modern approach from either a deontological or utilitarian perspective. Either rights flow from the basic equality and dignity of humans – Immanuel Kant grounds them in the fact that rational beings are ends in themselves – or they flow from the natural needs of humans which must be met to maximize happiness (John Stuart Mill).

Of course, the Utilitarian, Jeremy Bentham (1941) refers to rights as "nonsense on stilts," since from his point of view, the word "right" is just shorthand for securing those actions which will bring about that greatest happiness. From Bentham's perspective one finds rights, not by consulting a catalogue of rights, but by examining whether behavior such as respecting peoples' property leads to more pleasure than pain. His successor, John Stuart Mill grounds rights in the same way. Mill defends the existence of a right to liberty by demonstrating that a society which allows its members to express themselves freely will be a society that is better off (happier) than a society which does not allow such self expression.

Deontologists, following Kant, would maintain that the difficulty with this position is that it makes the rights of individuals susceptible to revocation if they no longer serve the needs of the society. This is incompatible with the notion of inalienable or indefeasible rights, where inalienable means those incapable of being surrendered or transferred, and indefeasible means not capable of being annulled, voided or undone. Of course, Marx, critiquing Kant's individualism maintained that rights are egoistic since they give the individual predominance over the community. Sides of this debate can be seen in contemporaries such as H. L. A. Hart (1955) and Ronald Dworkin (1978).

Whatever the grounding of rights, there are certain other aspects of rights theory that must be mentioned. It is often held that for every right there is a correlative duty. Hence, if I have rights to life and liberty, others have a duty to respect that right and not interfere with my life and liberty.

Since rights is a relational concept, the elucidation of the rights will reflect the view of the relationship. So while in England and Europe, the predominant view of the employer-employee relationship was that of master-servant, with its consequent rights and obligations, in the USA the predominant view of the relationship was as a quasi contractual or implied contractual relationship. Some Pacific Rim countries, of course, have their own cultural version of some sort of quasi familial relationship, with their consequent rights and obligations. Thus, the list of employee rights will vary according to the predominant image of the relationship. For example, if one views the relationship in feudal terms such as lord and serf, then while the serf has few claims to private property and independence, he has large claims to protection and sustenance.

The reciprocity of rights and duties leads to a distinction between positive and negative rights, for if every right has a corresponding duty and rights are based on needs, the question arises who has the duty to provide those goods? Positive rights are rights of recipience. They are claims to entitlement to receive certain goods or services. For example, the right to an education is a positive right. The right to employment is a positive right. Whether such rights exist is a subject of debate, for given the law of reciprocity of rights and duties, if I have a right to education, someone has a correlative obligation to provide the education. If I have a right to employment, someone has the obligation to provide the employment. The last is a difficult kind of claim in a free market society, for how can it be claimed that anyone has an obligation to start a business so that others have employment? If one lays the obligation on the state, then the free market is compromised.

Some argue that it makes sense to claim such rights only when there are facilities to provide the goods available. What sense would it make to claim a right to health care in a society that had no health care delivery systems? It certainly would make sense to claim a need for health care, but that underscores the difference between a right and a need.

Given the above difficulties with the notion of positive rights, some claim that there are only negative rights, for negative rights do not require others to provide the goods or the needs. They are rights that protect those goods or needs. Hence the rights to life, liberty and property are negative rights, for no one has the obligation to provide those goods, only an obligation to respect them which means in essence, not to violate them.

Still, as Stanley I. Benn (1967) says, the positive rights are different, a more modern concept that is the corollary of the equally modern notion of social justice.

> Rights of this kind are different in that though they appear to make a very definite claim, the correlative duty seems to rest neither on individuals at large (as with freedoms) nor on anyone in particular. To say, as does the 1948 UN Universal Declaration of Human Rights, that "everyone as a member of society, has the right to social security" (article 22) and "to a standard of living adequate for the health and well-being of himself and his

> family, including food, clothing, housing" (article 25), is not to say that his government has a duty to provide these things; many who subscribe to this declaration would deny that such services were a government's proper business. Rather, statements of this kind provide, in the words of the Preamble, "a common standard of achievement for all peoples;" that is, they are canons by which social economic, and political arrangements can be criticized. Human rights, in short, are statements of basic needs or interests. They are politically significant as grounds of protest and justification for reforming policies. They differ from appeals to benevolence and charity in that they invoke ideals like justice and equality. A man with a right has no reason to be grateful to benefactors; he has grounds for grievance when it is denied. The concept presupposes a standard below which it is intolerable that a human being should fall – not just in the way that cruelty to an animal is not to be tolerated but, rather, that human deprivations affront some ideal conception of what a human life ought to be like, a conception of human excellence. It is on the face of it unjust that some men enjoy luxuries while others are short of necessities, and to call some interests luxuries and others necessities is implicitly to place them in an order of priorities as claims. Upsetting that order then demands to be justified.

Are rights inalienable? Is not some interference justifiable? The classic case against free speech is that one is not free to shout fire in a crowded theater if there is no fire. Issues of killing in self-defense and in war, and issues of capital punishment, require working out the limits of the indefeasibility. It is helpful to remember that the modern working out of rights was for the purpose of securing a justification for rebelling against governmental authority. Since, one of the primary functions of government was to secure the rights of its citizens. If the government, for no good reason, violated those rights, it failed in its primary task as a government, thereby losing its legitimate authority.

Besides the traditional doctrines on rights, the number of rights articulated have expanded. For example the UN declaration of human rights in article 22, claims that everyone has a right "to a standard of living adequate for the health and well-being of himself and his family, including food, clothing, housing." (This echoes the "right to a living wage" enunciated in the Papal Encyclical *Rerum Novarum*, in 1891.) Others claim rights such as a right to adequate health care. There are contemporary concerns for animal rights. In such contexts, we see clearly that these rights claims are statements of basic needs or interests, either of humans or animals, which rest on criteria for the good life which become a standard by which to judge existing governments and policies.

Employee Rights

Given the above we can now sort out various claims about employee rights. Legal rights of employees are simply those that exist through legislation or government regulations. However, claims made about natural rights, or conventional rights of employees will be based on how one views the relationship between employer and employee. The supposed "proliferation of rights" that is taking place in the latter part of the twentieth century, can be best understood as what results from new ways of viewing the employer-employee relationship.

There are philosophers who view employer-employee relationships as reciprocal relationships where moral obligations exist by virtue of those relationships. The primary example of reciprocal relationships are those found in a family. For example, parents are in a relationship with their children where they are obliged to provide for the children's food, shelter, clothing and education. Consequently, the children have rights to receive those things. However, this relationship also gives the parents the right to lay down rules without consultation with the children, a kind of paternalism. Of course, reformers of the nuclear family wish to invest the children with a right to participate in family decisions. Attributing such rights to children, however, alters the view of how the family should operate – and, consequently, what the family is – since, in one sense, a family is described by its nexus and relationships, and the obligations and rights that go with those relationships. Hence, some sets of relationships are in essence moral, since they specify rights and obligations in describing the relationship.

Different views of what the employer-employee relationship is, and ought to be, will yield different claims of rights and obligations on the part of the employer and employee. So, depending on the way the relationship is viewed, different rights will be claimed.

One of the earliest views of the employer-employee relationship was of the master-servant view. That was the successor to the feudal dependency relationship of lord-serf. If we look at the lord-serf relationship, we see that the lord had the obligation to provide for the serf's safety. The serf owed his allegiance and first fruits of his labor to the lord. That means the lord had a right to those first fruits, but the lord, in return, owed to the serf safety and protection. Thus the serf had rights that the lord needed to respect. There were, of course, unscrupulous lords who did not respect those rights, but they are considered evil, or at least some sort of moral slackers. Further, there was a bond of loyalty that was expected. Paternalism was justified and, although there was equality among lords and among serfs, there was no equality between lord and serf. As a matter of fact, it was commonplace for the serf to bow down to the lord in an expression of fealty.

The master-servant relationship, which was an operative paradigm at the beginning of the industrial revolution, was severely critiqued by Marx on the one hand and enlightenment utilitarians on the other. To break the feudal mode, the view of the employer-employee relationship had to be revised away from the master-servant view. It was replaced by the implied contractual view, which simply views the relationship as a contractual relationship of two self-sufficient individuals, agreeing to engage in commerce with one another. One claim against the implied contractual view is that it does not take enough note of the complexity of the relationship between employer and employee.

Since each of these views are analogies to the real situation, the analogies sometimes fit and sometimes do not. A master-servant or slave view is more accurate to the extent that it reflects more the asymmetry of power inherent in some contractual relationships, particularly involving those employees with no marketable skills. An implied contractual relationship reflects more the equality relationship that is a political desiderata since the enlightenment. Contractual relationships do not carry the baggage of loyalty, which is a virtue, and obligation more in accord with master-servant. Hence, the rights claimed will usually reflect the model of the relationship developed.

The most recent and useful model of the employer-employee relationship in business ethics, superseding the master-slave and implied contract views, that has been developed in recent years is the stakeholder model, according to which the various constituencies of the business are seen as having a stake in the business. In the light of our subject, that means the business will impact on some of the interests of the stakeholders, be they members of the community where the business is located, potential hires, customers, other businesses with whom the company does business, stockholders or employees. If those interests are important, those stakeholder constituencies can make a rights' claim against the business. For example, vendors can claim a right to be paid for their services, but they can do that on the contract view. The consumer movement has claimed that consumers have a right to truthful advertising and a safe, quality product. The government claims a right to taxes. Communities make claims to rights to protection against environmental impurities, and last but not least, employees claim a plethora of rights. Rights expand and multiply as certain things are seen as necessary for a sufficient quality of life, or for the maintenance of one's dignity. We would expect those rights' claims to change as the view of the relationship of employer-employee changes.

Some rights are basic and some are derivative. Some philosophers have claimed that all human rights can be derived from Kant's second Categorical Imperative. "Act so as never to treat another rational being merely as a means to an end." Marx uses this as a moral critique of Capitalism. It reduces the worker to a commodity, a thing. Using someone as a thing is the height of immorality. Note though that Marx had no use for the notion of rights; neither, for that matter, did Jeremy Bentham. Kant's rule requires us to respect other human beings as fellow members of the Kingdom of ends. It is Kant's way of asserting basic human dignity.

Let us look at what specific rights have been claimed for employees in recent times. Such a list, of course, will not be exhaustive; no list of rights is. Nor will this list attempt to order the rights in terms of which are derived from which. To do that would require settling an issue in ethical theory of whether rights are derived from basic necessities for the good life or from the basic requirements necessary to achieve human dignity. In either case, as society changes and life adapts to new circumstances, newly perceived necessities will become candidates for rights. As the employer-employee relationship evolves, new rights will be asserted.

The right to work

Clearly, one cannot be an employee unless one is employed, so it seems somewhat odd to talk about the right to work as an employee's right. One can talk of a potential employee's right, but even, in that case, since there is no actual employer, who would have the corresponding obligation to provide a job? However, since having a job is currently an "essential need" or requirement for most people, it can be argued that all able-bodied individuals have a right to a job. So, the right to work would be a right of recipients that leaves it unspecified who has the obligation to provide the work. We cannot require a particular employer to provide a job for a particular individual. What can be claimed is that, if a particular employer has a job to offer, perspective employees, with proper qualifications, have a right to an equal opportunity to attain the job.

Does the person who is "most qualified" have a right to the job? The condition of qualified has force only within the context of a business which has as one of its primary goals, the maximization of productivity. In a family-owned private business, set up for the security of the family, the owner is perfectly within his or her rights to hire any of the children they wish without regard to qualifications, since the owner may have started the business for the specific purpose of providing jobs and financial security for members of the family.

Hence, if there are rights to work, they seem to be delimited by circumstances. It seems the claim that every able-bodied person has a right to work can only make sense if a consequent obligation to provide jobs falls primarily on the state to set up an environment that encourages job creation, and enforces equal opportunity for hiring. This would mean there would seem to be more force to the claim of a right to work within the context of a more socialist state than in a more free market oriented state. Certainly, one of the motivations behind socialism is the feeling of the necessity of providing jobs to the unemployed based on a belief that everyone who is able has a right to a job.

The right to meaningful work

A corollary to the right to work, is the claim of some that there is a right to meaningful work, i.e. a moral claim that tedious, repetitive, and boring work is dehumanizing. As John Ruskin (1968) said, "It is a good and desirable thing, truly, to make many pins in a day; but if we could only see with what crystal sand their points were polished – sand of human soul, much to be magnified before it can be discerned for what it is – we should think there might be some loss in it also." All agree it is a good thing to create jobs that do not alienate or dehumanize, but is the creation of jobs, that have meaning and purpose (whatever that might mean beyond the fact that they provide, through the division of labor a desired good for society), really an obligation of anyone? Is it even possible? There are some jobs that are tedious and distasteful by their very nature. Yet they need to be done.

There is an analogy here with the right to property. Most people want to claim property as their own, as long as it is beneficial for them, but any right to property should carry with it an obligation to protect the rest of society from that property which turns obnoxious. Not all property is beneficial. There is garbage, old cars, junk, and old deserted buildings. Does the right to property entail a right to dispose of it without any obligation, if it is undesirable property? One would think not. There needs to be more attention paid to the downside of property.

Just as there is undesirable property, similarly there are tedious jobs in the world. Society needs someone to do them. The issue of distributive justice must focus on how this burden of the world is to be distributed, as well as the goods of the world. Since some jobs are burdensome, a view that claims a right to meaningful work and equates meaningful work only with jobs that are not burdensome, is seriously flawed in facing reality. At most, what can be claimed is a right of a worker to a job which is made as meaningful as possible. The correlative duty would be for the employers to do what they can to alleviate tediousness, burdensome, and dehumanizing working conditions.

The rights of the employee

Once hired, an employee certainly can claim rights such as:

- the right to a safe and healthy work environment;
- the right to job security and due process in firing and promoting;
- the right to privacy;
- the right to compensation for injury;
- the right to participation or voice in matters affecting workers;
- the right to equal treatment without regard to race or gender;
- the right to pension protection;
- the rights to collective bargaining such as those established by the National Labor Relations Board;
- the right to be free from harassment;
- the right to a living wage.

We will examine each to see what the claim is based on and to what extent it is justified.

The Right to a Safe and Healthy Work Environment One can defend the claim that employees have a right to a safe and healthy environment on the grounds that an employer like everyone else is obliged to do no harm. However, such a claim is challenged by some defenders of a free market view which sees the employment relationship as simply a contractual arrangement, wherein both parties are free to accept or reject the terms of the contract. From such a perspective, the worker is seen as free to choose to do the job under whatever circumstances it occurs. If workers desire a safe and healthy environment, then they can refuse to work under those unsafe conditions. If enough workers refuse, there will be a short supply of workers and the employer will be forced either to develop safer work environments or to pay higher wages to reflect the higher safety risk. Defenders of the right to a safe work environment counter that the employment relationship must be seen in a more realistic light. It is clear that in an urbanized market economy where there are more workers than desirable jobs, there are severe asymmetries of power between employer and employee. Given that fact, the employee is forced to take certain jobs to survive, so that the conditions of a contract – two free and autonomous individuals making an uncoerced choice – are difficult to meet. Consequently, a claim that it is not incumbent on an employer to provide a safe and healthy work environment if the worker chooses to accept a job under such circumstances is disingenuous. Such an attitude justified the sweatshops of the late nineteenth and early twentieth century, but it seems no longer tenable.

Even if the free market contractual approach were tenable, the requirements of the free contract would make it imperative that the prospective employee knows the safety and health risks before going into the situation. So, the perspective employee could claim a right to the knowledge of the *conditions* of the job, as well as a right to some later choice if new and unforeseen health and safety factors come to light. There seems to be no way under either model that an employer can justify withholding such vital information from employees.

Given the realities of the asymmetries of power in the employer-employee relationship, it seems reasonable to assume that there should be a right to a safe and healthy work environment. Further, such a right would necessarily override the right of shareholders to profit maximization. All profit maximization is tramped by other stakeholder rights so the goal of business which is to maximize profits becomes limited to as much profit as possible while respecting the rights of other stakeholders.

The Right to Job Security and the Process in Disciplining, Demoting, Promoting, and Firing It was long held that the employer had a right to fire employees at will – the core of the doctrine euphemistically named, "employment at will." The arguments were: for the sake of efficiency (a utilitarian argument) and to respect the property rights of owners (a deontological argument), owners were free to fire workers as they wished. The business was the owner's property and the owner had the right to do what he or she willed with that property, including firing employees for whatever reason or no reason.

This view, of course, fails to recognize that the employment relationship is a reciprocal relationship which involves interdependencies between an employer and an employee. Implied or explicit agreements and promises are entered into when a job is offered and accepted. No prospective employees, in their right mind, would *freely* accept a job on the condition that they could be let go on the whim of the employer. The operative word here *is freely*. If one has little or no choice, one accepts to work under conditions that would not otherwise be endured. Reasonable people expect that others have justifiable reasons for what they do. Hence, there is a right to job security which means the person, once hired, has a right to hold that job as long as there are no good reasons for terminating the employment.

Given the right to job security, it is incumbent on the employer to give the employee the right to due process when decisions are made concerning his or her welfare. Such decision involve a renegotiation of the implied understanding. The insistence on due process is made because employers who hold power over the employee is analogous to the US government which holds power over its citizens. Since, to avoid the abuse of power, governments cannot act against its citizens without giving due process and since the employee is in the same subservient relationship to the employer, as the citizen to the government, similar protections need to be given. Hence, there should be right to due process, a right to procedures, including notice and a hearing or process where good reasons for firing or demotion need to be presented. Of course, given that most states in the USA are still employment-at-will states, the right to due process can be no more than a moral right, since it is not recognized as a legal right, except, of course, where it was negotiated into a contract. However, as we know, provisions in contracts that give power to one or the other party are only negotiated from strength.

The Right to Privacy The right to privacy is also argued for by drawing an analogy of the employee to the citizen. The right to privacy is not specifically mentioned in the US constitution, but is asserted in the rulings of supreme court justices. Justice Brandeis (1890), one of the first to assert privacy rights, maintained that the right to privacy was "the right to be let alone." The claim to a right to privacy springs from an individualism which asserts that no one has the right to tell another what to do in his or her personal and private life, and also asserts that other people do not have the right to know what goes on in a person's private life if that person does not wish to disclose it. A derivative of the general right to privacy, is of course, the right to freedom in one's off hours, as long as what one does not hurt the employer. Privacy rights, of course, are negative rights. The employer need not do anything except respect an employee's privacy.

There are arguments against privacy rights or, at least, arguments that there are times when those rights can be overridden. Specifically, privacy rights can be overridden when private action *harms* others. That, of course, means the actions are no longer private. Such a stance, however, respects privacy rights much more than an earlier view which held an employer had a right to tell an employee what they could or could not do in his or her private life. Here, we have the question of how much an employer is entitled to demand from an employee which is not job relevant. What are the rights of the employer vis-à-vis the employee?

Defenders of procedures which seem to violate privacy, such as polygraphs and drug testing, defend this invasion of privacy on the grounds that it conflicts with others' rights to a safe workplace. However, that would not be a denial of the right to privacy, only a claim that it conflicts with other rights.

The right to privacy, of course, implies a right to freedom in one's off hours and relates to a different and more controversial rights' claim, the claim that employees have a right to freedom of speech. Now, few contest the right to free expression of opinions, but what if those opinions, possibly gained in working for a company, when publicly expressed, are harmful to that company. The complexity of such issues indicate that a great deal of work needs to be done in resolving the public/private distinction and how it relates to the employer-employee relationship.

The Right to Compensation for Injury A rather compelling case can be made for a right to compensation for injury, on the basis of economic harm. There are good reasons to believe in compensatory justice. When one person suffers economic harm from another person's activity, the injured party is entitled to compensation. It is the principle that makes parents tell their child to fix or pay for the neighbor's window that the child broke. If I suffer harm in your service, fairness would seem to dictate that you reimburse me for that harm. There is, of course, an exception in the case where the harm was expected and compensation initially took the risk of harm into account, so that the employee was paid more for participating in a high risk job. As in other cases we have seen, the strength of the rights' claim here will rest on the characteristics of the contract or agreement, explicit or implied, between the employer and employee.

The Right to Participation or Voice in Matters Affecting Workers This is a recently articulated and much more controversial right, but it is a right that flows out of the temper of the times that call for solidarity and total quality control management. As the view of the relationships between owners, managers and employees changes, and as the notion of stakeholder gains ascendancy, the employee is seen as a more and more important player in the corporate culture. Accordingly, in those matters which seriously affect workers, participation in deciding their own fate is seen not so much as a desideratum, but more as a right. The existence of such a right becomes tenable, if one recognizes the asymmetry of power between employer and employee, and how that affects employment agreements. The right is asserted as a foil to ward off the potential abuse of power that can arise from such asymmetry. Existing agreements, to be morally binding, need to be the result of informed mutual consent. If existing implied and explicit contracts or established relationships need to be changed, those affected by the result of the changes ought to have a voice in renegotiating the revisions.

The Right to Equal Treatment without Regard to Race or Gender Since violations of equal treatment occur in the workplace, it seems obvious that one assert a right to equal treatment without regard to race or gender, where race or gender are irrelevant, as they usually are. This is a general human right, derived from the principle of justice which can be applied to workers specifically.

The Right to Pension Protection This right is a much more specific right and does not seem too problematic. Given the beliefs in a right to one's own property, or to what one worked for, and granting that the pension is the property of the workers, promised by the employer, it would seem that good stewardship would oblige the companies to protect the pension and not to put it at risk in speculative business projects.

The Right to Organization Bargaining and the Right to Strike These are, of course, legal rights and established by legislation and regulation in the USA by the NLRB, but there is a moral basis for the NLRB regulations. The US bishops remind us that human nature being what it is, one way to overcome power is to confront it with equal power. In modern industrialized societies with most of the power on the side of corporations, organizations of workers or consumers are indispensable to redress the balance of power. Hence, to gain the power to secure their rights, workers need to be able to organize. To attack the ability to organize is to attack a right essential to human dignity.

The Right to Be Free from Harassment This right, like the right to equal treatment is a human right, that should not be violated anywhere, let alone in the workplace. Emphasis lately has been on the right to be free from *sexual* harassment, but it is imperative to note that there are other forms of harassment.

The Right to a Living Wage This is the last employee right we wish to consider. As far back as 1891, Pope Leo XIII, in an encyclical entitled *Rerum Novarum* (Of New Things), articulated a number of employee rights. Among these was the right to a living wage. For him, a living wage was enough to support a family with children, so that the children were adequately cared for. It is debatable how many jobs today pay a living wage. At any rate, the Pope's call for rights was reiterated by the US bishops in 1986. The bishops not only argued for a living wage, they articulated a set of rights. The argument was simple and familiar.

According to the bishops, asymmetry of power presses workers into choosing between an inadequate wage and no wage at all. Justice demands minimum guarantees. "The provision of wages and other benefits sufficient to support a family adequately is a basic necessity to prevent (the) exploitation of workers. The dignity of workers requires adequate health care, security for old age or disability, unemployment compensation, healthful working conditions, weekly rest, periodic holidays for leisure and reasonable security against arbitrary dismissal" (National Council of Catholic Bishops, 1986).

We do not claim that this list is exhaustive, even if it is exhausting. For, if we ground rights on necessity, then as society articulates the new necessities required for living well in a new technologically advanced age, it will also articulate newly discovered goods which will become candidates for rights.

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Human Rights, Workers' Rights, and the "Right" to Occupational Safety

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Introduction

I take the position of the nonbeliever.[1] I do not believe in special workers' rights. I do believe that workers possess rights as human beings, as do publishers, philosophers, disc jockeys, students, and priests. Once fully interpreted, these rights may impose special standards at the workplace, as they may in hospitals, on athletics fields, or in the marketplace.

Human Rights

Our general rights, those we are morally justified to secure by organized force (e.g., government), are those initially identified by John Locke: life, liberty, and property. [*John Locke* (1632–1704), an English philosopher, was the first systematic theorist of *liberalism*, the view that the state's purpose is to preserve the natural rights of its citizens to life, liberty and property.] That is, we need ask no one's permission to live, to take actions, and to acquire, hold, or use peacefully the productive or creative results of our actions. We may, morally, resist (without undue force) efforts to violate or infringe upon our rights. Our rights are

1. absolute,
2. unalienable, and
3. universal:
   a. in social relations no excuse legitimatizes their violation;
   b. no one can lose these rights, though their exercise may be restricted (e.g., to jail) by what one chooses to do; and
   c. everyone has these rights, whether acknowledged or respected by others or governments or under different descriptions (within less developed conceptual schemes).[2]

I defend this general rights theory elsewhere.[3] Essentially, since adults are rational beings with the moral responsibility to excel as such, a good or suitable community requires these rights as standards. Since this commits one to a virtuously self-governed life, others should respect this as equal members of the community. Willful invasion of these rights – the destruction of (negative) liberty – must be prohibited in human community life.

So-called positive freedom – that is, the enablement to do well in life – presupposes the prior importance of negative freedom. As, what we might call, self-starters, human beings will generally be best off if they are left uninterfered with to take the initiative in their lives.

Workers' Rights

What about special workers' rights? There are none. As individuals who intend to hire out their skills for what they will fetch in the marketplace, however, workers have the right to offer these in return for what others, (e.g., employers) will offer in acceptable compensation. This implies free trade in the labor market.

Any interference with such trade workers (alone or in voluntary cooperation) might want to engage in, with consent by fellow traders, would violate both the workers' and their traders' human rights. Freedom of association would thereby be abridged. (This includes freedom to organize into trade associations, unions, cartels, and so forth.)

Workers' rights advocates view this differently. They hold that the employee-employer relationship involves special duties owed by employers to employees, creating (corollary) rights that governments, given their purpose, should protect, Aside from negative rights, workers are owed respect of their positive rights to be treated with care and consideration.

This, however, is a bad idea. Not to be treated with care and consideration can be open to moral criticism. And lack of safety and health provisions may mean the neglect of crucial values to employees. In many circumstances employers should, morally, provide them.

This is categorically different from the idea of enforcible positive rights. (Later I will touch on unfulfilled reasonable expectations of safety and health provisions on the job!) Adults aren't due such service from free agents whose conduct should be guided by their own judgments and not some alien authority. This kind of moral servitude (abolished after slavery and serfdom) of some by others has been discredited.

Respect for human rights is necessary in a moral society – one needn't thank a person for not murdering, assaulting, or robbing one – whereas being provided with benefits, however crucial to one's well being, is more an act of generosity than a right.

Of course moral responsibilities toward others, even strangers, can arise. When those with plenty know of those with little, help would ordinarily be morally commendable. This can also extend to the employment relationship. Interestingly, however, government "regulation may impede risk-reducing change, freezing us into a hazardous present when a safer future beckons."[4]

My view credits all but the severely incapacitated with the fortitude to be productive and wise when ordering their affairs, workers included. The form of liberation that is then vital to workers is precisely the bourgeois kind: being set free from subjugation to others, including governments. Anti-bourgeois "liberation" is insultingly paternalistic.[5]

Alleging Special Workers' Rights

Is this all gross distortion? Professor Braybrooke tells us, "Most people in our society … must look for employment and most (taking them one by one) have no alternative to accepting the working conditions offered by a small set of employers – perhaps one employer in the vicinity."[6] Workers need jobs and cannot afford to quibble. Employers can wait for the most accommodating job prospects.

This in part gives rise to special workers' rights doctrines, to be implemented by government occupational safety, heath and labor-relations regulators, which then "makes it easier for competing firms to heed an important moral obligation and to be, if they wish, humane."[7]

Suppose a disadvantaged worker, seeking a job in a coal mine, asks about safety provision in the mine. Her doing so presupposes that (1) she has other alternatives, and (2) it's morally and legally optional to care about safety at the mine, not due to workers by right. Prior to government's energetic prolabor interventions, safety, health, and related provisions for workers had been lacking. Only legally mandated workers' rights freed workers from their oppressive lot. Thus, workers must by law be provided with safety, health care, job security, retirement, and other vital benefits.

Workers' rights advocates deny that employers have the basic (natural or human) private property rights to give them full authority to set terms of employment. They are seen as nonexclusive stewards of the workplace property, property obtained by way of historical accident, morally indifferent historical necessity, default, or theft. There is no genuine free labor market. There are no jobs to offer since they are not anyone's to give. The picture we should have of the situation is that society should be regarded as a kind of large team or family; the rights of its respective parts (individuals) flow not from their free and independent moral nature, but from the relationship of the needs and usefulness of individuals as regards the purposes of the collective.

By this account, everyone lacks the full authority to enter into exclusive or unilaterally determined and mutual agreements on his or her terms. Such terms – of production, employment, promotion, termination, and so on – would be established, in line with moral propriety, only by the agency (society, God, the party, the democratic assembly) that possesses the full moral authority to set them.

Let us see why the view just stated is ultimately unconvincing. To begin with, the language of rights does not belong within the above framework. That language acknowledges the reality of morally free and independent human beings and includes among them workers, as well as all other adults. Individual human rights assume that within the limits of nature, human beings are all efficacious to varying degrees, frequently depending upon their own choices. Once this individualist viewpoint is rejected, the very foundation for rights language disappears (notwithstanding some contrary contentions).[8]

Some admit that employers are full owners of their property, yet hold that workers, because they are disadvantaged, are owed special duties of care and considerateness, duties which in turn create rights the government should protect. But even if this were right, it is not possible from this position to establish enforcible *public* policy. From the mere existence of *moral* duties employers may have to employees, no enforcible public policy can follow; moral responsibilities require freely chosen fulfillment, not enforced compliance.

Many workers' rights advocates claim that a free labor market will lead to such atrocities as child labor, hazardous and health-impairing working conditions, and so forth. Of course, even if this were true, there is reason to think that OSHA-type regulatory remedies are illusionary. As Peter Huber argues, "regulation of health and safety is not only a major obstacle to technological transformation and innovation but also often aggravates the hazards it is supposed to avoid."[9]

However, it is not certain that a free labor market would lead to child labor and rampant neglect of safety and health at the workplace. Children are after all, dependents and therefore have rights owed them by their parents. To subject children to hazardous, exploitative work, to deprive them of normal education and health care, could be construed as a violation of their individual rights as young, dependent human beings. Similarly, knowingly or negligently subjecting workers to hazards at the workplace (of which they were not made aware and could not anticipate from reasonable familiarity with the job) constitutes a form of actionable fraud. It comes under the prohibition of the violation of the right to liberty, at times even the right to life. Such conduct is actionable in a court of law and workers, individually or organized into unions, would be morally justified, indeed advised, to challenge it.

A consistent and strict interpretation of the moral (not economic) individualist framework of rights yields results that some advocates of workers' rights are aiming for. The moral force of most attacks on the free labor market framework tends to arise from the fact that some so-called free labor market instances are probably violations of the detailed implications of that approach itself. Why would one be morally concerned with working conditions that are fully agreed to by workers? Such a concern reflects either the belief that there hadn't been any free agreement in the first place, and thus workers are being defrauded, or it reflects a paternalism that, when construed as paternalism proper instead of compassion, no longer carries moral force.

Whatever its motives, paternalism is also insulting and demeaning in its effect. Once it is clear that workers can generate their own (individual and/or collective) response to employers' bargaining power – via labor organizations, insurance, craft associations, and so on – the favorable air of the paternalistic stance diminishes considerably. Instead, workers are seen to be regarded as helpless, inefficacious, inept persons.

The "Right" to Occupational Safety

Consider an employer who owns and operates a coal mine. (We could have chosen any firm, privately or "publicly" owned, managed by hired executives with the full consent of the owners, including interested stockholders who have entrusted, by their purchase of stocks, others with the goal of obtaining economic benefits for them.) The firm posts a call for jobs. The mine is in competition with some of the major coal mines in the country and the world. But it is much less prosperous than its competitors. The employer is at present not equipped to run a highly-polished, well-outfitted (e.g., very safe) operation. That may lie in the future, provided the cost of production will not be so high as to make this impossible.

Some of the risks will be higher for workers in this mine than in others. Some of the mineshafts will have badly illuminated stairways, some of the noise will be higher than the levels deemed acceptable by experts, and some of the ventillation equipment will be primitive. The wages, too, will be relatively low in hopes of making the mine eventually more prosperous.

When prospective employees appear and are made aware of the type of job being offered, and its hazards they are at liberty to

a. accept or reject,
b. organize into a group and insist on various terms not in the offing,
c. bargain alone or together with others and set terms that include improvements, or
d. pool workers' resources, borrow, and purchase the firm.

To deny that workers could achieve such things is not yet to deny that they are (negatively) free to do so. But to hold that this would be extraordinary for workers (and thus irrelevant in this sort of case) is to

1. assume a historical situation not in force and certainly not necessary,
2. deny workers the capacity for finding a solution to their problems, or
3. deny that workers are capable of initiative.

Now suppose that employers are compelled by law to spend the firm's funds to meet safety requirements deemed desirable by the government regulators. This increased cost of production reduces available funds for additional wages for present and future employees, not to mention available funds for future prospect sites. This is what has happened: The employee-employer relationship has been unjustly intruded upon, to the detriment not only of the mine owners, but also of those who might be employed and of future consumers of energy. The myth of workers' rights is mostly to blame.

Conclusion

I have argued that the doctrine of special workers' rights is unsupported and workers, accordingly, possess those rights that all other humans possess, the right to life, liberty, and property. Workers are not a special species of persons to be treated in a paternalistic fashion and, given just treatment in the community, they can achieve their goals as efficiently as any other group of human beings.[10]

Notes

[1] I wish to thank the Earhart, Jon M. Olin, and Reason Foundations for making it possible, in part, for me to work on this project. I also wish to thank Bill Puka and Gertrude Ezorsky for their very valuable criticism of an earlier draft of this essay, despite their very likely disapproval of my views.

[2] This observation rests, in part, on epistemological insights available, for example, in Hanna F. Pitkin, *Wittgenstin and Justice* (Berkeley, Calif.: University of California Press, 1972).

[3] Tibor R. Machan, "A Reconsideration of Natural Rights Theory," *American Philosophical. Quarterly* 19 (January 1980): 61–72.

[4] Peter Huber, "Exorcists vs. Gatekeepers in Risk Regulations," *Regulation* (November/December 1983), 23.

[5] But see Steven Kelman, "Regulation and Paternalism," *Rights and Regulation*, ed. T. R. Machan and M. B. Johnson (Cambridge, Mass.: Ballinger Publ. Co., 1983), 217–248.

[6] David Braybrooke, *Ethics in the World of Business* (Totawa, N.J.: Rowman & Allanheld, 1983), 223.

[7] Ibid., 224.

[8] For an attempt to forge a collectivist theory of rights, see Tom Campbell, *The Left and Rights* (London and Boston: Routledge & Kegan Paul, 1983).

[9] Huber, "Exorcists vs. Gatekeepers," 23.

[10] Ibid. Huber observes that "Every insurance company knows that life is growing safer, but the public is firmly convinced that living is becoming ever more hazardous" (p. 23). In general, capitalism's benefits to workers have simply not been acknowledged, especially by moral and political philosophers! It is hardly possible to avoid the simple fact that the workers of the world believe differently, judging by what system they prefer to emigrate to whenever possible.

Whistle-Blowing

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The Ford Pinto Case

Although a good deal of time has passed, the Ford Pinto case remains a classic in the annals of whistleblowing. Despite the lessons that were learned from it, even the Ford Motor Company, a principle actor in the case, seemed to many observers to have failed to learn enough when it was accused of failing to take responsibility and institute a recall soon enough in what is known as the Firestone tire case, in which the Ford Explorer was centrally involved.[1] In the later case, however, no whistle-blower came forth.

In the late 1960s, American automobiles were losing market share to smaller Japanese imports. Lee Iacocca, then CEO of the Ford Motor Company, wanted a 1971 model to meet the competition. He reportedly ordered that Ford produce a car for 1971 that weighed less than 2,000 pounds and that would be priced at less than $2,000. That meant the car had to be designed and produced in 25 months rather than the usual 43 months for a new car line. The resulting car was the Pinto.[2] Because of the accelerated production schedule, the Pinto was not tested for rear-end impact until after it was produced. There was no National Highway Traffic Safety Administration

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rear-end impact standard at the time. Ford engineers knew that testing for rear-end impact is a standard safety procedure. The car was tested after production, and it failed the test, meaning that it fell below the state of the art for cars of that size. The design of the car placed the fuel tank such that if the car was hit from the rear at a speed above 20 miles per hour, it would be punctured by a bolt from the bumper and could possibly burst into flame. Ford did a study and determined that if a baffle (estimated at costing between $6.65 and $11) were placed between the bumper and the gas tank, the Pinto would be comparable to other cars of its class with respect to the danger of fire from rear-end impact. A company cost-benefit analysis that weighed the cost of adding the baffle against the estimated cost of suits resulting from "excess" accidental deaths and injuries indicated that it would cost the company less not to insert the baffle than to insert it. For whatever reason, the company did not change the design from 1971 to 1978. Nor did the company offer its customers the option of purchasing the baffle.

Between 1976 and 1977 alone, Pintos suffered 13 fiery rear-end collisions, which was more than double the number for comparable-size cars. As it turned out, suits brought against Ford and the amount it had to pay (estimated at more than $50 million) far exceeded what it saved ($20.9 million) by not correcting the defect – not to mention the cost of bad publicity.

Nonetheless, despite reports of fires in the Pinto, the car sold well through 1978, when it was finally recalled to have the baffle inserted. When the State of Oregon, because of safety concerns, sold its fleet of Pintos at public auction, the cars went for as much as $1,800 each. Obviously, buyers discounted the danger, weighing it against the cost of what was considered adequate transportation at a good price.

Ford's actions with respect to the Pinto have been widely criticized. Harley Copp, a former Ford executive and engineer, was critical of the Pinto from the start. He left the company and voiced his criticism, which was taken up by Ralph Nader and others.[3]

Of course, the Ford engineers were not instructed to make an unsafe car, nor did Ford management set out to do so. That the Pinto was arguably below the state of the art may have been a result of the accelerated production schedule. That the defect was not corrected after the initial production year was the result of a business decision.[4]

Was anyone at Ford at fault? Did anyone at Ford have an obligation to make known to the public the facts that Ford knew but did not make public? If so, who? Why?

Blowing the Whistle

We have seen that corporations have a moral obligation not to harm. This obligation falls on the corporation as such, and internally it falls primarily on those who manage the corporation. Yet other members of the corporation – for instance, engineers and assembly-line workers – are not morally allowed to take part in any immoral activity. Hence, they may not morally take part in any activity that they know will cause harm, including manufacturing products that they know will cause harm. Do they further have a moral obligation to prevent harm, if they are able to do so?

As a general rule, people have a moral obligation to prevent serious harm to others if they are able to do so and can do so with little cost to themselves. As the cost increases, the obligation decreases. If we can save another's life only at the expense of our own life, we are not morally obliged to do so, and giving up our life for another is usually considered an act of heroic virtue. What is the obligation as an employee to prevent his or her company from harming others? The question is a complicated one and leads us to a consideration of what has become known as *whistle-blowing*.[5]

Kinds of Whistle-Blowing

"Whistle-blowing" is a term used for a wide range of activities that are dissimilar from a moral point of view. Sometimes the term refers to disclosures made by employees to executives in a firm, perhaps concerning improper conduct of fellow employees or superiors who are cheating on expense accounts, or are engaging in petty or grand theft. Students are sometimes said to "blow the whistle" on fellow students whom they see cheating on exams. In these cases, whistle-blowing amounts to reporting improper activities to an appropriate person. This can be called *internal whistle-blowing*, for the disclosure or allegation of inappropriate conduct is made to someone within the organization or system. Generally, one believes an investigation will follow and a sanction will be imposed. In the classroom situation, if the students are on the honor system, they have agreed to report cheating and are morally obliged to do so. If they are not on the honor system, such reporting may be morally permissible but is not usually required. A similar analysis applies on the job as well.

Someone who reports sexual harassment is also sometimes said to blow the whistle on the offender; this is often because simply speaking to the person has no effect. In this case, the charge is about an offense not against the organization or system, but against oneself; the whistle-blowing might be called personal, as opposed to impersonal whistle-blowing, in which the potential or actual injury is to others or to the organization rather than to oneself. *Personal whistle-blowing* is, in general, morally permitted but not morally required, unless other aspects of the case show that there is immediate danger to others.

Because workers have a right not to be sexually harassed, they should have a means by which to report such harassment if simply speaking to the harasser proves ineffective. Similarly, workers who have other rights violated should also have channels through which to get their legitimate complaints heard and acted on. Acts of personal whistle-blowing are usually within the organization. But if serious enough, the whistle-blower who gets no satisfaction internally might have to report to someone outside. Only a shortsighted firm would force external whistle-blowing; a well-managed firm would be so structured as to take care of such cases internally. This is in the best interests not only of the firm but also of the workers and their morale.

Whistle-blowing sometimes refers to government employees who divulge to a governmental regulatory or investigative bureau unethical practices in their division or office and/or to employees within a firm that has government contracts who report fraud against the government. It sometimes refers to reporting such things as cost overruns to congressional committees or to the media. (The former, even if done by government officials, is still considered external whistle-blowing, because one goes outside one's own division or office to alert someone in another part of the government system.) Sometimes whistle-blowing refers to leaks by government employees to the media. We can call all these kinds of disclosure *governmental whistle-blowing*.

This sort of whistle-blowing is different from private-sector whistle-blowing, which is done by employees on their employers. The obligations one has to one's government are considerably different from obligations that one has to a nongovernmental employer. The reason is that government employees are related to their government both as citizens and employees, and the harm done by governmental employees may have effects not only on the particular division in which they are employed but also on the government and country as a whole. The law recognizes this difference, and the U.S. Congress has passed special legislation governing and protecting certain kinds of governmental whistle-blowers.[6] The laws do not protect those who break the law by revealing classified information, but they protect from dismissal those who reveal waste, overspending, or illegal or corrupt activity within the government bureaucracy. The legislation has been enforced only sporadically, and those who have blown the whistle have usually not fared well in terms of promotion or career advancement, even if they have kept their jobs. No administration has yet signaled that such people, if they have the best interests of the country at heart, are to be rewarded and made examples to be emulated.

We shall restrict our initial discussion to a specific sort of whistle-blowing – namely, *nongovernmental, impersonal, external whistle-blowing*. We shall be concerned with (1) employees of profit-making firms, who, for moral reasons, in the hope and expectation that a product will be made safe, or a practice changed, (2) make public information about a product or practice of the firm that owing to faulty design, the use of inferior materials, or the failure to follow safety or other regular procedures or state of the art standards, (3) threatens to produce serious harm to the public in general, to employees, or to individual users of a product. We shall restrict our analysis to this type of whistle-blowing because, in the first place, the conditions that justify whistle-blowing vary according to the type of case at issue. Second, financial harm can be considerably different from bodily harm. An immoral practice that increases the cost of a product by a slight margin may do serious harm to no individual, even if the total amount when summed adds up to a large amount, or profit. (Such cases can be handled differently from cases that threaten bodily harm.) Third, both internal and personal whistle-blowing cause problems for a firm, which are for the most part restricted to those within the firm. External, impersonal whistle-blowing is of concern to the general public, because it is people or the general public rather than the firm that are threatened with harm.

As a paradigm, we shall take a set of fairly clear-cut cases – namely, those in which serious bodily harm, including possible death, threatens either the users of a product or innocent bystanders because of a firm's practice, the design of its product, or the action of some person or persons within the firm. (Many of the famous whistle-blowing cases are instances of such situations.)[7] We shall assume clear cases where serious, preventable harm will result unless a company makes changes in its product or practice.

Cases that are less clear are probably more numerous and pose problems that are difficult to solve – for example, how serious is *serious*, and how does one tell whether a given situation is serious? We choose not to resolve such issues here, but rather to construct a model embodying a number of distinctions that will enable us to clarify the moral status of whistle-blowing, which may, in turn, provide a basis for working out guidelines for more complex cases.

Finally, the only motivation for whistle-blowing we shall consider here is moral motivation. Those who blow the whistle for revenge, and so on, are not our concern in this discussion.

Corporations are complex entities. Sometimes those at the top do not want to know in detail the difficulties encountered by those below them. They wish lower management to handle these difficulties as best they can. On the other hand, those in lower management frequently present only good news to those above them, even if those at the top do want to be told about difficulties. Sometimes lower management hopes that things will be straightened out without letting their superiors know that anything has gone wrong. For instance, sometimes a production schedule is drawn up that many employees along the line know cannot be achieved. The manager at each level has cut off a few days of the production time actually needed, to make his or her projection look good to those above. Because this happens at each level, the final projection is weeks, if not months, off the mark. When difficulties develop in actual production, each level is further squeezed and is tempted to cut corners in order not to fall too far behind the overall schedule. The cuts may consist of not correcting defects in a design, or of allowing a defective part to go through, even though a department head and the workers in that department know that this will cause trouble for the consumer. Sometimes a defective part will be annoying; sometimes it will be dangerous. If dangerous, external whistle-blowing may be morally mandatory.

Producing goods that are known to be defective or that will break down after a short period of time is sometimes justified by producers, who point out that the product is warrantied and that it will be repaired for consumers free of charge. They claim it is better to have the product available for the Christmas market, for the new-model season for cars, or for some other target date, even if it must later be recalled and fixed, rather man have the product delayed beyond the target date.

When the product is so defective as to be dangerous, the situation from a moral point of view is much more serious than when only convenience is at stake. If the danger is such that people are likely to die from the defect, then clearly it should be repaired before being sold. As in the Pinto case, there have been instances when a company, knowing that its product was dangerous, did a cost-benefit analysis. The managers of the company determined how many people were likely to be killed and what the cost to the company would be if a certain percentage of the deceased persons' families successfully sued the company. They then compared this figure with the cost of repairing the defect, or of repairing it immediately rather than at a later date, through a recall. They also estimated the cost to the company if they were not only sued but also fined. If the loss from immediate repair substantially exceeded the probable cost of suits and fines, they continued production.

Such a cost-benefit analysis might seem, at first glance, to resemble a utilitarian calculation. However, a utilitarian calculation would not fail to consider the effect on all parties. The cost-benefit analysis is made exclusively from the standpoint of the company. How much, we have to ask, is a human life worth? If a defective part will probably cause 50 or 60 deaths, can we simply calculate the probability of a certain number of people suing and then weigh that cost against the cost of replacing the part? An adequate moral utilitarian calculation would include the deaths and the injuries, as well as the inconvenience for all the purchasers, and weigh these factors against the dollars saved. The equation is not difficult to solve. We know that we all have a moral obligation not to harm others, when we can prevent it. In such cases, the equation of deaths to dollars is an equation that, from a moral point of view, will always balance out in favor of lives saved. This realization often provides the moral motivation for whistle-blowers.

A variety of corporate activities have led people to disclose publicly the internal actions of their companies, In some cases, companies were dumping toxic wastes into a water supply, knowing that it would harm the people who lived near the supply. In other cases, papers were signed by employees certifying that a dangerous defect had been repaired, when in fact no repairs had been made. In the Bay Area Rapid Transit case, three engineers saw a dangerous defect in the system. When their warnings were systematically ignored, and they were told to keep quiet, they felt it was their moral duty to make the danger known to the public.[8]

Whistle-blowers usually fare very poorly at the hands of their company, as we mentioned before. Most are fired. In some instances, they have been blackballed in the whole industry. If they are not fired, they are frequently shunted aside at promotion time and treated as pariahs. Those who consider making a firm's wrongdoings public must therefore be aware that they may be fired, ostracized, and condemned by others. They may ruin their chances of future promotion and security, and they also may make themselves a target for revenge. Only rarely have companies praised and promoted such people. This is not surprising, because the whistle-blower forces the company to do what it did not want to do, even if, morally, it was the right action. This is scandalous. And it is ironic that those guilty of endangering the lives of others – even of indirectly killing them – frequently get promoted by their companies for increasing profits.

Because the consequences for the whistle-blower are often so disastrous, such action is not to be undertaken lightly. Moreover, whistle-blowing may, in some cases, be morally justifiable without being morally mandatory. The position we shall develop is a moderate one that falls between the two extremes: that whistle-blowing is always morally justifiable and that it is never morally justifiable. Nonetheless, the whistle-blower, when motivated by moral concern, demonstrates the virtue of moral courage. This consists in acting in a way intended to prevent serious harm to others at the risk of potentially serious harm to himself or herself.

Whistle-Blowing as Morally Prohibited

Whistle-blowing can be defined in such a way that it is always morally permissible or always morally obligatory. Initially, however, we can plausibly consider as morally neutral the act of an employee making public a firm's internal operations, practices, or policies that affect the safety of a product. In some cases whistle-blowing may be morally prohibited, in some cases it may be morally permissible, and in others it may be morally mandatory.

Each of the two extreme positions on whistle-blowing, although mistaken, is instructive. The view that whistle-blowing is always morally prohibited is the more widely held view. It is held not only by most managers, but also by most employees. There is a strong tradition within American mores against "ratting," or telling on others. We find this to be true of children, in and out of school, and in folk wisdom: "Don't wash your dirty linen in public." There is ample evidence that when someone does blow the whistle on his or her company – even for moral reasons, and with positive results for the public – he or she is generally ostracized, not only by the management of the firm but also by fellow employees. The whistle-blower is perceived as a traitor, as someone who has damaged the firm – the working family – to which he or she belongs. In so doing, he or she has hurt and offended most of those within the firm.

Rarely are whistle-blowers honored as heroes by their fellow workers. A possible explanation might be that, by this action, the whistle-blower has implied that fellow workers who did not blow the whistle are guilty of immorality, complicity in the wrongdoings of the company, or cowardice. The whistle-blower did what the others were obliged to do but failed to do. His or her presence is therefore a constant reminder of their moral failure. Such a scenario may describe some situations; but whatever the scenario, the evidence is overwhelming that the whistle-blower is not considered a hero by most fellow workers.

How can we justify this feeling of most workers and managers that an employee ought not blow the whistle on the firm for which he or she works? Are they not operating under a double standard if they themselves wish to be preserved from injury caused by other firms, even if the means of achieving that protection is the result of someone in another firm blowing the whistle?

The most plausible, and most commonly stated, rationale for not blowing the whistle is given in terms of loyalty. When people join a company, it is claimed, they become part of an organization composed of fellow employees. They are not simply automatons filling positions. They are people with feelings, who are engaged in a joint enterprise. In accepting employment, employees at every level owe something to the employing firm as well as to those with whom they work. Employees owe not only a certain amount of work but also a certain positive attitude toward that work and to their fellow workers. Without such a positive attitude (which we can characterize roughly as loyalty), a worker is either indifferent or disaffected. An indifferent or disaffected worker is clearly not a team player and typically contributes only enough work to keep from being fired. Given the chance, such a worker would gladly leave the firm for a job with another company. Such employees lack loyalty to their employer.[9]

Now, if the indifferent or disaffected worker were to blow the whistle on his or her employer, one might doubt that he or she did so from noble or moral motives. One might be mistaken in assuming ignoble motives, but the natural tendency would be to see the whistle-blowing as stemming from the worker's indifference or disaffection. Therefore, it is unlikely that those workers who feel a sense of obligation or loyalty to the firm will look kindly on the whistle-blower or the whistle-blowing.

This leaves us to consider the loyal worker. What is the basis of this loyalty, and to what extent is it owed to the company or employer? In one view, loyalty is based appropriately on gratitude. The firm or employer, after all, gives the worker a job, which is no small consideration in a society in which 4 percent unemployment is considered normal and in which unemployment for some groups in the society has recently reached 18 percent. To be disloyal to your employer is to bite the hand that feeds you – hardly an admirable or praiseworthy action. But even if the worker feels no gratitude, both the worker and the employer profit from their mutual contract, because if workers are to be more than cogs in an impersonal machine, they come to see the company as their company. Workers, in any event, have a stake in the firm for which they work. The stake is appropriately translated into positive concern for the firm, if not full identification with it – a concern that is in part what people mean by *loyalty*.

But even if we concede that an employee appropriately feels loyalty to a firm or to those within it, we cannot agree that such loyalty involves or demands that a worker engage in immoral activities for the firm. Nor need we admit that loyalty is always the overriding consideration in an employee's actions. The flaw in the argument of those who claim that whistle-blowing is always immoral is that they make loyalty to a firm the worker's highest obligation and consider it to be always overriding. Nor do they consider the possibility that an employee might blow the whistle out of loyalty to the firm, if the employee believes that those engaged in the endangering process are in fact harming the company, even if inadvertently.

On the other hand, those who argue that whistle-blowing is always at least morally permissible typically approach such acts from the point of view of the right of free speech. Workers do not give up the right of free speech – a civil right – by taking employment. They usually make no pledge of loyalty; and any claim that employers make regarding an employee's obligation to be loyal to their firm is wishful thinking, or self-serving ideological hogwash that they try to foist on naive employees. There is no obligation of employee loyalty, either as a result of a contract or as an implied condition of employment. But there is the right of free speech.

The right of free speech, of course, is a limited right. One is not free to yell "fire" in a crowded theater when there is no fire. One is legally prohibited from making libelous statements. But one is not prevented from making true statements, whether they be about one's employer or about others. American citizens freely criticize their government and their elected leaders. It would be strange if they did not have a similar right to criticize their employers. Moreover, the argument continues, if the actions of their employers, or of some members of the firm, are morally suspect, or if actions of the firm may in some way damage consumers, workers, or innocent bystanders, or if these actions threaten the interests of shareholders or of other interested parties, then workers clearly have the right to speak out in whatever way, and in whatever forum, they desire. By doing so, they violate no commitment to loyalty because there is no such commitment; they are simply exercising their right to free speech. It may be imprudent at times to speak out, and they may suffer from the often unjust reactions of others, but whistle-blowing, or speaking out about a company's practices, is not immoral; it is always a morally defensible act.

This extreme position has much to recommend it. But it is extreme because it makes the right of free speech always overriding, and it fails to consider the harm done to one's firm or fellow workers by the usual kind of whistle-blowing. In denying any obligation of loyalty, it implicitly denies any consideration of the harm that one's actions may do to those with whom one is associated, and fails to consider whether there are morally preferable alternatives – or perhaps even morally required alternatives.[10]

Each of the two positions we have described as extreme suffers from the same defect. Each makes absolute one aspect of a complex situation and fails to consider the conflict of obligations, rights, and responsibilities that usually arise in the conditions that lead to whistle-blowing. If neither loyalty nor the right to free speech is always overriding, and if neither always determines the morality of a case, it is sometimes possible for loyalty to be overriding, sometimes for the right of free speech to be overriding – and it is possible, therefore, that at times neither be overriding, and that both may give way to some other consideration. This suggests that sometimes whistle-blowing may be immoral – as when loyalty is overriding – and that sometimes it is morally justified – as when the right to free speech is overriding.

On whom does the onus of justification rest? Should we assume that whistle-blowing is generally morally justifiable, and require that anyone who claims that a given act of whistle-blowing is immoral make out that case? Or should we assume that whistle-blowing is generally immoral, and require moral justification for those acts that are morally permissible or obligatory? Tradition has placed the onus on those who justify whistle-blowing, the common assumption being that it is morally prohibited. We have already noted the general attitude of most workers to whistle-blowing, and their negative reaction to the whistle-blower. Moreover, unless we are to indict most workers as moral cowards, the relatively rare incidence of whistle-blowing indicates that most workers do not feel it is their moral obligation to blow the whistle. Although these considerations do not by themselves show that workers feel it is immoral to blow the whistle, they at least tend to put the onus on those who would claim it is morally obligatory. Finally, the literature on whistle-blowing has developed in such a way that those who justify it have assumed the need to do so.

That whistle-blowing needs justification makes sense, moreover, if it is seen as an instance of disobedience to the corporation or organization. Frequently, whistle-blowers are in fact told by their superiors to mind their own business. To blow the whistle is to go beyond what they are paid to do, and to fly in the face of orders given by a legitimate superior within the firm or organization. Disobedience typically requires justification if it is to be considered moral – whether it is a case of civil disobedience, disobedience to the corporation, or a child's disobedience to his or her parents. Under the appropriate conditions, obedience is the expected and required moral way to act. Disobedience may be morally justified, but if it is, the onus is on the disobedient person or his or her spokesperson to make out the case.

To admit that whistle-blowing is often an instance of disobedience to the corporation and that at least sometimes one (i.e., the corporation) is owed obedience leads us to the conclusion that at least sometimes whistle-blowing is morally wrong. That it is sometimes morally wrong seems the general consensus in American society, and there is no reason to challenge the consensus. But sometimes whistle-blowing is morally permissible, and sometimes it is even morally obligatory; therefore, it is appropriate to accept the onus of spelling out and justifying the conditions for each.

Whistle-Blowing as Morally Permitted

The kind of whistle-blowing we are considering involves an employee somehow going public, revealing information or concerns about his or her firm in the hope that the firm will change its product, action, policy, or whatever it is that the whistle-blower feels will harm, or has harmed others, and needs to be rectified. We can assume that when one blows the whistle, it is not with the consent of the firm, but against its wishes. It is thus a form of disloyalty and disobedience to the corporation. Whistle-blowing of this type, we can further assume, does injury to a firm. It results in either adverse publicity or in an investigation of some sort, or both. If we adopt the principle that one ought not to do harm without sufficient reason, then, if the act of whistle-blowing is to be morally permissible, some good must be achieved to outweigh the harm that will be done.

There are five conditions that, if satisfied, change the moral status of whistle-blowing. If the first three are satisfied, the act of whistle-blowing will be morally justifiable and permissible. If the additional two are satisfied, the act of whistle-blowing will be morally obligatory.

Whistle-blowing is morally permissible if the following conditions are met:

1. The firm, through its product or policy, will do serious and considerable harm to employees or to the public, whether in the person of the user of its product, an innocent bystander, or the general public.

Because whistle-blowing causes harm to the firm, this harm must be offset by at least an equal amount of good if the act is to be permissible. We have specified that the potential or actual harm to others must be serious and considerable. That requirement may be considered by some to be both too strong and too vague. Why specify "serious and considerable" instead of saying "involve more harm than the harm that the whistle-blowing will produce for the firm"? Moreover, how serious is "serious"? And how considerable is "considerable"?

There are several reasons for stating that the potential harm must be serious and considerable. First, if the harm is not serious and considerable, if an action will do only slight damage to the public or to the user of a product, the justification for whistle-blowing will be at least problematic. We will not have a clear case. To assess the harm done to the firm is difficult; but though the harm may be rather vague, it is also rather sure. If the harm threatened by a product is slight or not certain, it might not be greater than the harm done to the firm. After all, a great many products involve some risk. Even with a well-constructed hammer, one can smash one's finger. There is some risk in operating any automobile because no automobile is completely safe. There is always a trade-off between safety and cost. It is not immoral not to make the safest automobile possible, for instance, and a great many factors enter into deciding just how safe a car should be. An employee might see that a car can be made slightly safer by modifying a part and might suggest that modification; but not making the modification is not usually grounds for blowing the whistle. If serious harm is not threatened, then the slight harm that is done, say by the use of a product, can be corrected after the product is marketed (e.g., as a result of customer complaint). Our society has a great many ways of handling minor defects, and these are at least arguably better than resorting to whistle-blowing.

To this consideration should be added a second. Whistle-blowing is frequently, and appropriately, considered an unusual occurrence – a heroic act. If the practice of blowing the whistle for relatively minor harm were to become a common occurrence, its effectiveness would be diminished. When serious harm is threatened, whistle-blowers are listened to by the news media, for instance, because the harm is news. But relatively minor harm to the public is not news. If many minor charges or concerns were voiced to the media, the public would soon not react as it is now expected to react to such disclosures. This would also be the case if complaints about all sorts of perceived or anticipated minor harm were reported to government agencies, although most people would expect that government agencies would act first on the serious cases and only later on claims of relatively minor harm.

There is a third consideration. Every time an employee has a concern about possible harm to the public from a product or practice, we cannot assume that he or she makes a correct assessment, nor can we assume that every claim of harm is morally motivated. To sift out the claims and concerns of the disaffected worker from the genuine claims and concerns of the morally motivated employee is a practical problem. It may be claimed that this problem has nothing to do with the moral permissibility of the act of whistle-blowing; but whistle-blowing is a practical matter. If viewed as a technique for changing policy or actions, it will be justified only if effective. It can be trivialized. If it is, then one might plausibly claim that little harm is done to the firm, and hence the act is permitted. But if trivialized, it loses its point. If whistle-blowing is to be considered a serious act with serious consequences, it should be reserved for disclosing potentially serious harm and will be morally justifiable in those cases.

"Serious" is admittedly a vague term. Is an increase in probable automobile deaths from 2 in 100,000 to 15 in 100,000 over a one-year period serious? Although there may be legitimate debate on this issue, it is clear that matters that threaten death are prima facie serious. If the threatened harm is that a product may cost a few pennies more than otherwise, or if the threatened harm is that a part or product may cause minor inconvenience, that harm – even if multiplied by thousands or millions of instances – does not match the seriousness of death to the user or the innocent bystander.

The harm threatened by unsafe tires – for example, sold as premium quality but blowing out at 60 or 70 mph – is serious, for such tires can easily lead to death. The dumping of metal drums of toxic waste into a river, where the drums will rust, leak, and cause cancer or other serious ills to those who drink the river water or otherwise use it, threatens serious harm. The use of substandard concrete in a building, such that the building is likely to collapse and kill people, poses a serious threat to people. Failure to X-ray pipe fittings, as required in building a nuclear plant, is a failure that might lead to nuclear leaks; this may involve serious harm, for it endangers the health and lives of many.

The notion of *serious* harm might be expanded to include serious financial harm, as well as kinds of harm other than death and serious threats to health and body. But as we noted earlier, we shall restrict ourselves here to products and practices that produce or threaten serious harm or danger to life and health. The difference between producing harm and threatening serious danger is not significant for the kinds of cases we are considering.

2. Once employees identify a serious threat to the user of a product or to the general public, they should report it to their immediate superior and make their moral concern known. Unless they do so, the act of whistle-blowing is not clearly justifiable.

Why not? Why is not the weighing of harm sufficient? The answer has already been given in part. Whistle-blowing is a practice that, to be effective, cannot be routinely used. There are other reasons as well. First, reporting one's concerns is the most direct, and usually the quickest, way of producing the change the whistle-blower desires. The normal assumption is that most firms do not want to cause death or injury and do not willingly and knowingly set out to harm the users of their products in this way. If there are life-threatening defects, the normal assumption is, and should be, that the firm will be interested in correcting them, if not for moral reasons, at least for prudent reasons – viz., to avoid suits, bad publicity, and adverse consumer reaction. If serious harm is threatened and an employee can prevent it by reporting it, he or she has the obligation to report it. The argument from loyalty also supports the requirement that the firm be given the chance to rectify its action, procedure, or policy before it is charged in public. In addition, because whistle-blowing does harm to the firm, harm in general is minimized if the firm is informed of the problem and allowed to correct it. Less harm is done to the firm in this way, and if the harm to the public or the users is also averted, this procedure produces the least harm, on the whole.

The condition that one report one's concern to one's immediate superior presupposes a hierarchical structure. Although firms are usually so structured, they need not be. In a company of equals, one would report one's concerns internally, as appropriate.

Several objections may be raised to this condition. Suppose one knows that one's immediate superior already knows of the defect and the danger. In this case, reporting it to the superior would be redundant, and condition 2 would be satisfied. But one should not presume without good reason that one's superior does know. What may be clear to one individual may not be clear to another. Moreover, the assessment of risk is often a complicated matter. What appears as unacceptable risk to a person on one level may appear as legitimate to a person on a higher level, who may see a larger picture and know of offsetting compensations and the like.

Would not reporting one's concern effectively preclude the possibility of anonymous whistle-blowing and so put one in jeopardy? This might be the case, and a person should weigh this consideration before blowing the whistle. We will discuss this matter later in this chapter. If the reporting is done tactfully, moreover, the voicing of one's concerns might, if the problem is apparent to others, indicate a desire to operate within the firm, and so make one less likely to be the person assumed to have blown the whistle anonymously.

By reporting his or her concern to the immediate superior or other appropriate person, the employee preserves and observes the regular practices of firms, which on the whole promote their order and efficiency; this fulfills the employee's obligation of minimizing harm, and it precludes precipitous whistle-blowing.

3. If one's immediate superior does nothing effective about the concern or complaint, the employee should exhaust the internal procedures and possibilities within the firm. This usually will involve taking the matter up the managerial ladder and, if necessary – and possible – to the board of directors.

To exhaust the internal procedures and possibilities is the key requirement here. In a hierarchically structured firm, this means going up the chain of command. But the employee may do so either with or without the permission of those at each level of the hierarchy. What constitutes exhausting the internal procedures? This is often a matter of judgment. But because going public with one's concern is more serious both for oneself and for the firm, going up the chain of command is the preferable route to take in most circumstances. This third condition is of course satisfied if, for some reason, it is truly impossible to go beyond any particular level.

Several objections may once again be raised. There may not be time enough to follow the bureaucratic procedures of a given firm; the threatened harm may have been done before the procedures are exhausted. If, moreover, one goes up the chain to the top and nothing is done by anyone, then, a great deal of time will have been wasted. Once again, prudence and judgment should be used. The internal possibilities may sometimes be exhausted quickly, by a few phone calls or visits. But it should not simply be assumed that no one at any level within the firm will do anything. If there are truly no possibilities of internal remedy, then the third condition is satisfied.

As we mentioned, the point of the three conditions is essentially that whistle-blowing is morally permissible if the harm threatened is serious and if internal remedies have been attempted in good faith without a satisfactory result. In these circumstances, an employee is morally justified in attempting to avert what he or she sees as serious harm by any means that may be effective, including blowing the whistle.

We can pass over as not immediately germane the questions of whether in nonserious matters there is an obligation to report one's moral concerns to one's superiors and whether a person fulfills this obligation once he or she has reported them to the appropriate party.

These three steps can be taken as an analysis of the moral obligation to bring the matter before the attention of those who can prevent it. We noted earlier that everyone has the moral obligation to prevent serious harm to others when they can do so at little cost to themselves. Since one's own good is as important as the good of another, there is no general obligation to sacrifice oneself for another. To do so is generally agreed to go beyond the call of duty. As the cost to oneself grows, the obligation generally diminishes, unless the threatened harm is very great. Once again one must use one's judgment to decide how to weigh the harm to oneself as opposed to the serious harm to others. Yet the general rule applies in the case of serious harm threatened to others by one's own company, and if one can present that harm, one has the obligation to do so and to take what steps one can. Hence we can argue that employees have the general obligation to report the threatened harm they perceive to their superiors and to go as high up in the company as they can to prevent it. The obligation to do so sets the stage for the obligation to externally blow the whistle.

If these three steps have been taken, and if the company does not take any action to prevent the harm, then one has exhausted the internal remedies. Having exhausted them is sufficient justification for the employee to turn to external whistle-blowing. The employee, by using all available internal mechanisms, has satisfied any legitimate claim of loyalty to the company and has provided the company an opportunity to prevent the harm without publicity, and so without damage to its reputation. From an ethical point of view, the employee who has taken these three steps without successful remedy is permitted to go outside the company and blow the whistle externally in order to prevent the threatened harm.

Whistle-Blowing as Morally Required

To say that external whistle-blowing under these conditions is morally permitted does not impose any obligation on an employee to externally blow the whistle. Unless two other conditions are met, the employee does not have a moral obligation to blow the whistle. To blow the whistle when there is no moral requirement to do so, and if done from moral motives (i.e., concern for one's fellow humans) and at risk to oneself, is to commit a supererogatory act. It is an act that deserves moral praise. But failure to so act deserves no moral blame. In such a case, the whistle-blower might be considered a moral hero. Sometimes he or she is so considered, and sometimes not. If an employee's claim or concern turns out to be ill founded, his or her subjective moral state may be as praiseworthy as if the claim were well founded, but the person will rarely receive much praise for his or her action.

For there to be an obligation to blow the whistle, two conditions must be met, in addition to the foregoing three.

4. The whistle-blower must have, or have accessible, documented evidence that would convince a reasonable, impartial observer that one's view of the situation is correct, and that the company's product or practice poses a serious and likely danger to the public or user of the product.

Employees do not have an obligation to put themselves at serious risk without some compensating advantage to be gained. Unless they have documented evidence that would convince a reasonable, impartial observer, their charges or claims if made public would be based essentially on their word. Such grounds may be sufficient for a subjective feeling of certitude about the charges, but they are not usually sufficient for others to act on the claims. For instance, a newspaper is unlikely to print a story based simply on someone's undocumented assertion.

Several difficulties emerge. Should it not be the responsibility of the media or the appropriate regulatory agency or government bureau to carry out an investigation based on someone's complaint? It is reasonable for them to do so, providing they have some evidence in support of the complaint or claim. The damage has not yet been done, and the harm will not, in all likelihood, be done to the complaining party. If the action is criminal, then an investigation by a law-enforcing agency is appropriate. But the charges made by whistle-blowers are often not criminal charges. And we do not expect newspapers or government agencies to carry out investigations whenever anyone claims that possible harm will be done by a product or practice. Unless harm is imminent, and very serious (e.g., a bomb threat), it is appropriate to act on evidence that substantiates a claim. The usual procedure, once an investigation is started or a complaint followed up, is to contact the party charged.

One does not have a moral obligation to blow the whistle simply because of a hunch, guess, or personal assessment of possible danger, if supporting evidence and documentation are not available. One may, of course, have the obligation to attempt to get evidence if the harm is serious. But if it is unavailable – or unavailable without using illegal or immoral means – then a person does not have the obligation to blow the whistle.

5. The employee must have good reasons to believe that by going public the necessary changes will be brought about. The chance of being successful must be worth the risk one takes and the danger to which one is exposed.

Even with some documentation and evidence, a potential whistle-blower may not be taken seriously, or may not be able to get the media or government agency to take any action. How far should one go, and how much must one try? The more serious the situation, the greater the effort required. But unless one has a reasonable expectation of success, one is not obliged to put oneself at great risk. Before going public, the potential whistle-blower should know who (e.g., government agency, newspaper, columnist, or TV reporter) will make use of the evidence, and how it will be handled. The whistle-blower should have good reason to expect that the action taken will result in the kind of change or result that he or she believes is morally appropriate.

The foregoing fourth and fifth conditions may seem too permissive to some and too stringent to others. The conditions are too permissive for those who wish everyone to be ready and willing to blow the whistle whenever there is a chance that the public will be harmed. After all, harm to the public is more serious than harm to the whistle-blower, and, in the long run, if everyone saw whistle-blowing as obligatory, without satisfying the last two conditions, we would all be better off. If the fourth and fifth conditions must be satisfied, then people will only rarely have the moral obligation to blow the whistle.

If, however, whistle-blowing were mandatory whenever the first three conditions were satisfied, and if one had the moral obligation to blow the whistle whenever one had a moral doubt or fear about safety, or whenever one disagreed with one's superiors or colleagues, one would be obliged to go public whenever one did not get one's way on such issues within a firm. But these conditions are much too strong, for the reasons already given. Other conditions, weaker than those proposed, might be suggested. But any condition that makes whistle-blowing mandatory in large numbers of cases may reduce the effectiveness of whistle-blowing. If this were the result, and the practice were to become widespread, then it is doubtful that we would all be better off.

Finally, the claim that many people very often have the obligation to blow the whistle goes against the common view of the whistle-blower as a moral hero, and against the commonly held feeling that whistle-blowing is only rarely morally mandatory. This feeling may be misplaced. But a very strong argument is necessary to show that although the general public is morally mistaken in its view, the moral theoretician is correct in his or her assertion.

A consequence of accepting the fourth and fifth conditions stated is that the stringency of the moral obligation of whistle-blowing corresponds with the common feeling of most people on this issue. Those in higher positions and those in professional positions in a firm are more likely to have the obligation to change a firm's policy or product – even by whistle-blowing, if necessary – than are lower-placed employees. Engineers, for instance, are more likely to have access to data and designs than are assembly-line workers. Managers generally have a broader picture and more access to evidence than do nonmanagerial employees. Management has the moral responsibility both to see that the expressed moral concerns of those below them have been adequately considered and that the firm does not knowingly inflict harm on others.

The fourth and fifth conditions will appear too stringent to those who believe that whistle-blowing is always a supererogatory act, that it is always moral heroism, and that it is never morally obligatory. They might argue that, although we are not permitted to do what is immoral, we have no general moral obligation to prevent all others from acting immorally. This is what the whistle-blower attempts to do. The counter to that, however, is to point out that whistle-blowing is an act in which one attempts to prevent harm to a third party. It is not implausible to claim both that we are morally obliged to prevent harm to others at relatively little expense to ourselves, and that we are morally obliged to prevent great harm to a great many others, even at considerable expense to ourselves.

The five conditions outlined can be used by an individual to help decide whether he or she is morally permitted or required to blow the whistle. Third parties can also use these conditions when attempting to evaluate acts of whistle-blowing by others, even though third parties may have difficulty determining whether the whistle-blowing is morally motivated. It might be possible successfully to blow the whistle anonymously. But anonymous tips or stories seldom get much attention. One can confide in a government agent, or in a reporter, on condition that one's name not be disclosed. But this approach, too, is frequently ineffective in achieving the results required. To be effective, the source must usually be willing to be identified, to testify publicly, to produce verifiable evidence, and to put himself or herself at risk. As with civil disobedience, what captures the conscience of others is the willingness of the whistle-blower to suffer harm for the benefit of others, and for what he or she thinks is right.

Although we have concentrated on a specific type of nongovernmental, impersonal, external whistle-blowing that threatens serious physical harm to the public, the analysis provides a model for dealing with other kinds of whistle-blowing as well. What should employees do when the harm threatened is not physical but monetary – to customers, suppliers, or the general public? How serious does such threatened harm have to be? What of unjustified cost overruns on government contracts, or tax evasion, or other illegal activities on the part of a company? When is a worker prohibited from blowing the whistle, and when is a worker permitted or required to blow it?

Internal Whistle-Blowing

Impersonal external whistle-blowing is the most dramatic and publicized kind of whistle-blowing. An equally troubling kind is impersonal, internal, nongovernmental whistle-blowing. The analysis of the conditions under which the first kind is prohibited, permitted, or mandatory does not automatically apply to the internal kind. If serious harm is threatened to employees, then the first three conditions come into play and the analysis yields an obligation to internally blow the whistle. But in many instances of internal whistle-blowing, there is no question of going outside the firm because the harm done is not to employees or to the public but to the firm.

Rather than being an act of corporate disloyalty, internal whistle-blowing is more often than not an act of corporate loyalty. However, it usually does involve disloyalty or disobedience to one's immediate superior or disloyalty to one's fellow workers. If done from moral motives, the intent of such whistle-blowing is to stop dishonesty or some immoral practice or act in order to protect the interests and reputation of the company or to increase a company's profits.

Those in management positions are usually expected to see that those below them follow proper procedures and obey company policy. But what obligation, if any, does a subordinate have to report that someone above them is padding his or her expense account, or is taking kickbacks on orders placed with a supplier, or is accepting large unreported gifts from suppliers? Most companies would like to know about such activity and stop it. However, unless reporting it is stated as an obligation, such as in corporate guidelines, if those doing the reporting would not in any way be considered accomplices and have nothing to do with the wrongdoing, it is difficult to see how subordinates can have a moral *obligation* to report such activity. In doing so, they would help the company, but they might also put their own positions, jobs, or promotions in jeopardy. Workers are not typically hired to spy on their fellow workers or superiors. Nor is it clear that asking employees to act in that capacity would make for a productive corporate atmosphere. There is no general moral obligation for everyone to report every minor instance of wrongdoing of which they become aware. Such a requirement would be impossible to fulfill and would cause more social harm than good. It would turn a normal society into a police state or develop a police-state mentality among its citizens in which everyone watches and reports on everyone else. The cases here do not involve illegal activity or harm to others outside the corporation, and so they are appropriately handled within the corporation. They also involve relatively minor harm to the firm. This does not excuse the activities, but it does affect the obligation of subordinates to report such activity.

Although not obliged to blow the whistle on superiors so acting, are employees morally permitted to do so? Are they ever morally prohibited from doing so?

In the analysis of external whistle-blowing, we acknowledged a requirement to try to prevent the threatened harm by reporting it within the firm first. Is there a parallel requirement that before reporting the wrongdoings of a superior, one inform that person first? Although this might frequently be the preferable course of action, providing one could do so tactfully and with relative personal impunity, it is not a general requirement. In the cases we are discussing, the action has already been done and the harm inflicted. Because the perpetrators of the prohibited actions in question are acting against the good of the firm, they can claim no right to privacy with respect to those actions and no immunity from being reported. Those above them clearly have the right and often the obligation to stop that activity. Hence, a subordinate who feels strongly about the action may report it. There is no general moral prohibition about reporting wrongdoing, and there is no special prohibition if the wrongdoing occurs within a firm.

A similar kind of analysis applies to reporting the wrongdoings of one's peers or fellow workers.

The analysis changes once the activity is illegal or causes harm to individuals or serious harm to the company. Reporting such activity is morally permitted. Whether it is morally required depends on the severity of the harm, one's position within the firm and vis-à-vis the perpetrator, the firm's general operating procedures, and other pertinent factors. The point is not to look for an automatic rule, but to learn to consider and weigh the pertinent factors in each case.

A company that wishes to foster both collegiality and honesty among its employees will have policies that will help employees work through their responsibilities with respect to issues involving ethical breaches on the part of superiors and fellow employees.

Three cases

In January 2003, *Time* magazine surprised its readers by choosing three women whistle-blowers as its "Persons of the Year."[11] The three were Coleen Rowley of the FBI, Sherron Watkins of Enron, and Cynthia Cooper of WorldCom. Each engaged in a kind of whistle-blowing different from the nongovernmental, impersonal, external whistle-blowing in which serious bodily harm or death is threatened by a company's actions. They therefore allow us to test our model and to see how it might be modified and applied to other kinds of whistle-blowing. None of the three considered herself a whistle-blower, and many others did not consider them whistle-blowers either.[12] Part of the reason why this is the case is that each reported her perception of wrongdoing internally, and it was only through accident or the action of others that they were called on to publicly testify against their employers.

Coleen Rowley worked for the FBI, and so her actions were a form of internal governmental whistle-blowing. There are several general types of governmental whistle-blowing, and the analysis of each is somewhat different. One is whistle-blowing by a government employee concerning fraud against the government or whistle-blowing by an employee of a firm with a government contract whose firm is involved in defrauding the government. These form the largest number of governmental whistle-blowing cases, and the ones that the U.S. government typically has been most interested in. Legislation going back to the False Claims Act of 1863 attempts to protect the government against fraud, and when the Act was revised in 1986, it provided such whistle-blowers not only with protection against reprisals of any sort, but also with a claim on a percentage of the money the government recovers. A second kind of whistle-blowing is by a government employee who reports to the appropriate government agency corruption within government. A third is the unauthorized release of government documents to the general public (usually via the media) of proof of wrongdoing of any sort that the government refuses to make public. A fourth involves the reporting of threatened harm by either the government or some contractor for the government, exemplified by the case of engineers working on the ill-fated Space Shuttle Challenger launch, which exploded, causing the death of its seven crew members.[13]

The actions of Coleen Rowley do not fall neatly into any of these four categories. Following the September 11, 2001, attack on the World Trade Center and the Pentagon, Rowley tried to bring to the attention of her superiors a failure of the FBI to follow up reports filed before September 11 on the actions of Zacaias Moussaoui, who had taken instruction on how to fly a 747, and whom the government later charged with aiding the Al Qaeda in the attack.[14] She wrote up her concerns for the Director of the FBI, Robert Mueller, and two members of the House and Senate Intelligence Committee, which was investigating the attacks. She didn't intend her letter to be made public. It was released to the press by someone else, and as a result she was contacted by various news media and called to testify publicly at the Committee's hearings. She became famous for her detailing of failures she perceived in the FBI and of some of the procedures and atmosphere that worked against FBI employees being able to function effectively and the FBI being able to respond appropriately to threats that were reported.

Whether or not she is considered an internal whistle-blower, it seems clear that she acted appropriately in making her concerns known and in trying to bring them to the attention of the director of the FBI. In this case, the first three conditions that must be fulfilled to justify whistle-blowing are the same as in cases of nongovernmental whistle-blowing. Serious harm was threatened if procedures were not changed, and she appropriately worked first within the system. The other two conditions were also arguably fulfilled, even though she did go public on her own.

The other two whistle-blowers that *Time* honored were Sherron Watkins and Cynthia Cooper. What makes these cases different from our paradigm case of whistle-blowing is that the harm threatened was not bodily harm or death, but financial harm. The entity primarily affected was the company in question itself, although those harmed included not only employees but shareholders, including pension fund and mutual fund holders. At the time both individuals contacted senior management about their findings and concerns, they could not know that their respective companies and the shareholders would suffer the extensive and very serious harm they eventually did. But they did know that certain individuals were doing what was illegal or very likely so, and they could foresee harm to the company once the illegality became known.

Cynthia Cooper was vice president of internal audit at WorldCom, which dealt with operations auditing within the company. Financial audits were handled by the accounting firm of Arthur Andersen. When an unusual accounting practice was brought to her attention (listing operating expenses as capital expenses in order to inflate the corporate earnings report), she started investigating it. Although operations expenses were part of her responsibility, the reporting of earnings was officially part of the financial audit. Nonetheless, she pursued it. What she and her team uncovered were accounting practices that inflated the company's profit statement by $3.8 billion. She reported her findings to the audit committee of WorldCom's board of directors, which shortly thereafter fired Scott Sullivan, the firm's CEO, and David Myers, WorldCom's controller. When her audit memo was released to the press in connection with a government investigation into the company's fraudulent practices, Cooper became a center of attention. Myers cooperated with the federal authorities, who indicted Sullivan for accounting fraud. The company was forced into bankruptcy. *Time* reports that "some employees think the company could have borrowed its way out of its problems and avoided bankruptcy if she [Cooper] had stayed quiet."[15] Whatever other employees may think, it is clear that Cooper was morally permitted to write the memo she did to the audit committee, since the practices she uncovered were illegal. She was also morally permitted to go beyond the strict lines of her job description to uncover the evidence of the wrongdoing. Whether she was morally obliged to do so is less clear, if we look simply at our whistle-blowing model. But any firm that wishes to behave both ethically and legally would be happy that employees act this way, since it is clearly in the firm's best interest to uncover and correct such actions rather than have them discovered by federal agencies.

The story of Sherron Watkins and Enron is somewhat similar to Sullivan's. Like Sullivan, she was a vice president. She was given the assignment by Andrew Fastow, the company's CFO, to identify some of the company's assets that it could sell. In doing so, she found accounting anomalies and investigated further. She intended to report her misgivings to the CEO, Jeffrey Skilling, but he resigned before she could do so, and he was replaced by Kenneth Lay. A week later she wrote a memo to the new CEO detailing her findings, and then went to see Lay in person.[16] In October the company announced a large loss, and in December it filed for bankruptcy. When a federal investigation was begun, her memo became public and she shot to the center of media attention. Unlike Sullivan's fellow employees, *Time* reports, "Some laid-off Enron employees began blaming Watkins for not taking her concerns to the Securities and Exchange Commission,"[17] that is, for not publicly blowing the whistle. Whether she was morally required to do so is not clear. In retrospect a great deal of harm came to a large number of people. If we use our whistle-blowing model, then one might argue that all five conditions were met, and she did have the moral obligation to go public. But unlike the paradigm case in which physical harm or death is threatened, she could not know what the outcome would be for Enron. Not all cases of fraud result in the demise of a company and in the loss of their life's savings by thousands of people. Furthermore, the rationale for making whistle-blowing mandatory rests on the strong possibility that the harm can be prevented. In this case, had she gone public it is not clear that the investors and employees who suffered as a result of Enron's demise would have fared any better. What is clear is that morally and legally she could not take part in any fraud or in covering up any fraud, and both that she was morally permitted to do what she did and that she would have been morally permitted to go public.

Precluding the Need for Whistle-Blowing

The need for moral heroes shows a defective society and defective corporations. It is more important to change the legal and corporate structures that make whistle-blowing necessary than to convince people to be moral heroes.

Because it is easier to change the law than to change the practice of all corporations, it should be illegal for any employer to fire an employee, or to take any punitive measures, at the time or later, against an employee who satisfies the first three aforementioned conditions and blows the whistle on the company. Because satisfying those conditions makes the action morally justifiable, the law should protect employees when they are acting in accordance with what their conscience demands. If the whistle is falsely blown, the company will have suffered no great harm. If it is appropriately blown, the company should suffer the consequences of its actions being made public. But to protect a whistle-blower by passing such a law is no easy matter. Employers can make life difficult for whistle-blowers without firing them. There are many ways of passing over an employee. He or she can be relegated to the back room of the firm or be given unpleasant jobs. Employers can always find reasons not to promote employees or not to give them raises. Not all of this can be prevented by law, but some of the more blatant practices can be prohibited.

Second, the law can mandate that the individuals responsible for the decision to proceed with a faulty product or to engage in a harmful practice be penalized. The law has been reluctant to interfere with the operations of companies. As a result, those in the firm who have been guilty of immoral and illegal practices have gone untouched even though the corporation was fined for its activity.

A third possibility is that every company of a certain size be required by law to have an inspector general, an internal operational auditor, an ethics officer, or some comparable person whose job it is to uncover immoral and illegal practices. This person's job would be to listen to the moral concerns of employees, at every level, about the firm's practices. He or she should be independent of management and report to the audit committee of the board, which, ideally, should be a committee made up entirely of outside board members. The inspector or auditor should be charged with making public those complaints that should be made public if not changed from within. Failure on the inspector's part to take proper action with respect to a worker's complaint, such that the worker is forced to go public, should be prima facie evidence of an attempt to cover up a dangerous practice or product, and the inspector should be subject to criminal charges.

The Sarbanes-Oxley Act of 2002 attempts to provide some protection for whistle-blowers[18] by providing both civil and criminal penalties for violating a whistle-blower's rights in reporting fraud. The provisions are stronger now for such whistle-blowers than they are for those reporting environmental or safety issues, although OSHA is the agency that drew up the rules implementing the act. Whether the act will induce companies to encourage employees to report financial, ethical, and legal misconduct, and immunize them against retaliation remains to be seen.

Nonetheless, a company that wishes to be moral – that does not wish to engage in harmful practices or to produce harmful products – can take steps to preclude the necessity of whistle-blowing. It can establish channels whereby those employees who have moral concerns can get a fair hearing without danger to their position or standing in the company. Expressing such concerns, moreover, should be considered a demonstration of company loyalty and should be rewarded appropriately. The company might establish the position of ombudsman to hear such complaints or moral concerns, or an independent committee of the board might be established to hear such complaints and concerns. Someone might even be paid by the company to present the position of the would-be whistle-blower, who would argue for what the company should do from a moral point of view, rather than what those interested in meeting a schedule or making a profit would like to do. Such a person's success within the company could depend on his or her success in precluding whistle-blowing, as well as the conditions that lead to it.

Unions and professional organizations should become concerned with the problem of whistle-blowing. They should support their members who feel obligated to blow the whistle on a company; they should defend and support members in their endeavors and prevent them from being fired or abused on the job. They can also establish channels of their own, to which members can report concerns, and then follow up such concerns and force appropriate action.

Although we have concentrated on a specific type of nongovernmental, impersonal, external whistle-blowing that threatens serious physical harm to the public, the analysis provides a model for dealing with other kinds of whistle-blowing as well.

Because external whistle-blowing involves disloyalty or disobedience at some level, we start by requiring that it be justified, rather than assuming it needs no justification. To distinguish the various kinds of whistle-blowing, listing conditions that make it morally permissible and those that make it morally required is useful as a guide. In personal whistle-blowing, there are many instances in which it is permitted but not obligatory. Many people may prefer to change employers rather than blow the whistle, and this may be perfectly justifiable. In all cases, one must weigh the harm done against the good to be achieved and the rights to be protected.

Whistle-blowing is a relatively recent phenomenon in the workplace. It is one more indication of the falsity of the Myth of Amoral Business. Whistle-blowing should also alert corporations to what can and should be done if they wish to be both moral and excellent. When corporate structures preclude the need for whistle-blowing, they protect both workers' rights and the public's good.

Study Questions

1. In your opinion, was the Ford Motor Company or anyone in the company guilty of any ethical breaches? Defend your answer by means of a utilitarian analysis.
2. Did anyone in the Ford Motor Company have an obligation to blow the whistle? Defend your answer.
3. Define *whistle-blowing, internal whistle-blowing, external whistle-blowing, personal whistle-blowing, impersonal whistle-blowing, governmental whistle-blowing*, and *nongovernmental whistle-blowing*. Give an illustrative example of each.
4. How might someone argue that whistle-blowing is always morally prohibited? What is wrong with that argument?
5. How much loyalty, if any, does a worker owe a firm? Defend your answer.
6. How might someone argue that whistle-blowing is always morally permitted? What is wrong with that argument?
7. Under what three conditions is whistle-blowing morally permitted? How do you defend the legitimacy of those three conditions?
8. In the kind of whistle-blowing developed in the chapter, why must the threatened harm be serious and considerable? Give examples of kinds of harm that you judge to be serious and considerable. What kinds would you not judge to be serious and considerable?

9. In external whistle-blowing, why must internal avenues of remedy be tried first?
10. Under what conditions is whistle-blowing morally mandatory?
11. Are employees in a subordinate position obliged to internally blow the whistle on their superiors whom they know are padding their expense accounts? are embezzling funds? In each case say why or why not.
12. Describe the cases of Coleen Rowley, Cynthia Cooper, and Sherron Watkins. Do you consider them whistle-blowers? Explain.
13. Develop guidelines for personal whistle-blowing. Defend the guidelines you develop.
14. What can government do to protect whistle-blowers? How effective can they be?
15. How can firms preclude the need for whistle-blowing?
16. How does whistle-blowing indicate the falsity of the Myth of Amoral Business?
17. Using the analysis for external, impersonal, and nongovernmental whistle-blowing as a model, under what conditions is external, impersonal, and governmental whistle-blowing morally permissible? morally mandatory?
18. Jane Fainsell works for an airplane manufacturer and has access to evidence that the company is charging the government for spare parts up to five times what they cost, amounting to about $1 million in overcharges. Is she morally obliged to do anything about this? If so, what?

Notes

[1] For details of the case, including documents, see Public Citizen, "Firestone Tire Resource Center," at http://www.tradewatch.org/autosafety/suvsafety/ford_frstone/ (accessed on October 12, 2008).

[2] For sources and more details on the Pinto, see Richard T. De George, "Ethical Responsibilities of Engineers in Large Organizations: The Pinto Case," *Business and Professional Ethics Journal*, 1, no. 1 (1981), pp. 1–14; Lee P. Strobel, *Reckless Homicide? Ford's Pinto Trial* (South Bend, Ind: And Books. 1980); Mark Dowie, Douglas Birsch, and John H. Fielder (eds.), *Ford Pinto Case* (Albany, NY: State University of New York Press, 1994).

[3] Among the many articles that have appeared, one of the earliest and most incendiary was Mark Dowie, "Pinto Madness," *Mother Jones*, 2 (1977), pp. 18–32. For a defense of Ford and an explanation of the decisions made, see Matthew T. Lee and M. David Ermann, "Pinto 'Madness' as a Flawed Landmark Narrative: An Organizational and Network Analysis," *Social Problems*, 46, no. 1 (1999), pp. 30–47.

[4] For other analyses of the case, see John R. Danley, "Polishing Up the Pinto: Legal Liability, Moral Blame, and Risk," *Business Ethics Quarterly*, 15, no. 2 (2005), pp. 205–236; and Matthew T. Lee and M. David Ermann, "Pinto 'Madness' as a Flawed Landmark Narrative: An Organizational and Network Analysis," *Social Problems*, 46, no. 1 (1999), pp. 30–47.

[5] Some general works dealing with whistle-blowing are Myron Peretz Glazer, Penina Migdal Glazer, *The Whistleblowers: Exposing Corruption in Government and Industry* (New York: Basic Books, 1989); C. Fred Alford, *Whistleblowers: Broken Lives and Organizational Power* (Ithaca, NY: Cornell University Press, 2001); Roberta Ann Johnson, *Whistleblowing: When It Works – And Why* (Boulder, Colo.: Lynne Rienner Publishers, 2003); Gerald Vinten (ed.), *Whistleblowing: Subversion or Corporate Citizenship?* (NewYork: St. Martin's Press, 1994); Marcia P. Miceli and Janet P. Near, *Blowing the Whistle: The Organizational and Legal Implications for Companies and Employees* (New York: Lexington Books, 1992). Ancorr Web: Anti-Corruption Ring Online has a useful bibliography on whistle-blowing at http://wwwl.oecd.org/daf/nocorruptionweb/Corruption/prev_whistle.htm#references.

[6] U.S. Merit Systems Protection Board, *Whistle Blowing and the Federal Employee* (Washington, DC: U.S. Government Printing Office, 1981). In 1986, Congress revised the False Claims Act. It not only protects those who blow the whistle on government contractor fraud but also gives the whistle-blower up to 30 percent of the amount received from a successful suit (Miceli and Near, *Blowing the Whistle*, pp. 247–248).

[7] Two of the most famous cases were made into movies: In *Erin Brockovich*, Julia Roberts (portraying Brockovich) is a woman who discovers a chemical company is polluting drinking water. In *Silkwood*, Meryl Streep (playing Karen Silkwood) uncovers corruption and previously unreported danger of contamination at a nuclear plant.

8 Robert M. Anderson, Robert Perrucci, Dan E. Schendel, and Leon E. Trachtman, *Divided Loyalties: Whistle-Blowing at BART* (West Lafayette, IN: Purdue University, 1980).

9 For one discussion of loyalty, see Alan F. Westin, Henry I. Kurtz, and Albert Robbins, *Whistle Blowing: Loyalty and Dissent in the Corporation* (New York: McGraw-Hill, 1981).

10 Lars Lindblom, "Dissolving the Moral Dilemma of Whistleblowing," *Journal of Business Ethics*, 76 (2007), pp. 413–426, argues against this position.

11 *Time*, December 20, 2002, and January 6, 2003, cover and pp. 30–60.

12 Of the three, Sherron Watkins after the fact portrayed herself as a whistle-blower. Dan Ackman. February 14, 2002, available at http://www.forbes.com/2002/02/14/0214watkins.html, disagrees and argues that Watkins was not a whistle-blower.

13 Diane Vaughan, *The Challenger Launch Decision: Risky Technology, Culture, and Deviance at NASA* (Chicago: University of Chicago Press. 1996).

14 For the U.S. government indictment against Moussai, see http://www.usdoj.gov/ag/mouss aouiindictment.htm.

15 *Time*, p. 50.

16 The text of the memo is available at http://www.itm-web.com/f012002.htm. In the memo, she suggests ways to resolve the difficulties of the company and suggests that the best plan is to "clean up quietly if possible."

17 *Time*, p. 56.

18 Ashlea Ebeling, "Blowing the Sarbanes-Oxley Whistle," *Forbes*, online at http://www.forbes.com/2003/06/18/cx_ae_0618beltway.html.

The Morality of Whistleblowing
A Commentary on Richard T. De George

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Introduction

Among the many important contributions to the business ethics field provided by Richard T. De George is his discussion of the morality of whistleblowing. De George (2010), in his classic textbook *Business Ethics*, provides a succinct analysis of the conditions under which external whistleblowing by employees (e.g. to the media, government regulators, or public interest groups) can be considered either morally permissible or morally obligatory. De George's whistleblowing criteria have been referred to as: "important," "famous," and having gained "widespread acceptance" (Lindblom, 2007, pp. 414–415), representing the "standard theory" on whistleblowing (Davis, 2009, p. 154), as well as "frequently cited in articles by other scholars" (Hoffman and McNulty, 2010, p. 47).[1]

The topic of whistleblowing continues to be an important and challenging business ethics issue for society: "Whistleblowing is one of the classic issues in business ethics" (Hartman and Desjardin, 2008, p. 128). In terms of corporate whistleblowing, the Ethics Resource Center's 2011 National Business Ethics Survey found that while 45 percent of employees witnessed illegal or unethical misconduct during the previous year, a significant percentage (35 percent) did not report it (Ethics Resource Center, 2012a). The range of illegal and unethical activity that goes unreported is extensive and includes corruption, bribery, receiving and giving gifts and entertainment, kickbacks, extortion, nepotism, favoritism, money laundering, improper use of insider information, use of intermediaries, conflicts of interest, fraud, aggressive accounting, discrimination, sexual harassment, workplace safety, consumer product safety, and environmental pollution (Ethics Resource Center,

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2012a; US Sentencing Commission, 2011). One study by the Association of Certified Fraud Examiners (2012, p. 8) estimates that the global total fraud cost alone to organizations per year is US$3.5 trillion. According to the study, whistleblowing "tips" were the primary method of detection (43%) followed by management review (15%) and then internal audit (14%). The major source of whistleblowing tips were employees (51%), followed by customers (22%) and then by anonymous sources (12%) (2012, p. 14).

Unfortunately, one doesn't have to look very far over recent years to see significant examples of crime and unethical activity within or on behalf of business organizations and the serious negative impact such scandals have had on investors, employees, customers, competitors, the natural environment, and society in general (e.g. Enron – accounting fraud; Siemens – bribery; Bernie Madoff – investor fraud; BP – Gulf oil spill; Barclays Bank – interest rate manipulation, etc.). While one might hope that the internal reporting of misconduct would help alleviate the problem, research surveys indicate that 22 percent (up from 12 percent in 2007) of those reporting misconduct experienced some form of retaliation in return (Ethics Resource Center, 2012a). Examples of retaliation include exclusion from work activity, receiving the cold shoulder, verbal abuse by managers and other employees, almost losing one's job, and not receiving promotions or raises (Ethics Resource Center, 2012a). Forty-six percent of employees indicated fear of retaliation as the reason they did not report wrongdoing (Ethics Resource Center, 2012b). Such empirical evidence suggests that it may be unwise for an employee to report any wrongdoing.

Due to its continued importance and normative complexity, we suggest that a re-examination of De George's normative position on whistleblowing is in order, particularly in light of new developments in whistleblowing legislation and corporate compliance and ethics programs. In so doing, we attempt to build on and refer to existing whistleblowing literature including positions both similar to De George (e.g. Bowie, 1996; Velasquez, 2006) and critical of De George (e.g. Davis, 2009; Hoffman and McNulty, 2010; Lindstrom, 2007). For our purposes, while there are numerous definitions, we rely on the relatively broad and general definition of whistleblowing provided by Velasquez (2006, p. 377): "An attempt by a member or former member of an organization to disclose wrongdoing in or by the organization".

In order to assess De George's contribution, we first provide in the first part of this article a brief overview of the key arguments as expressed by De George. In the second part, we critique De George's normative assessment by suggesting that there are additional considerations that should be taken into account when discussing the morality of whistleblowing, leading to our proposed set of revised criteria. In the third part, De George's criteria along with our proposed revised criteria are applied to three classic whistleblowing cases in the business ethics field to initially test each theory's practicality: (i) the Ford Pinto; (ii) Enron, and (iii) Brown & Williamson. We then conclude with its implications. The objective of our paper is not to minimize or diminish De George's important normative contribution to the whistleblowing literature, but rather to attempt to enhance his criteria to make them more robust while pointing out the challenges that are faced when attempting to apply any given set of normative criteria to the act of external whistleblowing.

Summary of De George's Position

In the normative literature on external whistleblowing, there are two extreme positions on moral permissibility or obligation, which to date have always been rejected. One extreme position is that employees are never permitted to externally blow the whistle, typically based on the notion of loyalty to one's firm and/or due to confidentiality agreements. This position is rejected either because it is morally repugnant to a free and democratic society, or because absolute loyalty towards anyone or any entity either does not exist (Duska, 2009) or as an ethical notion is never absolute (Lindblom, 2007). The other extreme position is that employees are always morally permitted to externally blow the whistle for any reason, typically based on the notion of free speech. This position is also always rejected as free speech has never been considered an absolute moral principle, or due to the unnecessary harm caused to the firm by externally blowing the whistle.

De George's set of criteria for external whistleblowing, like other proposed sets of criteria, takes a position somewhere between these extremes. De George's starting position is based on the universal ethical principle that "corporations have a moral obligation not to harm" (2010, p. 299). Based on this fundamental notion, De George (2010, p. 301) restricts his initial discussion to external whistleblowing by "employees of profit-making firms" that produce a product or provide a service that "threatens to produce serious bodily harm to the public in general, to employees, or to individual users of the product." While De George believes that employees owe a degree of loyalty to their firms, he indicates that this obligation is not the highest obligation and can therefore be overridden (2010, p. 304). That being said, De George, based on societal norms and general employee beliefs, views whistleblowing as an initial act of "disobedience" (2010, p. 306) which will tend to cause injury to the firm. This then requires a proper moral justification for external whistleblowing, i.e. that more good will result than harm when one blows the whistle externally (2010, p. 306).

While De George does not specifically address the issue of motivation, he does briefly suggest that there should be a "moral motivation" when one blows the whistle, e.g. the whistleblowing should not be out of revenge. This is contrary to Bowie's (1999) criteria for morally justified whistleblowing. Bowie (1999) requires a proper moral motive for blowing the whistle, i.e. to expose unnecessary harm, and illegal or immoral actions, which is not based on one seeking profit or attention. Similar to De George, we are not as concerned with the motive of the whistleblower as Bowie (1999) in relation to our proposed criteria, since motives do not relate to the consequences one is hoping to achieve (i.e. avoiding harm). We would suggest, however, that proper motive (e.g. not based merely on financial reasons, for revenge, or to try to make it more difficult to be fired) should still relate to whether internal or external whistleblowing can be considered morally praiseworthy.[2]

Such initial principles lead to De George's three criteria or conditions under which external whistleblowing can be considered to be morally *permissible* (thereafter referred to as 'DG1', 'DG2', and 'DG3'):

1. "The firm, through its product or policy, will do serious and considerable harm to employees or to the public, whether in the person or the user of its product, an innocent bystander, or the general public" [DG1].
2. "Once employees identify a serious threat to the user of a product or to the general public, they should report it to their immediate superior and make their moral concern known. Unless they do so, the act of whistleblowing is not clearly justifiable" [DG2].
3. "If one's immediate superior does nothing effective about the concern or complaint, the employee should exhaust the internal procedures and possibilities within the firm. This usually will involve taking the matter up the managerial ladder and, if necessary – and possible – to the board of directors" [DG3].

His next two conditions (thereafter referred to as 'DG4' and 'DG5'), in addition to the previous three, lead to a moral *obligation* to externally blow the whistle:

4. "The whistleblower must have, or have accessible, documented evidence that would convince a reasonable, impartial observer that one's view of the situation is correct, and that the company's product or practice poses a serious and likely danger to the public or user of the product" [DG4].
5. "The employee must have good reasons to believe that by going public the necessary changes will be brought about. The chance of being successful must be worth the risk one takes and the danger to which one is exposed" [DG5].

Each of De George's five criteria will now be discussed and evaluated.

Critique and Proposed Revised Criteria

De George's first criterion (DG1) might be referred to as the "Harm Principle". De George makes it clear that without the possibility of serious harm resulting from the misconduct (i.e. the harm threatened by a firm's product or policy), one is morally prohibited from blowing the whistle externally. The word "harm" is ambiguous, as one can argue that every product or action of every company has a potential negative impact (i.e. harm) on one or more stakeholders. The qualifiers "serious" and "considerable" are clarified by De George by suggesting that any matters that threaten death are serious. For example, De George suggests that toxic metal drums being dumped into a river by a firm which can later cause cancer should be considered as being serious (2010, p. 307). Tires sold as premium quality but blowing out at 60–70 mph are also considered serious. While De George opens the door to serious financial harm being included as part of his first criterion, he then avoids this possibility by restricting his analysis to death and serious threats to health and body.

Velasquez, like De George, also requires serious harm: "the organization is engaged in some activity that is seriously wronging or will seriously wrong other parties" (2006, p. 379). Others also require harm, but broaden its scope. Davis for example broadens the criterion by using the words "moral wrongdoing" rather than "harm": "[Organizations] engaged in serious moral wrongdoing" (not just to prevent harm) (1996, p. 151). Similarly, Hoffman and McNulty (2010, p. 51) refer to "non-trivial or unethical actions … that are deemed to violate the dignity of one or more of its stakeholders."

Empirical research appears to support the practicality of De George's first criterion. One study found that "Employees weigh the severity of the problem when deciding whether or not a problem should be reported externally" (Ethics Resource Center, 2012b, p. 14). The following factors were found to be related to whether employees believed the issue was sufficiently serious to report externally: whether it was a very serious crime (83 %); the potential harm to people (78 %); the potential harm to the environment (68 %); and the potential for the company to get into big trouble (59 %) (Ethics Resource Center, 2012b, p. 15).

Our view of potential harm is that it should be explicitly *broader* than what De George suggests. It appears that De George merely wanted to establish a paradigm case upon which to formulate and present his other criteria and thus limited his harm criterion to "physical" harm. We believe that De George would not necessarily disagree with expanding his notion of harm to other types of harm. For example, De George states: "The notion of serious harm might be expanded to include serious financial harm, as well as kinds of harm other than death and serious threats to health and body" (2010, p. 308). To clarify the nature of the DG1 harm criterion, we would explicitly include those actions that could result in serious financial harm, as well as serious psychological harm (e.g. James, 1990). We would also include actions that are clearly in serious breach of the law (i.e. would potentially lead to legal disciplinary action such as a fine against the firm or legal disciplinary action taken against an individual within the firm[3]). Actions that infringe basic moral rights or involve serious injustice would also be included in our criterion (e.g. Velasquez, 2006). Our first criterion would therefore potentially capture those matters that would be excluded by De George: "sexual harassment, violations of privacy, industrial espionage, insider trading …" (James, 1990, p. 294) or falsification of previous serious misconduct (Davis, 1996) as each involves a serious violation of basic moral rights or constitutes a serious injustice.

It could be argued that requiring the employee to first determine whether the harm can be considered "serious" before blowing the whistle externally is too difficult, onerous, or subjective a criterion. For example, one could ask how an employee could ever make a determination of what might be "serious" harm due to the lack of awareness of all of the potential implications of even minor misconduct, or whether the minor misconduct might actually represent the tip of major wrongdoing or a scandal. Instead, external whistleblowing might be suggested as being morally required for any observed misconduct with any degree of potential harm, leaving the recipients of the whistleblower's information (e.g. government regulators, the media, or special interest groups) with the responsibility to determine whether the reported activity is "serious" enough to render appropriate action to be taken.

We agree with De George, however, that a distinction between minor misconduct and misconduct involving "serious" potential harm must necessarily be determined by the employee in order to require external whistleblowing. For example, we would not want an employee to be considered to be morally required to externally blow the whistle on a co-worker taking scotch tape from the supply room for personal use, or when a purchasing manager is observed receiving a coffee mug from a current supplier as a gift (although observation of such acts might still require internal whistleblowing as discussed below). To assist in the determination of what might be considered "serious" misconduct, one might attempt to link the harm criterion to the "newspaper test" used in ethical decision making, i.e. does one believe that the misconduct is sufficiently serious that it should be reported in one of the major headlines of the newspaper?

Our revised criterion (which we identify as Hoffman–Schwartz or HS1) would therefore be:

> *Misconduct has taken place or is expected to take place that violates the law or involves serious physical harm, serious psychological harm, serious financial harm, serious infringement of basic moral rights, or a serious injustice* [HS1].

Due to their similarity, De George's second criterion (DG2) and third criterion (DG3) can be merged together for our purposes and labeled the "Internal Reporting Principle". The two criteria collectively require that internal whistleblowing must take place, initially to one's supervisor (DG2), and then if no action is taken, all the way up the corporate hierarchy to the board of directors if necessary (DG3).Velasquez agrees by requiring that "reasonably serious attempts to prevent the wrong through internal whistleblowing have been tried and have failed" (2006, p. 379). Bowie (1999) also argues that "The whistleblower, except in special circumstances, has exhausted all internal channels for dissent before going public." Empirical research supports the proposition that most employees are both willing and able to report matters internally first.A study by the Ethics Resource Center (2012b) found the following (emphasis added):

> The current stigma assigned to a "whistleblower" as a rogue and disloyal employee is inaccurate. Only one in six reporters (18 percent) ever chooses to report externally. Of those who do go outside their company at some point, *84 percent do so only after trying to report internally first*. Furthermore, many of those who are "whistleblowers" in the narrowest sense of the word still try to address the problem within their own company; half of those who choose to report to an outside source initially later report internally as well. Only 2 percent of employees solely go outside the company and never report the wrongdoing they have observed to their employer.

De George (2010, p. 303) points out the risks and often difficulties faced by those wanting to report matters. Despite the challenges, we agree with De George that internal whistleblowing whenever possible should be a requirement before external whistleblowing takes place. If discussing the misconduct with one's supervisor, senior management, or the board of directors is not possible, then one would fulfill the internal reporting criterion by taking one's concerns through the designated reporting channel (e.g. legal counsel, human resources manager, internal auditor, ombudsperson, compliance officer, or ethics officer), if a reporting channel exists.[4] We also believe that the internal reporting criterion would be met if the whistleblowing takes place anonymously. Our revised criterion would therefore consist of the following:

> *The misconduct must first be reported internally whenever feasible to one's direct supervisor and, if no action is taken, all the way up to the board of directors or through the designated reporting channel if one exists (e.g. compliance or ethics officer)* [HS3].

While we would not go so far as to make it a criterion, we would strongly recommend, however, one additional procedural step whenever possible (and it may not always be possible), that the perpetrator be informed that the misconduct will be reported if it does not cease. De George refers to informing the person first (he focuses on a "superior") as a "preferable course of action, providing one can do so tactfully and with relative personal impunity, [but] it is not a general requirement" (2010, p. 313). We would suggest, however, that warning one's colleagues of their improper misconduct or of one's intention to blow the whistle should always be considered as a first step whenever possible before reporting one's colleagues in accordance with principles of procedural justice.This would obviously be easier with respect to the perpetrator being a co-worker or person in a more junior position, rather than one's own supervisor or a senior manager. If the primary objective is to reduce harm, then taking the initial step of warning the perpetrator can potentially cause the misconduct to come to an end prior to any additional steps being taken. Rather than being related to the moral permissibility or moral obligation of blowing the whistle, taking the additional step of ensuring that the perpetrator has been warned supports the moral praiseworthiness of ultimately blowing the whistle either internally or externally.

Due to the risks of internal whistleblowing, we would also add another level of protection to the whistleblower by suggesting that if the firm does not have a written anti-retaliation policy against whistle-blowing that is enforced, one is not obligated to blow the whistle internally. We would leave it completely up to the employee to make this determination, and if no formal anti-retaliation policy exists or if there is no evidence to suggest the policy will be upheld by the firm's management, then one would not be required to internally report wrongdoing. We would still require the existence of an effective firm anti-retaliation policy even when anonymous whistleblowing is possible, due to the inherent risks of one's identity ultimately being discovered and the demonstrated negative harm caused to the employee as a result. Recent cases demonstrate that without such protection, whistleblowers remain at the mercy of their firms' retribution.[5] The exception would be for professionals working within a firm, who would still be bound by their professional ethical obligations of taking steps to avoid potential harm by reporting misconduct internally even when facing personal risk to oneself by doing so. Our revised criteria would therefore be as follows:

> *Unless one is a professional working within the firm, an effective written anti-retaliation policy must exist at the firm* [HS4].

De George's next criterion (DG4) involving the requirement to have documented evidence (i.e. the "Evidentiary Principle"), is intended to avoid frivolous claims or claims being made based on improper motives. Others agree with De George on requiring proper evidence before external whistleblowing takes place. Velasquez indicates that there should be "clear, substantiated, and reasonably comprehensive evidence" (2006, p. 379); Hoffman and McNulty (2010) as well as Bowie (1999) require "compelling evidence" while Davis (1996, p. 151) requires that the whistleblower's beliefs are "justified" and "true". It would be difficult to argue that some sort of evidentiary standard should not exist before one is morally obligated to externally blow the whistle, or morally permitted to blow the whistle at all for that matter.

Davis, however, goes on to qualify the evidentiary requirement to distinguish it from De George: "[T]he … theory does not require the whistle-blower to have enough evidence to convince others of the wrong in question" (1996, pp. 152–153). While James believes that one should not merely blow the whistle based on mere suspicion, guess, or hunch, and should take steps to "gather as much evidence as they can" (James, 1990, p. 297), he views De George's evidentiary requirement as too strict. We agree, and instead of requiring "documented" evidence, we subscribe to the less stringent legal test used in the Dodd-Frank Act of "reasonable belief," i.e. one should hold a reasonable belief that the misconduct is taking place based on firsthand knowledge.[6] We believe that appropriate responsibility can also be expected of and placed on the media or government regulator to engage in proper fact-finding and confirmation before any misconduct is reported to the public. Libel laws and accusations of lack of due process would hopefully ensure some protection against erroneous claims being made by either the media or government based on a whistleblower's report. The requirement of internal whistleblowing will also act as an evidentiary screening mechanism by providing the firm with the opportunity to properly investigate and then verify or dispute the evidentiary basis of the claim being made before it goes public. We therefore agree with James (1990) and Davis (1996) that De George's evidentiary requirement for external whistleblowing is too stringent.

Our revised criterion would therefore be as follows:[7]

> *Reasonable evidence or belief of misconduct based on firsthand knowledge can be provided* [HS2].

One of the most stringent of De George's criteria (DG5) is what we call the "Make a Difference Principle", i.e. one has good reason to believe that blowing the whistle will lead to changes in the firm's practices. This criterion combined with the previous evidentiary criterion elevates for De George the moral *permissibility* of external whistleblowing to one of moral *obligation*. Velasquez agrees with De George by stating a similar requirement: "It is reasonably certain that external whistleblowing will prevent the wrong" (2006, p. 379) as does Bowie (1999): "Whistleblowing has some chance of success". Davis, however, disagrees by invoking what he calls the "paradox of failure," i.e. as the history of whistleblowing demonstrates its general ineffectiveness in causing change, external whistleblowing will paradoxically never be morally obligated if DG5 is applied. As a result, Davis argues that external whistleblowing (1996, p. 151): "does not require [belief] that [the] revelation will prevent … the wrong." While empirical research shows that the vast majority of employees (79 percent) who blow the whistle believe that corrective action will take place (Ethics Resource Center, 2012b), it's not clear what percent erroneously decide not to blow the whistle externally because they believe changes in practice will not take place.

Our assertion is that the requirement that employees will have "good reasons" to believe that external whistleblowing will result in changes in practice is too stringent. If internal whistleblowing has already taken place up to the board of directors with no changes being effected, then one might reasonably expect that even the media or government regulators will face a challenge in causing the firm to change its practices as well. It is simply too great a hurdle to require employees to first "have good reasons to believe" that external whistleblowing will likely lead to change, as opposed to merely hoping that things will change. We would find it ethically offensive that a major corporate scandal involving loss of life resulted from an employee not acting because he or she believed that there was a low likelihood of any changes taking place through reporting the misconduct. In addition, at the very least, the fact that there was a whistleblowing report that was not acted upon could be used later on with respect to punishing those (e.g. firm executives or government regulators) who did not act appropriately after receiving the information, which can hopefully prevent similar inaction in the future.

De George's concern over the potential harm to the whistleblower is a valid one, however: "The chance of being successful must be *worth the risk one takes and the danger to which one is exposed*" (2010, p. 311, emphasis added). Hoffman and McNulty (2010) make it clear that legal protections, despite improvements over the years, remain insufficient or are not enforced leaving external whistleblowers extremely vulnerable to personal harm. Similar to HS4 (i.e. anti-retaliation policies must exist for morally obligated internal whistleblowing), this concern for the well being of the whistleblower is partially addressed in our next additional criterion for external whistleblowing as follows:

> *Unless one is a professional working within the firm, legal protections for employees that blow the whistle externally must exist and be effective (i.e. enforced) in order for external whistleblowing to ever be morally required* [HS5].

If an employee decides to blow the whistle externally when no legal protection exists (e.g. for private firms), this is the point where we would label such actions as not only morally permissible but supererogatory or morally praiseworthy. This criterion might therefore be looked upon as an exempting condition with respect to the moral obligation to blow the whistle externally. The employee, after doing all he or she can do internally to rectify the misconduct, due to lack of legal protection against retaliation, should not be morally compelled to place the interests of others who might be harmed by the company's actions before his or her own interests as well as the interests of one's family (see Vandekerckhove and Tsahuridu, 2010). This action is similar to that of someone who places their entire financial and mental well-being at risk in order to save the lives of others. We would not therefore morally criticize an employee who does not blow the whistle externally when there are insufficient legal protections. We would, however, argue that such an employee, if required to be involved in the misconduct or in a cover-up, would at that point have a moral obligation to *quit* the firm after first finding another position elsewhere to avoid being an accomplice in harming or wronging others.

Our only exception to the HS5 criterion is with respect to professionals (e.g. engineers, lawyers, accountants) working within a firm (see, e.g., James (1990) and Velasquez (2006)). Due to their professional codes of ethics, professionals possess additional ethical obligations to prevent harm to society, even when their own personal self-interests are at stake. They are aware of this obligation upon receiving their professional designations, and are therefore aware of the risks of working for a firm that is engaged in misconduct that can harm society. Employees who are not professionals with inherent additional ethical obligations should not be held to the same standard in terms of being morally obligated to blow the whistle externally when no legal protections exist.

We believe our position is in alignment with that proposed by Hoffman and McNulty (2010, p. 52, emphasis added): "If an employee has compelling evidence of organizational misconduct, he or she has a duty to blow the whistle *unless* that person has reason to believe that his or her own dignity would be seriously harmed by doing so." Due to the empirical research on the high likelihood of negative implications of blowing the whistle (Velasquez, 2006), along with the current lack of legal protections (Hoffman and McNulty, 2010), we believe our suggested HS5 criterion provides at least some protection for the whistleblower against otherwise being morally required to seriously harm his or her personal well-being.

To summarize, our revised proposed criteria in order for either internal or external whistleblowing to be morally obligatory consist of the following:

HS1. *Misconduct has taken place or is expected to take place that seriously violates the law or involves serious physical harm, serious psychological harm, serious financial harm, serious infringement of basic moral rights, or a serious injustice.*

HS2. *Reasonable evidence or belief of misconduct based on firsthand knowledge can be provided.*

HS3. *Misconduct must first be reported internally whenever feasible to one's direct supervisor and, if no action is taken, all the way up to the board of directors or through the designated reporting channel if one exists (e.g. compliance or ethics officer).*

For *internal* whistleblowing to be morally obligatory, in addition to HS1 (or HS1 modified, see below), HS2, and HS3, the following criterion is required:

HS4. *Unless one is a professional, an effective written anti-retaliation policy must exist at the firm.*

For *external* whistleblowing to be morally obligatory, in addition to HS1, HS2, HS3, and HS4, the following criterion is required:

HS5. *Unless one is a professional, effective legal protections for employees must exist.*

While our discussion, similar to De George, focuses on the moral permissibility or moral obligation of *external* whistleblowing, we should point out how our criteria would apply to *internal* whistleblowing, which as previously indicated is much more common than external whistleblowing.

De George does provide a brief indication that his harm criterion (DG1) would be less stringent for internal whistleblowing. De George (2010, p. 312) appears to broaden his harm criterion substantially in terms of the moral permissibility of internal whistleblowing to include other less serious types of harm to the firm including "padding … expense accounts … taking kickbacks [from] suppliers" or "accepting large unreported gifts from suppliers". De George states that reporting activity internally is morally permitted if "the activity is illegal or causes harm to individuals or serious harm to the company" (2010, p. 313). We would refer to this criterion as "DG1 (modified)," which would necessarily incorporate the more serious harm involved in DG1. Whether internal whistleblowing is morally required or obligatory, however, according to De George depends on other factors to be considered including the "severity of the harm, one's position within the firm and vis-à-vis the perpetrator, [and] the firm's general operating procedures" (2010, p. 313). According to De George, rather than disloyalty to the firm, internal whistleblowing often represents disloyalty to one's immediate supervisor or one's peers which would thereby justify less stringent criteria.

We would argue that *internal* whistleblowing is always morally *permissible* as long as our first three criteria are met. In terms of our first criterion (HS1) with respect to internal reporting, similar to De George, we would also drop the requirement for the harm to be considered "serious" in nature by the employee. We would include any potential legal or ethical misconduct, including any misconduct involving a violation of the firm's code of ethics if one exists. We will refer to this less stringent harm requirement as "HS1 (modified)," which would necessarily incorporate the more serious harm involved in HS1. In other words, internal whistleblowing above one's supervisor is *always* morally permissible as long as any misconduct or harm (physical or financial) is or is about to take place (HS1 modified), if reasonable belief of the misconduct or potential misconduct exists (HS2), and if one has already reported the matter to one's supervisor when feasible (HS3). If the firm has an effective anti-retaliation policy in place (HS4), then one would be *morally obligated* under such circumstances to blow the whistle internally. As a professional, one would be morally obligated to internally whistleblow if only the first three criteria are met (HS1, HS2, HS3) even when there is no effective anti-retaliation policy in place (HS4). In other words, business firms should not expect employees to be morally required to blow the whistle internally (which is now a requirement in many corporate codes of ethics the failure of which can lead to dismissal) unless business firms are prepared to take the necessary steps to ensure that their employees will be protected against reprisals for doing so. If an employee decides to blow the whistle internally on wrongdoing without guaranteed protections from the firm against reprisals, they have simply acted in a morally praiseworthy (but non-obligatory) manner.

Table 1 below summarizes the criteria for De George (DG) versus Hoffman–Schwartz (HS) in relation to morally permissible/obligatory and internal/external whistleblowing.

Application of Revised Criteria

In order to preliminarily evaluate the practicality of our proposed criteria, we will apply them to several classical business ethics cases including the Ford Pinto, Sherron Watkins of Enron, and Jeffrey Wigand of Brown & Williamson.

Ford Pinto: In the case of the Ford Pinto and its defective fuel tank, one can argue that a Ford employee or manager would only have been morally *permitted* to blow the whistle externally (which would also have been a morally praiseworthy act), but would not have been morally *obligated* to do so. There was clear potential for physical harm to the users of the vehicle (HS1), reasonable belief that the defect existed (HS2), while reporting internally was irrelevant since even senior

Table 1 De George (DG) versus Hoffman–Schwartz (HS) criteria for whistleblowing.

	De George's (DG) criteria for whistleblowing	
	Internal whistleblowing	*External whistleblowing*
Morally permissible (or not morally prohibited)	DG1 (modified) (Harm) DG2 (Internal – Supervisor) DG3 (Internal – Up to the Board)	DG1 (Serious harm) DG2 (Internal – Supervisor) DG3 (Internal – Up to the Board)
Morally obligatory	Suggested factors to consider: – Severity of harm – One's position in firm vis-à-vis perpetrator – Firm's operating procedures	DG1 (Serious harm) DG2 (Internal – Supervisor) DG3 (Internal – Up to the Board) DG4 (Documented evidence) DG5 (Make a difference)
	Hoffman–Schwartz (HS) criteria for whistleblowing	
	Internal whistleblowing	*External whistleblowing*
Morally permissible	HS1 (modified) (Misconduct) HS2 (Reasonable belief) HS3 (Internal reporting)	HS1 (Serious harm) HS2 (Reasonable belief) HS3 (Internal reporting)
Morally obligatory	HS1 (modified) (Misconduct) HS2 (Reasonable belief) HS3 (Internal reporting) HS4 (Anti-retaliation policy)	HS1 (Serious harm) HS2 (Reasonable belief) HS3 (Internal reporting) HS4 (Anti-retaliation policy) HS5 (Legal protection)

management was aware of the defect (HS3). One might assume, however, that Ford did not possess any anti-retaliation policy at the time (HS4), and that legal protections against whistleblowing were non-existent (HS5). For the latter two reasons, employees would not have been obligated to blow the whistle either internally or externally, although it would have been morally praiseworthy to do so. Ford engineers, however, as professionals would have been morally obligated to blow the whistle internally up to the Board of Directors even if no effective anti-retaliation policy existed (HS4), and externally against Ford, despite any lack of effective legal protections (HS5), due to their additional professional ethical obligations to protect society from harm. Although not obligated to blow the whistle externally, any Ford employee who might be complicit in covering up the defect from the public would be morally obligated to quit Ford once another job was found.

De George would come to a similar conclusion but for different reasons. De George does appear to indicate that despite the relatively low risk of harm, and the fact that "it is not immoral not to make the safest automobile possible" (2010, p. 307), the defect's potential seriousness of harm (i.e. death) suggests that his first criterion (DG1) would be met. As mentioned, one might assume that the matter was already well known internally up to the most senior levels of management (DG2 and DG3). There also appeared to be accessible, documented evidence that would convince an impartial observer that the Ford Pinto posed a serious danger to the users of the vehicle with respect to DG4. However, De George's fifth criterion (DG5) of the likelihood of making a difference is not as clear. While De George asks the question "Did anyone at Ford have an obligation to make known to the public the facts that Ford knew but did not make public?" (2010, p. 299), he unfortunately does not clearly answer the question for the reader. But due to the DG5 criterion, one might not be morally obligated to blow the whistle externally, according to De George, including Ford's professional engineers.

Enron: According to our proposed criteria, Sherron Watkins of Enron, as a professional accountant, was morally *obligated* to blow the whistle both internally and externally based on the fraud taking place. In terms of our first criterion (HS1), there was a reasonable expectation held by Watkins that Enron would financially implode, leaving employees and shareholders in a serious and precarious financial situation. This would be considered significant financial harm leading to a potential obligation to blow the whistle internally. As Watkins reported her concerns directly to Ken Lay, who was not only the CEO but was also the Chairman of the Board of Directors, and no action was taken (even after received guidance from a law firm), our third criterion (HS3) was met (although Watkins might have also taken her concerns to the Board's audit committee). Watkins had more than reasonable evidence (HS2). In terms of our fifth criterion (HS5), although sufficient legal protections did not exist to protect her at the time (Texas law apparently did not protect whistleblowers[8]), as a Certified Public Accountant (i.e. professional) working within the firm, our criterion would not act as an exempting condition, and she would have to be prepared to face the personal circumstances that would result, including being fired for her actions. As a professional, Watkins was morally obligated to blow the whistle internally as well, despite the apparent lack of an effective anti-retaliation policy (HS4) for whistleblowers.

De George (2010) addresses the Enron case and appears to hold that Watkins was not morally obligated to blow the whistle externally. The primary reason is that it was not clear according to his DG5 criterion whether blowing the whistle would effect any change ("it is not clear that the investors and employees who suffered as a result of Enron's demise would have fared any better [by Watkins going public]" (De George, 2010, p. 316). De George does later state, however, that "[Watkins] would have been morally permitted to go public" (2010, p. 316), suggesting he is prepared to extend his notion of "harm" to now include serious financial harm as well as physical harm.

Brown & Williamson: Dr. Jeffrey Wigand, former Vice President of Research and Development at the tobacco firm Brown & Williamson, had much to lose by blowing the whistle on his firm. Dr. Wigand was receiving a significant salary, and had a child who required expensive medical care covered through his firm's health benefits. Dr. Wigand also at one point signed an expanded confidentiality agreement with his firm. Dr. Wigand had become aware, however, that the company was intentionally manipulating its tobacco blend to increase the amount of nicotine in its cigarettes, which increased the level of addiction and danger to the users of its already dangerous product. While the additional harm was not clear, one can argue that the product if even more addictive and dangerous did represent significant potential harm to the users (HS1). Dr. Wigand had reliable firsthand evidence (HS2), and had reported his concerns internally to the CEO, which were ignored (HS3). On this basis, it was morally permissible and morally praiseworthy for Dr. Wigand to externally blow the whistle to the news television program *60 Minutes*, but not morally obligatory due to the lack of an effective anti-retaliation policy (HS4) and the lack of legal protections for blowing the whistle (HS5). In other words, we do not believe that Dr. Wigand was morally required to sacrifice his job and his career, and put his own family's health coverage at risk, even though he had information that might indirectly save additional lives. This would not be true, of course, if Dr. Wigand were subject to higher ethical standards by being a member of a profession which demanded that he protect the public from harm.

According to De George's fifth criterion (DG5), however, Dr. Wigand might have assumed that there was little chance that blowing the whistle would lead to any changes of practice by tobacco companies, and thus for this reason alone he would not have been morally obligated to blow the whistle externally. We are concerned that even if legal protections exist for whistleblowers, De George's criteria would morally permit individuals (including professionals) to walk away from whistleblowing situations that could lead to the deaths of others simply because they do not have "good reasons" to believe that blowing the whistle externally will necessarily make a difference.

Implications and Conclusion

Any proposed set of criteria that renders external whistleblowing obligatory will be subject to criticism, exceptions, and potential modifications due to changes in practical reality. De George, however, has provided the business ethics community with an important initial set of normative criteria for external whistleblowing which has withstood several competing positions and criticism over the years. Like everyone else, De George rejects the position that external whistleblowing is *always* morally justifiable, and also rejects the position that external whistleblowing is *never* morally justifiable. Due to the high likelihood of negative consequences to the whistleblower, however, such as being fired, blackballed in the industry, denied promotions, or becoming targets for revenge, according to De George the decision to report wrongdoing by an employee cannot be taken lightly (2010, p. 303). The potential severe negative impact on the employee and the firm due to external whistleblowing appears to be his critical concern, leading to his somewhat stringent criteria, which arguably will rarely if ever lead to a moral obligation to blow the whistle.

Should one be obligated to lose one's job, be harassed, or blackballed from one's industry, in order to save the lives of others or protect them from serious physical or financial harm? Is this not similar to the basic life-saving ethical dilemma of whether one can be morally compelled to put oneself at risk in order to save someone else? One's answer to this question may determine where on the spectrum one falls in terms of the moral obligation to blow the whistle externally, and the sort of criteria one should reflect upon. The issue becomes more complex when a situation is faced whereby the firm might go bankrupt due to a scandal being disclosed. Should one be required to blow the whistle externally to protect someone from being seriously physically harmed by their company if the expected result is that thousands might lose their jobs and tens of thousands of shareholders might lose their wealth?

We believe the answer to both of these questions should be 'yes', but would typically not be 'yes' as matters currently stand today due to the lack of effective anti-retaliation policies at many firms (see, e.g., Hassink *et al.*, 2007) and insufficient legal protections in many jurisdictions (see, e.g., Lewis, 2008). Unlike other proposed criteria, we also impose corresponding ethical obligations on business firms and governments as well. First, firms have an ethical obligation (and for US public firms it is now a legal obligation under the Sarbanes-Oxley Act) to ensure that there are proper whistleblowing channels for their employees. Such whistleblowing channels should provide for anonymity when desired, confidentiality whenever possible, guaranteed protections against harassment and retaliation, due process taking place during investigations, and there must be a follow-up with the employee who has blown the whistle on the outcome. There must also be a designated individual who receives the complaints (e.g. compliance or ethics officer) and then reports not to the CEO but to the firm's independent directors (e.g. audit committee), and that this individual is preferably not hired or fired by the CEO (see Hoffman and Rowe, 2007).

Second, we also place ethical obligations on governments around the world to ensure that proper legal whistleblowing protection is in place and is being properly enforced for employees of all firms, including both public and private firms. While progress on both of these fronts has taken place over the years (e.g. US False Claims Act, US Sarbanes-Oxley Act, US Dodd-Frank Act, UK Public Interest Disclosure Act, etc.), there is certainly room for improvement. We believe that only when firms establish effective internal whistleblowing channels for their employees with effective anti-retaliation policies (HS4) and when there is effective government legislation to protect external whistleblowers (HS5), will one be able to argue that non-professional employees are morally obligated to blow the whistle externally when our proposed criteria are otherwise met.

Finally, if firms were to take reasonable steps to ensure that they possess an ethical corporate culture, including instilling ethical values within the firm's policies, procedures, and practices, establishing a comprehensive ethics program (including codes and ethics training), along with the existence of ethical leadership, then the vast majority of instances of potential internal and external whistleblowing of misconduct will become greatly reduced (see Schwartz, forthcoming). Research supports the proposition that "strong ethical cultures" diminish organizational misconduct and thereby the need for employees to blow the whistle internally or externally (Ethics Resource Center, 2012a). Our view is that, based on our proposed criteria, while employees may on rare occasions have a moral obligation to blow the whistle externally, firms (through their boards of directors and senior management) possess a contemporaneous ethical obligation to ensure that their employees work within an organization that has a strong ethical corporate culture that reduces the need for whistleblowing while simultaneously protecting those employees who do choose to blow the whistle.

Notes

[1] Although we refer to the 7th edition of De George's *Business Ethics* (2010), his criteria have not changed significantly from his 1st edition of 1982.

[2] In terms of financial motives, the issue is, however, potentially more relevant today in light of the Dodd-Frank Act, which provides for significant monetary payouts to whistleblowers who report directly to the US Securities and Exchange Commission (SEC) even if they don't report internally within their own firms (see Gilley and Hoffman, 2011). The primary concern is that providing monetary incentives may motivate and thereby prevent many employees from reporting misconduct internally before going to the SEC.

[3] This could include illegal practices such as tax evasion, anti-competitive practices, fraud, environmental pollution, or deceptive advertising.

[4] It should be noted, however, that recent case law suggests that reporting internally first before going to the SEC could prevent one from claiming whistleblower status and protection against retaliation under the Dodd-Frank Act. See: http://newsandinsight.thomsonreuters.com/Legal/News/2012/06_-_June/GE_wins_dismissal_of_Dodd-Frank_whistleblower_suit/.

[5] See the National Whistleblowers Center at: www.whistleblowers.org/.

[6] See: http://sec.gov/rules/final/2011/34-64545.pdf.

[7] We place this as the second criterion as it appears to more closely follow the temporal order of the whistleblowing process: first harm must exist, leading to reasonable belief, then internal reporting.

[8] See legal case at: http://bulk.resource.org/courts.gov/c/F3/433/433.F3d.1.04-2291.04-1801.html, where it is stated that Texas law does not protect whistleblowers.

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Conflicts of Interest

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This paper has two distinct objectives. (1) I defend an analysis of the concept of a conflict of interest. On my analysis the concept of a conflict of interest is broader than is generally supposed. I argue that a very large class of cases not ordinarily considered conflicts of interest should be so regarded. Conflicts of interest are an integral feature of many professional relationships and do not (as is often supposed) require the existence of "external" financial or personal relationships. (2) I defend and explain the common-sense view that conflicts of interest are *prima facie* wrong and argue that in ordinary cases it is wrong, all things considered, to allow an avoidable conflict of interest to occur. It is beyond the scope of this paper to defend the ultimate moral principles to which I appeal, but I attempt to establish these claims on the basis of weak and relatively noncontroversial assumptions.

I. Analysis of the Concept

Consider the following examples of conflicts of interest:

1. A mayor purchases insurance for city employees from his son's insurance agency.[1]
2. A judge rules on a case involving a company in which he has a substantial financial interest.
3. An official of a company has inside information about a matter which affects the value of his firm's stock. He uses this information to his advantage in buying or selling that stock.[2]
4. A personnel officer in a corporation fills a position with the child of a close personal friend.

In all of these cases there is an actual or potential conflict between the interests of an individual (or the interests of his friends or family members) and the interests of the party for whom he works. This suggests the following definition of "conflict of interest":

> A conflict of interest exists if, and only if, the interests of an individual (*I*) (or the interests of *I's* friends or family) conflict (or have the potential to conflict) with the interests *of I's* employer (or client).

This definition is too broad, as the following example makes clear. It would be in my personal interest for my employer to pay me $ 1 000 000 a year, but it would not be in my employer's interest to pay me such a salary. This is a case in which the interests of an employee conflict with those of her employer, but it is not a conflict of interest.[3]

Conflicts of interest involve a clash between the interests of an individual (or those of her friends and family, etc.) and the interests of some other party for whom she works. But the existence of such a clash is not sufficient for a conflict of interest. In order for there to be a conflict of interest, the conflicting interests must somehow hinder the individual from discharging the duties of her office or position. This feature of conflicts of interest helps to account for the moral significance which we attach to them. In all of the paradigm cases of conflicts of interest noted above, the conflicting interests in question hinder the individual from discharging the duties of her position.

Consider the following provisional definition of "conflict of interest":

> A conflict of interest exists in any situation in which an individual (*I*) has difficulty discharging the official (fiduciary) duties attaching to a position or office she holds because either: (i) there is (or *I* believes that there is) an actual or potential conflict between her own personal interests and the interests of the party (*P*) to whom she owes those duties (her employer, client, or organization), or (ii) there is (or *I* believes that there is) an actual or potential conflict between the interests of her friends, family, or other clients and the interests of the party to whom she owes these duties.

Some complications

Conflicts of interest needn't involve a conflict between *I's* own self-interest and the interests of *P*. As the case of Mayor Daley (see Note # 1) makes clear, a conflict of interest can be created by a conflict between the interests of one's friends or family and the interests of the party to whom one owes official duties. Any definition of conflict of interest must specify the sorts of other parties whose interests can create conflicts of interest. My provisional definition says that this other party must be a friend, family member, or other client. This is too narrow. Consider the following case. Suppose I am in charge of hiring for a position in a corporation. One of the people who applies is a man who once saved my father's life. He is not a friend, family member or client. I am grateful to him and am tempted to hire him for that reason. This case is a conflict of interest. Another case: I am sorely tempted to hire someone simply because he is from the same home town as my grandfather or because he has the first name of "Elvis." One's desire to promote the interests of *any* person or persons can create a conflict of interest. Moreover, there seems to be no *a priori* reason why this other party (whose interests create a conflict of interest) must be a human being. A person's desire to promote the interests of an animal could create a conflict of interest.[4]

Conflicts of interest can be created by one's desire to *promote* one's own interests or the interests of others. They can also be created by one's desire to *thwart* the interests of others.[5] Suppose that a personal enemy is among those bidding on a contract with my company and I have the authority to determine who is given the contract. Or suppose that I review a book written by someone I dislike intensely, These cases would constitute conflicts of interest, provided that my desire (to thwart the interests of the individuals in question) makes it difficult for me to perform my official duties.[6]

How should the provisional definition be revised in light of these considerations? It seems that we must broaden the earlier definition to say that a conflict of interest is any case in which *I's* official duties are compromised by *I's* concern to promote *or thwart* the interests of any party. In cases of conflict of interest *I* has desires or divided loyalties which hinder her in the loyal discharge of her duties to *P*. I propose the following definition:

> A conflict of interest exists in any situation which an individual (*I*) has difficulty discharging the official (conventional/fiduciary) duties attaching to a position or office she holds because either: (i) there is (or *I* believes that there is) an actual or potential conflict between her own personal interests and the interests of the party (*P*) to whom she owes those duties, or (ii) *I* has a desire to promote (or thwart) the interests of (*X*) (where X is an entity which has interests) and there is (or *I* believes that there is) an actual or potential conflict between promoting (or thwarting) *X's* interests and the interests of *P*.

Some features of the proposed analysis

1. On my definition, it is not necessary that there be an *actual* conflict between the interests of the relevant parties. According to my definition, it is sufficient that *I* believes that there is an actual or potential conflict between the interests of the relevant parties. A person might be hindered in the performance of the duties of her position because she mistakenly believes that her doing so is contrary to her own interests (or the interests of others whose interests she is concerned to advance). Consider the following case:

> A lawyer works for a client. Her fiduciary obligations include protecting the financial interests of the client. The lawyer incorrectly perceives a conflict between her own financial interests and those of the client. As a result, she is tempted to act in ways that are harmful to her client.

This case constitutes a conflict of interest, even though there is no actual incompatibility between the lawyer's interests and those of her client. The justification for calling this a conflict of interest is that the lawyer's perception of a clash between her interests and those of her client can create just as great a hindrance to her successful performance of her official duties as an actual clash. An actual clash between the interests of *I* and *P* (or clash between *I's* desire to promote the interests of some third party and the interests of *P*) is not sufficient to create a conflict of interest. This clash must somehow hinder *I* in the performance of her official duties.[7]

2. My definition does not require that the individual *fail* to perform her official duties in order for there to be a conflict of interest. It only requires that the situation makes it *difficult* for *I* to perform her official duties. Our ordinary concept of a conflict of interest is consistent with my definition on this score. Consider the following example. A business executive makes a hiring decision. Her official duties require her to hire the best person for the job. She hires her best friend for the position. This case could be a conflict of interest, even if the friend is the applicant best qualified for the job. Conflicts of interests can exist even when officials actually discharge the duties of their positions.

3. *I's* desire to promote (or diminish) the welfare of members of particular ethnic or religious groups can create conflicts of interest if *I's* desire conflicts with the interests of *P*.

4. Bribery is a special case of a conflict of interest.[8] To be bribed is to be paid to do things that are incompatible with the duties of one's office, position, or role.[9] The recipient's personal financial interest in accepting the bribery payments creates a conflict of interest. One's interest in receiving the bribery payment creates a conflict between one's personal interests and the interests of *P*. For example, when a policeman is bribed to ignore a traffic ticket he is being paid to ignore his official duties. His official

duties require him to issue traffic tickets to all who violate traffic laws. In order for the bribery offer to create a conflict of interest, the offer must be sufficiently large to *tempt* the officer to ignore his duties. An offer of ten cents would not make it difficult for the officer to fulfill his official duties and, therefore, would not create a conflict of interest. An extremely wealthy person is less likely to be tempted by (*monetary*) bribes than other people. There may be some truth to the adage that wealthy politicians are less likely to be corrupted than politicians of modest means.

5. My definition implies that a person can be involved in a conflict of interest only if he is employed by others (this includes those who work for clients) or has "official" duties in virtue of holding a position in an organization. Those who have no official duties as employees, professionals in private practice, or members of organizations cannot have conflicts of interest. Consideration of nepotistic employment practices supports this feature of my analysis. Such practices clearly constitute conflicts of interest when the person who hires his friends or relatives is himself an employee or officer of an organization. For example, a conflict of interest exists if I am a personal officer in a corporation and hire a close personal friend for a job with the corporation. Suppose, however, that my uncle hires me to work for a business which he owns. This would not be a conflict of interest, because he has no duties attaching to his job or position which conflict (or might conflict) with my interest in being hired.[10] His position as owner of the business carries with it no obligation to hire the best people for positions within the business. To take another example, it would not be a conflict of interest if I were to hire my brother to paint my house, but it would be a conflict of interest if I were to hire him to do painting for my employer.

Two alternative definitions

1. *Black's Law Dictionary. Black's Law Dictionary* (fifth edition) gives the following definition of "conflict of interest":

> Term used in connection with public officials and fiduciaries and their relationship to matters of private interest or gain to them. Ethical problems connected therewith are covered by statutes in most jurisdictions and by federal statutes on the federal level. Generally, when used to suggest disqualification of a public official from performing his sworn duty, the term "conflict of interest" refers to a clash between public interest and the private pecuniary interest of the individual concerned.

This definition is unduly narrow in that it restricts conflicts of interest to cases involving public officials. Our ordinary concept of a conflict of interest is also applicable to officials of private businesses and to members of professions who are hired by clients. When reformulated so as to allow for this, the definition in *Black's Law Dictionary* comes to something like the following:

> A conflict of interest exists in any case in which an individual having official or fiduciary duties "disqualifies" himself from doing those duties because of conflict between his official duties and a private interest of the individual.

We need to ask what is meant by "private interest of the individual" If this is taken to mean that the person's own self-interest must be in conflict with his official duties, then the modified definition is inadequate. For as we saw earlier, conflicts of interest can be created by *I's* desire to advance or thwart the interests of third parties.

Another ambiguity of the definition in *Black's* is the reference to disqualifying oneself from performing the duties of one's position. If this is taken to mean that an official must actually fail to perform the duties of his position, then the definition is unacceptable for reasons that I gave earlier ("Some Features of the Proposed Analysis" – # 2). If this is taken to mean something weaker, then it may be consistent with my definition.

According to the definition from *Black's*, a conflict of interest cannot exist unless there is an *actual clash* between a *I's* own interests and the interests of *P*. According to my definition, it is not necessary that there be an *actual conflict* between *I's* own interests (or *I's* desire to promote or thwart the interests of third parries) and the interests of *P*. My definition is preferable on this score. (See "Some Features of My Proposed Analysis" – # 1.)

2. *John Boatright's definition.* John Boatright offers the following definition of "conflict of interest":

> As a preliminary definition, then, a conflict of interest may be described as a conflict that occurs when a personal interest interferes with a person's acting so as to promote the interest of another *when the person has an obligation to act in that other person's interest.* This is equivalent to asserting that a conflict of interest arises when a personal interest interferes in the performance of an agent's obligation to a principal.[11]

Boatright says that he only intends his definition to apply to conflicts of interest which occur in business. He does not claim that his definition is adequate for cases involving public officials or professionals such as lawyers.[12]

Boatright's definition differs from mine in several respects. (a) Boatright contends that in order for there to be a conflict of interest, the agent's personal interests must conflict with the interests of the agent's principal. According to Boatright, *I's* desire to promote or thwart the interests of a third party cannot create a conflict of interest; it is not enough that *I* "take[s] an interest in" the welfare of a third party, it is necessary that *I* (herself) gain some "tangible" benefit or advantage ("usually restricted to a financial gain or some kind").[13] This feature of Boatright's definition is highly counter-intuitive. (I refer the reader to the earlier discussion of this matter and the ease of Mayor Daley.)

(b) Boatright claims that "improper use of one's position" can constitute a conflict of interest, even if such cases do not compromise one's duties as an agent. Boatright offers the example of a supervisor who suggests that a new subordinate who is looking for a house use the supervisor's wife as a real estate agent. This example is problematic in that there is a significant possibility that this action will be presented by the subordinate and thus affect the subordinate's morale. But, in that case, the supervisor's actions are at odds with the duties of his position. (His official duties include eliciting the best performance from subordinates.) Boatright's assumption that this is not a case in which the official duties of the agent are compromised is open to question. He needs to find a better example to support his position. It seems to me that cases in which a person uses his position for "ulterior" purposes constitute conflicts of interest only if the discharge of his official duties is jeopardized. Consider the following two examples. Case # 1 – a business executive uses personal contacts from his position to publicize the activities of the local garden club to which he belongs; this neither harms nor benefits his employer. Case # 1 is not a conflict of interest. Case # 2 – a business executive uses his position to make sexual advances on subordinates. Case # 2 is a conflict of interest. Inasmuch as sexual harassment is usually deeply distressing to its victims it also hinders their job performance and thus is contrary to the executive's official duties.[14] Given that the impairment of official duties seems to be part of all paradigm cases of conflict of interest and given the utility of using an evaluative term such as "conflict of interest" to point to a specific kind of moral problem or dilemma, there are strong pragmatic reasons for rejecting Boatright's proposal here.

(c) Boatright notes that his preliminary definition implies that there can be unavoidable conflicts of interest. He finds this unacceptable and proposes a modification in his definition:

> It is necessary to qualify the definition that has been given to avoid cases of the following kind. Lawyers are regarded in the law not only as agents of a client but also as agents of the court. In this dual role, a lawyer might find that delaying a trial unnecessarily is to the advantage of a client. Doing so, however, would be an abuse of the court system and a violation of the lawyer's duty to the court. … I would be reluctant to say that cases of this kind involve conflict of interest, mainly because the term "conflict of interest" implies some wrongdoing that the agent has an obligation to avoid. The cases just described involve systematic features of situations that professionals, such as lawyers and accountants cannot alter. This kind of case can be excluded from the definition by stipulating that none of the agency obligations in a situation arise because of unavoidable systematic features of that situation.[15]

On my definition, unavoidable and systematic conflicts of interests are still conflicts of interest. Indeed, one of my main objectives in Part II is to show how frequently such conflicts of interest occur. This is an important point of disagreement. I will take this up below and argue that, although Boatright's definition is closer to our ordinary use of the term "conflict of interest" in some respects, there are strong pragmatic reasons for accepting the broader definition which I propose.

Is my definition too broad?

My definition is considerably broader than most alternative definitions. Many would regard my theory as counter-intuitive in certain cases. Consider the following cases:

1. An employee is in a position to steal company funds without serious danger of being caught.
2. I have two beautiful children. My desire to spend time with them constantly tempts me to ignore my official duties and call in sick at the office.
3. A soldier has a strong personal interest in not being killed in battle. This makes it difficult for him to carry out his official duties in combat.
4. An SS guard in a concentration camp has difficulty following orders because his moral beliefs make him concerned to promote the welfare of all human beings, including the Jews and Gypsies he has been assigned to guard. He is strongly tempted to allow inmates to escape.

My definition does not count Case # 1 as a conflict of interest. Refraining from stealing money is not a duty which one has in virtue of occupying an office or position. It is an obligation all people have independently of their roles or positions.

Case # 2. Almost all working parents feel torn between their roles as parents and employees. The time and energy one devotes to one role limits that which one can devote to the other. Being a parent is incompatible with completely devoting oneself to one's career. However, this does not mean that all working parents are involved in conflicts of interest. One's *duties* as a parent need not conflict with one's *duties* as an employee. A parent who finds adequate child care and who works "reasonable hours" can fulfill both his duties as a parent and an employee. Almost every day I limit my professional activities in order to spend time with my children. But I almost never fail to perform the *duties* of my position on that account. The *temptation* to ignore my duties and spend the extra time with my children is not a serious obstacle to my performing the duties of my position, particularly when I remember that supporting my children is also one of my most important duties as a parent. A parent whose desire to spend more time with his children created a serious obstacle to his fulfilling the duties of another office would be involved in a conflict of interest.

According to my definition, there can be "unavoidable and systematic" conflicts of interest. (My Case # 3 seems to be such a case.) Boatright finds this objectionable for reasons noted earlier. I agree with Boatright that no moral disapprobation ought to attach to agents in unavoidable conflicts of interest. But I see no reason to follow Boatright and revise the definition in such an *ad hoc* way. Given the firmness of our conviction that agents ought not to be blamed for unavoidable circumstances, no unwarranted disapprobation attaches to someone if we say that she was involved in an "*unavoidable conflict of interest.*" However, even if the agent is not culpable for the existence of unavoidable conflicts of interest, such conflicts are still morally problematic and need to be taken into account by all affected parties.[16] Boatright and I both define "conflict of interest" in terms of *I's* having desires or loyalties which hinder her in the discharge of her official duties. Situations which create such desires or divided loyalties can be either avoidable or unavoidable. This fact is most perspicuously expressed by allowing that either kind of situation can create conflicts of interest and distinguishing sharply between "avoidable" and "unavoidable" conflicts of interest.

Case # 4. Some find it counter-intuitive to say that a conflict of interest exists when the desires (of *I*) which conflict (or might conflict with) the interests of *P* derive from impartial benevolence or other moral considerations. For my own part, I do not find this consequence of my definition to be counter-intuitive. Contested intuitions about these kinds of cases do not provide compelling reasons to make restrictions on the kinds of desires which can create conflicts of interests. It *would be* a matter of grave concern if my definition of "conflict of interest" committed us to the view that it would be wrong for the guard to permit inmates to escape. But by calling Case # 4 a conflict of interest is consistent with the view that the guard ought to allow the inmates to escape; it is also consistent with saying that he lacks even a *prima facie* moral obligation to fulfill his official duties (see below III.3).

I concede that my definition is at odds with some people's linguistic intuitions about the proper use of the term "conflict of interest." But since people have different intuitions about the proper use of the term, no definition can possibly be consistent with everyone's linguistic intuitions. Further, in at least some cases the linguistic intuitions which oppose my definition can be attributed to a blindness of common opinion in failing to perceive serious moral problems. Many people are reluctant to count as conflicts of interest cases which they do not regard as morally problematic. Almost everyone can see the moral problems involved when a judge makes a ruling affecting a company in which he owns stock; and we would all acknowledge this as a conflict of interest. Many people fail to perceive the moral dilemmas created by the self-regulation of professions and are therefore reluctant to claim that conflicts of interest exist in such cases. Some uses of evaluative terms which presently seem counter-intuitive might not seem counter-intuitive to us in the light of heightened awareness of relevant moral considerations. For example, it might seem counter-intuitive to most people to call X a "sexist practice." This fact about people's linguistic intuitions would create some presumption against definitions of sexism which count X as a sexist practice. But this presumption could be overturned if those who find this use of the term "sexist" counter-intuitive were oblivious to certain morally relevant (and morally objectionable) features of X.[17]

I define "conflict of interest" in terms of a certain kind of conflict: a conflict between *I's* interests (or his desire to promote or thwart the interests of third parties) and the interests of *P* which makes it difficult for *I* to discharge his official duties to *P*. This sort of conflict is a feature of all paradigm cases of conflicts of interest; it is also a little noticed feature of a large range of other cases which our linguistic intuitions are reluctant to call conflicts of interest. It is useful to extend the term "conflict of interest" to these other cases. This helps us to *point out* and take notice of the similar morally problematic character of a large number of other cases which are not ordinarily taken to be problematic. (I defend this at length in the next section of the paper.)

II. The Pervasiveness of Conflicts of Interest

Our ordinary picture of a conflict of interest is one in which some personal or financial relationship *external* to one's position makes it difficult for one to perform the duties of one's position. A conflict of interest is caused by some external factor which conflicts with one's *presumed* interest in advancing the interests of one's employer, client, or organization. This picture is, I believe, profoundly mistaken, It assumes a far greater harmony between the interests of individuals and those whose interests they are supposed to serve than is actually the case. The interests of employees are routinely opposed to those of their employers. Similarly, the interests of "self-employed" professionals are routinely opposed to those of their clients.

1. *Bureaucracies*. Almost any member of a bureaucratic organization has some interest in being promoted or advancing his/her career. In such organizations promotion and advancement are determined largely by one's experience and seniority relative to fellow workers. This means that almost all members of bureaucracies benefit from increases in the size of the bureaucracy. If one's department or division is enlarged by hiring new people, one's seniority and experience relative to that of fellow workers are thereby increased and one's chances of being promoted are also increased.[18] A good illustration of how limitations on the size of one's organization can limit one's prospects for promotion is the fact that, as late as 1936, after having been in the US Army for more than twenty years, Dwight Eisenhower had only attained the rank of major. Eisenhower had shown himself to be an extremely able officer,[19] but he had almost no chance for promotion given the small size of the Army and its policy of promoting officers solely on the basis of seniority. Eisenhower was very unhappy with his career prospects and seriously considered leaving the military.[20]

Employees have a strong vested interest in the expansion of the size of the bureaucracies of which they are a part. However, those whose interests they are supposed to serve, e.g., the stockholders, owners of their companies, or the citizens or taxpayers, have an interest in limiting the size of bureaucracies. Other things being equal, any increase in the size of the government bureaucracy increases the burden on tax payers. Unneeded bureaucrats in private businesses diminish returns to shareholders.[21] Members of bureaucratic organizations are often in a position to influence decisions regarding the size of their organizations. (For example, the members of a bureaucracy typically submit reports evaluating the needs and performance of their own departments. Such reports can be slanted so as to suggest a greater need for continued or increased funding than is actually the case. This problem is particularly acute when the members of the bureaucracy possess special technical expertise which others lack, e.g., military officers.)[22] The fundamental conflict of interest in (most) bureaucratic organizations consists in the following: in order to serve the interests of those they are supposed to serve, members of a bureaucracy must act so as to limit the size of the organizations of which they are a part; however, their own career interests require them to promote the expansion of the bureaucracy.[23] Many have noted a tendency for bureaucracies to expand almost without limit. This phenomenon is no accident. It is explained by the career interests of bureaucrats. Members of bureaucracies tend to act so as to expand the size of the organizations and departments of which they are a part, because it is in their own self-interest to do so.

An even more obvious point is that members of bureaucracies have a personal interest in not being dismissed from their positions. This means that it is generally in their interests to combat attempts to eliminate positions within the bureaucracy, even when doing so would best serve the aims of the larger organization.

2. *Hiring*. Sometimes individuals with a voice in hiring decisions will be in competition with the people who are hired in future decisions regarding retention and promotion. Thus, it may not be in one's own self-interest that one's employer hire the best possible people for openings within the organization. For example, if I am a junior member of an academic department with a fixed amount of money for salary increases and a fixed number of tenure slots, then it is likely to be contrary to my own self-interest for the department to hire anyone whose credentials are superior to my own. For, in so doing, I am likely to obtain smaller salary raises in the future, diminish my relative standing within my department and university, and perhaps even lose my job. (The situation is no different for tenured faculty, except that their job security is not threatened by hiring colleagues who possess superior credentials.)[24] This type of case clearly constitutes a conflict of interest. One's official duties as a member of an academic department include trying to hire the best possible people for any openings that occur in the department. However, one's own personal interests are sometimes best served if one hires people with whom one fares well by comparison.[25]

3. *The Self-Regulation of Professions*. The self-regulation of professions creates many possibilities for conflicts of interest. In self-regulating professions, members evaluate each other's work and hear grievances against other members. Conflicts of interest arise because the kinds of evaluations and judgments one makes about other members of the profession are likely to influence the way in which one's own work and conduct are evaluated and judged. A person who makes unfavorable judgments about other members of her profession is liable to be judged more harshly herself as a result. One's official duties as a member of a profession often require that one judge or evaluate other members of the profession in accordance with impartial standards. This often conflicts with one's personal interest in not antagonizing other members of one's profession. Consider just a few commonplace examples from the academic profession.

(i) A member of an academic department sits on a grievance committee which hears a student's complaint against a colleague. If she sides with the student she is likely to antagonize her colleague and his friends. Unless she is in an unusually strong position within the department, this would be contrary to her own self-interest. The people she antagonizes will later sit in judgment on her in decisions regarding her promotion and tenure, salary, leaves of absence, and (possibly) grievances filed against her.

(ii) I am in charge of an academic conference for which papers are submitted to be read and chosen competitively. The papers have been blind-reviewed by others, but I am aware of the identity of the authors. One of the papers submitted was written by the editor of a major journal in which I am *dying* to publish. It will be difficult, if not impossible, for me to choose impartially between this paper and the work of an obscure philosopher.

The tendency of members of professions to tolerate the incompetence and misconduct of colleagues is well-known and widely acknowledged.[26] These phenomena are in large measure explained by the conflicts of interest inherent in self-regulation.

4. *Payment of Professionals*. Michael Bayles argues that there exists a "fundamental conflict of interest" in any relationship between a client and a professional person. This conflict of interest is created by the professional person's interest in income and leisure. When professionals are paid on a fee for service basis they have an interest in providing more services than are either necessary or desirable for their clients. For example, when physicians are paid according to how much work they do for their patients, many physicians succumb to the temptation to provide their patients with unnecessary, even dangerous treatments. Bayles continues:

> Alternative systems of paying professionals do not remove this conflict but merely reverse the effect on the client. In a capitation payment system, professionals have an interest in having as many clients as possible to maximize their income and in performing as few services as possible to minimize their costs. On a salary system or flat fee for a case, professionals receive the same income no matter the number of clients or services performed, so they have an interest in minimizing clients or services. These payment systems thus encourage professionals not to perform useful services.… This fundamental conflict of interest between professional and client cannot be removed. It is inherent in the professional-client relationship.[27]

5. *Technological Change*. It is often in a person's own self-interest that her employer continue to use certain technologies or adhere to certain plans, irrespective of the actual merits of those technologies or plans. Most employees have a strong interest in resisting new technologies which would render their skills and knowledge obsolete. Few of us are willing to suggest or consent to changes which would cost us our jobs.

Military history provides many striking examples of officials who continued to support outmoded technologies in which they were proficient. After the First World War Poland fought a series of wars with the Soviet Union and a short-lived Ukrainian state. Polish Cavalry played a major role in these campaigns. Between the two world wars the Polish military continued to rely heavily on mounted troops and resisted the efforts of those who sought to modernize it. The combat on the western front during the First World War took place on a static front with deep entrenchments and involved the massive use of artillery. After the war the French military anticipated a similar situation in the next war and spent enormous sums of money on the heavily fortified Maginot Line. The French military establishment bitterly opposed De Gaulle's proposals to create a corps of six mobile tank divisions.[28] Some historians contend that French military authorities were motivated by concern for career advancement in their decisions about armored units.[29] It is reasonable to suppose that these considerations also influenced the deliberations of the Polish military. (I will have more to say about both of these cases below (II.6).)

6. *Intangible Interests*. We desire certain things not for the sake of any tangible benefits which they afford anyone, but because they bolster our pride or sense of self-esteem (or the pride or self-esteem of those dear to us). Intangible interests can create conflicts of interest. Let me give a few brief examples of this. Case # 1: I created and implemented a set of policies and procedures followed by my employer. I am extremely proud of these policies and would view any departure from them as a repudiation of my efforts on behalf of the organization. My interest in the perpetuation of what I have done seriously distorts my judgment regarding alternative policies. I would be involved in a conflict of interest if my official duties required me to assess the merits of alternative policies proposed by others. Case # 2: I am seriously deficient in self-confidence and self-esteem. As a consequence, I am unwilling to tolerate any serious criticism from subordinates. Yet the duties of my position require me to solicit and heed the criticisms of subordinates.

Pride, reluctance to admit error, and other intangible interests probably played more of a role in the calamitous decisions of the French and Polish armies (alluded to above [II.5]) than did the concern for individual career advancement. Marshall Pilsudski led the Polish Army in its wars with Russia after the First World War. Pilsudski and other leaders of the Polish Legion greatly exaggerated their achievements during these wars. They created a popular mythology about the spirit of the Polish military and its cavalry units. This blinded them to developments in military technology which rendered cavalry obsolete. Pilsudski was virtual dictator of Poland from 1926–1935, and he and his comrades from the earlier wars succeeded in opposing attempts to modernize the Polish Army.[30] Similarly, the French military had spent so much money on the Maginot Line that it was unwilling to consider seriously the need for alternative strategies. In 1934 Charles De Gaulle published a book *Toward a Professional Army* in which he advocated the creation of six tank divisions within the French Army. This would have given the French Army offensive capabilities which it lacked. This was crucial in view of France's system of alliances with countries in Central and Eastern Europe. In order to provide assistance to its eastern allies, France had to be prepared to attack Germany in case the Germans marched east. (In 1939 when Germany invaded Poland, the German forces opposite France consisted of only 25 second rate divisions; the French and British had 110 divisions, but did not attack Germany.)[31] A mobile armored force was also needed in order to repel a German attack through Belgium. (The Maginot Line did not extend along France's borders with Belgium. Germany invaded France through Belgium during both world wars.) In 1935 Paul Reynaud made an unsuccessful attempt to persuade the French Parliament to adopt De Gaulle's proposal for the creation of armored divisions. General Maurin spoke against this measure. His statement before the Parliament is extremely revealing:

> How can anyone believe that we could think again of taking the offensive when we have spent milliards [billions] to establish a fortified barrier? Are we to be so mad as to advance in front of this barrier? That, Gentlemen, shows you the mind of the government. For the government, at least as far as I am concerned, knows perfectly what the plan of the next war will be.[32]

III. The Moral Status of Conflicts of Interest

(1) *If it is Wrong to be in a Conflict of Interest, What Should One Do in Order to Avoid Doing Wrong*? Whenever one claims that another person acted wrongly, one must be able to point to some alternative course of action that the agent should have taken. "Ought not" implies "should do otherwise." Thus, when we criticize someone for acting so as to create a conflict of interest (or so as to allow one to occur) we must be prepared to specify what it is that the person in question should have done instead. Often individuals have no responsibility for the existence of conflicts of interest in which they are centrally involved. A judge does not act wrongly simply in virtue of the fact that a friend or a relative appears before her in court. However, the judge would probably be acting wrongly if she failed to eliminate the conflict of interest by disqualifying herself and allowing someone else to try the case.[33] Often, conflicts of interest can be avoided if *I* asks someone else to assume her official duties. Sometimes one should not reveal the existence of the conflict of interest, but simply turn over the decision to some other party without giving a full explanation of the circumstances. For example, suppose that I am a corporate executive. The daughter of a personal friend applies for a position in the company. I am the person who has the power to make hiring decisions concerning the position for which she has applied. It would constitute a conflict of interest for me to decide on the merits of her application. I should ask a subordinate to make a decision in my stead. If he were aware of my connection with the applicant, the subordinate might feel some pressure to hire my friend's child; this itself could create a conflict of interest. I should ask the subordinate to make the decision without explaining my connection to the applicant. If she is applying for a position in which she would be my subordinate and would be evaluated by me, then hiring her would *create* a conflict of interest regardless of the manner in which she is hired. (It would be a conflict of interest for me to evaluate her work.) In that case, there is a strong presumption for thinking that I should try to persuade my friend's daughter to withdraw her application, or failing that, refuse to consider her application.

There are cases in which an individual finds himself in a conflict of interest which he can neither remove nor avoid short of resigning his position. For example, one might be the only person in an organization with the authority to decide a case affecting the interests of a close friend. Instead of immediately resigning it would usually be permissible for one to inform all of the affected parties and try to obtain their informed consent to the situation.[34] (I will have more to say about this sort of case later.)

(2) *The Moral Presumption Against Allowing "Avoidable" Conflicts of Interest Which Result in One's Failing to do One's Official Duty*. In this section I consider conflicts of interest in which one fails to do one's official duty. Later on (in Section III.6) I will take up cases in which one fulfills one's official duties and acts in the interest of one's employer or organization, in spite of the existence of the conflict of interest. I shall argue that, except in unusual cases, it is *prima facie* wrong to allow oneself to become involved in an avoidable conflict of interest which prevents one from doing one's official duty. I understand the expression "*prima facie* wrong" in the sense that it is explained by Ross in *The Right and Good*.[35] An act's being *prima facie* wrong constitutes a reason (a moral reason) not to do it. If an act is *prima facie* wrong, then it is wrong, all things considered, unless there is an even weightier reason or justification for doing it.

Suppose that someone fails to perform the duties of her position because of a conflict of interest.Two sorts of arguments can be given to show that this is *prima facie* wrong. First, it usually results in bad consequences when one fails to perform the duties of one's office. Organizations have objectives which require the coordination of the actions of many different individuals. Creating offices with carefully defined duties attaching to them helps organizations to coordinate the actions of different individuals. Organizations rely on individuals to fulfill their official duties. Anything which prevents one from carrying out the duties of one's office is likely to hinder the organization in the pursuit of its objectives. Most organizations have morally acceptable ends; the frustration of these ends is usually bad (see III.3). Similar kinds of considerations apply to professionals who work for individual clients. Failing to carry out one's duties to clients tends to frustrate the clients in the pursuit of their (morally acceptable) goals.

Conflicts of interest are often impossible to keep secret. A person who allows herself to be involved in a conflict of interest risks being found out. The appearance of a conflict of interest can create substantial harms. It can arouse resentment and undermine trust and morale within an organization and often greatly detracts from the reputation and credibility of those involved. It is often said that people not only have a duty to avoid conflicts of interest, but also a duty to avoid the appearance of conflicts of interest. I will not pursue this issue in the present paper. My argument here is that any considerations which weigh against creating the appearance of a conflict of interest also weigh against allowing actual conflicts of interest. (By allowing an actual conflict of interest, one risks *appearing* to be in a conflict of interest.)

Offices within organizations and relationships between professionals and their clients carry with them special duties. A person who voluntarily assumes an office within an organization (or who voluntarily takes on a client) tacitly agrees or promises to fulfill those duties.[36] If we allow that it is *prima facie* wrong to break promises, it follows that avoidable conflicts of interest that cause one to fail to perform one's official duties are also *prima facie* wrong on account of being instances of promise breaking.

It is a matter of controversy whether breaking promises is *prima facie* wrong; most consequentialists would deny this. It is far beyond the scope of this paper for me to try to settle this issue. However, the view that it is *prima facie* wrong to harm others is not open to serious question.This principle alone creates a strong moral presumption against (unavoidable) conflicts of interests. If promise breaking is also *prima facie* wrong, then the presumption against allowing avoidable conflicts of interest is even stronger.

(3) *Positional Duties Can Be Overridden, Duties Attaching to Offices or Positions Within Immoral Organizations or Professions May not Even Generate Prima Facie Moral Duties, but Such Cases Are Unusual.* The "positional duties" which are compromised in conflicts of interest are only *prima facie* duties and can sometimes be overridden by other, more important, duties. It is not difficult to imagine cases in which such duties would be outweighed by other more important duties. A person who has very weighty financial obligations, e.g., feeding his children, which he cannot otherwise meet, might be justified in being involved in an avoidable conflict of interest. The duties of one's position, carry little, *if any*, moral weight unless the goals or purposes of the employer or organization are morally permissible. This condition is not

satisfied if one is an employee or official of a criminal gang, a government bent on wars of conquest, or a tyrannical government. All things considered, it is not wrong for a member of a criminal gang to gather evidence against the gang in return for a grant of immunity from criminal prosecution. The offer of immunity is tantamount to a bribe and creates a conflict of interest.

The great majority of businesses, government agencies, and professions in our society pursue morally permissible ends. The goods and services provided by these entities satisfy wants of individual human beings (wants which are consistent with the demands of morality) and thus afford benefits to those to whom they are provided. Special problems are posed by cases involving government officials. Consider the following argument: in non-tyrannical governments which are not engaged in aggressive wars, government officials have a *prima facie* duty to avoid conflicts of interest, because by allowing conflicts of interest to exist, they prevent agencies of government from functioning as they were intended (and thereby harm the general public).

The foregoing argument assumes that the agencies of government promote the general welfare when they fulfill their intended functions. Libertarians would reject this assumption. There is a great deal of controversy about the proper functions of government. I will not be so foolish as to enter into this controversy in the present paper. I would be happy if my arguments succeeded in showing that it is usually wrong, all things considered, for business people and members of professions to be involved in avoidable conflicts of interest. However, let me briefly outline an argument for the stronger conclusion that in ordinary cases it also is wrong (all things considered) for government officials to allow themselves to be parties to avoidable conflicts of interest. Suppose that we grant the libertarian's claim that, at present, most government employees in the United States perform functions which should not be performed by government. It doesn't follow that these employees have no reason to perform their official duties or that those officials who faithfully perform their duties do not thereby promote the general welfare. The libertarian must distinguish between the following:[37] (1) useful goods and services presently provided by the government which she thinks should be provided by private organizations, e.g., education, postal service, housing, health insurance, inspection of food and drugs, and support for the arts, and (2) things which the government does which she thinks should not be done by any party, e.g., licensing of professions, laws mandating minimum safety standards for food, drugs, automobiles and other potentially hazardous goods. Clearly, all government officials whose responsibilities fall under the first heading promote the general welfare when they do their jobs well. A similar line of argument could be given to show that those who oppose private ownership of the means of production are not thereby committed to the view that employees of privately owned businesses have no moral obligation to fulfill their official duties. Whatever one's views about the merits of private ownership of businesses, it is clear that most workers in private industry contribute to the production of useful goods and services.

(4) *Obtaining the Consent of Affected Parties.* Sometimes conflicts of interest can be avoided only if *I* resigns from her position. This often constitutes a serious hardship for the individual in question and it might also be harmful to those she serves. Many would think it unreasonable to require that *I* resign in such cases. An alternative to resigning would be to inform all of the interested parties of the conflict of interest and ask them to either: (i) remove one from one's position (or request one's resignation), or (ii) consent to one's continuing in one's position in spite of the conflict of interest. From a consequentialist perspective this seems preferable to simply resigning one's position. Suppose that I inform my employer of a conflict of interest in which I am involved. As a result, the employer will either (i) remove me from my position, or (ii) consent to the conflict of interest. If (i) occurs then the consequences of my informing the employer are just the same as those of my resigning. But if the employer consents to the conflict of interest (and if there are no third parties whose interests are significantly affected), then there is a strong reason to think that this outcome is preferable to my resigning. An outcome preferred by *all* the parties whose interests are at stake is very likely to be a better outcome than the one to which it is preferred.[38]

(5) *In Ordinary Cases it Would be Wrong, All Things Considered, for One to Permit and Fail to Report Conflicts*

of Interest which Result in One's Failing to Perform the Duties of One's Position. I will begin my argument by offering a typology of the kinds of *prima facie* duties that apply *(or might apply)* in such a case.

1. The duty to benefit others and avoid harming others.
2. The duty not to lie or deceive others.
3. "Special duties" to promote the interests of (or act in accordance with the wishes of) people to whom one has made promises and others to whom one stands in morally significant relations, e.g., family, friends, those from who one has received benefits, and people one has wronged. (If there are special duties of this sort, then they can sometimes override utilitarian considerations.)

Ross distinguishes between the obligation to keep promises and obligations of gratitude and reparations. All these count (or can count) as "special duties to others." They can all be the basis of obligations to help particular parties (or act in accordance with their wishes), even to the detriment of the general welfare. The duty not to lie or deceive others can also constitute a justification for failing to bring about the best consequences.

My argument is as follows: (1) in typical cases in which one fails to do one's official duty because of an unreported conflict of interest the net balance of good and bad consequences (benefits and harms) that results is less favorable than it would have been had one avoided or reported the conflict of interest. (2) Allowing a conflict of interest to occur (and keeping it secret) makes it more likely that one will lie or deceive others. (3) *If* consequentialism is mistaken and there are "special duties" in the sense that I have just explained, then in ordinary cases the special duties to one's employer or organization are at least as weighty as any conflicting special duties that one might have. Given these three assumptions, it follows that in typical cases it is wrong, all things considered, to allow and fail to report an avoidable conflict of interest which prevents one from discharging the duties of one's position.

This result holds independently of the truth or falsity of utilitarianism as a theory of right and wrong. (This is important, since I am in no position to either defend or attack utilitarianism in the present paper.) My argument that there is a substantial, but possibly overridable, moral presumption against conflicts of interests is compatible with either utilitarianism or a view such as Ross's according to which there are several ultimate *prima facie* moral principles. But my argument is not compatible with the view that any of the duties which are violated in conflicts of interest are absolute or exceptionless duties. For example, if it is always wrong to break a promise no matter what the consequences, then there is an absolute prohibition against allowing avoidable conflicts of interest which cause one to violate (implicit) promises to one's employer or client.[39] I have said nothing about rule or indirect consequentialism. However, if successful, my arguments to show that allowing and failing to report conflicts of interest generally has bad consequences provide strong reasons to think that optimific moral codes will provide for strong prohibitions against conflicts of interest. The results of the second section of the paper strengthen this contention. Conflicts of interest are a very pervasive phenomenon and need to be seriously addressed by any acceptable public code of morality.

A defense of assumptions 1 and 3[40]

In ordinary cases, allowing and failing to report conflicts of interest which result in one's failing to do one's duty results in more bad than good.The kinds of bad consequences noted earlier (III.2) are typically not outweighed by countervailing good consequences. The economic or other tangible goods gained by an individual or her connections as a result of the conflict of interest are goods, which otherwise would have been enjoyed by someone else. Conflicts of interest generally redistribute wealth and other goods, but they rarely promote the creation of goods or benefits. Clearly, there will be cases in which the benefits obtained by the individual or her connections as a result of a conflict of interest exceed the benefits that would have been realized (by someone else) had there been no conflict of interest. But this is not generally the case. In ordinary cases, the benefits brought about as a result of a conflict of interest are no greater than the benefits that would have been enjoyed by other parties had there not been a conflict of interest. For example, the benefit which a person enjoys when she is hired on the basis of personal considerations is, on average, no greater than the benefit that would have been enjoyed by the person who otherwise would have received the job. Most conflicts of interest which result in one's failing to do one's official duty also have other bad consequences (thwarting the aims of one's employer or organization) which tip the balance of consequences against the conflict of interest.

In most cases the consequences of unreported conflicts of interest which cause one to be derelict in the performance of one's official duties are worse than the consequences of avoiding them. I shall now argue that in ordinary cases of conflicts of interest the special duties (if any) that one has to friends, family members, and others which might provide one with reason to violate one's official duties do not outweigh one's special duties to one's employer or organization. (I should like to stress that I am not assuming that there are any "special duties" to help others. I am only claiming that if it is reasonable to suppose that such duties are created by friendship, "favors," and family ties, then it is also reasonable to suppose that there are special duties created by one's implicit and explicit agreements with one's employer, client, or organization.)

One's special duties to one's own children are as weighty as any that one might have. So, if we can show that these duties do not outweigh one's special duties to one's employer, client, or organization in ordinary cases of conflicts of interest, we can be reasonably sure that special duties to friends, family, etc., rarely outweigh one's duty to fulfill the duties of one's position. Consider a case in which an employee is in a position to benefit his own child as a result of a conflict of interest, e.g., the case of Mayor Daley of Chicago. Let us grant that parents have some special duty to provide financial assistance to their adult children. Mayor Daley could fulfill this duty to his son by giving him the insurance contract with the city. But the mayor could to other things to help his son which do not violate his official duties. The mayor could give his own money to his son or he could devote his own time and expertise to helping the son to manage his business. Daley's duty to help his son does not require him to violate other important duties. Similarly, although my duty to provide for my children is much more important than my duties to the neighborhood grocer, I am not justified in stealing from the grocer in order to provide for my children.[41] Finally, if we depart from consequentialism and allow for such special duties as a parent's duty to help his own children, it also seems plausible to posit a special duty to keep promises. The obligation to keep promises clearly weighs against allowing conflicts of interest which causes one to fail to fulfill one's official duties.

To sum up the foregoing argument, in ordinary cases the consequences of allowing and failing to report conflicts of interest which cause one to violate one's official duties are worse than the consequences of avoiding or reporting them. The duty not to lie or deceive others (if there is such a duty) generally weighs against allowing and failing to inform people of conflicts of interest. In ordinary cases, one's special duties (if any) to friends, family members, or others who might benefit from the conflict of interest, can be fulfilled in other ways. Further, any such special duties are largely counter-balanced by one's obligation to keep implicit promises to one's employer.

(6) *Cases in Which Officials Perform the Duties of Their Offices in Spite of Unreported Conflicts of Interest.* Suppose that in spite of an unreported conflict of interest one discharges one's official duties and acts in the interest of one's employer.[42] For example, suppose that I hire the son of a friend and it turns out that he is the person best qualified for the job. Suppose also that no one finds out about his connection with me so that the morale of his department or section is not adversely affected by speculation about favoritism. In this case I fulfilled my duty to hire the best person for the job.[43] But my conduct is still objectionable on other grounds. I am guilty of having knowingly *risked* failing to do my duty. When I considered my friend's son for the position, I knew that (1) I might deceive myself into thinking that he is the applicant best qualified for the job, even if he is not, and (2) I might be tempted to hire him, even if I judge him not to be the best qualified applicant. I knowingly did things which might have caused me to fail to do my duty. This itself is morally objectionable. Here I would appeal to the following principles:

1. It is usually wrong to allow and fail to report conflicts of interest which result in one's failing to perform the duties of one's position (this was defended above III.5).

2. Other things equal, it is morally wrong to risk doing something which is morally wrong (all things considered).

Note that # 2 is perfectly consistent with consequentialism. If consequentialism is true, then an act is morally wrong if it fails to result in the best consequences. From this it follows that, other things equal, it would be wrong to risk failing to bring about the best consequences. Here, I am assuming that the consequentialist assesses the rightness or wrongness of actions in terms of their *expected consequences* (as opposed to their actual consequences). This raises controversial issues within the utilitarian tradition – issues which I cannot hope to resolve here. "Actual consequence" versions of act-consequentialism, entail that it is permissible to allow (and fail to report) conflict of interest in some cases in which "expected consequence" versions of consequentialism entail that this is not permissible. (The cases in question are ones in which the actual consequences of allowing and failing to report conflicts of interest are no worse than the consequences of avoiding or reporting them, but the "expected consequences" of allowing and failing to report conflicts of interest are worse than those of avoiding or reporting them.) But note the following: (a) In such cases, the "actual consequence consequentialist" would still say that the agent's choice was rationally indefensible under the circumstances, and (b) From the point of view of the agent deliberating about what to do the difference between actual and expected consequence versions of (act) consequentialism is of no practical significance. There is no difference between trying to do what will have the best consequences and trying to do what will have the best expected consequences. On either version of act-consequentialism, the difference between the goodness actually achieved by an action and the goodness which one can reasonably expect to achieve by it is relevant only to the retrospective assessment of actions.

(7) *The Obligations of Other Parties*. To this point, our discussion of the moral status of conflicts of interest has focused on the conduct of the individual *I* whose duties are compromised by the conflict of interest. It is appropriate that our discussion should pay special attention to the conduct of this party. From the moral point of view, the most salient feature of conflicts of interest is the compromising of "positional" duties. The wrongness of what others might do in cases of conflicts of interest derives from the wrongness of a person compromising the duties of her position. But we should also consider the conduct of the other parties involved in conflicts of interest, in particular, those who act so as to bring about conflicts of interest or who act so as to make it difficult for others to avoid conflicts of interest. I am thinking particularly of cases in which the interests of one's friends, (or family members) conflict with one's official duties. For example, suppose that my nephew applies for a position in my firm. In so doing he creates a conflict of interest. He and other family members might also do things which make it difficult for me to escape from the conflict of interest. Suppose further that I ask him to withdraw his application because of the conflict of interest. He might refuse and he and his parents might bring various sorts of pressures to bear on me. What they do in this case is *prima facie* wrong (perhaps very wrong). I think that the following variation on Principle 2 (from Section III.6) can be defended:

2′. It is *prima facie* wrong to attempt to pressure someone else to do something that is wrong all things considered.[44]

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Notes

[1] Such a case occurred in Chicago during the early 1970s. The city purchased a substantial amount of insurance through Mayor Richard J. Daley's (Richard I's) son John (brother of the current mayor). John Daley received more than $100 000 in commissions from the city contracts. The mayor is reported to have said that his critics could "kiss my ass" if they thought that it was wrong for a father to help his sons (Len O'Connor, *Clout: Mayor Daley and His City* [Chicago: Contemporary Books, 1984, pp. 238–239]).

2 In 1963, exploratory drilling by the Texas Gulf Sulfur Company indicated the presence of a rich body of mineral ore. The ore was located on land to which the company owned the mineral rights. This discovery promised to increase dramatically the value of the company's stock. In a press release of April 12, 1964 company officials tried to minimize the value of the discovery by describing it as a "prospect." On April 16 a second company press release described the results of the drilling as "a major discovery." In the four day interim, several company officials purchased large amounts of Texas Gulf Sulfur stock and realized a large profit. Those stockholders who sold their stock after the first press release lost a great deal of money. Vincent Barry, *Business Ethics*, first edition (Wodsworth, 1979), p. 196.

3 Cf. Joseph Margolis, "Conflicts of Interest and Conflicting Interests," in *Ethical Theory and Business*, Tom Beauchamp and Norman Bowie, (eds.) first edition (Prentice Hall, 1979), pp. 361–372 and John Boatright, "Conflict of Interest: An Agency Analysis," in *Ethics and Agency Theory*, Norman Bowie and R. Edward Freeman, eds. (Oxford, 1992), pp. 187–203.

4 One might wish to go further and say that one's desires regarding buildings and other inanimate objects can create conflicts of interest. I don't think that the definition should be broadened in this way, since that would be inconsistent with the root meaning of the term "conflict of interests." Inanimate objects do not have interests (which can conflict with those of *P*).

5 This is almost entirely overlooked in discussions of conflicts of interest.

6 One might object that, inasmuch as I desire to harm someone (or promote someone's welfare), it is in my own self-interest to harm (benefit) her. But the ill-fare (or welfare of others) does not by itself (apart from its consequences such as giving me pleasure) contribute to my own welfare. It is not analytic that (other things equal) my welfare is enhanced when a state of affairs that I desire obtains. Among other things, this would make it logically impossible for one to desire or prefer actions which are contrary to one's self-interest and thus logically impossible for there to be genuine acts of self-sacrifice. (See Mark Overvold, "Self-interest and the Concept of Self-Sacrifice," *Canadian Journal of Philosophy* 10, 1980, pp. 105–118.) The satisfaction of other-regarding desires does not necessarily contribute to one's own personal welfare.

7 In order for the conflict between the interests of one's employer or organization (etc.) and the interests of one's friends or family (etc.) to make it difficult for one to fulfill one's official duties, one must have some desire or preference to the effect that the interests of one's family or associates be advanced. Consider the following case: a person has no special interest in or attachment to her third cousin. Her official duties conflict with the interests of the cousin. The conflict between the interests of her cousin and those of her organization will not create any difficulty for her in fulfilling her official duties. On my view, such a case would not constitute a genuine conflict of interest. Less probably, suppose that *I* is completely indifferent to the welfare of his own daughter. Cases in which his daughter's best interests conflict with those of *P* would not constitute conflicts of interest, because they would not make it difficult for him to discharge his duties to *P.* I would describe such cases as apparent, but not actual, conflicts of interest.

8 Cf. Joseph Margolis, "Conflicts of Interest and Conflicting Interests," p. 364; Neil Leubke, "Conflicts of Interest as a Moral Category," *Business and Professional Ethics Journal*, Spring 1987, p. 70; and John Boatright, "Conflict of Interest: An Agency Analysis," p. 189.

9 I have defended this analysis at some length in "Bribery, Extortion and 'The Foreign Corrupt Practices Act,'" *Philosophy & Public Affairs*, 1985, pp. 66–90. Also see my "Bribery and Implicit Agreements: A Reply to Philips," *Journal of Business Ethics*, February 1987, pp. 123–125.

10 It is permissible for my uncle to engage in nepotistic hiring. However, if he does so he should not advertise the position or interview other people for the job, since that would give others the false impression that they are *competing* with others and that they will be judged on their merits.

11 "Conflict of Interest: An Agency Analysis," pp. 191–192. Boatright calls this a "preliminary definition." He qualifies the definition later on (I discuss this below), but never reformulates the definition in light of these qualifications.

12 "Conflict of Interest: An Agency Analysis," pp. 187– 188.

13 Boatright, p. 192.

14 Sexual harassment is wrong primarily on account of the harm it causes those who are harassed. It can also be wrong on account of the harasser's failure to discharge his duties to third parties (his employer or client, etc.).

15 Boatright, p. 193.

16 See Part III where I argue that agents involved in unavoidable conflicts of interest are still usually obligated to inform their principals about the existence of such conflicts.

17 I am *not* imagining a case in which people come to regard X as objectionable as a result of revising their basic moral principles. Rather, I am thinking of a case

in which certain *facts* about X are brought clearly to light, and we come to see that X is objectionable.

18 In most European and American government bureaucracies, a bureaucrat is rewarded for simply increasing the number of people she supervises. Gordon Tullock cites a case in which an engineer invented an automatic shell loading machine. Installation of this machine in major arsenals would have resulted in a substantial savings for the government. But plans to install the machines were rejected by officials at the arsenals because installation of the machines would have jeopardized their civil service grades. Gordon Tullock, *The Politics of Bureaucracy* (Public Affairs Press, 1965), pp. 134–135.

19 During 1925, the US Army sent 275 of its best junior officers to the Army Command and General Staff School for a year of intensive training. Eisenhower was one of the officers chosen and he graduated first in his class. (*Eisenhower*, Volume I, Steven Ambrose, 1983, pp. 83.)

20 *Eisenhower*, Volume I, pp. 101 and 113–118. During this time he was offered several civilian jobs. One of the positions offered him would have paid him five times his military salary, another would have paid him twenty times his military salary.

21 Harms to organizations resulting from the growth of bureaucracies are not confined to the costs of paying bureaucrats. Tullock argues that increasing the size of a bureaucracy often complicates control and communication within the organization so that the organization is, other things equal, less able to achieve its goals (Tullock, p. 150–151).

22 Cf. Gwynne Dyer, *War* (Crown, 1985), p. 218.

23 We might imagine a very different sort of situation in which divisions within a bureaucracy are assigned a fixed amount of money and given considerable discretion as to how they spend that money. In that case, members of the bureaucracy would not have a personal interest in expanding the size of their own divisions. But there is still a serious potential for conflicts of interests. The members of any particular division might have a personal interest in cutting essential positions within the division (in order to increase their own salaries).

24 In order to avoid this kind of situation, universities need to give above average raises to strong departments. Otherwise, it will not be in the financial interests of department members to hire the best possible job candidates.

25 Hiring the best qualified candidates tends to enhance the prestige of academic departments and thus indirectly enhances the prestige of all their members. In this respect, the often excessive concern of academics with professional prestige is beneficial.

26 Michael Bayles defends his view and offers empirical evidence to support it in *Professional Ethics* (Wodsworth, 1981), pp. 130–132.

27 Michael Bayles, *Professional Ethics*, second edition (Wodsworth, 1989), p. 89.

28 See Alden Hatch, *The De Gaulle Nobody Knows* (Hawthorn Books, 1960), p. 74.

29 Duncan Grinnell-Milne alleges that the French Army rejected De Gaulle's plan to create an armored corps of six tank divisions because it would have dramatically reduced the number of troops in the French Army and thus harmed the career prospects of the officer corps. See *The Triumph of Integrity* (The Bodley Head, 1961), pp. 63–64.

30 See *Politics in Independent Poland*, Antony Polonsky (Oxford, 1972).

31 Brian Crozier, *De Gaulle* (Scribners, 1973), p. 84.

32 The reply is cited in *De Gaulle*, by Aidan Crawley (Bobbs-Merrill, 1969), pp. 75–76.

33 Cf. Margolis, "Conflicts of Interest and Conflicting Interests," p. 363. Several distinctions made by Davis are helpful in this context. He distinguishes between "having a conflict of interest" and "acting in a conflict of interest." He also distinguishes between "avoiding" a conflict of interest and "escaping" from one.

34 Cf. Luebke p. 72 and Davis p. 20. Michael Bayles raises a serious problem for this kind of resolution. Sometimes revealing the existence of a conflict of interest to all of the parties whose interests are at stake would violate obligations of confidentiality.

35 W. D. Ross, *The Right and the Good* (Oxford, 1930), Chapter 2.

36 See my papers "Bribery, Extortion, and 'The Foreign Corrupt Practices Act'" and "Bribery and Implicit Agreements: A Reply to Philips" for a defense of this.

37 This distinction is not intended to be exhaustive.

38 Sometimes the existence of a conflict of interest is obvious to all parties. In such cases the failure of other parties to protest or request one's resignation can be tantamount to consenting to the conflict of interest.

39 I cannot fully defend this assumption here. However, I make two observations in support of this. (1) The view that there is an absolute moral prohibition against promise-breaking or lying is extremely counterintuitive. Among other things, it implies that one could not be justified in breaking a promise or lying, even if doing so were necessary in order to save someone's life. (2) Kant is the most important philosopher who holds that there is an absolute prohibition against lying or promising breaking. But, contrary to Kant's intentions, his theory does not support the view that there is an absolute prohibition against promise-breaking. Kant's theory does not support the view that

it is always wrong to break a promise. At most, Kant's theory only supports the view that there is a strong moral presumption against breaking a promise. I will now defend this at considerable length.

The categorical imperative does not commit one to the view that there is an absolute prohibition against breaking a promise. Kant proposes the "categorical imperative" (CI) as a criterion or test for the rightness or wrongness of actions. He states the CI as follows:

> Act only according to that maxim though which you can at the same time will that it should become a universal law (*Groundwork for the Metaphysics of Morals* (Harper and Row, 1964), Paton Trans., p. 88.)

Kant gives two other formulations of the CI: (i) "always treat humanity, whether in your own person or in the person of any other, never simply as a means, but at the same time as an end" (p. 96), and "A rational being must always regard himself as making laws in a kingdom of ends" (p. 101). Kant claims that the other two formulations of the CI are equivalent to the first.

> there is therefore only a single categorical imperative and it is this: "act only on that maxim through which you can at the same time will that it should become a universal law" (p. 88).

The universal law formulation of the CI is equivalent to the following:

> An act is morally right if, and only if, the person who performed it would be willing to have everyone else follow the same principles which he employed in performing the act.

Kant argues that it is always wrong to make a promise that one does not intend to keep. His argument constitutes what is probably the most well-known illustration of his notion of a "perfect duty." I will argue that Kant's argument does not succeed and cannot be modified to show that it is always wrong to break a promise. The relevant passage in Kant reads as follows:

> Another [man] finds himself driven to borrowing because of need. He well knows that he will not be able to pay it back; but he sees too that he will get no loan unless he gives a firm promise to pay it back within a fixed time. … [T]he maxim of his actions would run thus: "Whenever I believe myself short of money, I will borrow money and promise to pay it back, though I know that this will never be done. … I see straight away that this maxim can never rank as a universal law of nature and be self-consistent, but must necessarily contradict itself. For the universality of a law that everyone believing himself to be in need can make any promise he pleases with the intention not to keep it would make promising and the very purpose of promising, itself impossible, since no one would believe he was being promised anything, but would laugh at utterances of this kind as empty shams (pp. 89–90).

According to Kant, the CI commits us to an absolute prohibition against making promises in bad faith. The duty not to make promises in bad faith is a perfect duty. Not only are we *unwilling* to have everyone else follow maxims which permit making promises in bad faith, but such a state of affairs (everyone's following maxims which permit them to make promises in bad faith) is impossible. For universal adherence to such maxims would destroy the background of honesty and trust necessary for the existence of the institution of promise-keeping.

Universal adherence to such maxims such as "let me make a promise which I do not intend to keep whenever doing so would be to my advantage" might destroy the background of trust necessary for institution of promise keeping to be viable. But this doesn't show that the CI commits us to an absolute prohibition against making promises which we do not intend to keep. Making a promise in bad faith can be described by maxims the universal adherence to which would not so greatly undermine trust between individuals as to threaten the institution of promise keeping. Consider the following maxim:

> M. Let me make a promise in bad faith when and only when doing so is necessary in order to save the life of an innocent person.

Universal adherence to M. would not threaten the institution of promise keeping. Our present experience demonstrates that the existence of promise keeping is compatible with a far greater incidence of making promises in bad faith than would prevail if M. were universally adhered to. Further, most of us would be *willing* to have everyone else follow the policy of making promises in bad faith when doing so is necessary in order to save lives.

Following Kant, we could construct an analogous argument to show that breaking promises is always wrong:

> Not only are we *unwilling* to have everyone else follow maxims which permit promise breaking, but such a state of affairs is impossible. For universal adherence to such maxims would destroy the background of trust necessary for the institution of promise keeping and without this background the institution of promising could not exist.

The reply to this argument follows what I said above. "Let me break a promise whenever doing so would be to my advantage" is a maxim the universal adherence to which might very well threaten the very existence of the institution of promise-keeping, but it is not the only maxim that sometimes permits promise breaking. Maxims of the following sort also permit one to break promises on certain occasions:

> Let me break a promise when and only when doing so is necessary in order to save the life of an innocent person.

40 Assumption # 2 is rather obvious and I will not bother to defend it here.

41 Of course, if I were desperately poor and stealing were the *only* way in which I could feed my family, I might be justified in stealing. It is extremely unlikely that an official could justify an avoidable conflict of interest on grounds such as this. Almost any official who possesses sufficient power to help a child by means of a conflict of interest is also sufficiently well-paid to help the child from his/her own private resources.

42 Another interesting case is one in which one fails to do one's official duties, but does not harm the party to whom the duties are owed. The following case is an example of this. I am in charge of purchasing bolts to be used in an aircraft factory and purchase bolts which do not meet the specifications of my employer. However, no harm comes from this since the substandard bolts never cause any problems with safety or maintenance.

43 This assumes that there is no formal company policy forbidding officials to deal with personal friends. If company policy prohibits officials from hiring people with whom they have personal connections, then my offering the job to my friend's son violates the duties of my office, even if he is the person best qualified for the job.

44 For a defense of this principle see my paper "Bribery, Extortion, and 'The Foreign Corrupt Practices Act,'" pp. 84–89.

The Moral Problem in Insider Trading

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Insider trading can have sensational results.[1,2] Its perpetrators risk finding themselves behind bars for many years and vilified in popular opinion, while their firms and the people heavily invested in them risk financial ruin. Even so, doubt may be raised about our understanding of insider trading, a doubt that should prompt concern about the justice of insider trading prosecution and about the harsh moral judgments people often make of insider traders. The doubt comes from trying to identify the moral wrong in insider trading. Candidates for this wrong abound. One might, for example, identify the wrong in consequentialist terms, that is, in terms of the unfavorable balance of harms and benefits insider trading causes. But scholars disagree deeply about whether insider trading in fact causes social harm, and even those who think it does concede that their evidence is weak.[3] One might, alternatively, say that insider trading is wrong on deontological grounds, arguing that the act of insider trading is itself wrong in ways that cannot be understood in terms of the harms and benefits it produces. As we will see, the deontological alternative has its own problems.

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I will argue that the judicial treatment of insider trading aligns with a deontological interpretation: courts have consistently identified insider trading as securities fraud; the heart of securities fraud is fraud, a kind of wrongful deception; and deception is a paradigmatic deontological wrong. Establishing these claims is difficult. The deceptive element in insider trading can be elusive. To make matters worse, several moral principles, other than that proscribing deception, are commonly invoked in arguments against insider trading, including principles that proscribe theft, breach of trust, and unfair dealing. It is not obvious how insider trading might violate any of these principles, or how one should understand the relationship among them as they bear on insider trading. In this chapter I try to resolve these issues. I contend that insider trading is in fact wrong because of the deception it involves, and that establishing that contention requires establishing corollaries about other moral wrongs.

Before investigating what might make insider trading morally wrong, I mention a preliminary problem. Insider trading resists simple characterization. The standard legal analysis of insider trading says that it occurs when a corporate insider engages in a securities transaction on the basis of material, nonpublic information.[4] This analysis is schematic, relying on ideas that often seem treacherous in application: a corporate insider, material information, nonpublic information. Moreover, it excludes a perplexing and practically important class of insider trading cases, namely, those committed by so-called outsider traders – tippees (people who wrongly receive stock tips from corporate insiders) and others who wrongly trade on inside information even though they are not themselves corporate insiders. Fleshing out the standard analysis by explicating and extending the ideas in the traditional analysis would be distracting and require more space than I am allotted. I undertake much of this task elsewhere.[5] For simplicity, I will therefore restrict this discussion to cases in which the standard legal analysis of insider trading proves unproblematic. Perhaps the most famous such case is *SEC v. Texas Gulf Sulphur*, in which officers of Texas Gulf Sulphur learned of their company's rich ore strike in Canada and traded on this information before the news became public.[6] These officers, who engaged in securities transactions on the basis of material, nonpublic information, are paradigm insider traders, at least under the standard analysis. It is clear that they committed a legal wrong. We will find more challenging the matter of identifying the moral wrong in their conduct.

In the remainder of this chapter, I critically examine the leading arguments for treating insider trading as morally wrong, including arguments that insider trading is wrong because it is harmful, deceptive, unfair, constitutes theft, or breaches fiduciary duties. I conclude that these arguments, as ordinarily formulated, are unpersuasive – they either rely on dubious empirical premises or assume normative premises that are equivalent to their conclusions. But then I suggest a way to salvage at least some of the arguments. I consider a society in which insider trading was not legally prohibited, and ask about the moral viability of contracts among firms, employees, and stockholders that would license insider trading. I argue that such contracts would be unconscionable, and that facts about this unconscionability show why insider trading should always be regarded as involving morally wrongful deceit.

Harm

The argument from harm, popular among the law-and-economics scholars who dominate securities scholarship in law schools, is not a deontological argument. Instead, it maintains that insider trading is wrong because of the social harm it causes, given that we understand "causing harm" expansively, as causing a failure to attain optimal social welfare or social good.

In a securities market there are winners and losers, people who get good prices and people who get bad prices. Other things being equal, the person with the best information about what is being bought or sold stands in the best position to find bargains and get the best price. Competing against corporate insiders, who possess superior information, thus increases the risk that one loses. Ordinary traders will balk at the risk of trading against insiders, and insider trading, then; will undermine confidence in securities markets and deter investment, increasing the price a firm must pay to raise capital and hindering both a firm's development and a society's economic growth more generally, according to the argument from harm.[7] As a society, we have good moral reason to protect ourselves against this kind of economic harm, and laws prohibiting insider trading afford the relevant protection. On this view, insider trading is wrong because it fails a cost/benefit test, depriving us of a peculiar kind of benefit, a social good whose continued existence requires the cooperation of many people in maintaining a credible securities market. The harm in insider trading may be seen as resembling the harm that occurs when people damage other social goods, for example, by gratuitously burning a forest or spoiling a lake. Healthy forests, clean lakes, and thriving securities markets all serve the social good only because we as a society protect them. It is wrong to damage the social good. The wrong in insider trading is in its compromise of this good.[8]

An empirical claim forms the core of the argument from harm: that insider trading will significantly deter investment. Influential research lends some supports to this claim. A leading article on insider trading compares the cost of capital (the price that firms must pay to raise money in a securities market) in (mostly developing) countries both before and after they begin enforcing insider trading laws, and it concludes that because this cost generally decreases after insider trading laws are enforced, social welfare improves when insider trading diminishes.[9] Does the article show that insider trading is socially harmful? Its authors acknowledge that they locate no causal link between insider trading and changes in social welfare, but merely noncausal correlation. For all we know, the securities law enforcement practices upon which these scholars focus may be mere epiphenomena reflecting more significant social forces, including economic development or the broad adoption of a securities regulation framework. Even the best social science research, then, expresses no confidence about whether insider trading deters investment in ways that prove socially harmful. Moreover, there is good reason to wonder whether insider trading will deter investment. Securities traders are accustomed to the idea that other traders may possess advantages in information, even if it is not inside information, and hardly seem deterred by this idea. Most investors do not believe that the quality of their information is as good as Warren Buffet's – or that of the stock market wizards at Goldman Sachs. If the investment public is willing to trade against Warren Buffet and the wizards at Goldman Sachs, perhaps it will not be deterred by the prospect of trading against corporate insiders, either.

In addition to doubt about the harm insider trading causes, there are other reasons for skepticism about the argument from harm: credible economic arguments purport to show that insider trading, if it causes some harm, also creates benefits – perhaps these benefits are more significant than any harms that insider trading causes.[10] Some scholars find these benefits in the idea that insider trading facilitates getting insider information to market quickly. Arguably, when market information improves, so does market performance. One may also argue that insider trading benefits the firm and hence society more generally by providing a cheap compensation device: if a firm gives its employee the valuable perquisite of a right to trade insider information, it costs the firm nothing, but it should feel warranted in asking the employee to give back some of his otherwise high salary. When the firm saves money in salary, it can pass on the benefit to others, one might think. An entirely different but equally plausible argument that insider trading is socially beneficial focuses on the costs of law enforcement. The argument is simple. If we as a society need not pay the costs of enforcing laws against insider trading, we save money. Government avoids the costs of policing and prosecuting insider trading, and firms avoid the costs of requiring their compliance programs to limit insider trading. These savings create economic benefits from which, presumably, everybody gains.

There are, then, arguments both that insider trading harms us and arguments that it benefits us. Which, if any, of these arguments should prevail in our decision making about insider trading? Scholars who examine the issue say that the economic considerations for and against insider trading seem both closely balanced and rest on speculative assumptions.[11] We should worry about accepting either the idea that insider trading is generally beneficial or that it is harmful. But that is not the largest problem for the argument from harm. Suppose that we know that allowing insider trading would create both harms (because of deterring investment) and benefits (because of facilitating information transfer, providing cheap compensation, and saving law enforcement costs). If we are to take these considerations seriously as a foundation for criminal policy and moral attitudes, we face a problem. There exists no measure for the magnitudes of these harms and benefits, and nobody knows that a reliable measure will ever emerge. So we do not know how to balance the good consequences of insider trading (if they exist) against the bad (if they exist).

So far I have been developing skepticism that our knowledge about the harm in insider trading warrants us in seeing a significant moral wrong in insider trading. There are limits to this skepticism. It does not impugn the intellectual value of the scientific project of finding causal connections between insider trading and changes to social welfare. The skepticism is limited to the idea that however interesting and important the scientific research project of understanding causal connections between insider trading and harm, the project seems not far enough along to serve as a foundation for either social policy or moral attitudes about insider trading.

If we cannot adequately explain the wrong of insider trading in terms of harm, then we must look elsewhere for a rational basis for criminalizing insider trading and for our harsh moral attitudes against insider traders. I will explore the possibility that deontological arguments, which eschew empirical speculation about the social consequences of insider trading, and instead aim to explain the wrong in terms of the inherent character of certain acts by providing a more plausible basis for understanding the morality of insider trading than do analyses in terms of costs and benefits.

Deception

Courts have always seen insider trading as a kind of fraud, namely, securities fraud.[12] Historically, wrongful deception forms the heart of fraud. Hence we might look to the wrong in wrongful deception as the explanation of the wrong in insider trading. Recall *Texas Gulf Sulphur*. On the deception account, insiders deceived shareholders by buying stock from them while concealing material, nonpublic information relevant to the valuation of the securities.

The deception account allows a deontological interpretation that avoids the speculative pitfalls of the harm account. Deception can be understood as inherently wrong, apart from any harm it causes. Indeed, a standard philosophical analysis of the wrong in deception identifies it as a vicious kind of manipulation.[13] One person may wrongly deceive another when he intentionally causes that person to have a false belief in a way that compromises the autonomy of his decision making, even if doing so benefits that other person. Suppose, for example, that I intercept a phone call to you about a job offer, and hide from you the information about the call. I know that the job would be bad for you, but I also know that I cannot convince you that I am right. So I lie, telling you that no call was made. Arguably, I wrongly deceive you even if I make you better off by doing so. I manipulate you by the way in which I cause you to have a false belief. If insider trading is deceptive, then we might establish that it is similarly wrong, at least from a moral point of view, even if we cannot establish that it is socially harmful.

The deception account of insider trading has its problems. Most salient is the elusiveness of any deception that occurs in insider trading. Recall, again, the Texas Gulf Sulphur officers. As a matter of fact, these officers were responsible for a number of misstatements that appeared in the press and misled the trading public about their discoveries of ore, and these statements were used at trial against the officers. Yet insider trading law requires no false or misleading statement for a finding of liability. The law is clear that if corporate insiders trade on material, nonpublic information while silently failing to disclose the basis of their trade, their silence may ground a conviction. Thus imagine a variant on *Texas Gulf Sulphur, Texas Gulf Sulphur**. Texas Gulf Sulphur* differs from Texas Gulf Sulphur only in that Texas Gulf Sulphur* officers make no false or misleading statements about their ore find. Texas Gulf Sulphur* officers might nonetheless be convicted of insider trading. If deception is at the core of insider trading, whom do Texas Gulf Sulphur* officers deceive and how do they do it? They do not commit the most obvious kind of deception. They do not lie. Lying involves making a relevant false statement and they made none. This raises a difficulty for the idea that insider trading is wrong because it is deceptive: how can silence, saying nothing, be deceptive? In trying to resolve that difficulty, one may appeal to the fact that silence, in the right circumstances, may serve as a signal that causes false belief. Take a crude example: suppose that I tell you that if I learn that Tom is now angry, I will come to your party at 3 P.M. and then stay silent five minutes; I show up and stay appropriately silent, even though I know Tom is not angry. You believe he is angry on the basis of my silence, and you are deceived. Perhaps there are less crude examples of silence deceiving by causing a false belief. But even their possibility seems to raise a difficulty in the charge that Texas Gulf Sulphur* officers deceive. The difficulty is causal. Typically when one person deceives another, causation matters: whether by lying or not, the deceptive act causes a false belief in the deceived. Texas Gulf Sulfur* shareholders arguably do have a false belief when they buy. They falsely believe that Texas Gulf Sulphur* has no new rich ore strike that will lead to skyrocketing stock prices. But since Texas Gulf Sulphur* officers, we are supposing, say nothing relevant about this strike, it seems doubtful that they cause the relevant false belief or influence relevant shareholder beliefs in any way. Shareholders will have had their false belief even before the officers decided to buy, and the sellers will have not been influenced at all by the action of the officers. Perhaps no deception occurs.

One might understand Texas Gulf Sulphur* officers' silence as deceptive, however, even if it does not in fact influence beliefs. Suppose that these officers have a moral obligation to inform shareholders of significant firm developments before they trade on firm stock. Then, before making a trade, they have an obligation to say, if true, that there has been an important strike. By their silence they license the inference that no new strike occurred. Had the officers discharged their obligations, shareholders would have had very different beliefs – fewer relevantly false beliefs – about Texas Gulf Sulphur*. Perhaps that suffices to show that they deceive shareholders. The underlying principle, though counterfactual in form, seems appealingly realistic: If one has an obligation to be truthful to a person, and breaches that obligation in a way that leaves the person with more relevantly false belief than he would have had if one had been truthful, then one deceives that person, even if one fails to make a false or misleading statement. The queerness of this underlying principle is in its suggestion that one may do something (that is, wrongly deceive) by inaction (that is, by staying silent). Assessing this queerness would require a foray into the metaphysics of inaction and its relation to moral obligation, too much to attempt here. Luckily there seems to be a way around the metaphysical issues. We may distinguish between deception as it ordinarily occurs, which involves a discrete deceptive act, and a failure of candor, which need involve no discreet deceptive act. We may then criticize Texas Gulf Sulphur officers for their failure of candor. We may say that sometimes minimal decency requires not merely that one not conceal the truth, but instead that one reveals the truth. If your car has a massively defective engine, or if your house has a cracked foundation, it seems wrong not to disclose the fact to a prospective buyer. Indeed, the law will treat such nondisclosure as fraud, and it is no moral or legal defense that you did not he or mislead the buyer. You should have volunteered the truth. Sometimes morality requires candor. Perhaps that is so in cases of insider trading, such as Texas Gulf Sulphur*. Having distinguished deception as it is ordinarily understood from a mere failure of candor, we may then stipulate an interpretation of "deception" to be used in discussions of fraud, including securities fraud. According to this interpretation, deception in fraud includes not only deception as it is traditionally understood but also some failures of candor. This stipulation will, I think, simplify our discussion of insider trading and track well with judicial treatment of insider trading. But it hardly solves our deeper problem of finding the moral wrong in insider trading.

No doubt Texas Gulf Sulphur* officers were not as candid as many might like. But it would be too quick to infer, without further explanation, that they should have been more candid, or that they showed a wrongful lack of candor. In a competitive business environment, one need not always be entirely candid. Suppose that you work for The Walt Disney Company, which assigns you the task of purchasing land for a new theme park. You need acquire one more plot of land to complete your assignment. On that plot sits the home of a savvy used car salesman. Should you disclose to the homeowner what Disney intends to do with his land, or even that you work for Disney? If you disclose, you risk that the homeowner, knowing how valuable the land is to Disney, will insist on an unfairly high price, and you will have no choice except to pay it.[14] I suggest that although it would plainly be wrong for you to lie to the homeowner about what you will do with the land, morality does not require you to be forthcoming. Reflection on the Disney case shows that honesty does not always require full disclosure in a competitive business environment, even when a failure to disclose denies benefits to others. How, then, do we know that Texas Gulf Sulphur* officers should disclose?

The judgment that the officers' stock sale is deceptive, even in our expansive interpretation of that term, makes little sense unless one also finds that they fail in some duty to disclose the truth. So we are left with the question: what is the moral basis for this duty to disclose? Nothing in the argument from deception begins to answer this question. In the next section, I investigate fiduciary duties, which are often invoked as the basis of a duty to disclose in securities transactions.

Fiduciary Duties

A fiduciary duty is, roughly, a duty of utmost loyalty and trustworthiness that an agent may be said to owe to his principal. These duties are a staple of legal analysis, have rich moral content, and consistently play a role in judicial thinking about insider trading. As I mentioned, a common argument in insider trading jurisprudence says that fiduciary duties form the basis of the duty to disclose that is breached when insider trading occurs.

Fiduciary duties play a central role in the "traditional theory" of insider trading, which understands insider trading as a kind of wrongful deception.[15] The traditional theory employs the notion of fiduciary duties in this way:

1. Corporate insiders stand in a fiduciary relation to shareholders.
2. Because of (1) an insider must disclose all relevant information to his principal before engaging in a securities transaction with that principal.
3. An insider's failure to disclose in a securities transaction (insider trading) constitutes wrongful deception.
4. Insider trading is wrong.

I will eventually argue that a version of this argument can be salvaged, but the argument as presented is flawed, because it relies on an idea expressed in (2), the idea that a fiduciary must always be forthcoming with his principal.

An example shows why (2) may seem attractive. Consider a paradigmatic fiduciary relationship, that between a lawyer and his client. When Fred buys property from his real estate lawyer, Ed, the lawyer must be completely forthcoming, or make himself vulnerable to an action for fraud. He cannot conceal any information that Fred might reasonably find relevant to the deal. The obligation to be candid to one's principal, legal and moral tradition argue, forms an essential part of the fiduciary's task. Suppose that the real estate would be a great purchase for Fred, but Ed does not want to tell Fred that he owns it, because he suspects that doing so would make Fred worry unreasonably about the deal, and lose money. As a matter of law, Fred must nonetheless disclose because of his fiduciary relationship with Ed.

Law and morality demand that Fred be perfectly forthcoming. There are strong reasons to doubt that fiduciaries should always be so forthcoming. Consider a standard economic argument. The fiduciary obligation that officers owe to shareholders is, we are told, to devote their utmost allegiance to advancing shareholder interests. Hence, whether a practice of insider trading should be regarded as a breach of fiduciary duty depends on whether it is socially harmful or beneficial. This argument cannot be dismissed. Why think that a fiduciary should always disclose all relevant information? In the real estate lawyers case discussed above, the answer is easy: the lawyer is hired as a counselor, a person whose task is to aid his principal in making a reasonable and informed choice; providing relevant information is essential to his task of advancing his principal's interest in making an informed judgment of his principal. But the role of corporate officers as fiduciaries seems fundamentally different, one might argue: it is not to counsel shareholders, but to make money for them, within reason. If a practice of insider trading tends to benefit shareholders, then perhaps it violates no fiduciary duty after all. At a minimum, we need some argument to regard respect for fiduciary duties as requiring not trading on insider information. A mere appeal to fiduciary duties, in the absence of argument for a specific interpretation of those duties, goes nowhere. It begs the question.

Unfairness

The argument from unfairness contends that insider traders get an unfair advantage over people with whom they engage in securities transactions and that their trades are therefore wrong on grounds of justice.[16] The supposed unfair advantage is in their use of insider information, which stock market competitors lack. The unfairness argument differs crucially from the harm argument because it does not rely on speculative empirical premises about the consequences of insider trading. It instead looks at the comparative position of buyer and seller of stock and declares these positions unacceptable on grounds of justice.

The idea that market actions can be unfair, and hence wrongful no matter what their social consequences, has ancient lineage. The Bible bans charging unfairly high prices, declaring that "when you sell something to your fellow, or buy from the hand of your fellow, don't oppress each other."[17] Aquinas asserts that it is wrong to sell something for more than it is worth.[18] Even today, courts will declare a contract to be unconscionable and hence unacceptable if its substance is acutely unfair to one party. Proponents of the unfairness objection to insider trading echo this nonconsequentialist tradition, maintaining that the wrong in insider trading can be identified apart from reflection on the social consequences of insider trading.

The unfairness argument against insider trading identifies the relevant unfairness in terms of an acute inequality of information separating buyer and seller in a securities transaction. There are certainly cases, outside the securities realm, in which an asymmetry casts doubt on the legitimacy of a sales transaction. Typically these cases involve the kind of dishonest action discussed earlier in the deception section of this essay. Hence, again, if you have a car that has a massively defective engine, or if your house has a cracked foundation, it seems wrong not to disclose the fact to a prospective buyer. One might think that the asymmetry of information that separate insider traders and parties on the other end of a securities transaction is similarly problematic.

But not all asymmetries of information are unacceptable. Suppose that Edna, an engineering genius, studies internal combustion engines for years and finds a deep design flaw in Toyota's favorite engine. She alone knows that soon most Toyotas in the world will cease functioning abruptly, as their engines melt, creating billions of dollars of liability for Toyota, and ruining its name and stock value. So Edna sells short the stock. Even though there is an acute asymmetry of information between Edna and those at the other end of her securities transactions, she does nothing wrong. Not all acute asymmetries of information in securities transactions present unfairness. Why, then, should one think that an acute asymmetry arising from inside corporate information in a securities transaction is a problem?

One might try to bolster the unfairness argument by conceding that an acute asymmetry of information does not suffice to establish the relevant unfairness, but by saying that some instances of asymmetry are problematic; in particular, one might say that the relevant unfairness occurs in instances of asymmetry that result from an unequal access to information. In general, of course, corporate insiders have greater access to corporate secrets than do outsiders. So the appeal to unequal access may appear to mark progress for the proponent of the unfairness argument. But this appearance is illusory, I believe. Sometimes the existence of unequal access does not seem to render problematic an asymmetry of information. Suppose that I am the brother of Engineer Edna, and she refuses to tell anyone but me about the defective Toyota engine. Then I have unique access to the information about the bleak future of Toyota stock. Other traders do not have access that equals mine. Yet I do nothing wrong by trading on the information Edna gives me. So the unfairness argument so far seems unconvincing.

A final modification of the unfairness argument may seem more promising. This argument identifies the unfairness in insider trading not in terms of a simple asymmetry of information between the buyer and seller of a security, or in terms of an asymmetry stemming from unequal access, but instead in terms of an asymmetry stemming from wrongly unequal access. Put more simply, the argument is that insider trading is unfair because one party trades on information stolen from the firm. The argument relies on the idea that inside information is owned by the firm. When Texas Gulf Sulphur officers use their inside information about an ore strike to get a bargain in Texas Gulf Sulphur stock, they use valuable information that belongs not to them, but to their firm. They steal something valuable, information that belongs to the firm, and hence to its shareholders. They have no right to use the information. When they do so, they act unfairly and hence wrongly.

A difficulty for the theft argument lies in explaining why one should regard the firm as possessing the relevant property rights in information. One might reason on Lockean grounds that since it is the firm's labor and investment that produces the information, the information is owned exclusively by the firm. A troubling feature of this argument is its contingent nature and hence its limited scope. The soundness of the argument depends on contingencies regarding certain contracts. Suppose that a firm's board of directors, operating in a different legal regime than the United States, legally tells managers that as a reward for their excellent performance, it grants them the right to trade on insider information. Indeed, the firm might even warn prospective shareholders of its policy to grant employees this right. It would seem that these managers do not steal anything when they trade on inside information: the owners agree to their use of the property. Thus this version of the unfairness argument has limited scope. It cannot show that it is always wrong, either legally or morally, for insiders to trade on material, nonpublic information. It would at most show that it is wrong for insiders to trade on such information unless the firm has agreed to the trades. On this argument, firms would have the authority, in the absence of legal regulation, to render legitimate insider trading. The legal acceptability of insider trading would be a matter of contract; the moral acceptability would be a matter of the validity of promises that underlie the contract. To say, however, that insider trading is wrong unless permitted by contract or promise is to find nothing inherently wrong with insider trading.

The unfairness argument thus fails to show that insider trading is wrong in any significant sense. But the construction of the argument that appeals to contract suggests a promising twist: that we look at the contracts that might license insider trading as a way to assess the morality of insider trading. In the next section I will argue that any contract sanctioning insider trading will be morally defective, and that reflecting on the defects suggests a path to salvaging some of the traditional arguments against insider trading.

Unconscionable Contracts

The argument I make in the remainder of this chapter is simple at its core, though its execution requires patience. The core idea is that insider trading acceptably occurs only if people could legitimately make contracts transferring property rights in inside information from the firm to corporate insiders. But these contracts could never be legitimately made, I will argue. Any such contract would be unconscionable and hence both legally and morally wrong. So insider trading cannot acceptably occur. Indeed, I will maintain that because insider traders can have no right to use the information on which they trade, their trades involve deception, as the traditional theory of insider trading provides. In the remainder of this section, I argue simply that contracts for insider trading would be unconscionable. In the next section, I examine the relevance of the unconscionability argument to more general arguments that insider trading is wrong.

To begin the unconscionability argument against insider trading, set aside the law of insider trading. Imagine that all jurisdictions simultaneously strike from the books all bans on insider trading. Some firms might then insist on contracts that prohibit the practice of insider trading, either because they believe that doing so will somehow create a competitive advantage over other firms, or because they find the practice objectionable; other firms might allow the practice, perhaps because of its value as a cheap compensation device. In such a strange world, whether any particular corporate officer might *permissibly* engage in insider trading would appear to be a matter of contract. But this appearance is not veridical, I will argue. A contract permitting insider trading will unavoidably have an objectionable feature: it will be unconscionable; it will therefore also be in relevant part unenforceable.

What is unconscionability? Theorists discuss two varieties – substantive and procedural. Only the substantive variety will prove relevant here. Procedural unconscionability involves cognitive or volitional defects in a contracting party, something arguably not present in common insider trading cases, because involved parties are quite sophisticated.[19] Then what is substantive unconscionability? A contract is substantively unconscionable when its terms are exploitative or grossly unfair, that is, when it requires one party to pay an unreasonably high price for the benefit the contract confers on him. This can be simplified, and it will be useful to do so, because the idea of unconscionability plays so important a role in future discussion. So let us say, "A contract is substantively unconscionable when it requires one party to pay an unreasonably high price for the benefit that the contract confers on him." Obviously, this characterization of substantive unconscionability will not by itself suffice for picking out instances of substantive unconscionability; it relies on a notion of unreasonability that I leave unanalyzed and that different people will interpret differently. Even so, the concept of unconscionability, as I characterize it, is common enough in legal reasoning and everyday moral reasoning. Consider *Hume v. U.S.*, a legal case concerning a contract for corn; the contract requires that the buyer pay the seller what amounts to forty times the market value of the corn.[20] Because of the disparity in value the contract assigned to the parties, the court upheld a lower court's decision that the contract was unconscionable and hence unenforceable with respect to the price provision. The most plausible reading of cases such as *Hume* is that courts, when reaching their legal judgments about unconscionability, rely on a moral judgment of unconscionability. I will soon contend that insider trading contracts would involve similar, though more complex, Judgments of unconscionability.

Suppose that I am correct in arguing that insider trading contracts would be unconscionable. So what? Why should the law not enforce these contracts? Paternalism provides a common answer. Courts may refuse to enforce an unconscionable contract, at least with respect to its unconscionable term, on the paternalistic account, to protect a person from the consequences of his own mistaken decision to enter the contract.[21] In *Hume*, for example, the court may be understood as protecting the buyer from the consequences of his bad decision on how much to pay for corn. However plausible this paternalistic account may seem generally (and the jury is out on that question), paternalism does not seem useful in providing an explanation for why one should regard insider trading contracts as unconscionable. A paternalistic intervention seems relevant only when a person is not competent to protect his own interests, either because of his ignorance or because of problems in voluntariness.[22] The paternalistic paradigm hardly seems well suited for participants in securities markets, who tend to be comparatively sophisticated and to have a wealth of choices available to them. In the scenario I have painted, market participants are informed when a firm permits insider trading – presumably they have other investment opportunities. Their choices thus seem neither relevantly uninformed nor coerced.

Even if one resists endorsing paternalistic intervention in securities markets, there is reason to balk at unconscionable contracts. Seana Shiffrin argues that enforcing unconscionable contracts is wrong because it involves facilitating wrongdoing.[23] Her argument is not paternalistic; it does not turn simply on what courts might do to advance the welfare interests of victims in unconscionable contracts. It instead turns on government's role in the process: the government should not facilitate wrongful contracts. Shiffrin's position relies on the idea that we can distinguish between refusing to do what a person asks out of concern for his interests and refusing to do what a person asks out of respect for one's own integrity. I believe that the cogency of this distinction is needed to provide a sound nonpaternalistic explanation of our reticence to enforce unconscionable contracts, and that it illuminates social values in other realms of choice. Consider another example Shiffrin gives. One may interfere with a person smoking a cigarette out of concern for his health-doing so is paternalistic. But even a person put off by paternalism may refuse to provide cigarettes to a smoker because he does not want to assist the smoker in his objectionable activity. Similarly, our society, through the courts, may refuse to assist people in creating their unconscionable contracts.

Assume that Shiffrin is correct in asserting that courts should not enforce unconscionable contracts because it would be wrong for them to facilitate wrong doing.There are implications for contracts that would allow insider trading, because, I will contend, these contracts should be regarded as unconscionable. Insider trading contracts would be unconscionable because of the kind of disparity of benefits they confer on shareholders and corporate insiders. The involved disparity is complex, however, and not analyzable in purely financial terms. I hope that an analogy will help make clear the nature of this complex disparity.

Consider *Hooters of America, Inc. v. Phillips*, a legal case involving an arbitration agreement in an employment contract that made it extremely difficult for Hooters employees to pursue sexual harassment grievances.[24] Appealing to the unreasonable obstacles that the contract created for an employee seeking redress for sexual harassment, the court decided that the contract was unconscionable. A narrow interpretation of *Hooters* would see it as about the unconscionability of denying a person a remedy when a contract goes awry. I concede that the *Hooters* court focuses on the remedial issue: doing otherwise might seem poor judicial craftsmanship, since the remedial issue fits so neatly within legal precedent. But there is a less technical and more revealing way to think about the case, from a moral point of view. What makes Hooters contracts terrible goes beyond remedies. Hooters contracts make employees unreasonably vulnerable to sexual harassment, because they leave the employer unworried about how employees would react to harassment, in effect protecting employers. The creation of that vulnerability provides independent reason for deeming the contract unconscionable; it transforms the value of the contract for an employee in ways that cannot be translated into monetary terms or compensated by increases in salary. So there is an insurmountable disparity in the value that the contract confers on Hooters employees and the Hooters firm; while Hooters gets the benefit of diminished litigation costs and liability, the employees on the other end of the employment contract receive something much worse, even if they receive some benefits in increased pay: these employees get a package deal that includes a substantially increased vulnerability to sexual harassment. Because Hooters contracts cause one party to pay an unreasonably high price for the benefit the contract confers, they are unconscionable.

In analyzing how unconscionability makes Hooters contracts wrong, I mentioned the costs that these contracts impose on Hooters employees. Despite my reliance on the idea of costs, the analysis of unconscionability in *Hooters* cannot be understood in cost-benefit terms. If a cost-benefit analysis were correct, then it would have been appropriate for the *Hooters* court to assess the contract by asking whether the benefits that the contract created for the firm and society more generally somehow compensated for the burden imposed on Hooters employees. Yet clearly a focus on these social benefits would have been repugnant in *Hooters*. Making a person vulnerable to sexual harassment is wrong even if the Hooters firm or society more generally somehow benefits from it, and the court should play no role in facilitating this wrong. Hooters contracts were wrong as a matter of moral principle because it is wrong to make Hooters employees so vulnerable to abuses of power and control by their employers, no matter what the prospects are that the employers will actually act abusively.

The lesson I draw from *Hooters* is that when agreement to a contract causes one party to suffer vulnerability to a substantial wrong committed by the other party, there is an insurmountable disparity in benefits that the contract confers on the parties, a disparity amounting to unconscionability. This lesson has great relevance for insider trading. Insider trading contracts, like Hooters contracts, would create an environment that makes a contracting party vulnerable to wrongdoing. Of course, in the insider trading case, the relevant wrong would not be sexual harassment. It would instead be wrongs of the sort canvassed in our earlier discussion of insider trading as a breach of fiduciary duty, for example, the mismanagement that consists of creating damaging rumors in order to manipulate stock prices. Judicial enforcement of insider trading contracts would, then, facilitate wrongdoing just as enforcement of Hooters contract would facilitate wrongdoing. No court should be willing to enforce a contract that so needlessly exposes shareholders to wrong. So insider trading contracts are unconscionable.

A natural objection can be made against the unconscionability argument. One might say that the argument cannot be correct because it would implausibly undercut not only insider trading contracts but also a broad range of unquestionably legitimate contracts. The objection stems from the fact that the unconscionability in insider trading contracts, as I have argued, occurs because these contracts leave a party vulnerable to abuse. In an important sense, one may contend, most contracts leave a party similarly vulnerable to abuse: if one party performs his part of the contract and the second party thereby benefits, but then the second party opportunistically does not do his part, abuse occurs. Consider a contract that a storekeeper makes to have a new roof installed on his store. Typically a roofer requires a substantial payment before he begins work. If the roofer takes the payment, choosing to flee with the money rather than install the roof, abuse occurs. Yet from that fact, it would be rash to infer that all roofing contracts are unconscionable, even though all such contracts create the possibility that a roofer will abscond with a storekeeper's money or do a poor job. A contract may therefore make a party vulnerable to abuse, even though contracts of its kind are not generally unconscionable. So why should one think that insider trading contracts, as I have been conceiving them, are unconscionable?

Two elements seem particularly important in the analysis of vulnerability arising from contracts: a person is vulnerable to the extent that he lacks the power or information to respond to a threat. So characterized, vulnerability seems a matter of degree; some contracts make a person more vulnerable than others. The vulnerability in insider trading contracts is acute, exceeding that in the roofing contract example. Stockholders in an insider trading regime cannot protect themselves against the wrongful harm that insiders traders cause, at least in part, because it is too hard for them to get timely knowledge that it occurs. Suppose, for example, that an insider trader wishes to sell short his company's stock, and so creates unfavorable information about this firm, either by spreading false rumors, or by secretly compromising the quality of his firm's product in ways that will soon hurt the firm's reputation. In the case of spreading rumors, it is hard to trace the origins of rumors and often too late to mitigate damage when one does so; in the case of intentionally degrading product quality, it is hard to know whether the action occurs because of poor judgment or bad intent. Because it is so hard to know whether the insider trader engages in misconduct aimed at affecting stock prices, it is hard to take action to limit his misconduct or mitigate its consequences. The situation is entirely different when one is trying to protect oneself against a roofer who does not do his job. As a general matter, a person protects himself against the roofer not doing the job at all by either paying him through an escrow account or by paying him in increments as he makes progress on the job. And a person protects himself against the roofing job being done poorly through the use of warranty; indeed, courts are loathe to allow parties to make a contract that contains no warranty. The vulnerable party in a roofing contract typically has information and resources to protect himself against abuse. The stockholder in an insider trading contract we have been envisaging does not have these resources. As a practical matter, then, the vulnerability that renders an insider trading unconscionable does not affect ordinary contracts like roofing contracts. We may safely conclude that insider trading contracts would be unconscionable without embracing absurd conclusions about contracts being generally unconscionable.

The Wrong in Insider Trading

So far I have argued that contracts permitting insider trading would be wrong because they would be unconscionable. But that argument is purely counterfactual – it is about contracts that do not in fact exist. It does not say anything about actual insider trading, which does not rely on insider trading contracts. It does not show why insider trading, as it now exists, is wrong. In this section I aim to establish a connection between the unconscionability of counterfactual insider trading contracts and the moral wrong in actual insider trading. I will argue that facts about counterfactual unconscionability help show that insider trading *involves* both theft and wrongful deception.

Earlier I contended that there is a problem explaining how insider trading might be theft. Insider information – whether trade secrets, such as information about proprietary technologies, or confidential information, such as information about ongoing negotiations – exists for the benefit of shareholders, and hence presumptively is the property of the firm. So when an insider trades on the information, he uses information to which he has no right, presumptively committing theft. The problem with the theft argument thus stated is its limited scope. It explains why insider trading is wrong when a firm insists on keeping inside information private, but not why the firm cannot give the information to the corporate insider, thus dissolving his status as a thief. The unconscionability argument fixes the scope problem. It provides that the firm cannot rightly give the relevant information to the insider, at least for the purpose of trading on it: an attempt to do so would rely on an unconscionable contract; the property rights are therefore relevantly inalienable. So insider trading is always theft, a wrong.

Theft is not the wrong U.S. courts typically invoke in their condemnation of insider trading. Instead they accuse insider traders of engaging in fraud. The heart of fraud is deception, as we have seen. There is a problem in finding these defects in the action of the insider trader, because typically he neither lies nor makes a misleading statement. Instead he fails to state or disclose a truth. But such a failure is deceptive or otherwise dishonest only if the insider has some duty to disclose, and earlier we found no basis for that duty. The unconscionability argument suggests a basis.

Recall, again, Texas Gulf Sulphur officers. We have now established that they stole the information that they used in their stock trade. It belongs to the firm, and derivatively, the stockholders. The fact that they use information against stockholders that they stole from them helps show that they breach a duty to disclose. consider an analogy. Fred is shopping in an antique store when a small earthquake occurs. Price tags fall off items for sale; Fred sees an inept clerk try to replace the tags but put the wrong tags on the items. A cup tagged as $1,000 before the earthquake now has a $25 tag on it. Fred grabs the cup, takes it to the cashier, and purchases it for $25. It seems clear, and law agrees, that Fred did something wrong. He should have told the clerk about the mistake in price; he breached his obligation to disclose. Fred's failure to disclose was dishonest. The unacceptability of Fred's contact suggests the following principle of disclosure: "(D) If you have information that rightly belongs to the other party in a sales transaction, and you know that he has somehow lost it, then you must disclose it rather than using it to your advantage." why believe (D)? Elsewhere I defend it at length,[25] but here I can only sketch the defense. Not to require disclosure is to allow Fred to deprive the antique dealer of something rightly his – not merely the information about the price of his antique cup but also the economic value of that information. That deprivation would be wrong. Now one might retort that it was not Fred but the earthquake or the incompetent clerk doing the deprivation. But that would be too generous to Fred. Absent his connivance, the value in the antique dealer's cup would lurk in his store, awaiting his next survey of merchandise. It is only when the cup leaves the store at the bargain price that the dealer loses the relevant value. The truth of (D) is, then, an implication of the antique dealer's right to retain the value attaching to information about the cup.

The antique dealer example shows that before engaging in a sales transaction with a person, one must disclose to him valuable information that one possesses but that rightfully belongs to the other party. In a typical insider trading case, one covertly trades on information that rightfully belongs to the corporation, and derivatively to the shareholders. One has no right to keep that information from them. One owes a moral obligation to disclose the information. Insider trading breaches a duty to disclose and hence constitutes wrongful deception.

In the insider cases that we have been so far discussing, the corporate insider buys stock from his own shareholder. When insiders buy stock without disclosing, they violate principle (D), because in some morally significant sense shareholders have property rights in their firm and the information owned by the firm. But principle (D) is limited in scope. It helps us understand how the corporate buyer who trades on inside information, without disclosing, may treat his shareholder unfairly and, ultimately, how the insider deceives the shareholder. Principle (D) does not explain the wrong in many other insider trading cases, however. Consider the very common cases in which an insider does not buy stock, but instead sells it to a party who does not already own stock in the insider's firm. In such cases, it makes little sense to say that the insider steals information from the buyer of stock, even derivatively, because the buyer does not yet stand in an ownership relation to the firm. Principle (D) does not directly explain the wrong that occurs when a corporate insider steals information from his firm and then relies on this information in selling stock to someone outside the firm, a stranger to the firm. How, then, should we understand this wrong? This is a complex matter that I take up at length elsewhere.[26] The argument is roughly as follows. Principle (D) helps us understand that it is unfair to get a trading advantage by using information that one has no right to use. The unfairness remains whether one wrongly acquires the information from one's trading partner (as in *Texas Gulf Sulfur)* or from another source. When a corporate insider steals information from his firm and then uses it to trade with another party (even a stranger to the firm), he treats that party unfairly. To avoid the unfairness while still making a trade, one must avoid taking advantage of the wrongfully acquired information. So one must disclose. If one fails to disclose when one should, and one's disclosure would have cured relevant false beliefs, then one engages in morally wrongful deception. Insider trading is always morally wrong because of the deception it involves.

Conclusion

Inside information exists for the benefit of the firm and its shareholders. It is therefore presumptive theft for a corporate insider to trade on this information without the agreement of its owners. No firm could make a morally acceptable agreement with relevant parties – its management and shareholders – that would give corporate insiders a right to trade on material, nonpublic information. Any contract purporting to assign such a right would be unconscionable; it would leave shareholders with an unreasonably bad deal in which they were overly vulnerable to managerial abuse. It follows that when a corporate insider trades on material, nonpublic information, he trades on information he can have no right to use, and thus steals the information from its owners – the firm and its shareholders. One may not, then, as a moral matter, trade on insider information. If one wants to make the trade, one must first assure that the information becomes public, that it is no longer insider information. If an insider nonetheless insists on trading on such information, he trades on information he has no right to keep secret from the person on the other side. He engages in wrongful deception. Such deception is wrong no matter what the social consequences. It is wrong as a matter of principle; it is a deontological wrong.

Notes

[1] For valuable discussion, I thank Tom Dunfee, Waheed Hussain, Eric Orts, Richard Shell, David Silver, and audiences at the Philosophy Department, University of Delaware, and Department of Legal Studies and Business Ethics, the Wharton School of the University of Pennsylvania. I also thank Katherina Glac for her research assistance; she would have been a coauthor had institutional barriers not complicated matters. For its generous financial support, I thank the Zicklin Center for Business Ethics Research.

[2] Insider trading is illegal in the United States and in approximately one hundred other countries. In the United States and many other countries, it is treated as a felony, a serious crime. See Utpal Bhattacharya and Hazem Daouk. "The World Price of Insider Trading," *Journal of Finance* 57 (2002): 75–108. In some countries, however, insider trading is on the books as a crime, but the law is not enforced. The broad range of treatment of insider trading in different jurisdictions makes generalization difficult. For purposes of this discussion, I will limit myself to U.S. law. My discussion of insider trading as a crime will concern its status as a violation of criminal law. I will also and more fundamentally be concerned with insider trading as a moral wrong. Hence I will be concerned with whether there are good moral reasons to treat insider trading as a crime.

[3] See Battacharya and Daouk, "The World Price of Insider Trading," and Andrew Metrick, "Insider Trading," in *The New Palgrave Dictionary of Economics*, 2nd. ed, eds. Larry Blume and Steven Durlauf, (New York: Palgrave Macmillan, 2008).

[4] For a simple overview of the legal issues, see Stephen Bainbridge, *Securities Law. Insider Trading* (New York: Foundation, 1999). The analysis of insider trading I give in the text is a partial specification of the concept, adequate for specifying paradigmatic instances of insider trading, but nothing as complete as a set of necessary and sufficient conditions for insider trading.

[5] See Alan Strudler and Eric W. Orts, "Moral Principle in the Law of Insider Trading," *Texas Law Review* (1999): 375–437.

[6] *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

[7] For an unsurpassed survey of the economic issues, see Metrick, "Insider Trading."

[8] Because the existence of this social good may depend on social cooperation, nonconsequentialist reasons, including reasons rooted in fairness or reciprocity, may also be triggered. But those reasons are not my concern here. Instead, I am concerned with the purely consequentialist argument that we should promote and protect social goods to the extent that doing so satisfies the duty to bring about the best possible outcome.

[9] Battacharya and Daouk, "The World Price of Insider Trading."

[10] Henry Manne, *Insider Trading and the Stock Market* (New York: Free Press, 1966). For an argument against Manne, see Roy A. Schotland, "Unsafe at Any Price: A Reply to Manne. Insider Trading and the Stock Market," *University of Virginia Law Review* 53 (1967): 1425–1478.

[11] For a survey of scholars reaching this conclusion see Strudler and Orts, "Moral Principle in the Law of Insider Trading," 383, n24.

[12] Strudler and Orts, "Moral Principle in the Law of Insider Trading."

[13] See Christine M. Korsgaard, "The Right to Lie: Kant on Dealing with Evil," *Philosophy & Public Affairs* 15 (1986): 325–349; Alan Strudler, "Deception Unraveled," *Journal of Philosophy* 102 (2005): 458–473.

[14] One might wonder how we know that Disney risks paying an unfairly high price, or how we know that any price is unfairly high. This is an enormously difficult issue that I cannot resolve here. In my view the seller in the Disney case, if fully informed, has so much leverage that he approaches the point of being able to engage in extortion and hence of being able to credibly demand much more than the property is worth at the time of sale. The seller is taking economic value that Disney creates and claiming it for his own. But I rely on my own subjective judgment, which I think would be widely shared. If a particular reader does not share this judgment, I ask him or her to accept for the sake of argument the idea that the well-informed buyer is in a position to ask an unfairly high price for the Disney property, and consider the argument that flows from the idea.

[15] For elaboration of the traditional theory, see Strudler and Orts, "Moral Principle in the Law of Insider Trading," 389–393. For skepticism that I echo here about the traditional theory, see Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1991), 269–270.

[16] The unfairness argument is defended, in different forms, in Victor Brudney, "Insiders, Outsiders, and Informational Advantage Under the Federal Securities Laws," *Harvard Law Review* 93 (1979) 322–378; Kim Lane Scheppele, "It's Just Not Right: The Ethics of Insider Trading," *Law and Contemporary Problems* 56 (1993): 123–173; Patricia H. Werhane, "The Indefensibility of Insider Trading," *Journal of Business Ethics* 10 (1991): 729–731

[17] Leviticus 25:17.

[18] Thomas Aquinas, *Summa Theologica*, II-II, q. 77, a. 4.

[19] Caveat: courts strain hard to find both procedural and substantive elements of unconscionability in a contract before declaring the contract itself unconscionable. If both elements are in fact necessary for unconscionability in U.S. law, then I advocate a departure from U.S. law. U.S. law however, seems uncertain on this point. In my view, courts tend to make a purely perfunctory finding on the procedural element.

[20] *Hume v. United States*, 132 US. 406 (1889).

[21] For a discussion of in contract law, see Duncan Kennedy, "Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power," *Maryland Law Review* 41 (1982) 563–658.

[22] In the text I use the term "paternalism" to signify what philosophers call *soft paternalism*, which would justify interfering with a person's self-regarding choice when it is compromised by defects in information or defects in the reasoning and decision process. Another version of paternalism, *hard* paternalism, would justify interfering with a person's self-regarding choice even in the absence of such defects, so long as a person makes a bad choice about what is in his interests. I cannot do justice to hard paternalism in this chapter. Like many people, I find hard paternalism implausible because I find it offensive to interfere with the liberty of competent and well-informed adults to make choices about their own good.

[23] Seana Shiffrin, "Paternalism, Unconscionability Doctrine, and Accommodation," *Philosophy & Public Affairs* 29 (2000): 205–250.

[24] *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999).

[25] Alan Strudler, "Moral Complexity in the Law of Nondisclosure," *UCLA Law Review* 45 (1997): 337–384.

[26] Strudler and Orts, "Moral Principle in the Law of Insider Trading."

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Questions for Discussion

1. Duska suggests that once hired, employees can claim various rights such as the right to job security, the right to pension protection, and the right to a living wage. Do you agree with Duska?
2. Does Machan's argument that there should be no special workers' rights make sense? What do you think would happen if occupational health and safety legislation did not exist?
3. "Employees owe their employers loyalty and obedience, therefore they should never blow the whistle." Make a case for or against this statement, keeping in mind the arguments of De George.
4. De George believes that employees are obligated to blow the whistle only if they have documented evidence of a serious harm, and if they have reason to believe that whistleblowing will be effective in preventing the harm. Hoffman and Schwartz suggest these criteria are too strict in several respects. Do you agree with De George or Hoffman and Schwartz, and why?

6

The Modern Workplace Obligations and Limits

A Kantian Theory of Meaningful Work[1]

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I have always believed that one of the moral obligations of the firm is to provide meaningful work for employees.[2] However, just what constitutes meaningful work has been a contentious matter. Is "meaningful work" to be defined as nothing more than what the employees say it is? Or should the term "meaningful work" be given an objective normative definition which would permit managers to say the provide it even if the employees do not agree. A standard problem with the latter approach is that it is subjective and individualistic. I cannot see how a manager could provide meaningful work in that sense since it would be practically impossible to do so. Moreover, I do not see how management could have a moral obligation to provide meaningful work in the subjective sense in part because one cannot be obligated to do what cannot be done and because I cannot imagine how such a duty could be justified even if it were practically possible. Why should management have a duty to provide each employee meaningful work as he or she defines it? On the other hand, a standard problem with the objective approach is that it has been difficult to find a justification for any objective normative definition that can be given. In this paper I call upon the moral philosophy of Immanuel Kant to provide such a definition. In this way a concept of meaningful work will be grounded in a standard ethical theory. I recognize of course that such a Kantian definition may not satisfy non Kantians but one step at a time. In what follows I argue that a reading of Kant's ethical writings enables us to say that a Kantian would endorse the following six characteristics as characteristics of meaningful work:

1. Meaningful work is work that is freely entered into.
2. Meaningful work allows the worker to exercise her autonomy and independence.
3. Meaningful work enables the worker to develop her rational capacities.

Norman E. Bowie, "A Kantian Theory of Meaningful Work," *Journal of Business Ethics*, 17, 1998, pp. 1083–1092. Reprinted with permission of Springer.

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4. Meaningful work provides a wage sufficient for physical welfare.
5. Meaningful work supports the moral development of employees.
6. Meaningful work is not paternalistic in the sense of interfering with the worker's conception of how she wishes to obtain happiness.

Kant's Explicit References to Work

Our preliminary definition of "meaningful work" will be based on Kant's explicit writings. The focal point is the second formulation of the categorical imperative which says that one should always treat the humanity in a person as an end and never as a means merely. My argument is that at this point in human history within the context of business the possession of meaningful work is necessary for respecting humanity as an end in itself. Thus on Kantian grounds there is a moral requirement that the corporation provide it. Although much of my later argument will be based on contemporary interpretations of Kant's moral theory that I apply to the business world, Kant himself had a few explicit things to say about the nature of work.

First Kant argues that work is necessary for the development of self-hood understood as the development of one's ability to act autonomously and the ability to live independently.

> Life is the faculty of spontaneous activity, the awareness of all our human powers. Occupation gives us this awareness. ... Without occupation man cannot live happily. If he earns his bread, he eats it with greater pleasure than if it is doled out to him. ... Man feels more contented after heavy work than when he has done no work; for by work he has set his powers in motion.[3]

Somewhat surprisingly, perhaps, Kant endorses wealth and the pleasures it brings. Moreover, wealth contributes to self-respect because it provides independence. To work simply in order to make money is to display the vice of miserliness, a vice, which is even worse than the vice of avarice. So long as work is required to make money so that one can provide for one's needs and pleasures and in so doing make one's self independent, work has value. Selected comments of Kant's will establish his view.

> A man whose possessions are sufficient for his needs is well-to-do. ... All wealth is means ... for satisfying the owner's wants, free purposes and inclinations. ... By dependence on others man loses in worth, and so a man of independent means is an object of respect. ... But the miser finds a direct pleasure in money itself, although money is nothing but a pure means. ... The spendthrift is a lovable simpleton, the miser a detestable fool. The former has not destroyed his better self and might face the misfortune that awaits him with courage, but the latter is a man of poor character.[4]

This selection is from Kant's brief remarks, which amount to less than ten pages and represent student notes from Kant's lectures on ethics in the 1770s before Kant had written his more famous and critical works on ethical theory. Nonetheless they provide a starting point for a Kantian theory of meaningful work and for the obligations of a firm with respect to providing it.

So long as business firms provide jobs that provide sufficient wealth, they contribute to the independence and thus to the self-respect of persons. For a Kantian, the true contribution of capitalism would be that it provides jobs that help provide self-respect. The purchase of consumer goods in an affluent society often simply provides pleasure. Having a job provides the means for securing pleasure and the independence necessary for self-respect. As a corollary of Kant's position, if it is true that current welfare programs make people dependent, Kant would consider them a great evil. And a capitalism that provides jobs that do not provide sufficient income for independence is also morally flawed. Kant would be as concerned as we are about the scope of corporate downsizing and the loss of jobs that do not provide a living wage.[5]

Kant evaluated thrift on moral rather than economic grounds. He said

> Thrift is care and scruple in the spending of one's substance. It is no virtue; it requires neither skill nor talent. A spendthrift of good taste requires much more of these qualities than does he who merely saves; an arrant fool can save and put money aside; to spend one's money with refinement on pleasure needs knowledge and skill, but there is no cleverness in accumulating by thrift. The thrifty who acquire their wealth by saving, are as a rule small minded people.[6]

Alan Greenspan take note. It would be stretching the point to claim that Kant is a precursor of John Maynard Keynes but it is clear that wealth for Kant is something to be used to meet our material needs and that its moral value is in providing us the independence needed to meet our material needs. In the *Metaphysical Principles of Virtue*, Kant says "Therefore become thrifty so you do not become destitute."[7] Somewhat surprisingly, Kant does not follow Luther and Protestant ethics here. Weber could not cite Kant in favor of his thesis. Their is no intrinsic merit to saving itself. Savings are to be used to support one's autonomy in the material world. I say surprisingly, because Kant's ethics was strongly influenced by German pietism yet on this point is not consistent with it.

Although Kant's explicit remarks on work are rather limited, none the less, I believe the following ideas concerning the obligation of the manager to employees have explicit warrant in the Kantian texts.

1. A corporation can be considered moral in the Kantian sense only if the humanity of employees is treated as an end and not as a means merely.
2. If a corporation is to treat the humanity of employees as an end and not as a means merely, then a corporation should honor the self-respect of the employees.
3. To honor the employees' self respect, the employees must have a certain amount of independence as well as the ability to satisfy a certain amount of their desires. Thus the corporation should allow a certain amount of independence and make it possible that employees can satisfy a certain amount of their desires.
4. In an economic system, people achieve independence and satisfaction of their desires using their wages which they earn as employees.
5. Thus a corporation should pay employees a living wage, that is, a wage sufficient to provide a certain amount of independence and some amount of satisfaction of desires.[8]

Although this is as much as one can say given the Kantian text, I believe one can begin to formulate a Kantian theory of meaningful work. First, meaningful work provides a salary sufficient for the worker to exercise her independence and provides for her physical well-being and the satisfaction of some of her desires. Second, it seems obvious that meaningful work in a capitalist economy, be it the work of managers or the work of employees, must support the dignity of human beings. That is, capitalist work should support or enhance the dignity of human beings as moral agents. And since for Kant autonomy and rationality are necessary for moral agency the work relationship must support the autonomy and rationality of human beings. Work that deadens autonomy or that undermines rationality is immoral.[9] Thus the Kantian text explicitly provides two of the conditions for meaningful work.

I believe a Kantian can say more about meaningful work than that it gives us independence and thus self-respect.[10] By combining Kant's explicit early remarks on work with the rest of Kant's ethical theory and with the insights of the recent commentators on Kant, I believe a Kantian would endorse the additional remaining characteristics of meaningful work.

Contemporary Interpreters of Kant and Meaningful Work

An expanded Kantian definition of meaningful work builds on Kant's characterization of freedom, especially positive freedom. Let us begin with negative freedom. For Kant negative freedom is the ability to act independently of determination by alien causes. Negative freedom distinguishes us from animals and for humans a necessary condition for the meaningfulness of actions is that they be negatively free. Thus we have the justification for the first characteristic of meaningful work. The choice of one's work must be negatively free; is must be freely entered into.

Since autonomy plays such a role in Kant's thought, I believe this free choice should extend beyond the initial choice of a job. It should extend into the workplace itself. The worker should also be given autonomy on the job. If contemporary notions like "empowerment" provide more opportunities for workers to exercise autonomy on the job, Kantians are all for it.

But negative freedom does not exhaust Kant's rich notion of free action. Humans are positively free as well. One contemporary Kant scholar who has most persuasively articulated the Kantian theory of positive freedom is Thomas E. Hill, Jr. Positive freedom is the autonomy persons have to be a law unto themselves. As Hill says, "A person is a law to himself … if he adopts principles for himself and regards himself bound by them and if he was not caused or even motivated to adopt them by any contingent circumstances (such as his desires)."[11]

The task before us is to derive additional conditions for meaningful work from Kant's notion of positive freedom. In so doing, I make use of Hill's interpretation of the phrase "humanity as an end in itself." Hill begins his analysis by asking what does morality require if we are to treat humanity as an end in itself? To answer his question, we must know what Kant means by humanity. The popular answer to this question is that Kant equates humanity with our capacity for rational thought. But although rationality in the sense of being bound by the laws of reason is surely part of what Kant means by humanity, it is not the only part. Based on his examination of the Kantian texts, Hill argues that humanity includes the following capacities:

1. The capacity and disposition to act on the basis of reasons.
2. The capacity to act on principles of prudence and efficiency (hypothetical imperatives) so long as these hypothetical imperatives are not constrained by categorical imperatives.
3. The power to set any end whatsoever which includes the "ability to see future consequences, adopt long-range goals, resist immediate temptation, and even to commit oneself to ends for which one has no sensuous desire."
4. The capacity to accept categorical imperatives.
5. Some ability to understand the world and to reason abstractly.[12]

Assuming that Hill is right, it is a requirement of morality that people treat other people in ways that respect these rational capacities for that is what Kant means by treating humanity as an end in itself. Thus we have established our third condition that meaningful work should be work that facilitates the development of one's rational capacities.

This is not enough however. Hill's account focuses solely on our rational capacities. Some contemporary commentators have gone further. For textual support they focus on the two examples of moral duties from the *Foundations of the Metaphysics of Morals* specifically the imperfect duties to develop one's talents and give aid to the needy.[13] This duty requires that one do more to respect the humanity in a person than simply respect the rational capacities that people have.

These commentators indicate that additional textual support is available from the *Metaphysics of Morals*. These commentators point out that some interpreters of Kant's philosophy think it sufficient that people not use other people and certainly not using people is necessary for respecting the humanity of a person. But that is not sufficient. In the *Metaphsics of Morals* Kant explicitly says that being indifferent to someone does not treat them as a means merely (merely use them). But being indifferent does not treat that person as an end it itself. That is why, for Kant, not using people is not sufficient for respecting them in the way morality requires. In part two of the *Meaphysics of Morals, The Metaphysical Principles of Virtue*, Kant develops his theory of our obligations of virtue, that is of our obligations not backed by force of law. Kant argues that one has both a duty of perfection to oneself and a duty to promote the happiness of others. He asks. "What are the ends which are at the same time duties. They are these: one's own perfection and the happiness of others."[14] In an elaboration on our duty to promote the happiness of others Kant argues that each must be concerned with the physical welfare of others and with their moral well-being.[15] These interpretations of Kant provide additional evidence for the claim that meaningful work requires a living wage that provides independence and happiness and provide vindication for the fourth condition that supports the development of her moral powers.

I think we must be careful about how broadly we interpret this notion of happiness. Kant is basically concerned to show that we have an obligation to be concerned with the humanity of others. Thus our primary concern is with the rational capacities that Hill has identified as well as our rational well-being per se. One must also be concerned about the physical welfare of others and with their moral development. But one has no further obligation to make them happy. That is why condition four is limited to a wage sufficient for physical welfare rather than sufficient for happiness. What I intend to show is that within the context of business the obligation of the manager is to pay a living wage and that with respect to the obligation of beneficence that is sufficient to protect and support the humanity in each worker as defined above. That is the maxim which the moral manager should adopt.

To defend this view, a few more clarifying textual comments are necessary. What is the nature of our positive duty to promote the happiness of others or in our more restricted language to promote the positive freedom of another? Kant believed it is an imperfect duty in the sense that you did not need to help another on every occasion where it is possible to do so. Using the schemata provided by Hill,[16] the duty to help another is subject to the following conditions:

1. One cannot promote the happiness or positive freedom of another by violating a perfect duty. One cannot lie to promote the happiness of another.
2. One must have as a maxim that one will promote the happiness or positive freedom of others.
3. Nonetheless, for any given occasion where I could promote the happiness of another I have the option of not promoting it in this case.
4. I must actually promote the happiness of others on various occasions.
5. These acts of benevolence must be done from the appropriate moral motive.

But how should this be done? Onora O'Neill indicates that any application of the duty of beneficence involves a certain tension between love and respect.[17] On the one hand we must be concerned with the activities that others would adopt in order to be happy. This is the love part. On the other hand we cannot impose on them our views of what activities they should engage in to make them happy. That is the respect part. In paternalism love is carried too far at the expense of respect.

> Policies of respect must recognize that the other's maxims and projects are *their* maxims and projects. They must avoid merely taking over or achieving the aims of these maxims and projects, and must allow others the "space" in which to pursue them for themselves.[18]

Let us apply all this to the firm. Employers must not coerce (violate the negative liberty) of their employees; this duty is a perfect one. One's occupation should be freely chosen and the worker should have the opportunity to exercise freedom on the job as well. Moreover, employers have an imperfect duty to adopt a maxim to be concerned with the positive liberty of their employees, that is with their moral well-being and physical welfare. Of special concern are the rational capacities identified by Hill. Management practice should be such that it strengthens, rather than weakens, the rational capacities of employees.

With respect to the general welfare or happiness of employees, on the one hand, managers have an imperfect obligation to be concerned with the physical welfare of employees and to do nothing that impedes their moral development. Managers must allow employees the latitude to pursue their individual conceptions of happiness in accordance with their own desires. Moreover, firms also have an obligation to provide employees with a living wage and with security such that employees have the ability to pursue happiness in accordance with their own desires. What I am arguing is that the way for the manager to honor both beneficence and respect is to provide a living wage but not to decide what ought to make a worker happy.

We have now provided the justification from Kantian moral theory for the six characteristics that provide for "meaningful work." In this way the normative concept is grounded (justified) by moral theory. We have done this using Kant's own remarks on work and by spelling out the content of positive liberty which is required to respect the humanity in a person. Thus, meaningful work is work that is freely entered into, that allows the worker to exercise her autonomy and independence, that enables the worker to develop her rational capacities, that provides a wage sufficient for physical welfare, that supports the moral development of employees and that is not paternalistic in the sense of interfering with the worker's conception of how she wishes to obtain happiness.

Meaningful Work and Contemporary Business

It is one thing to provide a Kantian definition of meaningful work. But is the requirement that a firm provide meaningful work utopian? It is true that a moral requirement that firms provide meaningful work would have been considered impossibly utopian until recently. An although a Kantian philosophy of the workplace is still the exception rather than the rule, some organizational theorists and individual companies are committed to providing more meaningful work to employees. Moreover if it can be shown that meaningful work enhances quality and productivity, than the moral case for meaningful work is buttressed by a practical case. And such a case, as we shall see, can be made. For example, if U.S. firms must be concerned with the quality of their products in order to survive in international competition and if the provision of meaningful work is necessary for the production of high quality goods and services, then the provision of meaningful work becomes a prudential strategy as well as a moral one. Meaningful work provisions are not utopian; they are economic necessities.

The quality movement in the U.S. in the 80s and 90s has provided the basis for a defense of management practices that have much in common with our account of meaningful work. As Jeffrey Pfeffer has said:

> [T]he quality movement has legitimatized management practices that have been around a long time but have not generated a lot of support, perhaps because of the language. "Worker empowerment", "employee participation" or "participative management", "employee voice", "equity and fairness", "due process", "high commitment work practices", and similar terms often used in describing the employment relation somehow seemed to smack of coddling the work force.... The language of quality and the political support behind the quality movement overcome some of these problems at least to some degree.[19]

Moreover, the United States government, in response to the perception that foreign manufacturers were producing goods of much higher quality than those in the U. S., established the Baldridge Awards for quality. It is interesting to note how many of the good practice criteria refer not to the product itself put rather to how employees are managed. Even more interesting is the fact that these good management practices embody Kantian language that respects employee autonomy and responsibility. Emphasis is placed on the following factors:

a. Management practice ... such as teams or suggestion systems ... the company uses to promote employee contributions ... individually and in groups.
b. Company actions to increase employee authority to act (empowerment), responsibility, and innovation....
c. Key indicators ... to evaluate the extent and effectiveness of involvement by all categories and types of employees....
d. Trends and current levels of involvement by all categories of employees.[20]

Additional arguments which show that an obligation to provide meaningful work is not utopian come from Pfeffer. He has argued that firms can gain a competitive advantage if they focus on their employees. He identifies sixteen practices for managing people successfully. They include 1. employment security, 2. selectivity in recruiting, 3. high wages, 4. incentive pay, 5. employee ownership, 6. information sharing, 7. participation and empowerment, 8. teams and job redesign. 9. training and skill development, 10. cross utilization and cross training, 11. symbolic egalitarianism, 12. wage compression, 13. promotion from within, 14. a long term perspective, 15. the measurement of practices, 16. an overarching philosophy.[21] What I wish to do is show how these good human resource management practices match up with our six characteristics of Kantian meaningful work.

Let us begin by examining Pfeffer's list to provide an explanation of those practices that might not be intuitively clear. Cross utilization and cross training (Principle 10) is a technique that allows employees to do many different jobs. Symbolic egalitarianism (Principle 11) refers to the elimination of symbols of status from the workplace. Wage compression (Principle 12) refers to a policy that reduces large differences in pay between the top officials in the corporation and other employees as well as differences between individuals at roughly the same functional level. If wage compression were adopted horizontally, theVP for Finance would not earn a premium over the VP for Personnel as is now the case in most U.S. companies. Finally overarching philosophy (Principle 14) refers to management's commitment that these employment practices are a basic corporate value.

Although some of the items on this list have received general management attention, most of the items involve a sharp departure from current business practice. A comprehensive implementation of all the items would be quite revolutionary. Certainly a number of the practices are contrary to what is accepted as successful management practice.

Yet most of the items on this list provide a means for management to provide Kantian meaningful work for employees. They emphasize the importance of employee autonomy and independence. They emphasize the importance of employee autonomy and independence. They emphasize the importance of a good wage. They are consistent with the development of our rational capacities and they do not interfere with an employee's moral development. They treat employee's with respect, In the remainder of this paper many of these practices will be further elaborated and shown to be consistent with what a Kantian would expect of a moral firm that provided meaningful work, to its employees. Using Pfeffer's list of good practices for the management of people, the abstract notion that meaningful work is work that supports the worker in leading a moral and thus an autonomous rational life can be given some content.

What is now required is the examine Pfeffer's list to establish the connection of these sound management practice to meaningful work and to cite management practice that are in conformity with each of the items. This will show that providing for meaningful work is not utopian but rather represents best practice.

Meaningful work is work that provides an adequate wage. Principles 1, 3, and 12 are means for providing an adequate wage. Principle 3 (high wages) is obvious as a means to this goal. Job security (Principle 1) for many workers is a necessary condition for an adequate wage. The constant downsizing in American firms has meant that many workers have had to take ever lower salaries in each new position. The lives of families that had been comfortable before downsizing become precarious afterwards. Both survey results and the content of union contracts show that most workers would be willing to receive a lower salary in return for job security. Thus economic security is often what employees want most as an element of positive liberty. Job security is essential because it is necessary for achieving the conditions of meaningful work. Thus Kantian morality requires it.

Despite the fact that many firms behave immorally here – and some like those managed by Al Dunlop flaunt their immoral behavior, other companies try to provide employment security. For many years IBM was the leader in this regard, but bad economic times in the 1990s led to the abandonment of IBM's policy. One company that still provides security for employees is Hewlett Packard. William Ouchi describes Hewlett Packard's policy as follows;

> Twice in recent times, Hewlett-Packard has adopted the nine-day fortnight along with a hiring freeze, a travel freeze, and the elimination of perquisites. Each time these steps kept employees on while other companies in the industry had layoffs. The result at Hewlett-Packard has been the lowest voluntary turnover rate, the most experienced workforce in the industry, and one of the highest rates of growth and profitability.[22]

Wage compression (condition 12) would address one of the causes of having work and being poor and thus it would address the moral wrong that occurs when companies who could pay their employees a living wage do not do so. In the last decade there has been a steady increase in the ratio of the salaries of the top officials in a firm to wages paid to the least well compensated member of the firm. Moreover, the living standards of those at the bottom, often referred to as the working poor, have declined. Wage compression would be something of a corrective here. A situation where the rich get richer while the working poor fail to achieve an adequate standard of living is not acceptable to a Kantian.

Another important component of meaningful work is autonomy and independence. Principle 2, participation and empowerment, speaks directly to that issue. Open Book Management, a management technique developed by Jack Stack of the Springfield Remanufacturing Company, embodies these principles. With open book management every employee is given complete information and is expected to know the financial details regarding the firm. Every person knows how her job contributes to financial performance and is given the power to make changes to enhance the bottom line. Employees who work under open book management report that they feel empowered and responsible.

More and more companies are adopting a policy of flex time. Flex time gives employees greater latitude over their work schedules. Thus employees gain some autonomy over their work lives as required by condition two. An example here is a Baldridge Award winner in 1990 which is described as follows.

> "Empowerment" is a key theme in the Wallace approach to business. All associates are allowed to make customer related decisions of up to $1000 without seeking higher approval. Customer related decisions on values greater than that can be made in time sensitive situations. … Associates working in the warehouse can reject shipments if the material is defective or the shipment is incorrect … Wallace spent more than $2 million on formal education and training from 1987 to 1990.[23]

Another requirement of meaningful work is that the work contribute to the development of the employee's rational capacities. Principles 2 (selectivity in recruiting), 6 (information sharing), 8 (teams and job redesign), 9 (training and skill development), 10 (cross utilization and cross training) and 13 (promotion from within) all are a means to this goal. By selecting the right people in the first place, you do not get people who are overqualified for the job. Working on a job for which you are overqualified is usually boring and frustrating because it does not make best use of the employee's rational capacities. All the other items on the list contribute to skill development which is both valuable in itself (recall that one of Kant's perfect duties is the duty to develop one's talents) and adapts one for changes in the workplace so that the employee can remain gainfully employed. For example, Pfeffer argues for the importance of cross utilization. Routine assembly line work is often work that is dull, boring, and repetitious. By training a worker to do many different jobs a firm can eliminate or greatly mitigate the drudgery of assembly line manufacturing. Cross utilization makes teamwork possible and vice versa. In fact many of these principles fit together to transform traditional manufacturing work into an approach more compatible with a Kantian theory of meaningful work.

One principle, Principle 11 (Symbolic egalitarianism) is also necessary for self-respect and is a condition of fairness. It breaks down some of the class barriers that say not only is the work that I do different from yours, but it is more valuable than yours, and thus I am a more valuable person. The person who is doing what is perceived to be inferior work thus loses self-respect. And loses it unjustly. A business firm is a cooperative enterprise and thus every task is valuable to the enterprise. Market conditions, and other legitimate factors, may justify the fact that we pay one job category more than another but these conditions do not justify inequality of respect. In this way symbolic egalitarianism is supportive of a person's ethical development.

You do not find language in the business world that captures the pure Kantian spirit very often, but occasionally you do. In Pfeffer's terms few corporations have the appropriate overarching philosophy. I conclude this paper with exceptions, that is with examples of companies that at least come close to providing their workers with meaningful work in a Kantian sense.

Max DePree CEO of Miller Furniture captured the Kantian ideal when he work as follows:

> For many of us who work there exists an exasperating discontinuity between how we see ourselves, as persons and how we see ourselves as workers. We need to eliminate the sense of discontinuity and to restore a sense of coherence in our lives. . . . Work should be and can be productive and rewarding, meaningful and maturing, enriching and fulfilling, healing and joyful. Work is one of the great privileges. Work can even be poetic.
>
> What is it most of us really want from work? We would like to find the most effective, most productive, most rewarding way of working together. We would like to know that our work process uses all of the appropriate and pertinent resources: human, physical, and financial. We would like a work process and relationships that meet our personal needs for belonging, for contributing, for meaningful work, for the opportunity to make a commitment, for the opportunity to grow and be at least reasonably in control of our own destinies.[24]

Milliken and Company, a privately owned textile company with 14,000 employees won the prestigious Baldridge Award in 1989. A booklet used in recruiting describes the company as follows:

> In the process of arriving at new levels of quality, nothing supersedes the inner working of the human being. … There is emphasis on finding the best people for every career and on continuing education.… At Milliken, people are called Associates – not employees – implying the importance of each one as a contributor to our common objective. … All of this assumes a participatory management approach.[25]

But perhaps the statement of corporate philosophy that comes closest to the Kantian ideal is found in the way Hewlett-Packard expresses its philosophy toward its people. This passage is worth quoting at length.

> Our People
>
> Objective: To help HP people share in the company's success, which they make possible; to provide job security based on their performance, to recognize their individual achievements, and to insure the personal satisfaction that comes from a sense of accomplishment in their work.
>
> We are proud of the people we have in our organization, their performance, and their attitude toward their jobs and toward the company. The company has been built around the individual, the personal achievement. …
>
> The opportunity to share in the success of the company is evidenced by our above-average wage and salary level, our profit sharing and stock purchase plans, and by other company benefits.
>
> In a growing company there are apt to be more opportunities for advancement than there are qualified people to fill them. This is true at Hewlett-Packard, opportunities are plentiful and it is up to the individual, through personal growth and development to take advantage of them.
>
> We want people to enjoy their work at HP, and to be proud of their accomplishments. This means we must make sure that each person receives the recognition he or she needs and deserves. In the final analysis, people at all levels determine the character and strength of our company.[26]

Notes

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[2] See for example, "Challenging the Egoistic Paradox", *Business Ethics Quarterly* 1 (1991), pp. 1–21 and "The Paradox of Profit", in *Papers on the Ethics of Administration* Ed. N. Dale Wright (Provo, UT: Brigham Young University Press, 1990), pp. 97–120.

[3] Immanuel Kant, *Lectures on Ethics* (1775) (New York: Harper Torchbooks, 1963), pp. 160–161.

[4] Ibid., pp. 177, 181, 185.

[5] Although admittedly Kant wants a job to provide more than a living wage. A living wage is a necessary but not sufficient condition for a "good" job.

[6] Kant, op. cit., p. 184.

[7] Immanuel Kant, *Metaphysical Principles of Virtue* (1797) in Immanuel Kant *Ethical Philosophy* Trans James W. Ellington (Indianapolis: Hackett Publishing Company, 1994), p. 99.

[8] I indebted to Bryan Frances for the formalization of this summary. The argument has been reformulated after Robert Frederick pointed out the earlier version's inadequacies.

[9] I am not claiming that the only way one can gain autonomy and independence is through work that provides wages sufficient for independence. One can gain self-respect by being a priest or by being an impoverished artist. One can also gain respect by identifying with a group or cause. However if work in corporations is chosen and is to be morally justified, then something like the arguments I have attributed to Kant are necessary. I am grateful to Tanya Kostova for raising this issue.

[10] Although business ethicists have not emphasized meaningful work, some are giving it attention. Joanne Cuilla and Al Gini have both made important contributions. My own thinking on this topic has evolved from discussions with my graduate student Kathryn Brewer.

[11] Thomas E. Hill Jr., *Dignity and Practical Reason in Kant's Moral Theory* (Ithaca, N.Y.: Cornell University Press, 1992). p. 35.

[12] Ibid., pp. 40–41.

[13] Recall that an imperfect duty is one that you need to act upon on some occasions but not on all occasions. An imperfect duty should be distinguished from a perfect duty which is a duty one must always act on whenever the duty is present. Thus our duty not to lie is a perfect duty but our duty to aid others is imperfect.

[14] Kant, *Metaphysical Principles of Virtue,* p. 43.

[15] Ibid., p. 52.

[16] Hill, op. cit., Chapter 8.

[17] Onora O'Neill, *Constructions of Reason* (New York: Cambridge University Press, 1989), p. 114.

[18] lbid., p. 115.

[19] Jeffrey Pfeffer, *Competitive Advantage Through People* (Boston: Harvard Business School Press, 1994), pp. 215-216.

[20] Quoted in Pfeffer, op. cit., p. 209.

[21] Ibid., Chapter 2.

[22] William Ouchi, *Theory Z* (Reading, MA: Addison Wesley Publishing Company Inc., 1981), p. 118.

[23] Robert C. Hill and Sara M. Freedman, "Managing the Quality Process: Lessons from a Baldridge Award Winner". *Academy of Management Executive* 6 (1992), 78. Quoted in Pfeffer, op. cit., p. 214.

[24] Max DePree. *Leadership Is An Art* (New York: Dell Publishing, 1989), pp. 23, 32.

[25] Quoted in Pfeffer, op. cit., p. 212.

[26] Quoted in William Ouchi, op. cit., pp. 136–137.

Organization of Work in the Company and Family Rights of the Employees

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Businessmen are well aware of the marked relationship between family affairs of employees and their behavior in the company. The organization of work and activities in the company considerably affect family life. Some work set-ups can lead to family problems, and family problems, in turn, affect employee performance in the company. This intrinsic relationship between the family and organization of work makes it a subject of great concern to both employees and managers.

In countries such as Spain, where the family is a deep-rooted institution, the family-company relationship arouses considerable concern. According to a survey recently conducted by IESE among two hundred Spanish managers, the study of the family-work relationship came out as one of the four or five most important subjects that must be taught in the business ethics course.[1]

Until now, very little attention has been given to the study of the relationship between the organization of work in the company and the family rights and duties of the employee. However, a number of interesting works are available, albeit focussed only on some particular problems and referring specifically to American society.[2]

Some people consider that the family, by being a part of the employee's personal life, has no bearing on the company. Thus, any interference by the company in the employee's family life, is seen as an intrusion into the personal life of the employee. As such, it must be avoided. But in doing so, companies fail to take into account the importance of the family as the basic unit of society and its corresponding rights.

Others consider that it is sufficient to have flexible agreements between the company and its employees

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concerning family issues. In this situation, the rights of the family are taken into account only if the negotiating parties are conscious of them. Many times the family duties of the employees are viewed only as interests which are in conflict with the company's interests. They fail to realize, however, that the family is a source of real rights.

It must be pointed out that in the "Universal Declaration of Human Rights" and in the "International Agreement of Civil and Political Rights," it is categorically stated that "the family is the natural and fundamental unit of society and is entitled to the protection of society and the State.[3] Other international texts on human rights are couched in similar terms,[4] showing the existence of a wide international consensus on the intrinsic value of the family. In addition, a detailed Charter of the Rights of Family[5] was published by the Roman Catholic Church in 1983 and a European Charter of Family Rights is being prepared at the moment.[6]

Nevertheless, some family rights can easily be infringed upon as a result of the organizational work within the company. These rights can be enumerated as follows:

a. The right to find the necessary social support to consolidate the unity and stability of the family so that it may carry out its specific task.
b. The right to socio-economic conditions that enable it to carry out its duties with respect to the procreation and upbringing of children.
c. The right to working hours and periods necessary to devote to the other spouse, the children and to just being together.
d. The right to a quality of work life that does not affect the workers' genetic heritage nor their physical or mental health nor the necessary attention to their respective families.
e. The right to a sufficient compensation to start and maintain a family.

The following discussion deals with some aspects of work organization connected with the abovementioned family rights illustrated in several scenarios taken from cases that have been published or that the author has direct knowledge of.

Business and Working Environment Must Favor Marital Unity and Stability

Company policy on work organization may attack the family's unity and stability in a variety of situations such as those illustrated in the following scenarios.

a. Bribery or extortion using extramarital sexual relations

The use of sexual favour is a well known way of bribery or extortion.

Scenario 1

A company invites several managers from client companies to a convention at which its latest products will be presented. The reception includes all kinds of entertainment, including callgirls, which are supposed to smooth the way for sales to the potential buyers.

b. Sexual harassment

Sexual harassment within the company is, of course, another form against the unity and stability of marriage. It usually happens with extortion from someone superior.

Scenario 2

A male supervisor sexually harasses a female subordinate. The subordinate is aware of the unfavorable consequences that would result from rejecting the supervisor's advances: loss of promotion, misleading information on her performance to their superiors, effect on salary increases, and perhaps, dismissal in a future restructuring.

c. Situations that favor sexual attraction in the company

Moreover, some company practices – work arrangement, business trips, etc. – can also lead to immoderate sexual attraction among employees, although, these company practices are not conceived to lead to such consequences.

Scenario 3

A fast-moving finance company specialising in high-risk loans wishes to recruit a recent Harvard MBA graduate. On his first visit to the company, the young MBA realised that most of the women in the office were young and very attractive. In fact, he had never seen so many pretty women in one place before.

Later he learned that the company's vice-president (only him?) usually had some employee accompany him on his business trips, suggesting that they sleep together to "save the firm the price of a second room".

The executives earned a lot of money but if they wanted to get to the top they had to work Saturdays and Sundays. With all this, it is not surprising that the company's divorce rate was somewhat high.[7]

In all these situations, in addition to damaging the family, the business organization itself will suffer adverse consequences: distorted communications, hostile self-interests that go against the company's interest, impairment of the work unit's reputation, greater slowness in decision-taking, etc.

d. Dual careers and prolonged separation of spouses

In cases where both husband and wife work, a good working opportunity which requires relocation to another city, may come to either of the two. The overall success, however, can only be guaranteed if the other spouse can be permitted to relocate to the same city. Otherwise, the family may suffer temporary separation or the professional life of one may suffer to give in to the other.

A better alternative can be found if firms could take into account the family issues in dual careers.

Scenario 4

A large group of companies has recruited Antonio to turn around one of its ailing companies near Barcelona. Antonio is then asked to do the same in another company in the south of Spain. It is planned that he will spend three to five years in the new company. Antonio may have a very good career before him in this group of companies but he must be prepared to accept all the changes the company requires.

Antonio is married with three children aged less than 14. His wife Montse is an architect and works for the regional government. Her career prospects are also good. Montse also takes an active part in political life and knows a lot of people in the Barcelona area. Their children are happily enrolled in a school in Barcelona. Montse and Antonio also think that such a dramatic cultural change would not be good for the children. Antonio's bosses have pressured him a lot on this change and have made him understand that if he does not accept their demands, he can expect little future in the company. Antonio faces a dilemma and fears that he would not be able to find such a good job in another company.

It is hard to say just how much a company can pressure its employees in defense of its legitimate interests but it is clear that if it does not act with a certain consideration for family circumstances, it will be favoring the breakup of the family. Also, the prolonged separation of spouses gives rise to a lot of problems, especially when this separation is accompanied by frequent dealings with people of the other sex for work or social reasons, which may also undermine the unity and stability of the family.

On this point, the comment made by R. Quinn[8] is interesting in that he states that in 74% of the love affairs that occur at work, the man holds a higher position than the woman and, in almost half of the cases, the woman involved is his secretary.

In all these scenarios, of course, the person involved is free to refuse the proposition of infidelity but the company's policy, the work environment or the behaviour of its managers may significantly influence the preservation of the unity and stability of the marriage.

The company can make it easier to fulfill the duties of marital unity and stability by acting in the following areas:

1. Forbidding its employees to use all forms of bribery including the exploitation of the sexual instincts of potential customers.

2. Penalizing those who take advantage of their power by extorting people in exchange for sexual gratifications.
3. Taking steps to prevent sexual harassment between employees, especially those occurring from the abuse of power. It should be borne in mind that, according to the Merit System Protection Board, sexual harassment has little to do with mutual physical attraction, provocative behaviour or even sex.[9] It is above all an expression of dominance and nonreciprocal behaviour directed by the strongest at the weakest.
4. Acting with care in the design of work organization and avoiding, as much as possible, forms of business activity that may easily result in thoughtless sexual provocation among its employees.
5. Creating an appropiate atmosphere within the company in order to avoid sexual harassment and to encourage managers to exercise care in their relations with the people with whom they work the most.
6. Taking into account the effects of dual careers on the families, avoiding the considerable pressure on the employees resulting in discrimination.
7. Avoiding as much as possible prolonged separations of spouses.

Compatibility of Work with the Obligations of Parenthood

Attention given to the family, and especially to the bringing up of children, can be unacceptably low as a result of the ineffective work organization in the company. The organization itself can hinder, and in some cases, even prevent the parents from freely choosing the type of education their children should receive. Here are a few situations:

a. Moving employees or managers to another city or country

This may affect the professional or social interests of the concerned spouse or of the rest of the family, as well as affecting the children's education (change of school, educational system or culture).

Scenario 5

A leading leather tanning factory in Valencia (Spain) opened a factory in Indonesia. The factory had to be managed by someone trusted by the company, who knew the tanning process and the leather-tanning trade well. The company management was convinced that this person had to be one of its employees. However, moving the employee with his family not only meant having to live in a different country and culture but also the impossibility of finding a school that would educate his children in accordance with his wishes. In fact, in spite of the promotion and the good pay, there was no-one willing to accept the position and relocate.

The company saw two alternatives: pressure the person concerned in various ways until he was persuaded to move or find alternative solutions that respect the family rights. The final solution was to appoint two managers who would work alternately on three month periods in Indonesia and Valencia.

b. Business trips that excessively shorten the amount of time available to the family

Scenario 6

A Barcelona company is in the turnkey business of building and selling ceramic and earthenware plants. It has projects all over the world. Part of its staff of 1,500 employees work on the assembly and start-up of the new plants and, where necessary, on repairing those already existing.

These travelling workers spend from six months to two years away from their city (normally abroad). Their allowances are not excessive and they are not given more vacation time than their non-travelling colleagues. If necessary, the return from one country is tied up with the departure for an assignment in another country, as a result the worker is hardly able to spend any time with his family. Of course, his employment contract includes the obligation to travel as often as necessary.

On occasions, especially when the stay is going to be long, the workers take their families with them. The educational problems that arise are

> heightened by the cultural and religious differences in the customer-countries, some of which have communist governments.
>
> The trips abroad are organized without any consideration for the worker's personal situation.

Obviously, moving away is not equally distressing for all employees. Consider the case of a bachelor, or of a man whose children are already grown up or of a man whose children are of school age. It does not seem reasonable to exclude an employee's family situation unless no consideration is made of the personal aspect of work.

A totally liberal approach would argue that business trips and work abroad are within the contractual provisions and previously freely agreed upon. However, such circumstances harm family rights. And because family rights are natural rights, they must obviously come before any other kinds of commitment, including working commitments.

On the other hand, contracts that contain elements of coercion may lead one to question their fairness. This would be the case of a contract that did not respect the worker's family rights if the freedom of choice was reduced, as occurs, for example, in situations of excess supply of labor.

c. Rigidity in working hours and the possibility of working at home

It is becoming increasingly common for both wife and husband to work outside the home. In the USA, more than two-fifths of the work force (47 million employees), are composed of spouses in working households.[10] In Europe, the proportion of this kind of people could vary widely according to the country but is important enough to pay attention to.[11]

Rigid working hours adversely affect mothers who wish or need to work out of home, especially when the children are still young. This is perhaps one of the most pressing problems for many young families. The problems that usually arise when both parents work are well known: the care of small children, the mismatch between work and school vacations and working hours, the care of children when they fall ill and above all, the deficiencies in upbringing that usually arise because of lack of time and the parents being too tired to give enough attention to their children.

There seems to be no doubt that the best solution to these problems is to spend more time working at home, especially when the children are very young. However, this is not always possible for a number of reasons.

Some companies have proposed various solutions ranging from locating kindergartens and schools next to companies to flexible working hours. They are solutions that each have their pros and cons and respond rather to a compromise of interest than to a social recognition of the rights and duties of parents, foremost among which is the care and upbringing of their children.

On the other hand, working outside of home with a reasonable degree of flexibility may also provide very suitable solutions.[12]

Nancy R. Pearcy, a writer resident in Canada and a former feminist, advocates work in the house and not just housework. This would be compatible with the mother's important task of bringing up her children. She thinks that women who work at home can have the best of both worlds: earn a living while being able to freely organize their working hours, in accordance with the number and age of their children.[13] The idea is interesting and even feasible in some situations; however, when there is no appropriate labor legislation, there may be companies that take advantage of conscientious and hard-working mothers to exploit them using the well-known practices of the underground economy:

> **Scenario 7**
>
> An imitation jewelry firm contracts out assembly work to homeworkers. Without any employment contract, social security, abnormally low piece rates and tax avoidance, this firm is able to make large profits while the workers – mothers with small children in almost all cases – are able to look after their offspring while working at home but with a ridiculously low pay.

It does not seem fair that labor legislation prevents flexible working schedule or homeworking. Perhaps this justifies some forms of black economy but, in any case, business ethics demands that abuses be avoided and that alternatives be devised to solve this problem which, for many families, has serious effects.

d. Excessive working hours and lack of vacation periods which hinder family life and especially the care of children

Inflexible and prolonged working hours and rigidity at work in general (prohibition of part-time working, vacation periods dictated by the company, etc.) all too often affect family duties, especially those of mothers who work out of home. This situation largely depends on the company management. Even though working hours can be influenced by labor legislation, companies usually still have ample room for maneuver.

Scenario 8

Arturo Garcia, the managing director of a Spanish firm employing 90 people, usually has his lunch outside of the office and, after a long rest, returns to his office at about 5:30. He then starts to work at a feverish pace. He wants his immediate subordinates to extend their working day until very late to help him. One of his secretaries, who is an excellent worker, has stated her desire not to extend her working hours beyond the normal time because she must go to fetch her children from school. This attitude has upset Mr. Garcia who is not prepared to promote that person nor increase her salary beyond that stated in the collective agreement because, according to him, "she can't be counted on."

Arturo Garcia places his convenience and habits before the legitimate rights of his employees. Mr. Garcia could probably organize his work without interfering with the family rights of his employees.

e. Overwork to the detriment of family life

In some occasions, temporary increases in the workload make it necessary to do a lot of overtime work. And this at times becomes a habit and the person is forced to do overtime work on a regular basis. Without guidance, he may lose sight of the fact that work is not an end in itself.

Scenario 9

Juan is a top executive in a Spanish automobile company. He is married and has three children aged 6, 8 and 11. He leaves home at 6:30 A.M. and gets back exhausted at about 10 P.M. when the children are already in bed. He also goes to the office on many weekends or takes work home. His job requires frequent travel. In order to make the best use of time, he often starts his trips on a Sunday.

Juan earns a lot of money which he uses to try to satisfy all his wife's and children's desires. His wife, Maria, often complains that she has everything except a husband. The few times she is with her husband to talk about their children, she tries to explain to him that he cannot delegate to her his part of the children's upbringing. Juan justifies himself by saying that the amount of work he has to do is due to the pace set by the company's president and that he has to work as hard as the president does to maintain his position, earn enough money and maintain the, admittedly high, standard of living of his family.

In the situation of overwork shown in the previous situation, the initial responsibility lies with the employee. Juan should reconsider his scale of values, his duties as father and husband, his behavior towards his family and the organization of his own work. However, the company may also be partly responsible. Could Juan alone change the situation without giving up his job? Perhaps, but the management style imposed by the president no doubt has a significant influence.

Working Conditions in Relation to Family Duties

Hygiene and safety conditions at work primarily affect the worker. However, working conditions may have effects that go beyond the individual worker, involving his family life.

The following two situations, while not intended to be exhaustive, illustrate two types of inadequate working conditions and their relation to family rights.

a. Physical, chemical or psychological conditions that affect the employee's health

This obviously affects to a greater or lesser extent the real possibilities of carrying out family activities.

> **Scenario 10**
>
> In Spain, as in other countries, in the mid-60s there was no protection against the deafening noise in the cement factory mills. The people who worked there ended up completely deaf. In exchange, the company paid them a bonus for dangerous work. It is not difficult to imagine the problems of oral communication that occur in the family.

Today, this situation has been overcome in most industrialized countries by thick insulating walls and remote control. It is a point that is usually well protected by legislation in industrialized countries. The problem lies in the enforcement of this legislation and, above all, in the working conditions in certain developing nations.

b. Lack of protection of fertility and genetic heritage or inadequate working conditions for pregnant mothers

The protection of the transmission of life derives from the right of the new being already conceived to life or the genetic heritage which may be altered as a result of the action of certain substances present at the place of work. It also derives from the inalienable right of parents to responsibly transmit life, which should not be harmed by working conditions.

> **Scenario 11**
>
> AT&T detected a high rate of miscarriages among the female workers in the chip manufacturing lines. Consequently, in 1986, AT&T decided to transfer those pregnant workers who were working on the semiconductor production lines.[14]

Respect of Independence and Family Privacy

The company, as also the rest of society, should not interfere in family privacy nor in its future prospects. Nor should it pressure or discriminate due to:

a. the status of the spouse and the number of children
b. the type of education or school chosen by the parents
c. the family's moral or religious values.

> **Scenario 12**
>
> In 1978, the American Cyanamid Company in Willow Island (West Virginia) had a dye production plant which used lead chromate, a fetotoxic substance.
>
> Eight women worked in this section. As a result of legislation, the company drew up a series of safety regulations which included removing women from this section unless they could certify they were sterile. In fact, of the eight women employed in the lead dye section, five had themselves surgically sterilized. This drastic decision was probably influenced by the poor economic conditions in the area, the small size of the Willow Island facilities and the non-existence of jobs available for the women in the immediate short term. In subsequent lawsuits, the company argued that it had tried to dissuade the five women from sterilizing themselves and that it had offered them suitable alternatives in the form of jobs of similar rank and pay. If this is true, the offer was either not convincing or the regulations made did not take into account sufficiently the logical consequences in those female workers who destroyed all possibility of having children in order to keep their jobs.[15]

In cases such as this, the organization of work may violate family privacy and one of the most important family rights: the right of responsible procreation. This type of situation shows the inadequacy of a system of ethics that does not take into account the foreseeable consequences.

Sufficient Compensation for a Decent Family Life

Paying unjustly low wages is another way of violating family independence. It is well-known that remuneration for work done is the principle means of living for most employees.

If real pay is insufficient to bring up a family, then a basic right is trampled under foot which, to a large extent, conditions all the rest,

Scenario 13

A Spanish company employs 60 workers. Its financial situation is good. Most of the workers hold positions that require little skill or experience. However, wages are scaled above all according to years of service (for historical reasons and union pressure) and to date, very few benefits have been given to workers and their families. Unfortunately, economic protection of the family in Spain is one of the lowest in Europe (an annual allowance of 2,000 pesetas per child and tax deduction of 16,000 pesetas per child, in 1987).

Some of the workers in this company with large families are in serious financial difficulties. Others see in the current pay system an effective coercion tool against procreation. Obviously, these problems affect the working atmosphere.

Management is considering restructuring wage rates taking into account not only production but also the worker's family situation.

In several international human rights documents, the need has been stated to provide economic protection for the family.[16] John Paul II, following a long tradition of social teaching by the Roman Catholic Church, insists in the encyclical *Laborem exercens* on the need for a sufficient level of remuneration to enable the employee to lead a decent family life.[17]

The State, mainly through welfare benefits and tax deductions, can provide a certain economic protection for the family. However, the company cannot remain aloof from the economic rights of its employees' families, especially when State aid is insufficient. This consideration gives rise to two statements:

a. The wages paid should not be less than those required by an average family to live a decent life within the context of the time and place concerned.
b. The benefits granted by the company to its workers should cover all members of their families. These benefits should be greater the lesser the protection given by society in general to families. It is not always easy to give these family-weighted benefits. It requires a lot of solidarity not only from the company with respect to its employees but also among the individual employees, taking into consideration the over all financial capability of the firm to grant the benefits.

   Efforts should also be made to prevent a particular company from being excessively affected by the size of its workers' families.

   Also, those workers with large families may be discriminated against. It therefore seems advisable to create special funds for families from certain groups of companies or economic sectors.Thus, it would be possible to better respect the economic rights of the family without resorting to the State or overburdening individual companies.

Conclusion

The narrow attitude towards work which separates the worker from his family life should be dispelled. The worker is not just "labor" but a person who has family duties of crucial importance for himself and for society.

Family duties fall primarily upon the members of the family itself but, by being natural rights of all those who have chosen marriage and family, they should be respected and even promoted by the firm to ensure social justice in employer-employee relations.

It is one of the company's ethical obligations to organize work, taking into account the family duties of its employees and their subsequent compliance.

The idea that the loose agreement between employee and employer is insufficient, and unjust without the explicit consideration of the rights of the family. When the negotiating parties do not have the same power or there exists the need to work, family rights and other rights may be disregarded in the name of freedom of negotiation.

Family rights must be enforced with care and not just as a mere legalism in the organization or work in the firm. By doing so, the efforts to respect family rights will lead to corresponding improvements in labor relations.

Finally, when employees feel hindered to comply with their family duties because of excessive work, they became unmotivated and less efficient. Hence the organization is worse off.

Notes

[1] It will be published.

[2] Such as those by Cfr. R. M. Kanter: 1977, *Work and Family in the United States* (Russell Suge: New York). R. Bailyn: 1978, 'Accommodation of Work to Family' in *Working Couples* ed. by R. Rapoport and R. N. Rapoport (Harper and Row: New York). J. P. Fernandez: 1986, *Child Care and Corporation Productivity: Resolving Family/Work Conflicts* (Lexington Books: Lexington). A. C. Michalos: 1986, 'Job Satisfaction. Marital Satisfaction and the Quality of Life: A Review and a Preview', in *Research and the Quality of Life*, ed. by F. M. Andres (University of Michigan Press: Ann Arbor, Michigan), pp. 57–83.

[3] U.N.O.: *Universal Declaration of Human Rights*, Art. 16,3 (Paris, 12.10.1948); *International Agreement of Economic, Social and Cultural Rights*, Art. 10,1 and Art. 23,1, adopted by the General Assembly of the UN in its resolution 2200 A (XXI) on 11.16.1966. Came into effect on 12.30.1976.

[4] *American Declaration of Human Rights* (1948), Art. 6; *European Social Charter* (1961), Art. 16; *American Convention of Human Rights* (1969), Art. 17.1. Recommendation 2018 (XX) adopted by the General Assembly of the UN on 12.1.1965; *Declaration on social progress and development* proclaimed by the General Assembly of the UN in its resolution 2542 (XXIV) on 12.11.1969.

[5] Holy See: 1983, *Charter of the Rights of the Family* (London, Catholic Truth Society). In 1981, Pope John Paul II pointed out some basic family rights and committed the Holy See to prepare a Charter on the Rights of the Family (Exh. Apost. *Familiaris consortio*, n. 46. London, Catholic Truth Society). This Charter has been the first monografic international document on the rights of the family.

[6] This European Charter of Family Rights was proposed by Mr. Oreja, the Secretary General of the Council of Europe in his address to the 20th Conference of European Ministries responsible for the family (Allocution du Secrétaire Général pour la Ministres 20e Conférence des Ministres Européens chargés des Affaires familiaires. Brussels, May 19, 1987).

[7] C.P Dredge and V. Sathe. *Mike Miller (A)*, Case Study of Harvard Business School, ICCM 9.482.061.

[8] R. E. Quinn: March 1977, 'Coping with Cupid: The Formation, Impact and Management of Organizational Romance', in *Administrative Science Quarterly*.

[9] Merit System Protection Board: 1981, 'Sexual Harassment in the Federal Workplace' (U.S. Government Printing Office).

[10] Conference Board: 1985, 'Corporations and Families: Changing Practices and Perspectives', Report No. 868 (Conference Board, New York).

[11] On the employment of women by age group in different European countries: *vid*. 1986, *Year Book of Labour Statistics*, 406th Issue, pp. 35–42 (International Labour Office, Geneva).

[12] K. Ropp: 1987, 'Case studies' in *Personnel Administrator. 32*, No. 8. pp. 72–79.

[13] Cfr. N. R. Pearcey: 1987, 'Why I Am Not a Feminist (Any More)'; *The Human Life Review* New York, March, pp. 80–88.

[14] Cfr. *La Actualidad Electrónica*, Barcelona, January, 1987, p. 20.

[15] Cfr. J. B. Matthews, K. E. Goodpaster, and L. L. Nash: 1985, *Policies and Personas. A casebook in business ethics*. (McGraw-Hill, New York) pp. 72 ff.

[16] Cfr. U.N.O. *Universal Declaration of Human Rights*, Art. 23.3; *European Social Charter*, Art. 4.1; U.N.O. *International Agreement on Human Rights*, Art. 11.1, etc.

[17] John Paul II. Enc. *Laborem exercens*. No. 19. (Boston: St. Paul Press, 1981).

Workplace Wars
How Much Should *I* be Required to Meet the Needs of *Your* Children?

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Johnny's mom leaves work early to coach Johnny's soccer team; Katie's dad leaves work early to attend Katie's kindergarten graduation – while other, childless (or, alternatively, childfree) workers stay late to pick up the slack. Johnny's mom and Katie's dad both receive, as part of their benefit packages, health insurance for Johnny and Katie, as well as the opportunity to contribute to a tax-free childcare account – benefits not available to colleagues without children. While many applaud such company efforts to assist working parents, struggling under a dual burden of employment and parenthood, recently a chorus of voices has been raised to challenge "family-friendly" policies, charging that they are friendly to families at the expense of unfairness to fellow workers without children.

Are the special needs of parents ones we should be seeking to meet? If so, who is this "we" – the government, employers, fellow workers? What policies in the workplace are most fair to parents and non-parents alike?

Responsibilities, Choices, and Needs

One first answer here, which I hear from some of my most environmentally conscious friends, is that the rest of us should bear no responsibility whatsoever for parents' special needs, because people shouldn't be becoming parents in the first place. In a world as crowded as ours, and as environmentally threatened, people should not be having children at all. Admittedly, those in Western, developed nations are not currently reproducing at greater than replacement rates; nonetheless, it is these children who have the heaviest and most destructive "ecological footprint." One of my friends, environmentally outraged, refused to speak to his own brother after his third nephew was born! Few of us subscribe to this draconian environmental ethic, however. Children provide such a great part of the good of life that it seems unreasonable to expect people to forgo the central life experience of parenthood in exchange for environmental benefits that are speculative and diffuse.

On the other end of the spectrum, it is claimed that the continued production of children is a positive good for all of us, and parents are thus to be congratulated, and heartily and humbly assisted in their endeavor. According to this view, those who do not have children, far from being paragons of environmental virtue, are parasites on those who do. Sylvia Ann Hewlett, chairman of the National Parenting Association, is quoted in the *Denver Rocky Mountain News* as saying, "Children are 100 percent of the future and we are all stakeholders in their future because they are the folks who will be paying our Social Security. If you are a childless adult you are kind of a free rider on the effort of raising children." But this view as well seems overstated. Collectively we may need and want *some* people to be having children, but we hardly feel the more, the better. And most of those who have children don't approach the having of children in this light, as a duty grimly assumed for the benefit of humankind generally.

We are left, then, with a middle position. Having children, I claim, is a morally permissible but not morally mandatory choice that persons make to enrich their own lives. This would seem to support the view that the consequences of this choice – the increased needs that parenthood brings – should be regarded by and large as the responsibility of the parents alone. After all, if they didn't want to assume those burdens, they could have refrained from having children. We see a similar reaction in other areas of life

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in which special needs flow from voluntary choices rather than from the vagaries of chance and the uncertainties of fortune. We question whether we should be collectively providing medical care for those whose medical problems arise from poor lifestyle choices: smoking, over-eating, risky sexual behaviors. Moving closer to our current topic, some question whether welfare payments should be provided to poor mothers who repeatedly bear children out of wedlock.

However, even as we question the provision of assistance in such cases, by and large we do continue to provide it, and to feel morally uncomfortable with the refusal to provide it. Our response to need, we hope, is not in the first place dictated by a detached judgment regarding the cause of that need; we aspire to be more open-hearted than that. However, as the need in question becomes chronic rather than acute, and poses a less dire threat to life and health, we rethink our willingness to offer aid. We would rescue a child drowning in a pond, however she came to be floundering there; we don't feel the same way about repeatedly picking up our neighbor's child from day care, when he *could* leave work on time but chooses to stay late. In the latter case, we may wonder whether we have left the realm of "needs" behind altogether.

Yet it may be a mistake to press too heavily on the voluntariness of the choice to bear and raise children. While this is indeed a choice we make, it seems to be misrepresented as a (mere) "lifestyle choice." Having children is such a central part of a full human life, something Aristotle felt comfortable including as a fundamental element in *eudaimonia*, human flourishing. While some – and perhaps a growing number – obviously define flourishing for themselves differently, it is hardly eccentric to view a full human life as including children of one's own (biological or adopted) to love and care for. Life without children seems importantly similar, in my view, to life without sex. There are those who live a full and joyous life without sex; yet most of us don't feel that sex is something we can simply ask people to renounce, as the price of absolving themselves of responsibility for any future offspring (although some of us do). So, while we can consider the bearing and raising of children as a choice, it is not a choice which most people feel blithely free to take or leave, especially given heavy societal pressures and expectations to reproduce.

It is not clear how relevant this concession is, however, to the question we are pursuing here. For even if we accept that parents' special needs don't flow from choices we can reasonably ask them to forgo, we may be wary of workplace policies which place too much weight on the meeting of particular, personal needs. To be blunt, "To each according to his needs," is not, contrary to what many Americans in a recent opinion poll reported believing, a creed enshrined in the American Constitution. While I will argue below that allocation according to need *is* an important principle at the level of government policy, in the workplace other competing principles – such as allocation according to effort, or to accomplishment – command greater allegiance.

In the case of meeting parental need, it would seem strikingly unfair to most of us to pay parents more than non-parents for the same work, on the grounds that they have greater income requirements. In the past considerations such as this provided the rationale for paying men higher salaries (as family "breadwinners") than women without dependents. It is not only the sexism here that troubles us, but also the unfairness of giving greater pay to one employee than to another for the same contribution.

If we move toward the other extreme, however, of disregarding need, we can arrive at some seemingly ludicrous results. Should one worker complain that another, who suffers a heart attack, receives consider ably greater benefits from his company-provided health insurance policy than she does from hers? Lisa Benenson, editor of *Working Mother* magazine, is quoted in the *New York Times* as asking, "If the person at the desk next to you gets cancer, do you think of them as 'earning' more because their health dollar costs are higher?" However, the health insurance case is a special one, which can't be generalized too far. The whole idea of health insurance is based on a commitment to risk-sharing; if we were just going to pay for our own health-care needs, unwilling to take a chance on having to pay for anybody else's, we wouldn't have gotten health insurance in the first place. We recognize that health insurance is in some respects a lottery, in which we may emerge as either winners or losers.

A better example to test our willingness to match benefits to needs might be: Suppose a company provides each employee with three days of bereavement leave annually, as needed. Would it make sense to allow the non-bereaved to use this leave to enjoy summer barbecues or time at the spa? Here, while intuitions may differ, this doesn't seem to me absurd. As we shall see below, many employers are moving in precisely this direction, of providing an extensive and variable menu of benefits from which both parents and non-parents can choose at will. Of course, what employers are willing and financially able to provide for all may fall considerably short of what employees in special circumstances need. But here it may be unreasonable for the needy to expect their plight to be addressed by their employer rather than by a general societal safety net.

My conclusion so far, then, is that greater parental need is an insecure foundation for greater parental benefits – partly because the need flows from a voluntary choice (although one that is hardly trivial or eccentric), partly because we are only moderately willing to apportion workplace benefits according to need, in any case.

A more promising approach, I suggest, proceeds as follows. Whatever we decide about the choice to have children, and our appropriate response to the needs generated by it, nobody benefits when children are not raised well. It may or may not be in my interest that you have children; but it is definitely in my interest that your children, once here to share the planet with me, grow up to be as happy, loving, good, and decent as possible. This is one kind of argument that supports the provision of free public education to all children, financed by the contributions of taxpaying parents and non-parents alike. What good does it do anyone to have children growing up uneducated? And, we can also ask, what good does it do anyone to have children growing up with poor parenting? So even if we understand the choice to have children as one that implies the responsibility to assume at least some of the additional burdens involved in raising these children, we all – parents and non-parents alike – have a stake in seeing these children raised well. We all share an interest in the optimal raising of our future citizens, neighbors, colleagues, and friends.

Now, this argument appeals to the enlightened self interest of non-parents, regarding the raising of other people's children. It may therefore seem to fall short of grounding actual moral obligations. What if someone were to listen to the argument just offered, and shrug and say, "Maybe I'm being foolishly short-sighted in not wanting to assist you with the raising of your children, but, frankly I just don't care"? Here my response is that one of the deepest problems of political philosophy is to establish actual obligations on the part of those who profess not to care about the collective benefits to be generated by collective cooperation: those who don't want to pay their share for national defense, or environmental protection, or other public goods. It is simply not feasible to permit individuals to opt out at will on the provision of collective benefits, while still remaining full-fledged citizens and members of our common life. Moreover I argue that it is morally imperative (and not merely optional) for us to ensure that all persons' *basic* needs are met, simply out of respect for basic human rights. Thus, we all bear some responsibility for meeting all children's most basic needs (for food, shelter, health care, and education), not as a duty owed to these children's parents, but as a duty owed to the children, as our fellow human beings, themselves. However, current workplace policies aim beyond the bare meeting of basic, universal human needs, toward facilitating good, rather than just minimally adequate, parenting.

Now, the appeal to the widely shared benefits of optimal child rearing can take us only so far. Raising happy, healthy children is an important societal goal, but it is not our only societal goal. Indeed, raising happy, healthy children is not even the only goal of those children's parents, who presumably continue to care about other aspects of their lives as well: their work, their marriages, their contributions to the larger community. So we need now to consider actual policy proposals regarding the treatment of parents and non-parents in the workplace, and in the community beyond.

How Far Do We Go?

If we recognize compelling reasons to provide at least some assistance to parents in child rearing, what does this mean in practice? Who should be assisting parents, and how? There is currently a wide range of options possible. The federal government provides tax breaks for parents by giving a $2,800 tax deduction for each dependent in a family, as well as an additional dependent-care credit (up to $4,800), and has recently added a $500 per child tax credit. There are calls for greater governmental subsidization of day care, and for stricter governmental regulation of day care. Employers can provide, more or less "family-friendly" policies, ranging from the provision of health insurance benefits for family members, to tax-free dependent-care accounts, to on-site, company-sponsored day care, to flextime and other ways of structuring a more accommodating workplace. And fellow workers and neighbors also lend various amounts of informal assistance: staying late when working parents need to be at home, watching children when working parents need to be at work.

Note that some family-friendly policies make it easier for parents *not* to work (by easing the financial burden imposed by children, and so reducing the need for parents to generate additional income); some make it easier for parents *to* work (by, for example, providing high-quality, affordable day care). Which kind of policies we favor will depend on our other views about how children are best raised: by stay-at-home parents or by working parents. I will not enter that debate here, except to say that, just as children are an important part of a flourishing, full human life, so is work. Just as I am reluctant to ask workers to forgo being parents, so am I reluctant to ask parents to forgo being workers. I do happen to think it is beneficial for children to see both male and female parents as making some (paid or unpaid) contribution to the world beyond the home. But even if I didn't, I would not want to insist that parents – or any of the rest of us – are required to do *everything possible* to raise the *best possible* children. I will return to this issue below.

At this point, our question is, given the desirability of some family-friendly policies, who should bear the cost of putting family-friendly policies in place? I want to argue that it is best if this cost is shared as widely as possible, by all members of society. For the good in question – the raising of healthy, happy children – is a public good, equally shared by all. Thus, it is preferable, in my view, to provide family benefits through general governmental revenues. This would include tax deductions for dependents (I would limit this to deductions for *two* children, to address the environmental concerns raised above), deductions for childcare as a legitimate business expense, and (in an ideal society) provision of welfare services and health care to all children, as to all persons generally.

I find it more problematic when differential benefits are provided to parents not by the government, but by employers (and more problematic still when working parents, through their own informal arrangements, simply impose a greater share of work on childless workers). Here it does seem to me that the provision of differential benefits to working parents violates our strong, long-standing commitment to the principle of equal pay for equal work. Elinor Burkett, author of *The Baby Boon: How Family-Friendly America Cheats the Childless*, says (in a *Denver Post* article), "If compensation packages given to parents are worth $10,000 more than those given to non-parents, then we're compensating parents for their fertility and not their work."

Thus I would argue for company policies that, as far as possible, treat parents and non-parents alike, by extending to all the benefits needed primarily by parents. This would mean offering a mix-and-match menu of benefits from which all workers could choose: health insurance for dependents, additional vacation time, flextime, and so forth. The case for uniform (but more generous) benefits goes like this. Employees have many needs, beyond the need to care for small children. As we move through the cycle of life, the need to care for growing children is replaced by the need to care for aging parents (though some, in the so-called "sandwich generation," may face both needs simultaneously). Employees who struggle with poor health would welcome a less strenuous schedule. Benefits such as flextime and enhanced personal leave (e.g., the typical European worker receives six weeks of annual leave, to our two weeks) would greatly enrich the lives of all workers, parents and non-parents alike. Many commentators have observed the extent to which the early twenty-first century workplace deforms and degrades human life. Juliet Schor, in *The Overworked American*, argues that leisure time has declined steeply for Americans in the past three decades. We work longer for less satisfaction, neglecting other passions and interests. It would be in the interest of all of us to adopt, as Jerome Segal has recently argued, a more graceful and humane pace of life. Theda Skocpol, Professor of Government and Sociology at Harvard, suggests that the solution to the workplace wars lies in looking for "ways to modify working conditions to facilitate both family and community involvements by everyone. In that way, contributions by parents can be considered one of a range of ways in which people engage in caring work and civic involvements." Even now some employers allow, and encourage, their employees to do a certain amount of community service on company time; employers could offer employees a choice of release time for *either* community service *or* family commitments.

Extending this idea still further, we might suggest that government offer tax benefits to its citizens for a range of important and life-enhancing activities: for dependent care generally, rather than child care more narrowly (as is the case with most of the deductions in the current tax code); for continuing education; and even for various other rewarding activities. The core idea here is to permit, and indeed to promote, the seeking of our own flourishing in our own chosen way.

Having It All

Would uniformly more benign workplace (and tax) policies solve the conflict between working parents and non-parents?

It may seem that uniform policies here would do violence to Aristotle's famous injunction to treat likes alike, and unlikes differently. Working parents may still complain that uniform policies would continue to leave them significantly disadvantaged at the end of the day. They have the same health stresses of their own as nonparents, the same obligations to elderly parents, the same need for a more graceful and humane pace of life. Plus, they have *kids*. So they need financial support and release time to meet parental obligations in addition to what they need just to *live*. Moreover, in our society at the present time, this double burden (triple burden? quadruple burden?) is especially likely to fall on women, who still assume a disproportionate share of childcare and other domestic responsibilities.

Here, though, is where I think working parents go too far. Part of maturity, indeed part of living gracefully, is to accept that all resources, including life itself, are finite. Quite simply, the time I spend doing x will be time I will not spend doing y. It would be unreasonable for parents to expect to face no consequences whatsoever for their choice to become parents. While the gendered inequities here trouble me deeply – mothers generally face greater consequences for their choice to become mothers than fathers do for their choice to become fathers – I don't think the best way to address these is to introduce further divisive inequities between parents and non-parents.

While I cannot document this, I suspect that some of the most bitter conflicts with working parents comes from those who consciously chose not to have children so as to pursue other valued objectives. Workers who are not currently parents, but were in the past, may be able to sympathize with working parents, even as they may mourn that certain benefits were not in place when they were struggling to balance home and work. (Of course, some are not: "I struggled without affordable day care; you should have to struggle, too.") Workers who are not currently parents, but will be someday, have a clear interest in seeing family-friendly policies put firmly in place, though this may not be an interest they are able fully to recognize (many of us have stories of friends who made a comically abrupt turn-around here on the day they discovered *they* were about to become parents). Those unable to have children may have less sympathy for working parents' laments: they would give anything to be able to assume such a double "burden." And those who made the decision not to have children just so that they could concentrate on professional success, or a strong marital relationship, or other interests, may well think: I made my choice and I'm living with it; why can't you live with yours?

A memory from my adolescent years comes to mind here. In the days before backpacks, I would limp home every day from school under the groaning weight of a huge armful of heavy textbooks. My best friend Debbie skipped and scampered beside me, unencumbered with any books whatsoever. Finally, one especially hot and weary afternoon, I asked her if she might want to help me out by carrying a few of my books. Her answer stayed with me for the next thirty years. "Claudia," Debbie told me, "if *I* wanted to carry home textbooks, *I'd* carry home textbooks, and *I'd* study, and *I'd* get good grades, but I don't want to carry home textbooks, so I don't." Her message was clear: if I wanted the good grades so badly, I would have to carry the weight of books that went with it.

To learn to live with our choices, and the inescapable limits they impose on us, is to give up the pipe dream of having it all. Yet one of the cruel paradoxes of our time is that just as parents are entering the work force in record numbers, the expectations for what counts as adequate parenting are also increasing. The less time parents have to give to parenting, the more we have come to expect of them as parents. Recent years have seen a staggering proliferation of extracurricular activities for children, all of which require parental chauffeuring, zealous attendance at games, endless recognition ceremonies. We not only have to be dutiful soccer moms, cheering at every soccer game, but, with children playing in two sports simultaneously, and studying two musical instruments, we have to cheer at every soccer game *and* every swim meet *and* every piano recital *and* every violin recital, as well as coach their Destination Imagination teams and plan extravaganzas for Vacation Bible School. We have seen the rise of what has been called "hyper-parenting"; we have taken too seriously the goal of *optimal* child rearing, as opposed simply to good parenting.

Now, it is admittedly difficult for individuals to act alone to buck societal trends. Working parents do feel intense pressures today – both to parent as if they were not workers, and to work as if they were not parents. But the sad, or perhaps not so sad, perhaps liberating and joyous, truth is that this can't be done. The sooner we accept this truth, the better it will be for us as workers, as parents, as human beings.

A rich and full life is a great good. I for one do not want to force people to choose between work and parenthood; and we all share some responsibility for meeting children's basic needs and assisting parents in raising tomorrow's citizens. It is best when this responsibility is met by broadly shared tax policies and governmental programs, and by workplace policies that offer a more humane and graceful way of working to parents and non-parents alike. But working parents also need to be realistic and non-hubristic, to accept the limitations of time and life, and experience the distinctive joy that such acceptance can bring.

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Discrimination, Harassment, and the Glass Ceiling
Women Executives as Change Agents

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Although sex discrimination is prohibited by law in the United States and various other regions, it continues to be a widespread problem for working women.[1] Title VII of the Civil Rights Act of 1964, amended in 1991 to include punitive damages, prohibits sex discrimination in the U.S. in all employment-related matters. Women in the U.S. have made considerable progress in organizations in the nearly 40 years since Title VII was passed and affirmative action for women was implemented. Nonetheless, women in the U.S. earn only about 76 cents to the dollar that men earn (Wall Street Journal, 1998), are more concentrated in lower earning industries and organizations than are men (Kim, 2000), and are under-represented in managerial and executive positions – positions of power, decision-making, and influence. Though comprising almost 50% of the U.S. workforce, women occupy only about 30% of all salaried manager positions, 20% of middle manager positions, and about 5% of executive level positions (Bose and Whaley, 2001; Fagenson and Jackson, 1993; Rice, 1994). These disparities in earnings, status, and position cannot be completely or largely explained by differences in the education, job tenure, or experience of working women, leaving much to be attributed to employment discrimination (Blau et al., 1998; Cain, 1986).

As in the U.S., discrimination against women is a continuing problem around the world (e.g., Can, 1995; Maatman, 2000; Muli, 1995; Korabik, 1993; Shaffer et al., 2000). Various countries provide prohibitions against discrimination. The Sex Discrimination Act of 1975 in the United Kingdom, the Canadian Human Rights Act, the Sex Discrimination Acts of 1984 and 1992 in Australia (Barak, 1997) and the Hong Kong Sex Discrimination Ordinance of 1996 (Shaffer et al, 2000) all prohibit discrimination on the basis of sex. These prohibitions provide criminal and/or individual penalties for such behavior (Maatman, 2000). Nonetheless, despite bans against sex discrimination, in most countries, as in the U.S., women's lower earnings, status, and occupation of managerial positions when compared with men's provide evidence of its continued existence (Roos and Gatta, 2001).

In this article, we discuss the relationships between discrimination, harassment, and the glass ceiling, arguing that many of the factors that preclude women from occupying executive and managerial positions also foster sexual harassment. We suggest that measures designed to increase representation of women in higher level positions will also reduce sexual harassment. We first define and discuss discrimination, harassment, and the glass ceiling, relationships between each, and relevant legislation. We next discuss the relationships between gender and sexual harassment, emphasizing the influence of gender inequality on sexual harassment. We then present recommendations for organizations seeking to reduce sexual harassment, emphasizing the role that women executives may play in such efforts and, importantly, the recursive effects of such efforts on increasing the numbers of women in higher level positions in organizations. Though much of the discussion focuses on U.S. women, because discrimination and harassment are issues for working women worldwide, we include available references to such issues in various regions outside of the U.S. In

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addition, our suggestions for addressing discrimination and harassment should be useful for organizations worldwide, particularly given the increasing recognition of the problems of discrimination and harassment for working women around the world (e.g., Maatman, 2000; Shaffer et al., 2000).

Discrimination, Harassment, and the Glass Ceiling

We propose three forms of sex discrimination that affect women in organizations: overt discrimination,[2] sexual harassment, and the glass ceiling. Though by no means exhaustive of discriminatory acts, each has negative effects on women's status and therefore on women's ability to effect change regarding such discrimination. We discuss each form of discrimination, their shared antecedents, and a possible solution below.

Overt discrimination

Overt discrimination is defined as the use of gender as a criterion for employment-related decisions. This type of discrimination was targeted by Title VII of the Civil Rights Act of 1964, which prohibited making decisions based on sex (as well as on race/ethnicity, national origin, and religion) in employment-related matters such as hiring, firing, and promotions. Overt discrimination includes, but is not limited to, such behaviors as refusing to hire women, paying them inequitably, or steering them to "women's jobs". Overt discrimination has long been a factor in women's employment experiences, yet its inclusion in Title VII is said to have been an "after-thought" perceived as certain to ensure its failure to pass.

Along with societal norms and perceptions of gender-appropriate occupations, overt discrimination led to occupational sex segregation. Occupational sex-segregation, in which at least 75% of workers in an occupation are male or female, has declined somewhat in the past three decades, however, most jobs remain fairly well sex-segregated (Bose and Whaley, 2001). In the U.S., women constitute the majority of nurses, flight attendants, and secretaries, in positions supportive of men, who comprise the majority of physicians, pilots, and executives, respectively (Roos and Gatta, 2001). Indeed, 7 of the 10 most common jobs for women are sex segregated (secretaries, cashiers, registered nurses, nursing aides/orderlies/assistants, elementary school teachers, and servers; Bose and Whaley, 2001). These jobs are characterized by low pay, low status, and short career ladders (Reskin, 1997).

Women's occupational sex segregation, and the concomitant low status, short career ladders, and low pay are common in other regions around the world (Kemp, 1994; Shaffer et al., 2000). In the U.S. and other countries, women who are low in organizational status, have low organizational power, and who earn significantly less than men are more frequent targets of sexual harassment (Fain and Anderton, 1987; Gruber, 1998; Gruber and Bjorn, 1982). Further, in these lower status positions, and many others that women occupy, women are considerably more likely to be supervised or managed by men than by women (Gutek and Morasch, 1982; Nieva and Gutek, 1981), which increases the risk that they will be harassed by their male superiors.

Sexual harassment

Sexual harassment, a form of sex discrimination, is but one manifestation of the larger problem of employment-related discrimination against women. It now appears obvious that sexual harassment is a form of sex discrimination. However, its inclusion under Title VII was not the original intent of the act (Clarkson et al., 1995, p. 743). Early legal cases under Title VII questioned whether sexual harassment constituted sex discrimination (Lee and Greenlaw, 2000), often finding that it did not. Some cases ruled that supervisor sexual harassment resulted from individual proclivities over which organizations had little control (e.g., *Corne v. Bausch & Lomb, In.*, 1975). However, in 1980, using Title VII, the U.S. Equal Employment Opportunity Commission (EEOC) published guidelines on sexual harassment. These guidelines clarified the illegality of harassment, describing two specific types as being unlawful sex discrimination: quid pro quo and hostile environment harassment.

In quid pro quo harassment, employment-related bribery or threat is used to obtain sexual compliance.

The coercive nature of quid pro quo harassment requires that the harasser have some power over the target, thus most of such harassment is perpetrated by managers or supervisors. Hostile environment harassment occurs when sexual behaviors have "the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile, or offensive" work environment (EEOC, 1980, p. 74677). This type of harassment may be perpetrated by managers, supervisors, peers, or subordinates (Paetzold and O'Leary-Kelly, 1996).

As is overt discrimination, sexual harassment is a persistent workplace problem for women worldwide. Numerous regions include prohibitions against such harassment (e.g., Canada, Israel, the United Kingdom, Australia; Barak, 1997), though with varying levels of stringency and application. Though specific prohibitions, terminology, and stringency vary worldwide, researchers have empirically identified three psychological dimensions of sexual harassment that persist across international boundaries: sexual coercion, gender harassment, and unwanted sexual attention (Fitzgerald et al., 1995; Gelfand et al., 1995). These dimensions have been confirmed in the U.S., Brazil, China, Canada, and other regions (e.g., Barak, 1997; Gelfand et al., 1995; Shaffer et al., 2000).

It is estimated that at least half of all U.S. women and about 15% of men will be sexually harassed at some point during their careers (Gutek, 1985; USMSPB, 1981, 1988). Although most sexual harassment targets do not file formal charges, more than 15,000 charges are filed with the U.S. EEOC each year (Buhler, 1999), an amount that has increased five-fold since the late 1980s. Most of those filing charges are women; 91% in 1992 and 86% in 2000 (EEOC, 2000). In contrast, most harassment perpetrators are men (Baugh, 1997; Keyton, 1996; O'Donohue, 1997, p. 2); clearly, sexual harassment is a gendered problem (Riger, 1991; Welsh, 1999). Indeed, reasons frequently suggested as explanations for the persistence and pervasiveness of sexual harassment are often gender-based, specifically, gender differences in perceptions of what constitutes harassment (e.g., Baugh, 1997; McKinney, 1992; Piotrkowski, 1998; Riger, 1991; Welsh, 1999) and gender differences in access to power and status (both a consequence and a cause of overt discrimination and harassment).

Sexual harassment may contribute to the perpetuation of occupational sex segregation. Women may purposefully enter occupations typically dominated by women – occupations that have lower pay and fewer opportunities for advancement (Gutek and Koss, 1993; Kemp, 1994), in part to be safer from harassing coworkers. O'Farrell and Harlan (1982) found that women working in non-traditional, craft worker jobs experienced frequent harassment. Similarly, women who were blue-collar trade and transit workers in Mansfield et al.'s (1991) study, also jobs not traditionally held by women, were more likely to be harassed than were secretaries. In these cases, such sexual harassment may be deliberate and resentful behavior, designed to deter women from entering historically male jobs (Kemp, 1994; Martin, 1989; Miller, 1997; Tangri et al., 1982). The sometimes virulent harassment experienced by some women in male-dominated environments (e.g., Yoder and Aniakudo, 1996) makes the suggestion of intentional, purposeful creation of an inhospitable working environment appear credible.

The glass ceiling

The glass ceiling is the third form of discrimination that we discuss as affecting women in organizations and is an important factor in women's lack of access to power and status in organizations. The term "the glass ceiling" refers to invisible or artificial barriers that prevent women (and people of color) from advancing past a certain level (Federal Glass Ceiling Commission – FGCC, 1997; Morrison and von Glinow, 1990). As discussed above, women comprise about 30% of *all* managers, but less than 5% of executive managers in the U.S. At the lowest levels, women comprise a larger percentage of managers, making more obvious the disparities between women in high and low-level managerial positions. The barriers that result in such disparities are often subtle, and include gender stereotypes, lack of opportunities for women to gain the job experiences necessary to advance, and lack of top management commitment to gender equity and equal employment initiatives, As with overt discrimination and sexual harassment, the glass ceiling exists in other regions of the world. According to Antol and Izraeli (1993), in industrialized nations overall, the number of women in the highest levels of management is about 6% (compared with about 5% in the U.S.). Of managerial women in China, Korabik (1992, p. 204) stated that "the higher the post, the fewer the women."

As an "invisible" barrier, the glass ceiling is difficult to eradicate through legislation. Informal networking and mentoring are frequently suggested as means of increasing the numbers of executive women (FGCC, 1997), yet these suggestions have had limited time to demonstrate effectiveness for women. Further, networking with and mentoring offered by executive men can be less fruitful and more problematic for junior women, who may be assumed to be sexually involved with their mentors. These problems can be particularly difficult for women of color (Thomas, 1989).

In sum, the relative lack of women managers and executives, the support roles many women workers provide to men workers, and occupational sex-segregation all facilitate sexual harassment. We propose that because overt discrimination, the glass ceiling, and sexual harassment are all forms of sex discrimination with (some) shared antecedents, measures to mitigate one will necessarily address the others. In the sections that follow, we discuss how having women in managerial and executive positions may be one particularly effective measure for reducing discrimination, for multiple reasons.

Women Executives and Harassment Prevention

In the previous sections we have discussed ways in which discrimination, the glass ceiling, and harassment affect women workers. Women who have attained executive positions have apparently achieved some measure of success against sex discrimination in matters of promotion and advancement. However, as evident by the existence of the glass ceiling, executive women are by no means discrimination free. Nonetheless, in the following sections, we propose that such executive women are uniquely positioned to address sexual harassment as illegal discrimination in their organizations in a variety of ways. From the perspective of the need for women executives in the battle against sexual harassment, we suggest that (1) women who work for male supervisors or managers report greater harassment and perceive their organizations as being more tolerant of harassment, (2) women rarely perpetrate harassment, (3) women view harassing behaviors differently from men and (4) women executives are more likely to have personal experience with sexual harassment than are men. Each is discussed below.

Supervisor gender and organizational tolerance of sexual harassment

Research suggests that leader gender and behavior influence perceptions of organizational tolerance for sexual harassment and the actual existence of sexual harassment in an organization. For example, in Gutek's (1985) stratified random sample of workers in Los Angeles, women who had a male supervisor were more likely to report being harassed. Most of these women were harassed by male co-workers, who may have perceived that such behavior was tolerated (or condoned) by male supervisors. In Hulin et al.'s (1997) study, women who reported to a male supervisor viewed the organization as being more tolerant of harassment than did women who reported to a female supervisor. Finally, in her study of women office workers who worked in male-dominated environments, Piotrkowski (1998) found that women whose supervisors were men experienced more frequent sexual harassment than did women whose supervisors were women. Further, the most frequent hostile environment harassment was reported by women whose supervisors were men whom they perceived as being biased against women (Piotrkowski, 1998). Gruber (1997, p. 95) reporting several studies, summarized the relationship between leader behavior and harassment, noting that "organizations whose leaders were perceived as discouraging harassment had a lower incidence of harassment." For those perceived as encouraging harassment and bias the opposite was true.

Supervisor gender and harassment perpetration

Supervisor gender itself is also a factor in sexual harassment, in a fairly simplistic way. Women infrequently perpetrate sexual harassment; EEOC estimates suggest that female to male of harassment comprises about 9% of harassment while male to female harassment comprises 90% of harassment, with the remainder being same sex harassment (Keyton, 1996). Thus, it appears that merely employing women in managerial and executive positions would necessarily reduce sexual harassment to some extent – particularly sexual coercion.[3]

Gender differences in perceptions of harassing behaviors

In addition to differing in the experience and perpetration of sexual harassment, some gender differences exist in the determination of what behaviors constitute sexual harassment. These differences are less pronounced with sexual coercion; men and women view such behavior similarly and clearly, both perceiving it as harassment (Blakely et al., 1995; Burgess and Borgida, 1997; Williams et al., 1997). Sexual coercion occurs less frequently than does hostile environment harassment (Gruber and Bjorn, 1982; Munson et al., 2000; O'Hare and O'Donohue, 1998). Whether the more frequent, but less clear cut behaviors, such as sexual joking, making obscene comments, and persistent requests for dates are deemed harassment depends largely on the pervasiveness and persistence of the behavior and the gender of the perceiver. Specifically, women are more likely to interpret ambiguous behaviors as harassing than are men; in situations where the behavior is less clear cut, women are more likely to label those behaviors as being harassing than are men (e.g., Konrad and Gutek, 1986; Thacker and Gohmann, 1993; Wiener and Hurt, 2000). Thus, the types of behaviors that are more common are also the types of behaviors about which there are gender differences in perceptions of whether sexual harassment has occurred (see also Baugh, 1997). These differences may help to explain the persistence of sexual harassment (Baugh, 1997). Even though women are more likely than men to believe that certain behaviors do constitute harassment, they are unlikely to be in positions of power to influence *behaviors*, which contributes further to the persistence of sexual harassment. Further, as suggested by Dipboye (1985), women may not be treated fairly in organizations because the organizational culture may directly and indirectly communicate that they should not be. The absence of women in such positions may signal to potential harassers that women are not viewed as valuable members of the organization.

Women executives and the experience of sexual harassment

Despite being of higher level and status than most working women, as noted earlier, women executives remain far outnumbered by men executives and also experience sexual harassment. In addition to harassment from higher status executives and peers, women executives may also experience "contra-power" harassment, in which higher status women are harassed by lower status men (Benson, 1984; Grauerholz, 1989; McKinney, 1990, 1992). Galen et al. (1991) reported that 53% of the National Association of Female Executives in their survey had been sexually harassed. In a study of healthcare executives, twenty-nine percent of the women executives and five percent of the men executives reported having been harassed (Burda, 1996). Executive women in a 1992 survey by *Working Women* were also harassed at a higher rate than non-executive women. *Working Woman* attributed this in part to the employment of such executive women in male-dominated companies (Sandoff, 1992). One respondent noted that "the higher up you climb, the worse the harassment gets," reflecting her belief that the harassment resulted from men's efforts to deter advancement of women (Sandoff, p. 48). Finally, in a sample of professional and managerial Canadian women, Burke and McKeen (1992) found that sexual harassment was a significant problem and resulted in lower organizational commitment and less job satisfaction. Clearly, sexual harassment is not limited to women of low occupational status, which may be beneficial in cessation efforts.

Women executives, as persons who are more likely to have experienced harassment than are men executives, may have a greater ability to empathize with harassment targets than would men. In addition, regardless of whether they have personally experienced harassment, executive women will be likely to perceive harassing behaviors similarly to other women, who, as discussed earlier, view such behaviors differently from men. As policy-makers, regardless of a genuine intent to maintain a harassment free environment, executive men may be perceptually disadvantaged with regard to sexual harassment. Specifically, due to their position as men, and a lifetime of unfamiliarity with sexual harassment or fear of assault, executive men may be less able to perceive sexually harassing behaviors as do women. Wells and Kracher (1993) have argued that life experiences and socialization make women likely to perceive sexual behaviors as offensive and possibly frightening; men may perceive the same behaviors as harmless or flattering. These differences in perception accentuate the need for women executives to battle in the war against sexual harassment.

Increasing Women Executives: Equity and Policies

We have discussed relationships between discrimination, harassment, and the glass ceiling, arguing that they are all factors that preclude women from occupying executive and managerial positions. Thus, we are in a double-bind with respect to executive women, discrimination, and harassment. More women are needed in executive positions to help curb sexual harassment. At the same time, sexual harassment (along with other forms of discrimination against women) may be preventing or limiting the advancement of women to executive positions. In the following sections, we provide suggestions for coping with this conundrum, drawn from the literatures on sexual harassment, discrimination, and gender equity. We begin with organizational support of gender equity, which is an important factor in reducing discrimination and harassment. Given the small percentage of women in positions of power and decision-making in organizations, such a commitment to gender equity would necessarily require the commitment of men in such positions. The high costs of sexual harassment, in the forms of withdrawal behaviors and intentions (Shaffer et al., 2000), physical and psychological effects on harassed employees (Hulin et al., 1997; Piotrkowski, 1998; Schneider et al., 1997), lowered job satisfaction (O'Farrell and Harlan, 1982; Piotrkowski, 1998), litigation costs, and damage awards if found liable, should result in executives of both genders and other stakeholders being wholeheartedly in support of efforts to curb harassment.

Organizational support of gender equity

Grundmann et al. (1997, p. 177) have argued that efforts to prevent sexual harassment would include equal numbers of women and men in various levels of authority, and clearly communicated job roles with expected duties and limits. Gutek and Morasch (1982) indeed found that women working in gender-integrated settings with approximately equal numbers of men and women reported the lowest levels of harassment. We thus propose that concerted organizational efforts be made to reduce sex segregation and to employ women and men in various levels of authority, across the organization. Women would be employed in non-stereotyped positions, in decision-making, and policy-making positions, and earning pay comparable to men. Although overt efforts to employ women in male-dominated environments may initially increase levels of sexual harassment and backlash (see Burke and McKeen, 1996 for a discussion), over time, sexist barriers and hostile environments should be reduced. In their research on sexual harassment of women working in male-dominated fields, Mansfield et al. (1991) noted that the women who experienced the most harassment were working in more recently sex-integrated environments. We suggest that in organizations committed to gender equity, awareness of the potential for increased harassment would mean more concerted prevention efforts, including a strong harassment policy that reflects women's perspectives.

Sexual harassment policies

Strong sexual harassment policies have long been suggested as an important means of curbing sexual harassment (e.g., Dekker and Barling, 1998; Pryor et al., 1993). Stronger prohibitions and sanctions against harassment are associated with fewer reports of sexual harassment (Dekker and Barling, 1998; Pryor et al., 1993). Further, researchers have suggested that considering a feminist view of harassment in designing harassment policies is important (Maier, 1997; Riger, 1991). Despite large damage awards discussed in the media, most women who are harassed do not file lawsuits or even formally complain (Gutek and Koss, 1993; Sandoff, 1992). Baugh (1997) and Riger (1991) have argued that women's failure to complain reflects gender bias in policies, stemming from perceptual differences in the way women and men view harassment and from women's belief that their complaints will not be taken seriously. Riger has also suggested that informal grievance procedures for sexual harassment complaints may be more successful than formal ones, given women's relative lack of power. In addition, rather than punishment or retribution, many harassed women simply want the behavior to stop (Riger, 1991; Robertson et al., 1988). This suggests that in addition to formal grievance policies, organizations should include informal dispute resolutions that focus on harassment cessation for harassment targets who would be more comfortable with such measures.

Women Executives: An Untapped Advantage

Women executives' leadership styles

A growing body of research indicates that women executives differ from men executives in many ways that enhance their management style and success (e.g., Rigg and Sparrow, 1994; Rosener, 1990; Stanford et al., 1995), which may translate into how they address issues of sexual harassment. A woman is more likely to lead an organization from the center of a network of interrelated teams, rather than from the top of a traditional command hierarchy as do most male leaders (Gilligan, 1982; Helgesen, 1990). As such "centralist" leaders, women executives are more likely to gain information directly about harassing or discriminatory behaviors, and can thus be more responsive (Smith, 2000, p. 38). As noted earlier, they may also be more likely to see such behaviors similarly to other women, rather than discounting or doubting them.

Another benefit of increased numbers of executive women may be higher satisfaction and retention of other managerial and professional women – those who would be future executives, shaping future policies. Burke and McKeen (1996) have reported that managerial and professional women working in organizations with predominantly men in higher level positions were less satisfied with their jobs and had greater intentions to quit than women in organizations with less skewed gender ratios in higher level positions. Burke and McKeen (1996) have also argued that the absence of women in executive positions may also result in the reluctance to create policies supportive of career goals of lower level managerial and professional women. We suggest that an underrepresentation of women may also result in reluctance or inability to create sexual harassment policies that meet the needs of women and men who are harassed. Regarding harassment of men, in McKinney's (1992) study of contrapower harassment, male participants thought that women who were harassed by persons of lower status would be more upset than men who were so harassed. Interestingly, female participants thought that both men and women targets of contrapower harassment would be equally upset. That is, regardless of the target of harassment, women see harassing behaviors negatively. Thus, in situations where men are harassed by women, women executives would be expected to perceive this negatively rather than as flattering or innocuous as executive men might (Wells and Kracher, 1993).

Feminist perspective, equity, and effectiveness

Feminists and other researchers have long argued that viewing discrimination and its effects from a feminist rather than masculinist perspective would be beneficial in many ways. For example, Maier (1997, p. 943) has suggested that feminist alternatives be considered in organizations, rather than continuing to "take the prevailing masculinist managerial paradigm for granted." He also suggested that efforts toward gender equity would be beneficial for men as well as for women, given the prevailing (mis)perceptions and dysfunctionality inherent in masculinst assumptions. Maier (1997, p. 943) argued that these assumptions disadvantage women, parents (including men), and reduce overall organizational performance. He suggests that "feminist-based organizational transformation" would promote gender equity as well as more effective and ethical organizational behavior.

We suggest that women executives may increase organizational effectiveness in other areas as well. A climate of intolerance of sexual harassment is associated with a climate of tolerance for differences (e.g., in terms of race or ethnicity, culture, religion, or physical ability) and one that supports employee growth, participation, and empowerment through training, mentoring programs, and equitable pay for all employees. Such a climate is associated with a positive public image, and the concomitant attraction and retention of top talent (e.g., *Fortune*, 2000). In order to compete for human resources in today's tight labor market, men (as well as women) executives in other organizations will likely see the need to adopt similar policies that foster a healthy organizational climate. Policies and actions that promote gender equity may also be adopted in other organizations as the latest "management fashion" or trend (Abrahmson, 1996; DiMaggio and Powell, 1983; Weaver et al., 1999). Thus, women executives have the potential to make sweeping, progressive changes, both within and beyond their organizations.

Conclusion

In this manuscript, we have discussed three forms of sex discrimination: overt discrimination, sexual harassment, and the glass ceiling. We have argued that women in executive leadership roles are uniquely positioned to reduce sex discrimination, and that because all three have some common antecedents, steps to reduce one form will likely affect the others. We focused on the reduction of sexual harassment in particular, and argued that not only should simply increasing the numbers of women in executive positions decrease sexual harassment, but also that women executives use their positions of influence to increase gender equity and reduce sexual harassment. A particularly important contribution of our work is our explication of how women executives are especially motivated and qualified to reduce sexual harassment and increase gender equity, and the specific steps that they may take to do so. Given the beneficial consequences of such actions, and the imitative nature of organizations, they will likely "spillover" and be adopted in other organizations as well (e.g., Abrahamson, 1996).

There is a critical, immediate need for such actions. For over 20 years, employers have had EEOC guidelines on sexual harassment, which include clarification of what it is and steps to prevent it, along with litigation and numerous damage awards that serve as warning signals. Nonetheless, the rate of sexual harassment charges filed with the EEOC has grown. This rate of growth in charges filed *may* be a good sign, insofar as it reflects the targets' understanding of their rights and willingness to report incidences of harassment, perhaps as a consequence of training and information about sexual harassment provided by organizations. On the other hand, the sheer number of charges filed indicates that sexual harassment continues to be a problem, if not a growing problem. The persistence of sexual harassment despite efforts to curb it via methods used thus far (i.e., legislation and organizational policies) points to the critical need for innovative strategies. We believe that increasing representation of woman at executive levels in organizations is just such a strategy, and one that will have comprehensive effects on all forms of sex discrimination and improve gender equity at all levels. This is no quick, easy solution, but one that is likely to have broad ranging positive effects on *all* employees, male as well as female, in the long run.

Notes

1 We acknowledge that the experience of sex discrimination and/or harassment is not limited to women, however, most discrimination and harassment involve women as targets. Thus, we focus our discussion on discrimination against and harassment of women.

2 We use the term overt discrimination to differentiate this type of discrimination from sexual harassment and the glass ceiling.

3 It could be argued that women do not perpetrate sexual harassment because they have not historically had the access to power and position that men have had; however, as women are 30% of all managers, but are estimated to be 9% of all harassers, it appears that managerial women are less likely to perpetrate sexual harassment than are men.

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The Debate Over the Prohibition of Romance in the Workplace

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Every couple of months or so the press reveals how yet another senior executive has lost his or her job because of a romantic entanglement.

In 2007 the American Red Cross fired its President because of a personal relationship with a subordinate, and the President of the World Bank resigned because of a conflict of interest arising from his relationship with an employee. In 2005 the President and CEO of Boeing was fired because of an "improper relationship" with a female Boeing executive.

Female executives have also fallen from grace. Julie Roehm, Wal-Mart's SVP of Marketing Communication, was fired in 2006, accused of having an affair with a junior executive. Suzy Wetlaufer was promoted briefly to be Editor-in-Chief of the *Harvard Business Review* before she was forced to resign in 2002 for having an affair with Jack Welch (CEO of General Electric) while preparing an interview with him for the magazine. Ironically, Wetlaufer had previously written an *HBR* case study about the ethical problems caused by a philandering CEO (Wetlaufer, 1999).

Not every senior office fling leads to a resignation, however. Like Bill Clinton before him, the British Deputy Prime Minister John Prescott was not forced to step down from his senior political position after his secretary disclosed in 2006 that they had carried on a 2-year extra-marital affair.

One recent workplace romance may have been the cause of the loss of two lives. On March 22, 2006 the 8800-ton British Columbia Ferry *Queen of the North* ran aground and sank while navigating the narrow and hazardous Inside Passage south of Prince Rupert. Alone together on the bridge were the male Fourth Officer and the female Quartermaster, who were known to have had a prior recurrent relationship. No course corrections or speed changes were made for a period of 30 min before the ship hit the northeast side of Gil Island (Transportation Safety Board of Canada, 2008). The crewmembers on the bridge were fired after refusing to cooperate with subsequent investigations (Heiman, 2007).

Such sexual scandals are not exclusively heterosexual either. In 2007, Lord John Browne, CEO of British Petroleum resigned because of revelations concerning his former male partner. Commenting on press investigations, he said: "For the past 41 years of my career at BP I have kept my private life separate from my business life. I have always regarded my sexuality as a personal matter, to be kept private" (Mufson, 2007).

This article deals with this general ethical issue – the degree to which an employee's sexual activities are a private matter, and the degree to which an employer may legitimately constrain an employee's liberty in matters of romance. This article will explore the various ethical arguments for and against the prohibition of workplace romance.

What is the Phenomenon?

Some organizations have employment rules that either prohibit or restrict the freedom of their employees regarding dating other employees. These types of rules are a relatively modern phenomenon, although there are some variant examples that have a longer history. For instance, the Toronto School Board (like many others) had a marriage ban from 1925 to 1947, which required all women to resign their teaching positions upon marriage. The military has long had a ban on fraternization between officers and enlisted personnel (Mahoney, 1988). From the nineteenth century into the 1950s, most US States enforced anti-miscegenation laws, prohibiting interracial marriage.

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In the modern era the creation of rules regarding workplace romance is clearly a by-product of the growth in the numbers of women in the workforce, a relationship that is noted by all of the writers on the topic. Responding to the fact that women appear to have stimulated this phenomenon Riach and Wilson (2007, p. 81) comment that "There is a danger in some of the discussion that women are seen to be to blame for increasing the problems that managers face".

The literature on workplace romance falls into several distinct categories. Most obviously there is a stream of writing on the topic in the management literature, pioneered by scholars such as Quinn (1977), Gutek (1985), and Mainiero (1986). Largely overlooked in the management literature is the wealth of analysis of the topic in law journals – indeed workplace romance seems to have been far more extensively debated by legal scholars than by management scholars.[1] There is also some relevant literature in sociology, psychology, history, and, surprisingly, also in economics.

One distinctive characteristic of the literature is that the vast majority originates from the United States – out of total of some 400 articles on the topic there is just one article from outside the US for every 10 articles originating from the States. The topic of banning workplace romance appears to be very US-centric, reflecting perhaps an inclination for US managers to seek to keep intimacy and emotion out of the workplace (Zelizer, 2009). Additional possible reasons for this topic to be so US-centric include the history of US Puritanism, the general movement toward political correctness in recent decades, the influence of radical feminists in creating workplace sexual harassment laws, and the litigatious nature of US society with regard to sexual harassment.

There are several different reasons why an organization might wish to manage workplace romance, and a number of alternative approaches, each of which is explained below.

Outright prohibition based on moral or religious grounds

In this case the organization feels that it has a moral duty to generally protect its employees from sexuality in the workplace, and specifically to prevent the possibility of adultery by married employees. The prime example of this was the case of Wal-Mart, which in 1993 fired a married employee and another employee who were dating because this romance was inconsistent with its "strongly held belief in and support of the 'family unit'" (Dworkin, 1997; Schaner, 1994). The married employee was separated and living apart from her husband, but was not yet divorced.

This case is particularly significant, because it led to the first court case prosecuted under New York Labor Law Section 201-d, which prohibits an employer from discriminating against an individual based on a variety of his or her activities outside the workplace, including "legal recreational activities" (Borden, 1996; Rogers, 1997). The case involved an intense debate over whether dating can be considered to be a "legal recreational activity". Wal-Mart lost the case in the lower court, but succeeded in having the verdict overturned in the Appellate Division.[2]

Wal-Mart eventually apparently changed its employee handbook so as to exclude any reference to married employees in its revised rule on dating, which now prohibited romance between a superior and a subordinate, no matter what their marital status.

The degree to which this represented a true change of heart on the part of Wal-Mart management is open to question, for in 2005 Wal-Mart was successfully taken to court in Germany for attempting to ban romance between its employees in that country. One European analyst stated his opinion that "The judgment is, above all, a clash of business cultures. The verdict signaled a backlash against American prudishness and political correctness" (Darsow, 2005).[3]

There are few other concrete examples of morality-based bans on employee dating. A number of large firms are rumored to have had morality-based bans at one time or another, but evidence of such bans is hard to come by. Some religion-based school boards may still operate bans on employee cohabitation. It is conceivable that some business organizations with explicit religious origins might have morals-based codes for employee behavior. Morals-based bans on homosexual dating among employees are probably more likely and may be commonly unwritten, although these have not received much publicity outside of the continuing debate over homosexual bans in the US military services.

One author who advocates a ban on employee dating appears to do so from a morality-based perspective which does not have its origins in religion. Loftus (1995) cites the anthropologist Margaret Mead who asked flatly in 1978 for "incest taboos" against dating in the workplace. "A taboo enjoins…," Mead wrote, "We need one that says clearly and unequivocally, 'You don't make passes at or sleep with the people you work with'" (Mead, 1980, p. 55). Anderson and Fisher (1991, p. 177) remarked that "Mead's 'organizational incest' proposition does not appear feasible or desirable given the social milieu of today's [1991] workplace."

Outright prohibition based on inherent conflict of interest

There are specific employment sectors where restrictions on employee romance are grounded in an inherent conflict of interest, for example restrictions on police or prison officers dating known felons or the children of known felons. Some smaller US police forces tend to have rules forbidding dating between employees, and on employing married couples, justified on the grounds that the partners would inevitably have to be scheduled to work together because the force was small. Hallinan (1992) cites several wrongful dismissal cases involving US police force and other public sector bans on fraternization, while Clarke (2006) cites a similar case regarding a police force in England.

Some employers have rules forbidding dating the employees of competitors or clients. Hallinan (1992) cites a 1984 wrongful dismissal case involving a female IBM employee who was fired because her partner worked for a competitor. She had originally met him when he too was employed by IBM, and continued the relationship when he left the firm. She won her case.

Outright prohibition based on productivity grounds

The twin themes here are that one or both of the dating couple are assumed to be distracted and inattentive, and consequently spend too much time not working; and that observation of the dating couple will cause coworkers to gossip and be distracted. The overall effect on productivity is considered to be harmful to the firm, and hence employee dating should be banned.

Schultz (2003, p. 2066) describes one origin of this negative view of the effect of workplace romance: "Classical organizational theory holds that sexuality and other 'personal' forces are at odds with productivity and out of place in organizational life." Similarly, Brady and Hart (2006, p. 123) consider that "Self-expression as found in office romances, the decoration of personal space, clothing, styles of language, and so on is often seen as a threat to institutional ideals and objectives."

A review by Pierce et al. (1996) of the literature on the effect of workplace romance on productivity concluded that "a substantial proportion of the literature indicates that job productivity can be negatively affected by workplace liaisons" (p. 19).

In a later article though, Pierce (1998) reports an empirical study that leads him to conclude that "participating in a workplace romance may not be entirely detrimental to an individual's performance at work (p. 1726)." He notes that that previous workplace romance research may have used unreliable measures of work performance, and that there is some literature to support the view that romance can have a positive effect on productivity.

There is no benchmark evidence in the literature of any attempt to compare productivity gains or losses resulting from an employee dating someone inside the firm compared to dating someone from outside the firm, nor compared to other external personal circumstances that might be suspected of affecting an employee's productivity.

One notable recent example of a gross invasion of employee privacy on the grounds of productivity was the revelation by *Stern* magazine that the German supermarket chain Lidl had employed private detectives and hidden cameras to investigate and report on employee conduct, including their romantic affairs (Boyes, 2008).

Outright prohibition based on fear of sexual harassment lawsuits

At first sight, this form of prohibition might be thought to be directed at eliminating any sexual harassment that could be perceived to arise from one employee trying to initiate a date with another employee. However, the literature is clear in distinguishing that the employer who bans dating is primarily afraid of sexual harassment claims arising from an *established* dating relationship rather than from any relationship that has not started yet.[4] Any elimination of harassment arising from an employee trying to initiate a date appears to be a secondary effect, and should presumably be covered anyway by the firm's general sexual harassment policy, outside of any specific ban on dating.

There are two possible outcomes of an established dating relationship that employers fear.

First, there is the possibility that if this workplace romance breaks down, then one partner's attempts at reconciliation may come to be perceived by the other former partner as harassment. The employer may be held responsible for not protecting that employee from such harassment. Second, if the relationship is between a superior and a subordinate, there is the possibility that one of the subordinate's coworkers might sue for sexual harassment because of real or perceived favoritism arising from the relationship (Depalo, 1996; Pierce and Aguinis, 1997).

Although there is little in the way of empirical evidence regarding the relative importance of each of these various reasons for bans on workplace dating, the literature does suggest that fear of sexual harassment lawsuits is the predominant factor, with the increasing costs of sexual harassment litigation probably stimulating this type of prohibition. For example, in The Society for Human Resource Management's 2002 survey of workplace romance, 95% of HR professionals cited "potential for claims of sexual harassment" as a reason to ban or discourage workplace romance, whereas the second most cited reason, "concerns about lowered productivity by those involved in the romance," was cited by just 46% (SHRM, 2002).

The specific case of the prohibition on dating between superior and subordinate

The literature reports that bans on dating between employees at different levels of an organizational hierarchy are more common than bans on dating applied to all employees. The prime reason for such a ban is the fear of the abuse of the power differential between superior and subordinate, and, as noted above, the subsequent potential for sexual harassment claims.

There is an additional productivity element that is part of the rationale for a ban on hierarchical workplace romances: there is fear of a conflict of interest arising from such romances such that coworkers lose productivity because of resentment of any preferential treatment given to the subordinate partner in the romance (Kramer, 2000).

Hymowitz and Pollock (1998) cite firms such as IBM, Staples, AT&T, Corning, and Xerox as examples of firms that have had historical bans on hierarchical romance, but which have since dropped such bans.

Legal arrangements based on fear of sexual harassment lawsuits: "the love contract"

Recognizing that a complete ban on romance may be impossible to effect, a number of firms have resorted to a legal approach to protect themselves from any adverse outcomes of workplace romance. They have introduced a consensual dating agreement which has come to be colloquially known as a "love contract", or alternatively as a "cupid contract" (Economist, 2005), or as a "dating waiver" (Nejat-Bina, 1999). This requires that a dating couple sign a document affirming that their workplace relationship is consensual, that they will not engage in favoritism, and that neither will take any legal action against the employer or each other if the relationship founders.

Tyler (2008) notes that the fear of the relationship going sour and the firm being hit with a harassment suit is the motivation for the use of such contracts. She quotes an employment law attorney: "Love contracts are a relatively painless way to mitigate risk of unlawful harassment liability. They aren't bulletproof, but it is more likely the [judge] will believe [the relationship was] consensual if it is in writing" (p. 42).

The topic of love contracts is one that has been raised in the business law practitioner media with increasing frequency. Kuntz (1998), Schaefer and Tudor (2001) and Wilson et al. (2003) provide examples of specimen contracts. Kramer (2000) and others have questioned love contracts and other variant "date and tell" policies as possible violations of the privacy rights of employees, forcing them to reveal otherwise private information.

The Ethical Issues Involved in Banning Romance

At first sight the calculus of the overall ethics of banning romance appears to be relatively simple: does an employer's self interest in banning or restricting workplace romance coupled with the protection of some employees from harm counterbalance the general workforce's consequent loss of rights of privacy and freedom of association?

One distinguishing aspect of the rights of dating couples in the workplace is the fact that, unlike other employee rights issues such as gay spousal benefits, or racial or gender equality, there is no lobby group that champions the rights of lovers in the workplace.[5] Is this right any less because it has no cohesive lobby group arguing for its position?

Speaking on another issue, one eminent academic sums up the general ethical dilemma of dating bans as follows: "To impose the burden of abstinence raises questions – how great should the restriction on liberties be to accommodate the vulnerable?" (Abraham, 2006).[6]

In the case of an organization instituting a dating ban, which party is being protected by the ban? Who exactly are "the vulnerable"? Whose rights are being defended? There are three possibilities.

Protecting the employer

For the employer, the benefits of banning romance appear to be primarily financial and administrative: there is a presumed (but contentious) net improvement in productivity plus a reduction in costs from sexual harassment suits arising from romances gone wrong, less the cost of replacing employees who may be fired for violations of a no-romance rule.

Various surveys of US case law regarding employee claims for wrongful dismissal arising from dating bans consistently reveal that the courts have largely sided with the employer:

> The privacy rights of employees typically do not prohibit employers from acting as the dating police by implementing or enforcing a policy against romantic relationships in the workplace. In many, if not most instances, the employer's legitimate business interests in maintaining a peaceful and productive work environment and avoiding liability outweigh an employee's right to privacy. This has proved to be especially true in the context of an employment relationship in the private sector. (Wilson et al., 2003)

Protecting female employees

The issue of protecting female employees from male romantic overtures has emerged to be tne most contentiously debated topic within the workplace romance literature. It has evolved to be a classic example of the "…two-sided debates … [that] have indeed dominated contemporary feminist politics … [and which] have frequently been highly charged and in some instances highly polarizing" (Chancer, 1998, p. 18).

At one extreme some radical feminist scholars have recast the various benefits and harms completely in their ethical calculus of workplace romance. The vulnerable are not considered to be the employer, nor those who might be harassed after a failed romance, but rather are considered to be the female workforce, exposed to possible harm from the initiation of any romantic approach:

> As things stand now, we protect the right of a few to have "consensual" sex in the workplace (a right most women, according to the studies, do not even want), at the cost of exposing the overwhelming majority to oppression and indignity at work. Is the benefit to the few so great as to outweigh the costs to so many more? I think not. For my part, I would have no objection to rules that prohibited men and women from sexual relations in the workplace, at least with those who worked directly for them. … I do not see this as going too far. (Estrich, 1991, p. 860)

Here the harm from harassment via workplace dating is presumed to be at least some high order of magnitude greater than any harm from the denial of privacy rights and of freedom of association produced by a dating ban. For radical feminists such as Susan Estrich, the duty to protect the workforce from harassment trumps all liberty rights in this calculation.

Estrich's views arise from extending her prior work on the law of rape into the field of sexual harassment: "[t]he very same doctrines, found in rape law but otherwise unique in criminal law, are becoming familiar tools in sexual harassment"(p. 815). She concludes that the "[un]welcomeness" standard measure of the acceptability of a male sexual overture "performs the doctrinal dirty work of the consent standard in rape law, … [and] shifts the focus from the man to the woman" (p. 830).

Similarly, she considers that any defense against the quid pro quo doctrine (whereby the victim must disprove the validity of any punishment arising from the rejection of rewards such as promotion that may be offered in exchange for sexual favors) "bears an uncanny resemblance to the law's traditional willingness to protect only the madonna in a rape case, and to brand her more common sister the whore, even though no woman remains a madonna once she has been raped (which is the cruelest irony, or perhaps the point)" (p. 838).

Her viewpoint on banning romance clearly stems from her frustration with the courts' treatment of women:

> The problem with the court decisions, and the attitudes they reflect, is that offensive sexuality is so routinely considered normal, abuse of power acceptable, and the dehumanizing of women in sexual relations unremarkable, that when we (or the courts, at least) see such things at work, it hardly seems a "federal case." (p. 860)

Other gender-feminists such as Andrea Dworkin and Catharine MacKinnon have expressed their general view that all sexual language and behavior in the workplace constitutes harassment. This places them unexpectedly in the same camp as US neo-conservatives and the religious right who champion the preservation of family values and who idealize the concept of pure and virtuous womanhood (Williams et al., 1999, p. 74). Gayle Rubin has noted this strange emergent alliance: "Feminist rhetoric has a distressing tendency to reappear in reactionary contexts" (1984, p. 298).

Wendy McElroy also notes the unfolding of this new form of puritanism in her remarks about how political correctness has morphed into what she calls sexual correctness:

> [S]omewhere along the line the rebellious joy has drained out of the feminist movement. Instead of celebrating the pleasures of sex, women are now barraged only by its perils: rape, domestic violence, harassment.… Now women are portrayed as victims of oppression. Gone is the emphasis on independence and spunk. …A certain go-to-hell spirit has been replaced by a life-is-hell attitude, and with it a strange new puritanism has gripped the feminist movement. (McElroy, 1996, p. 6)

McElroy is one of the "pro-sex feminists" or "anti-censorship feminists" who "argue that women are oppressed by restrictions on sexual expression" (Williams et al., 1999, p. 74). She assesses the impact of US sexual harassment law as follows:

> The issue of sexual harassment has prompted a politically correct inquisition, with the goal of rooting out and punishing men who express attitudes deemed to be improper towards women. Its casualties are freedom of speech, the right to privacy, and the mechanism of the free market. …The law must not be used to enforce a feminist standard of virtue or to advance a political agenda that views men as the natural enemy of women. (McElroy, 1996, p. 62)

Some pro-sex feminists (such as Betty Dodson[7]) do not engage in such complex political debate, but merely advocate the freedom of women to have sexual relations with whomever they want in whatever social context, thus implicitly opposing dating bans in the workplace.

One particular second-wave feminist, Helen Gurley Brown, went so far as to advocate that female office workers should actively seek sexual relations in the workplace if these were perceived to be in their own best interests. Her books *Sex and the Single Girl* (Brown, 1962) and *Sex and the Office* (Brown, 1964) were multinational best sellers. She went on to edit the highly popular magazine *Cosmopolitan* for 32 years. Strangely, despite the widespread popular consumption and acceptance of her *Cosmo Girl*[8] themes such as "How to Marry Your Boss", Helen Gurley Brown is ignored in the mainstream workplace romance literature.

Brown's biographer suggests that Brown has been ignored because of her extreme position within the continuum of feminist viewpoints:

> Brown's particular version of feminism, more likely practiced by single women than by housewives, and by

> working-class secretaries rather than middle-class students, has largely been left out of established histories of postwar feminism's emergence and ascendance. … Brown's playful approach put off many serious-minded feminists of her generation and later. Ever the optimist, she chose to see pleasure where others saw danger, allies where others saw oppressors, and opportunity where others saw obstacles. (Scanlon, 2009, p. x, xiii)

In her excellent analysis of Helen Gurley Brown's guidance to female employees on sexual emancipation, Julie Berebitsky (2006) provides an overview of the various prior advice manuals that sought to direct women's workplace behavior in the first half of the twentieth century:

> … this advice reaffirmed existing gender ideology that constructed men as rational, impersonal, and natural-born leaders and women as emotional and personal followers. Many of the writings [that I have] examined here acknowledged the existence of the office Don Juan or the contemptible "Felix the Feeler." Yet they painted such men as aberrations and nuisances, characterizations that in no way reflected on men's natural and normative ability to lead. (p. 104)

Berebitsky notes that it was "in this contradictory world of advice manuals that downplayed sex at work and popular culture that talked it up [especially in the movies] … that Brown sought to reeducate women on workplace sexuality" (p. 106).

According to Berebitsky, Brown's ideas were considered to be intellectually indigestible for a number of complex reasons:

> In the minds of many critics Brown's man-pleasing behavior was unnatural because it was not a sign of female abnegation or submission but a calculated strategy of self-interest. Brown presented her strategy at a time when social critics were already wringing their hands about the decline in American manhood (p. 110). … Her position also potentially undermined faith in corporate capitalism, since it exposed the irrationality of its inner workings (p. 117). …Brown, in short, called into question the cultural belief that men, because their rationality is superior to women's innate emotionality, are the "natural" leaders of business. In Brown's view the fact that men on occasion could not control their sexual desires made them manlier, but this construction of virile manhood rested uncomfortably beside the ideal of corporate masculinity. (p. 117)

Helen Gurley Brown's view of the working girl as a sexually liberated empowered free agent (later to be popularized in the hit TV show *Sex and the City*) stands in stark contrast to the Dworkin/MacKinnon view that the workplace should be completely desexualized.

We are thus faced with having to determine an appropriate ethical evaluation of workplace dating bans in a context where one group of feminists is vehemently in favor of such bans, whereas another group of feminists is vehemently against such bans.

The polarized positions of gender-feminists versus pro-sex feminists have been well assessed as follows:

> Both positions, in their extreme forms, are untenable. Sexual relationships at work are not always liberating and mutually fulfilling, nor are they always sexually harassing and harmful. Individuals can and do make distinctions between sexual harassment and assault on the one hand, and pleasurable, mutually desired sexual interactions and relationships on the other. (Williams et al., 1999, p. 75)

The implication here is that there is no need to throw the baby out with the bathwater by instituting dating bans as a policy for preventing sexual harassment - if other sexual harassment policies can effectively police and eliminate such behavior, then dating can be allowed. How successful have such other sexual harassment policies been?

Protecting the harassed ex-partner

At first sight it would seem that a dating ban would be primarily designed to protect employees who might be harassed after a workplace romance has failed. However, the literature makes it clear that the employer is not intent on reducing the *actual harm* caused by sexual harassment, but rather, the employer is intent on reducing the costs of any litigation that may arise from post-romance sexual harassment.

If dating bans (and indeed wider sexual harassment policies) enacted by employers were actually sincere attempts to prevent harm to female employees, then one might expect to see some parallel polices along similar lines. One UK legal scholar has some strong doubts about the sincerity of US firms in this regard: "Employers in the USA have not willingly embraced other policies which would further sex equality at work, such as maternity rights or equal pay" (Clarke, 2006, p. 350).

If corporate sexual harassment policies are not sincere attempts to mitigate harm to female employees, then what are the origins of such policies? Here is one view, which is typical of the modern view expressed in US law journals:

> US employers, intent on inoculating themselves against the crippling costs of sexual harassment lawsuits, think they have little choice but to encourage a peculiarly asexual form of office intercourse by insisting on regular mandatory sexual harassment training. … [They] can be forgiven for making that calculation. The US Supreme Court has given them little choice. In two recent cases, it encouraged the explosion of an industry of sexual harassment trainers by providing a safe harbor from punitive damages for employers who educate their employees and have anti-harassment policies; and by allowing employers to build part of an "affirmative defence" against sexual harassment suits if they can prove that they took "reasonable care" to prevent and correct bad behavior. (Waldmeir, 2006)

According to this theory, sexual harassment training has evolved to become an ornate administrative display which has the appearance of concern to protect employees from harm, but which at the core is expedient in that it mitigates employer liabilities in any future court cases.

The degree to which sexual harassment training has evolved to become an elaborate charade in the United States supported by a self-serving "sexual harassment training industry" has been discussed by a number of eminent legal scholars, including Bisom-Rapp (2001) and Rhode (2006). Dating bans appear to be open to the same criticism that they could be a self-serving charade for some firms, benefitting the employer rather than protecting the employee.

This raises the interesting philosophical issue of the ethical merit of corporate polices that ostensibly protect employees from harm, but which primarily protect the employer. Are they any less ethical than similar policies enacted by employers who are sincere in their wishes to protect their employees from harm? Was Groucho Marx right when he supposedly said, "The secret of life is honesty and fair dealing. If you can fake that, you've got it made!"?

I would argue that there is a difference between a "fake" sexual harassment policy and a sincere policy, in that a sincere employer might want to take some additional elements into consideration when thinking about instituting a dating ban. These elements, I propose, arise from evaluation of a consequentialist approach to this ethical dilemma. A utilitarian analysis provides some additional insights that may tip the balance toward the allowing of workplace dating.

Marriage Versus Harassment as an Outcome of Workplace Romance

Pierce and Aguinis (2009) cite data indicating that there are 10 million[9] new workplace romances a year in the US compared to an average of 14,200 sexual harassment claims per year, an incidence of one harassment case per 704 romances. Given that only a proportion of harassment claims arise from failed romances, the incidence of romance-related harassment may be as low as 1 in 3-to-5000 romances. They note that very few of these harassment cases (just 51 in a 24-year period) actually ended up as federal or state court cases.

Harassment is not the only possible outcome of a workplace romance, however. An American Management Association survey revealed that 44% of workplace romances led to marriage, while another 23% led to a long-term relationship that either continues or has since ended (AMA, 2003). Just 33% of respondents reported that office dating led to short-term relationships.

It should really not be surprising that some two-thirds of office romances end up as long-term relationships: one book that promotes office dating states that "Work-based romances develop gradually over months and years, allowing people to get to know one another instead of rushing to judgments based on first impressions." (Losee and Olen, 2007) These and other authors claim that the workplace is by far and away the best location to meet a future partner.

The main consequence of a universal ban on workplace romance would therefore be to deny the workplace as the main venue where one might meet one's future life partner. I would argue that this consequence of the denial of this right of freedom of association produces a greater amount of harm (via the elimination of a lot of happiness) than the harm arising from broken workplace romances, and that therefore workplace romance should not be banned. According to the data above, eliminating 1 sexual harassment claim would imply prohibiting 704 romances, of which roughly 470 would otherwise have resulted in marriage or other long-term relationships.

This is not to suggest that those employees who are prevented from meeting a life partner at work might not find a partner elsewhere eventually – but one implication of my argument is that marriages arising from workplace romances may be more robust than marriages arising from other sources of meeting place. This robustness would arise because of the ability to judge the qualities of a prospective partner over a long period of time at the workplace. If one substitutes the word "optimal" for the word "robust" in the previous sentences, then this analysis becomes akin to an economist's argument that workplace-related marriages are more optimal than non-workplace marriages.

Economists have, in fact, written about workplace romance (coldly called "the search process"), but in a rather roundabout way. They have pointed out that the greater the rate of female participation in the workforce, the higher becomes the rate of divorce (McKinnish, 2004; building on the work of Becker et al., 1977). Clearly the main underlying cause of this phenomenon has been the economic emancipation of women via access to their own income, but a secondary cause of increased divorce rates has been the mixing of genders in the workplace.

McKinnish reports that "women and men who work with a larger fraction of members of the opposite sex are more likely to get divorced" (p. 324). This finding is confirmed by a recent Swedish study, which analyzed government data on 37,000 employees across 1500 workplaces:

> A person is about 70 percent more likely to divorce if all of his or her coworkers are of the opposite sex and of appropriate age, compared to when all coworkers are either of the same sex, or are too old or too young to be interesting as potential partners. There is no significant difference in effect between the sexes; that is, married men and women are about as susceptible to the influence of those of the opposite sex. This result strongly suggests that the opportunity to find a spousal alternative increases the risk of divorce. (Åberg, 2004, p. 24)[10]

If workplace romance is to be praised for being a source of marriage, then how should we react to this news that workplace romances contribute to the breakup of marriages as well? This adds a further ethical twist to the whole question, especially for those who approach this topic from a strong religious perspective.

I would argue that divorce is a product of female emancipation, and is valued positively by society, as indicated by the general legal acceptability of divorce and the fact that many religions allow it. If workplace romances allow employees to escape from an unsatisfactory marriage and embark on a better relationship, then they have a positive value to society.

Åberg's extensive research about divorce patterns in Swedish workplaces produced some other remarkable findings. She found that among coworkers divorce is contagious – the higher the number of divorcees in the workplace, the higher the divorce rate among other employees. She also found that the availability of unmarried friends of one's own sex (not the opposite sex!) increased one's likelihood of getting divorced: "the risk of marital disruption is about 60 percent higher if all coworkers of the same sex are single as opposed to married. This result implies that the marital status of the same sex is far more important than the marital status of the opposite sex" (Åberg, 2004, p. 24).

There is one robust finding in Åberg's research that is especially fascinating: "If the spouse works in the same workplace, the risk of divorce is dramatically reduced… Married couples who work at the same workplace run only about half the risk of a marital breakup as do other couples. …this result supports the hypothesis that the risk for divorce is reduced if spouses share the same social context" (Åberg, 2004, p. 21).

Should Organizations Actively Promote Workplace Romance?

Åberg's finding that couples working in the same location have a 50% lower divorce rate has enormous implications for organizations such as Wal-Mart that perceive a need to act as moral guardians of their employees. To preserve their "strongly held belief in and support of the 'family unit'" Wal-Mart should really have been encouraging workplace romance rather than banning it, a 180 degree reversal of their former policy. The more married couples that Wal-Mart employs at any one location, the lower would be the dissolution of family units in society, according to Åberg's findings.

It is not outlandish to suggest that organizations such as Wal-Mart might actively promote romance in the workplace. A number of firms indeed have exactly this policy. Southwest Airlines, for example, is very progressive on this issue – "we encourage nepotism" – with 2000 of its 35,000 employees being married to each other. Not only are Southwest employees allowed to date each other (including subordinates) they are even allowed to ask passengers out for a date (Feeney, 2004).

AT&T has seen 8000 couples meet and marry at work out of 115,000 employees. Cummings (2001, p. 57) further describes how "AT&T's public relations department touted [one management-level couple's] relationship, showcasing how well it was managed within AT&T." The firm reports having very few cases of sexual harassment arising from its pro-romance stance. Williams et al. (1999) describe the romance policy of another progressive firm:

> Ben & Jerry's hosts winter solstice parties for its employees where it subsidizes hotel rooms to discourage drinking and driving. A personnel manager at the company is quoted as saying, "We expect that our employees will date, fall in love, and become partners." They make no effort to limit personal relationships among employees. (p. 84)

By encouraging marriage and long-term partnerships, these firms are knowingly increasing the probability of nepotism. But these firms are enlightened enough to recognize that married coworkers are not in themselves the problem – it is the possible misbehavior of a small proportion of these married coworkers that may be a future problem, misbehavior in the form of conflicts of interest or favoritism. However, there are many other possible sources of these types of misbehaviors besides nepotism that exist in the firm, and all of them can be dealt with by a generic conflict of interest policy. There is no need to have an anti-nepotism policy so as to exclude married couples from the workplace if a firm has established a good overall conflict of interest policy in the first place.

Similarly, it is not workplace romances themselves that cause problems for employers, but rather the behavioral consequences of a small proportion of them. Low productivity, harassment, and conflicts of interest have other sources in the firm besides workplace romances. If the firm has good policies to deal with these general problems, then there is no need to prohibit one small possible source of them. The social costs of banning workplace romance are just too great, given that firms must already have policies that deal with the wider range of employee behavioral problems to which workplace romances contribute a very small amount.

While the study of workplace romance has seen relatively little in the way of direct empirical analysis, the managerial practices of such pro-romance firms should be much more capable of being studied than has so far been the case with anti-romance firms. Future research may wish to examine the patterns of formal managerial policies and procedures of pro-romance firms, and analyze the various formal and informal outcomes thereof. Such research may pave the way for a more enlightened general approach to the management of workplace romance.

Notes

[1] For example, just one law journal article on workplace romance by Schultz (2003) is 132 pages long, with 495 footnotes and over 1000 citations. Other relevant law articles are by Mahoney (1988), Estrich (1991), Hallinan (1992), Schaner (1994), Massengill and Petersen (1995), Borden (1996), Dean (1996), Depalo (1996), Rogers (1996), Dworkin (1997), Wolkenbreit (1997), Nejat-Bina (1999), Kramer (2000), Gross-Schaefer et al. (2003), Sugarman (2003), Wilson et al. (2003), Yew and Ruoff (2004), Garcia (2006), Lee (2006), Lobel (2006),

Medina (2006), Paul (2006), Rabin-Margalioth (2006), Schultz (2006), Williams (2006), Yuracko (2006), Cohen and Cohen (2007), and Sheridan (2007).

2 This case may be of particular interest to ethicists because of the irony that New York Labor Law Section 201-d was a law that was apparently originally promoted by the tobacco industry in order to protect smokers from being discriminated against by employers seeking to avoid the higher health insurance cost of employing smokers. See Borden (1996). It was not originally conceived to be a protection of the right to date a fellow employee.

Borden also notes that at the trial Wal-Mart's anti-dating policy was additionally defended as a worker safety measure. Wal-Mart's attorneys argued that adulterous dating would invite violence into the workplace by the hands of jealous spouses. Disturbingly, homicide is the leading cause of death among women in the workplace (Phillips, 1996), and elsewhere attention has been drawn to a possible link between workplace romance and violence (Schaner, 1994; Scott, 2008). The most notorious recent incident of workplace-romance-inspired violence was the 2007 pepper spray attack by NASA astronaut Lisa Nowak on her romantic rival (CNN, 2007). It is highly unlikely that workplace romance itself, as compared to the multitude of social attachments that each employee has outside of work, is the cause of more than a miniscule proportion of cases of workplace violence. Phillips (1996) notes that the workplace is the unfortunate location for much violence against women because the victim is known to be at a specific physical location during a particular time period each day.

3 Talaulicar (2009, p. 353) reports the court's decision as follows: "The Land Labor Court Düsseldorf explained that individuals spend a lot of their time at work, that many of their social contacts are shaped by work experiences and that their self esteem will also depend on how they are seen by colleagues and other members of the firm. Meeting colleagues and other members of the firm after work is for the time being a personal matter of the involved individuals. The right to privacy is at the core of human dignity. The …Court therefore concluded that the [Wal-Mart] code obligations to ban fraternization contradicted the fundamental norms of the German Basic Law (*Grundgcsetz*, GG)."

4 For example, Dean (1996) states that "A predominant motivating factor for employer regulation of employee personal relationships is the fear of sexual harassment liability, arising in particular from coworker relationships that have 'turned sour' (p. 1053)."

5 The one domain in which there appears to be some form of lobbying regarding open dating rights is in the academic world. In the face of attempts by various US universities to prohibit professors dating students there is at least one web site denouncing the "attempted repression of student–professor consensual sexual relationships". See http://dankprofessor.wordpress.com/.

6 This quote comes from Arthur Schafer, director of the University of Manitoba's Centre for Professional and Applied Ethics, speaking about the peril for some few peanut-sensitive passengers posed by the airlines' prior widespread use of peanuts as an in-flight snack. In the peanut case, of course, this vulnerability means an innocent passenger's possible exposure to death from a peanut allergy, a far more serious circumstance than most negative outcomes from workplace romances.

7 Details of Betty Dodson's history as a pro-sex feminist can be found at her web site: http://dodsonan dross.com/ and at Wikipedia.

8 See Ouellette (1999) for a critical review of Helen Gurley Brown's "credo on topics ranging from sex and the workplace to the Cosmo Girl, the fictionalized woman she invented to characterize the magazine's imagined 18- to 34-year old reader" (p. 359).

9 I personally consider this figure to be almost an order of magnitude too high, and suspect that the annual number of US workplace romances may more likely be in the range of from 2 to 3 million. My estimate comes from consideration of the following data: (1) comparing the proportion of all marriages that derive from workplace romances with the total number of annual marriages in the US; (2) using Berebitsky's (2006) citation of Alfred Kinsey's 1948 survey of men's sexual behavior which estimated that about half of all married men had at some time committed adultery; and, (3) comparing the annual number of marriages to the size of the US workforce. Even with this lower estimate for the number of annual workplace romances the incidence of post-romance sexual harassment still appears to be low. Using the revised estimate combined with AMA (2003) data, for every 1,000 workplace romances, there are 440 marriages, 230 other long-term relationships, and 330 short-term relationships, of which one or maybe two could result in post-romance harassment.

10 In a private communication Yvonne Åberg states that the material in this working paper originally appeared in Åberg (2003). Åberg's research is also cited in Shellenbarger (2003).

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Questions for Discussion

1. Should employees have their "family rights" respected to the extent suggested by Melé?
2. Should employees without children indirectly subsidize those with children? Do you agree with Mills's position that subsidization of employees with children should not be provided by employers?
3. Do you believe that women still face a glass ceiling in the workplace, as discussed by Bell, McLaughlin, and Sequeira? If so, what measures would you suggest to eliminate the glass ceiling?
4. Should workplace romances be permitted, as Boyd suggests? Why or why not? Would you permit it if you were the CEO of a firm? Would you have fired Harry Stonecipher of Boeing based on his affair with a female executive?

Cases for Part 3

Introduction

The mini-cases in Part 3 relate to specific issues faced by employees in the workplace. In "Joan Drew," an employee must decide how to handle a case of sexual harassment. In "Julie Simpson," the employee must decide whether to accept a gift from a vendor, a typical conflict of interest situation faced by many employees.

The cases for Part 3 continue to explore issues of work in the corporation. "The Case of the Mismanaged Ms." addresses the issue of sexual discrimination. In addition to the article by Bell, McLaughlin, and Sequeira, the case brings out points raised in the article by Melé. In "Heineken NV: Workplace HIV/AIDS Programs in Africa," an executive faces the difficult decision of whether the firm should pay for expensive HIV/AIDS medication for its employees and their dependants, when it will not provide any overall direct or indirect net financial benefits to the firm by doing so. Both Duska's and Machan's articles might be considered in relation to this case. The case "Banking: A Crack in the Swiss Vault" describes the actions of former UBS investment banker Bradley Birkenfeld. The banker, after participating in hiding the taxable income of his US clients, ultimately blows the whistle on his firm. Unfortunately, he finds himself in jail as a result. The two whistleblowing articles (De George and Hoffman and Schwartz) can be helpful in deciding whether Birkenfeld had a moral obligation or whether it was even morally permissible for him to blow the whistle on his firm. The article "Will Rewards for Whistleblowers Encourage Ethical Behavior?" provides a point–counter-point discussion focusing on the benefits and desirability of rewarding external whistleblowers. The case "Boeing Chief is Ousted after Admitting Affair" relates to former Boeing CEO Harry Stonecipher, who was forced to resign following the discovery he was having a consensual sexual relationship with a senior executive. The article by Boyd relates directly to this case. The article "Abuse Scandal Inquiry Damns Paterno and Penn State" and "Timeline: The Penn State Scandal" relate to the two whistleblowing articles by De George and Hoffman and Schwartz. The final case, "You've Been Tagged! (Then Again, Maybe Not): Employers and Facebook," discusses the privacy concerns that have resulted from firms reviewing potential job candidates' content on their Facebook pages.

Mini-Cases

Joan Drew

Joan Drew, an associate in Assurance, has been working on the audit of a long-time client. Last week following a late-night session, the client's chief financial officer asked her to go out for a drink. She was quite surprised, but

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Business Ethics: Readings and Cases in Corporate Morality, Fifth Edition.
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politely declined and didn't think twice about the incident. A few days later, the CFO again asked her to go out. This time when she declined, the CFO seemed somewhat upset, noting, "You don't know what you're missing."

Since then, the CFO seems to go out of his way to stare at Drew. Today, the CFO intercepted her in the coffee area, commenting, "I don't like to be refused."

Drew now feels that the situation has gotten out of hand, and she is actually somewhat frightened. Since the CFO is the key client contact, she is concerned about what will happen if she reports the situation to the Assurance partner. She is so embarrassed about the whole thing that she hasn't mentioned the problem to anyone else on the team.

What should Drew do?

Discussion questions

1. What are the legal ramifications in this situation?
2. At what point did the CFO's conduct become improper?
3. Could the associate have done anything differently to defuse the situation?
4. What if the situation had been different, and there was mutual attraction. Could the associate have accepted the invitation?

Julie Simpson

Julie, a secretary in the Purchasing Department, was recently given the responsibility of entering information into a new system the department was implementing. The system is a proprietary software product developed by ABC Systems, Inc. that tracks performance measurements. She was excited to take on this new responsibility, especially since it involved a three-week training program in San Diego at the vendor's training facility.

Julie attended the training session in San Diego and felt confident about her new skills. On the last day of training, the vendor placed a gift on the seat of each participant in the training class as a congratulatory gesture for completing the course. Along with all her classmates, she was given an electronic calendar. Having recently ordered the same electronic calendar for her supervisor, she knew that the value of the calendar was over $200.

Should Julie accept the gift from the vendor?

Adapted from Niagara Mohawk Holdings, Inc. (now National Grid) training materials. © 1999 Niagara Mohawk Holdings, Inc. Reprinted with permission.

Discussion questions

1. What conflicts of interest exist in this situation, if any?
2. What are Julie's responsibilities?
3. Does the value of the gift warrant consideration?
4. Would the situation be different if Julie were a buyer in the Purchasing Department?

MBA Student Mini-Dilemmas

Colleague in a Prohibited Relationship?

You work for a firm where half the employees in your group have just been laid off. One of your co-workers, instead of being laid off, was promoted to Vice President (VP) by one of the Senior Vice Presidents (SVP). You, along with your colleagues, were quite surprised by this promotion. It was extraordinary that someone could be promoted during this difficult economic environment. You didn't think much of it until you noticed, while working late one night on a deal for another VP, that the female VP and the SVP were leaving the SVP's office at 2 a.m. The SVP rarely stayed past 6 p.m., and the VP had already left the office and said good-bye to everyone at 8 p.m. After your suspicions grew stronger, you mention your concerns to the SVP's executive assistant, who agrees that she has seen behavior that would indicate that the two were having an affair. The executive assistant does not want to say anything, however, as she believes it is a personal matter and doesn't want to possibly ruin the SVP's existing marriage. The firm has a policy against co-workers dating, and this may be of even greater concern since theVP reports directly to the SVP. Do you say or do anything, or just keep quiet?

Friend with Substance Abuse Problems?

You work for an equity research department of a leading global investment bank. You are one of two associate analysts on a team of four, which includes a senior associate-analyst and a lead research analyst. You have built a strong personal relationship with John, the senior associate on the team.You work closely together and he becomes your junior mentor. He spends countless hours training you, and never hesitates to stay late when you need help with intricate, challenging analyses. You become close friends, and often socialize outside of work. Unfortunately, John's work ethic and professional behavior deteriorates. His presence at work becomes sporadic, and he becomes irritable when dealing with clients and colleagues. He begins to ask you to cover for him and lie about his whereabouts. Your integrity has now been put at risk, and your productivity suffers as you take on a significant portion of his work. After nearly a month, you confront John and he confesses that he as a substance abuse problem but promises to get help. You soon realize that John has not taken any concrete steps to address his addiction. Do you report John's situation?

The Case of the Mismanaged Ms.

Sally Seymour

Former Lecturer in Communication,
Management Communication,
Harvard Business School

Sally Seymour, "The Case of the Mismanaged Ms." Excerpted from "The Case of the Mismanaged Ms.," by Sally Seymour, *Harvard Business Review*, November-December 1987. Reprinted with permission.

It started out as one of those rare quiet mornings when I could count on having the office to myself. The Mets had won the World Series the night before, and most of the people in the office had celebrated late into the night at a bar across the street. I'm a fan too, but they all like to go to one of those bars where the waitresses dress like slave girls and the few women customers have to run a mine field of leers when they go to a ladies' room labeled "Heifers." Instead, I watched the game at home with my husband and escaped a hangover.

So I was feeling pretty good, if a little smug, when Ruth Linsky, a sales manager here at Triton, stormed past my secretary and burst into my office. Before I could say good morning, she demanded to know what business it was of the company who she slept with and why. I didn't know what she was talking about, but I could tell it was serious. In fact, she was practically on the verge of tears, but I knew she wasn't the type to fly off the handle.

Ruth had been with the company for three years, and we all respected her as a sensible and intelligent woman. She had been top in her class at business school and we recruited her hand when she graduated, but she didn't join us for a couple of years. She's since proved to be one of our best people in sales, and I didn't want to lose her. She fumed around the room for a while, not making much sense, until I talked her into sitting down.

"I've had it with this place and the way it treats women!" she shouted.

I allowed her to let off some more steam for a minute or two, and then I tried to calm her down. "Look, Ruth," I said, "I can see you're upset, but I need to know exactly what's going on before I can help you."

"I'm not just upset, Barbara," she said, "I'm damned mad. I came over to Triton because I thought I'd get more chances to advance here, and I just found out that I was passed over for director of the marketing division and Dick Simon got it instead. You know that I've had three outstanding years at the company, and my performance reviews have been excellent. Besides, I was led to believe that I had a pretty good shot at the job."

"What do you mean, 'led to believe'?"

"Steve heard through the grapevine that they were looking for a new marketing director, and he suggested I put in my name," she said. "He knows my work from when we worked together over at Forge Techtronics, and he said he'd write a letter in support.

I wouldn't have even known they were looking for someone if Steve hadn't tipped me off."

Steve Baines is vice president of manufacturing. He's certainly a respected senior person in the company and he pulls some weight, but he doesn't have sole control of the marketing position. The hierarchy doesn't work that way, and I tried to get Ruth to see that. "Okay, so Steve wrote a letter for you, but he's only one of five or six VPs who have input in executive hiring decisions. Of course it helps to have his support, but lots of other factors need to be considered as well."

"Come off it, Barbara," Ruth snapped. "You know as well as I do there's only one thing that really matters around here and that's whether you're one of the boys. I've got a meeting this afternoon with my lawyer, and I'm going to file a sexual discrimination suit, a sexual harassment suit, and whatever other kind of suit she can come up with. I've had it with this old-boy crap. The only reason I'm here is that, as human resources director, you should know what's going on around here."

So the stakes were even higher than I had thought; not only did it look like we might lose Ruth, but we also might have a lawsuit on our hands. And to top it off, with the discrimination issue Ruth might be trying to get back at us for promoting Dick. I felt strongly about the importance of this legal remedy, but I also knew that using it frivolously would only undermine women's credibility in legitimate cases.

"Ruth," I said, "I don't doubt your perceptions, but you're going to need some awfully strong evidence to back them up."

"You want evidence? Here's your evidence. Number one: 20% of the employees in this company are women. Not one is on the board of directors, and not one holds an executive-level position. You and I are the only two in mid-level positions. Number two: there's no way for women to move into the mid-level positions because they never know when they're available. When a vacancy comes up, the VPs – all men, of course – decide among themselves who should fill it. And then, over and over again I hear that some guy who hasn't worked half as hard as most of the women at his level has been given the plum. Number three: there are plenty of subtle and sometimes not-so-subtle messages around here that women are less than equal."

"Ruth, those are still pretty vague accusations," I interrupted. "You're going to have to come up with something more specific than feelings and suppositions."

"Don't worry, Barbara. Just keep listening and maybe you'll learn something about how this company you think so highly of operates. From the day Ed Coulter took over as vice president of marketing and became my boss, he's treated me differently from the male sales managers. Instead of saying good morning, he always has some comment about my looks – my dress is nice, or my hair looks pretty, or the color of my blouse brings out my eyes. I don't want to hear that stuff. Besides, he never comments on a guy's eyes. And then there's that calendar the sales reps have in their back office. Every time I go in there for a sales meeting, I feel like I've walked into a locker room."

So far, this all seemed pretty harmless to me, but I didn't want Ruth to feel I wasn't sympathetic. "To tell you the truth, Ruth, I'm not so sure all women here find compliments like that insulting, but maybe you can give me other examples of discriminatory treatment."

"You bet I can. It's not just in the office that these things happen. It's even worse in the field. Last month Ed and I and Bill, Tom, and Jack went out to Dryden Industries for a big project meeting. I'll admit I was a little nervous because there were some heavy hitters in the room, so I kept my mouth shut most of the morning. But I was a team member and I wanted to contribute.

"So when Ed stumbled at one point, I spoke up. Well, it was like I had committed a sacrilege in church. The Dryden guys just stared at me in surprise, and then they seemed actually angry. They ignored me completely. Later that afternoon, when I asked Ed why I had gotten that reaction, he chuckled a little and explained that since we hadn't been introduced by our specific titles, the Dryden guys had assumed I was a research assistant or a secretary. They thought I was being presumptuous. But when Ed explained who I was, they admitted that I had made an important point.

"But that wasn't all," she went on. "The next day, when we explained to them that I would be interviewing some of the factory foremen for a needs assessment, one of the executives requested that someone else do it because apparently there's a superstition about women on the factory floor bringing bad luck. Have you ever heard of anything so stupid? But that's not the worst of it. Ed actually went along with it. After I'd pulled his bacon out of the fire the day before. And when I nailed him for it, he had the gall to say 'Honey, whatever the client wants, the client gets.'

"Well, we got the contract, and that night we all went out to dinner and everything was hurray for our team. But then, when I figured we'd all go back to the hotel for a nightcap, Ed and the guys just kind of drifted off."

"Drifted off?" I asked.

"Yeah. To a bar. They wanted to watch some basketball game."

"And you weren't invited?"

"I wasn't invited and I wasn't disinvited," she said. "They acted like they didn't know what to say."

By this point Ruth had cooled down quite a bit, and although she still seemed angry, she was forthright in presenting her case. But now her manner changed. She became so agitated that she got up from her chair to stare out the window. After a few minutes, she sort of nodded her head, as if she had come to some private, difficult decision, and then crossed the room to sit down again. Looking at her lap and twisting a paper clip around in her hands, she spoke so softly that I had to lean forward to hear her.

"Barbara," she began, "what I'm going to tell you is, I hope, in confidence. It's not easy for me to talk about this because it's very personal and private, but I trust you and I want you to understand my position. So here goes. When Steve Baines and I were both at Forge, we had a brief affair. I was discreet about it; it never interfered with business, and we ended it shortly after we both came to work here. But we're still very close friends, and occasionally we have dinner or a drink together. But it's always as friends. I think Ed found out about it somehow. The day after I notified the head office that I wanted to be considered for the director position, Ed called me into his office and gave me a rambling lecture about how we have to behave like ladies and gentlemen these days because of lawsuits on sexual harassment.

"At the time, I assumed he was referring somehow to one of our junior sales reps who had gotten drunk at the Christmas party and made a fool of himself with a couple of secretaries; but later I began to think that the cryptic comment was meant for me. What's more, I think Ed used that rumor about my relationship with Steve to block my promotion. And that, Barbara, is pure, sexist, double-standard hypocrisy because I can name you at least five guys at various levels in this company who have had affairs with colleagues and clients, and Ed is at the top of the list."

I couldn't deny the truth of Ruth's last statement, but that wasn't the point, or not yet. First I had to find out which, if any, of her accusations were true. I told her I needed some time and asked if she could give me a week before calling in a lawyer. She said no way. Having taken the first step, she was anxious to take the next, especially since she didn't believe things would change at Triton anyway. We dickered back and forth, but all I could get from her was a promise to hold off for 24 hours. Not much of a concession, but it was better than nothing.

Needless to say, I had a lot to think about and not very much time to do it in. It was curious that this complaint should come shortly after our organization had taken steps to comply with affirmative action policies by issuing a companywide memo stating that we would continue to recruit, employ, train, and promote individuals without regard to race, color, religion, sex, age, national origin, physical or mental handicap, or status as a disabled veteran or veteran of the Vietnam era. And we did this to prevent any problems in the future, not because we'd had trouble in the past. In fact, in my five years as HRM director, I'd never had a sexual discrimination or harassment complaint.

But now I was beginning to wonder whether there had never been grounds for complaint or whether the women here felt it was useless or even dangerous to complain. If it was the latter, how had I contributed to allowing that feeling to exist? And this thought led me to an even more uncomfortable one: Had I been co-opted into ignoring injustices in a system that, after all, did pretty well by me? Was I afraid to slap the hand that buttered my bread?

Questioning one's own motives may be enlightening, but it's also time consuming, and I had more pressing matters to deal with before I could indulge in what would likely be a painful self-analysis. I asked my secretary to find George Drake, CEO of Triton, and get him on the phone. In the meantime, I wrote down as much as I could remember of what Ruth had just told me. When George finally called, I told him I knew his schedule was full but we had an emergency of sorts on our hands and I needed an hour of his time this morning. I also asked that Ed Coulter be called into the meeting. George told me I had the hour.

When I got to George's office, Ed and George were already waiting. They were undoubtedly curious about why I had called this meeting, but as I've seen people do in similar situations, they covered their anxiety with chitchat about ball games and hangovers. I was too impatient for these rituals, so I cut the conversation short and told them that we were going to have a serious lawsuit on our hands in a matter of days if we didn't act very quickly. That got their attention, so I proceeded to tell Ruth's story. When I began, George and Ed seemed more surprised than anything else, but as I built up Ruth's case their surprise turned to concern. When I finished, we all sat in silence for I don't know how long and then George asked Ed for comments.

"Well, George," Ed said, "I don't know what to say. Ruth certainly was a strong contender for the position, and her qualifications nearly equaled Dick's, but it finally came down to the fact that Dick had the seniority and a little more experience in the industrial sector. When you've got two almost equally qualified candidates, you've got to distinguish them somehow. The decision came down to the wire, which in this case was six months seniority and a few more visits to factory sites."

"Were those the only criteria that made a difference in the decision?" George wanted to know.

"Well, not exactly. You know as well as I do that we base hiring decisions on a lot of things. On one hand, we look at what's on paper: years at the company, education, experience, recommendations. But we also rely on intuition, our feel for the situation. Sometimes, you don't know exactly why, but you just feel better about some people than others, and I've learned that those gut reactions are pretty reliable. The other VPs and I all felt good about Dick. There's something about him – he's got the feel of a winner. You know? He's confident – not arrogant – but solid and really sharp. Bruce had him out to the club a couple of times, and I played squash with him all last winter. We got to know him and we liked what we saw; he's a family man, kids in school here, could use the extra money, and is looking to stick around for a while. None of these things mean a lot by themselves, of course, but together they add up.

"Don't get me wrong. I like Ruth too. She's very ambitious and one of our best. On the other hand, I can't say that I or any of the VPs know her as well as we know Dick. Of course, that's not exactly Ruth's fault, but there it is."

I had to be careful with the question I wanted Ed to respond to next because Ruth had asked for my confidence about the affair. I worded it this way: "Ed, did any part of your decision take into account Ruth's relationship with anyone else at the company?"

The question visibly disturbed Ed. He walked across the room and bummed a cigarette from me – he had quit last week – before answering: "Okay, I didn't want to go into this, but since you brought it up. ... There's a rumor – well it's stronger than a rumor – that Ruth is more than professionally involved with Steve Baines – I mean she's having an, ah, sexual affair with him. Now before you tell me that's none of my business, let me tell you about some homework I did on this stuff. Of course it's real tricky. It turns out there are at least two court cases that found sexual discrimination where an employer involved in a sexual relationship with an employee promoted that person over more qualified candidates.

"So here's what that leaves us with: we've got Steve pushing his girlfriend for the job. You saw the letter he wrote. And we've got Dick with seniority. So if we go with Ruth, what's to keep Dick from charging Steve and the company on two counts of sexual discrimination: sexual favoritism because Ruth is Steve's honey and reverse discrimination because we pass over a better qualified man just to get a woman into an executive position. So we're damned if we do and damned if we don't. We've got lawsuits if we don't advance Dick, and, so you tell me, lawsuits if we don't advance Ruth!"

We let that sink in for a few seconds. Then George spoke up: "What evidence do you have, Ed, that Steve and Ruth are having an affair?" he asked.

"Look, I didn't hire some guy to follow them around with a camera, if that's what you mean," Ed said. "But come on, I wasn't born yesterday; you can't keep that kind of hanky-panky a secret forever. Look at the way she dresses; she obviously enjoys men looking at her, especially Steve. In fact, I saw them having drinks together at Dino's the other night and believe me, they didn't look like they were talking business. All that on top of the rumors, you put two and two together."

Well, that did it for me. I'd been trying to play the objective observer and let Ed and George do all the talking, but Ed's last comment, along with some budding guilt about my own blindness to certain things at Triton that Ruth had pointed out, drove me out in the open. "Come off it, Ed," I said. "That's not evidence, that's gossip."

Now Ed turned on me: "Look," he shouted, "I didn't want to talk about this, but now that you've brought it up, I'll tell you something else. Even if we didn't have to worry about this sexual discrimination business, I still wouldn't back Ruth for the director's job." He calmed down a bit. "No offense, Barbara, but I just don't think women work out as well as men in certain positions. Human resources is one thing. It's real soft, person-to-person stuff. But factories are still a man's world. And I'm not talking about what I want it to be like. I'm talking facts of life.

"You see what happens when we send a woman out on some jobs, especially in the factories. To be any good in marketing you have to know how to relate to your client; that means getting to know him, going out drinking with him, talking sports, hunting, whatever he's interested in. A lot of our clients feel uncomfortable around a woman in business. They know how to relate to their wives, mothers, and girlfriends, but when a woman comes to the office and wants to talk a deal on industrial drills – well, they don't know what to do.

"And then there's the plain fact that you can't depend on a woman the way you can on a guy. She'll get married and her husband will get transferred, or she'll have a baby and want time off and not be able to go on the road as much. I know, Barbara, you probably think I'm a pig, or whatever women's libbers call guys like me these days. But from where I'm sitting, it just made good business sense to choose Dick over Ruth."

"Ed, I don't believe it," I said. "The next thing you'll tell me is that women ought to stay at home, barefoot and pregnant." There was a long silence after that – my guess was that I had hit on exactly what Ed thought. At least he didn't deny it. Ed stared at the rug, and George frowned at his coffee cup. I tried to steer the conversation back to the subject at hand, but it dwindled into another silence. George took a few notes and then told Ed he could go back to work. I assumed I was excused too, but as I started to leave, George called me back.

"Barbara, I'm going to need your help thinking through this mess," he said. "Of course we've got to figure out how we can avoid a lawsuit before the day is out, but I also want to talk about what we can do to avoid more lawsuits in the future. While Ed was talking I took some notes, and I've got maybe four or five points I think we ought to hash out. I'm not saying we're going to come up with all the answers today, but it'll be a start. You ready?"

"Shoot."

"Okay, let's do the big one first," he began. "What should I have done or not done to avoid this situation? I mean, I was just patting myself on the back for being so proactive when I sent out that memo letting everyone know the company policy on discrimination. I wrote it not thinking we had any problem at Triton. But just in case we did, I figured that memo would take care of it."

"Well, it looks like it's not enough just to have a corporate policy if the people in the ranks aren't on board. Obviously it didn't have much of an effect on Ed."

"So what am I supposed to do? Fire Ed?"

Being asked for my honest opinion by my CEO was a new experience for me and I appreciated it, but I wasn't going to touch that last question with a ten-foot pole. Instead I went on to another aspect: "And even if you get your managers behind you, your policy won't work if the people it's supposed to help don't buy it. Ruth was the first woman to complain around here. Are the others afraid to speak up? Or do they feel like Ed about a woman's place, or have husbands who do? Maybe they lack confidence even to try for better jobs, that is, if they knew about them."

"Okay," he said, "I'll admit that our system of having the VPs make recommendations, our 'old-boy network,' as Ruth called it, does seem to end up excluding women, even though the exclusion isn't intentional.

And it's not obvious discrimination, like Ed's claim that Ruth is unqualified for a position because she is a woman. But wouldn't open job posting take away our right to manage as we see fit? Maybe we should concentrate instead on getting more women into the social network, make it an old boys' and old girls' club?"

"To tell you the truth, George, I don't much want to play squash with you," I replied, "but maybe we're getting off the subject. The immediate question seems to be how we're going to get more women into executive positions here, or, more specifically, do we give Ruth the director of marketing position that we just gave Dick?"

"On that score, at least, it seems to me that Ed has a strong argument," George said. "Dick is more qualified. You can't get around that."

I had wanted to challenge Ed on this point when he brought it up earlier, but I wasn't quite sure of myself then. Now that George was asking me for advice and seemed to be taking what I had to say seriously, I began to think that I might have something valuable to offer. So I charged right in. "George, maybe we're cutting too fine a line with this qualifications business. I know a lot of people think affirmative action means promoting the unqualified over the qualified to achieve balance. I think that argument is hogwash at best and a wily diversion tactic at worst. To my mind, Ruth and Dick are equally qualified, or equal enough. And wouldn't it make good business sense to get a diverse set of perspectives – women's, men's, blacks', whites' – in our executive group?"

"But isn't that reverse discrimination – not promoting Dick because he's a man? How would a judge respond to that? That's a question for a lawyer."

George leaned forward. "Let's talk about my last point, the one I think we've both been avoiding. What about this affair between Ruth and Steve? Boy, this is one reason why women in the work force are such trouble – no, just joking, Barbara, sorry about that. Look, I don't like lawsuits any more than anyone else, but I'd do anything to avoid this one. We'd be a laughing stock if it got out that Triton promoted unqualified people because they slept with the boss. I don't know how I'd explain that one to my wife."

"Look, George," I said, "in the first place, Dick's superior qualifications are debatable; in the second place, we have no proof that Ruth and Steve are involved in that way; and in the third place, what if they were once involved but no longer are? Does a past relationship condemn them for life? Isn't there a statute of limitations on that kind of thing, or are we going to make her put a scarlet letter on her briefcase? I thought these discrimination laws were supposed to protect women, but now it looks like a woman can be denied a promotion because someone thinks she's a floozy."

"Wait a second, Barbara. Don't make me look like such a prig," George said. "I realize that when men and women work together sexual issues are bound to crop up. I just don't know what I'm supposed to do about it, if anything. In some cases a woman may welcome a guy coming on to her, but what if it's her boss? And then there's that subtle stuff Ruth brought up – the calendar, dirty jokes, the male employees excluding women by going to bars to watch TV – and other women. And Ruth's treatment at that factory – how can we control our clients? I'm not sure these are things you can set policy on, but I am sure that I can't ignore them any longer."

And there we were. All the issues were on the table, and we had about 21 hours to make our decisions and act on them.

Heineken NV
Workplace HIV/AIDS Programs in Africa (A)

Diana Barrett

Harvard University Business School, currently President of the Fledgling Fund

Daniella Ballou

Research assistant to Diana Barrett

Diana Barrett and Daniella Ballou, "Heineken NV: Workplace HIV/AIDS Programs in Africa (A)," Harvard Business School Case (9-303-063), 2003. Reprinted with permission of Harvard Business Publishing.

On July 18, 2001, Hans Wesseling, corporate human resources policy and systems manager at Heineken NV (Heineken), considered the presentation in front of him. In a few short hours, he would propose a new HIV/AIDS policy to Heineken's executive board of directors and was contemplating the full range of issues that he expected the board would want to explore. Wesseling felt particularly responsible for effectively presenting the proposal because he was speaking for a team that included senior managers from across the company. A team with representatives from human resources, marketing, operations, and corporate medical services had developed the new HIV/AIDS policy after more than six months of meetings, drafts and revisions.

Preparing for the board meeting had been a joint effort. Henk Rijckborst, director of medical services, Stefaan van der Borght, corporate medical advisor, and Wesseling had developed a presentation that addressed the medical, financial, and managerial dimensions of the proposal. Still, Wesseling could not help but be a bit anxious. Wesseling was concerned not merely with his effectiveness at communicating or his credibility in the eyes of the board. Most of all, he was concerned about representing, to the best of his ability, Heineken's African workforce. He needed to convey the importance of the proposed program and the gravity of the situation that some of Heineken's African workers faced. Although Heineken's five-member executive board had all previously visited Heineken's African operations, only one board member had on-the-ground experience working in Africa.

That afternoon, Wesseling would propose an ambitious plan for Heineken to make life-saving AIDS treatment available to its entire African workforce, including spouses and dependents of its workers. The plan that Wesseling and his colleagues were proposing was not new to the board; he had met several times with the board as a whole and with individual, members. But this was it. At this meeting, the board would decide whether a Heineken comprehensive AIDS-treatment program in Africa would go forward. While there was no concluding slide in the presentation that said, "Today we are literally making a life or death decision," he almost felt that there should be.

Global HIV/AIDS Epidemic

By 2001, AIDS had become a public-health crisis comparable in scale only to the black plague of the 14th century. AIDS infected 40 million people globally, with 28 million infected persons living in Africa, the continent most affected by the epidemic.[1] According to the World Health Organization (WHO), the adult AIDS infection rate had reached 20% in South Africa and 38.5% in Botswana.

AIDS was having dramatic social, economic, and security consequences for the countries hardest hit by the epidemic. In Africa, AIDS had orphaned 13 million children. Medical professionals and educators in many African countries also suffered from high infection rates, further depleting already limited human resources in the health and education fields. Businesses were experiencing unprecedented turnover in their workforces, forcing some companies to hire three employees for every two jobs to compensate for the loss of workers due to AIDS. AIDS was expected to lead to a cumulative decline of 17% in the South African GDP by 2010[2] and had already decreased life expectancy from 68 to 39 years in Botswana.[3]

AIDS was increasingly recognized as a threat to countries and regions outside of Africa, especially, India, China, and Eastern Europe. In India, 4 million people were infected with AIDS, and it was estimated that 37 million people in India could have AIDS by 2010.[4] China had 850,000 reported AIDS cases[5] and was experiencing explosive growth of 40% or more cases per year.[6] In Eastern Europe, there were 250,000 new cases of AIDS in 2000, to bring the total to 1 million people infected. However, it was not only developing countries that saw AIDS as a grave concern. The U.S. Central Intelligence Agency (CIA) recognized HIV/AIDS as a national security threat, based both on the threat to stability in deeply affected nations and on the global public health impact of the epidemic, which would not stay limited to any one country or region.[7] The Joint United Nations Programme on HIV/AIDS (UNAIDS) stated that "Unless averted with renewed and more effective prevention efforts, resurgent epidemics will continue to threaten high-income countries."[8]

By 2001, the widespread use of antiretroviral medicines (ARVs) continued to significantly extend

Exhibit 1 Global HIV/AIDS statistics.

Region	*Adults and children living with HIV/AIDS*	*Adults and children newly infected with HIV*	*Adult prevalence rate*[a]	*Main mode(s) of transmission for adults with HIV/AIDS*[b]
Sub-Saharan Africa	28.1 million	3.4 million	8.4%	Hetero
North Africa & Middle East	440,000	80,000	0.2%	Hetero, IDU
South & Southeast Asia	6.1 million	800,000	0.6%	Hetero, IDU
East Asia & Pacific	1 million	270,000	0.1%	IDU, Hetero, MSM
Latin America	1.4 million	130,000	0.5%	MSM, IDU, Hetero
Caribbean	420,000	60,000	2.2%	Hetero, MSM
Eastern Europe & Central Asia	1 million	250,000	0.5%	IDU
Western Europe	560,000	30,000	0.3%	MSM, IDU
North America	940,00	45,000	0.6%	MSM, IDU, Hetero
Australia & New Zealand	15,000	500	0.1%	MSM

Source: UNAIDS, "AIDS Update: December 2001," www.unaids.org.

[a] The proportion of adults (15 to 49 years of age) living with HIV/AIDS in 2001, using 2001 population numbers.

[b] Hetero (heterosexual transmission), IDU (transmission through injecting drug use), MSM (sexual transmission among men who have sex with men).

the life of those with HIV/ AIDS in the United States, Europe, and other industrialized nations. Treatment regimens, using triple combinations of ARVs, were becoming more convenient and more tolerable to take. Yet, ARV therapy was not reaching 95% of the people living with HIV/AIDS, primarily those infected in the developing world, and especially sub-Saharan Africa.[9] These individuals would die within 3 to 10 years of being infected by HIV/AIDS, when the virus would destroy their immune system, and opportunistic infections, such as tuberculosis or Kaposi syndrome, would inevitably lead to death. An HIV vaccine remained a distant intervention, with at least another 5 to 7 years before an effective and safe preventive vaccine might be available. (See Exhibit 1 for statistics on the global epidemic.)

In early 2001, there was a dramatic increase in the international attention paid to the HIV/AIDS epidemic and the devastating economic and social consequences it was having on sub-Saharan Africa. Kofi Annan, Secretary General of the United Nations, led the call for greater world commitment to fight AIDS, challenging all sectors of society to contribute to efforts responding to the pandemic. In April 2001, he announced the formation of the Global Fund to Fight AIDS, Tuberculosis and Malaria.[10] The Global Fund sought to raise $7 billion-$10 billion to launch a comprehensive effort to fund AIDS programs in Africa and other highly affected regions. Furthermore, in June 2001, leaders from across the globe came together for the UN General Assembly Special Session on AIDS (UNGASS), the first time a session of this type had been held to address a single disease. (See Exhibit 2 for "We Can Beat AIDS," Kofi Annan's editorial in *The New York Times*.)

One of the most notable changes that had occurred in 2000 and 2001 was the dramatic reduction in prices of antiretroviral drugs. Through a combination of activist pressure, generic competition, and pharmaceutical company initiative, both branded and generic companies were now offering lower-cost AIDS drugs. In early 2001, Cipla, an Indian generic company, announced that it would offer certain triple-therapy combinations for as low as $350 dollars a year to

Exhibit 2 *The New York Times* Op-Ed.

We Can Beat Aids

by Kofi Annan, Secretary General of the United Nations

The world cannot underestimate the threat of AIDS, but it would be equally wrong to fall into despair. The facts about AIDS are stark; twenty-two million people have died, with last year's total of three million the highest yet. In some African countries, a quarter of the population is infected with HIV, the work force is shrinking and decades of progress in raising living standards is being wiped out. The same will soon happen to countries elsewhere – in Asia, Eastern Europe, the Caribbean – unless they take drastic action now. And no country is immune. But in the last few months the world has awakened at last, not only to the scope of the problem, but to the reality that we are not powerless against it.

The special United Nations session on AIDS that opens today comes at a time when we have more reason for hope than we have had in the last 20 years. Even poor and middle-income countries can protect themselves by combining prevention and treatment, as Brazil, Senegal, and Thailand have shown. Even the worst affected countries can confront the disease and contain its spread, as Uganda has shown. International drug companies have slashed the prices of antiretroviral drugs and other AIDS-related medicines in the poorest countries. And in Africa, political leaders have faced up to the problem as never before.

Two months ago, at the African summit in Abuja, Nigeria, I sensed a new spirit of urgency. All the nations represented there undertook to increase the share of resources they devote to health, and to AIDS and HIV in particular.

The proper strategy has also become clear: Prevention of new infection, above all, by teaching young people how to avoid it and by providing the medicines that can prevent transmission from mother to child. Care and treatment for those infected, for humane reasons but also to bring people in for testing, which they are likely to avoid when there is no hope of treatment. More research toward vaccines and a cure. And finally, protection of those whom AIDS has left most vulnerable – starting with children it has orphaned.

These are achievable objectives. All this can be done, in the whole of the developing world, for an annual expenditure of $7 billion to $10 billion. That is five times what is now being spent – and it would need to be sustained for many years – but it is only a quarter of New York City's budget. The world can surely find this amount.

Some of this money will have to be spent on improving general health care systems in poorer countries to equip them to provide for the effective treatment of AIDS. Some of the money will come from within the poorer countries most affected by AIDS, but I believe the public in the richer nations is also ready to contribute significantly. It is in these nations' self-interest as well as humanitarian interest to do so, since no country can be unaffected by a global disaster of this magnitude.

Governments, foundations, commercial companies, private individuals – all have been coming forward in the past few months, wanting to play their part in the global effort. Some already know how they want to spend their money and to whom they should give it. Others want to contribute to a global fund that can make sure the right strategy is followed and simplify the application procedures for countries that need assistance. At this week's special session of the United Nations General Assembly, I am sure more countries will announce contributions.

Every day lost is a day when 10,000 more people become infected with HIV. We can beat this disease, and we must.

Source: Kofi Annan, "We Can Beat AIDS," *The New York Times*, June 25, 2001.

countries suffering from the pandemic.[11] Branded manufacturers, through the Accelerating Access Initiative, now also provided a full range of ARV triple-therapy regimens at $1,000 to $2,000 per year. This was a major reduction from the earlier price of $10,000 per year from branded manufacturers that had made these drugs inaccessible to virtually all African's who suffered from AIDS.

The media played a major role in building awareness of the AIDS crisis, giving visibility to statistics about the growing global epidemic, and to debates about AIDS drug access and intellectual property. Brazil's national AIDS program was frequently cited as a success, achieved by offering free treatment to all citizens, including the use of government-produced generic ARV drugs.[12]

HIV/AIDS and the Private Sector

By 2001, individual businesses operating in Africa were increasingly faced with the impact of HIV/AIDS in their own workplace and surrounding communities. The Global Business Coalition on HIV/AIDS, a business network formed to respond to the global epidemic, identified three direct costs of the epidemic to businesses:[13] (1) lower productivity, with increasing absenteeism and staff turnover, loss of skills and declining morale; (2) increased costs, including training and recruiting, insurance coverage, retirement funds and funeral costs; and (3) declining profits and investment, as the epidemic affects consumers and business confidence. Academics had sought to quantify these direct costs of AIDS to company operations.[14]

HIV/AIDS was also raising broader issues about the corporate social responsibility of companies operating in highly affected regions. With HIV/AIDS becoming an increasingly important issue for stakeholders such as labor unions, governments, and NGOs, companies experienced growing external pressure to respond to the epidemic.

Business networks and partnerships

Although a large and active group of AIDS-focused nongovernmental organizations (NGOs) had existed for many years, there were only a handful of organizations focused on the business response to HIV/AIDS. The GBC was a well-established business network devoted to fostering an effective private-sector response on a global level but had less than 30 members. In January 2001, the World Economic Forum announced the formation of the Global Health Initiative, also aimed at strengthening the private sector response to AIDS, T.B. and malaria. Both organizations were focused on expanding membership in early 2001.

In addition to business networks, a limited number of partnerships between business and government or nonprofit agencies had started to arise. Government aid agencies such as the United States Agency for International Development (USAID) were funding research on the impact of HIV/AIDS on the private sector, while the German technical cooperation agency (GTZ) had developed a joint prevention program with Heineken and other private enterprises in the Democratic Republic of Congo.[15] Several other large employers, such as Unilever Africa, had also begun to work with local NGOs to implement prevention and education programs for its workers. Still, partnerships of this type were in their infancy.

Other firms with major African operations

Firms operating across Africa had nearly all begun to feel the impact of HIV/AIDS. Extractive industries (brewing, soft drinks, and a range of consumer-product companies) dominated African industry, with South Africa holding the highest concentration of multinationals and large local companies. Companies with widespread operations across Africa included Shell, ExxonMobil, BP, ChevronTexaco, TotalFina/ELF, Heineken, Coca-Cola, Unilever, Cargill, and South African Breweries. In South Africa, mining giants AngloAmerican and DeBeers, as well as financial-services companies such as Standard Chartered and Old Mutual, had large operations. Automobile manufacturers DaimlerChrysler, Volkswagen, Ford, and GM all had operations in South Africa.

Heineken had just begun to work with a group of six multinational firms to form the Private Investors for Africa Group,[16] and HIV/AIDS was one of the key issues this group planned to discuss with the World Bank and IMF. Other themes explored by the group were related to investment, privatization, transparency, and taxation.

However, in early 2001, none of the multinationals in Africa had a corporate AIDS policy yet that included treatment for all African workers.[17]

Heineken NV

Heineken NV was a global company with net sales of 8.1 billion euros (€), ($7.5 billion) in 2000. Its main product was beer, making up more than 80% of revenues. Heineken beer in the green glass bottle was its signature product, and the corporate identity remained linked to its long history as a Dutch company. Heineken was the top-selling brand in Europe and its Amstel brand held second place. In addition to these two international brands, Heineken produced a wide variety of local beer brands. (See Exhibit 3 for data on Heineken's historical financial performance.)

The Dutch Heineken family traced its entry into the brewing industry to the 1864 purchase of a brewery in Amsterdam. Since that time the company had continually sought global expansion of its product reach. Heineken's corporate headquarters and Dutch brewing operations remained in Amsterdam, but Heineken had become a truly global company. Heineken's 2000 annual report proudly stated that, "Heineken NV is the world's most international brewing group, with operations in more that 170 countries."[18] (See Exhibit 4 for a summary of Heineken's financial and operating performance by region.)

Heineken still prided itself on its history as "a family business"[19] although it had grown to a large corporation. Heineken Holdings NV, controlled by the Heineken family, retained a majority share (50.005%) in Heineken NV.

Exhibit 3 Heineken financial statements (1997–2000).

In millions of Euros	*1997*	*1998*	*1999*	*2000*
Net turnover	6,131	6,272	7,148	8,107
Raw materials, consumables and services				4,324
Excise duties				1,093
Staff costs				1,031
Amortization/depreciation and value adjustments				468
Total operating expenses				*7,186*
Operating profit	*546*	*659*	*799*	*921*
Results of nonconsolidated participating interests				59
Interest				-66
Profit before tax				***914***

Source: Heineken annual reports.
Note: Average exchange rate for 2000,1 Euro = $0,924.

Exhibit 4 Heineken performance by region (2000).

In millions of Euros unless noted	*Europe*	*Africa/ Middle East*	*Asia/Pacific*	*Western Hemisphere*	*Consolidated*
Net turnover	7,272	392	504	987	8,107
Operating profit	799	36	40	46	921
Employees (in numbers)	27,213	7,237	4,736	839	40,025
Sales volume (in millions of hectolitres)	50.7	9.2	7.5	7.4	97.9

Source: Heineken annual reports.
Note: Consolidated data includes eliminations/additions not accounted for in regional data.

Exhibit 5 Heineken operating companies and participating interests in Africa/Middle East (2001).

Country	*Company*	*Location*	*Brands*
Angola[a]	Nocal (27.1%)	Luanda	Nocal, Primus
Anglo[a]	EKA (46%)	Dondo	EKA
Burundi	Brarudi (59.3%)	Bujumbura, Gitega	Amstel, Primus, Dynamalt
Cameroon[a]	Brasseries du Cameroun (8.8%)	Bafoussam, Douala, Garoua, Yaounde	Amstel, Mützig
Chad	Brasseries du Logone (100%)	Moundou	Gala, Chari, Maltina
Congo-Brazzaville	Brasseries du Congo (50%)	Brazzaville, Pointe Noire	Mützig, Primus, Guinness, Ngok
Democratic Republic of Congo	Bralima (90%)	Boma, Bukavu, Kinshasa, Kisangani, Mbandaka, Lumbumbashi	Amstel, Primus, Mützig, Guinness, Turboking
Ghana	Ghana Breweries (75.6%)	Kumasi, Accra	Amstel Malta, Star, Guider, ABC Golden Bubra, ABC Golden Lager, ABC Stout
Israel[a]	Tempo Beer Industries (17.8%)	Netanya	Maccabee, Gold Star, Nesher, Malt Star
Jordan[a]	General Investment (10.8%)	Zerka	Amstel
Lebanon[a]	Almaza (10%)	Beirut	Almaza
Morocco[a]	Brasseries du Maroc (2.2%)	Casablanca, Fes, Tanger	Heineken, Amstel
Nigeria	Nigerian Breweries (54.2%)	Aba, Enugu, Ibadan, Kaduna, Lagos, Jjebu Ode, Owe Omamma	Amstel Malta, Maltina, Star, Guider, Legend
Nigeria[a]	Consolidated Breweries (23.9%)	Jjebu Ode, Owe Omamma	"33" Export, Hi-malt
Réunion	Brasseries de Bourbon (85.4%)	Saint Denis	Bourbon, Dynamalt
Sierra Leone[a]	Sierra Leone Brewery (42.5%)	Freetown	Star, Guinness, Maltina
South Africa[a]	South African Breweries (License)	Cape Town, Durban, Johannesburg	Amstel, Guinness

Source: Heineken annual report 2001.

[a] Affiliated company (non-consolidated)

Heineken's African Operations

> *We have been in Africa for 67 years. We have had and continue to have a strong commitment to the region and a long relationship with the communities in which we work.*
>
> —Henk Rijckborst, director of medical services

Heineken's long history in Africa meant that its operations were closely integrated with the communities where it operated. Heineken operated through a combination of wholly and majority owned subsidiaries in eight countries (Burundi, Chad, Congo-Brazzaville, Democratic Republic of Congo, Ghana, Nigeria, Reunion and Rwanda), as well as minority stakes and licensing agreements in ten additional countries.(See Exhibit 5 for a list of Heineken operating companies and participating interests in Africa and the Middle East.)

Heineken International had management control of its wholly and majority-owned operations, and all of these local subsidiaries had an ultimate reporting relationship to the parent company.

Healthcare at Heineken

Outside of Africa, health care for Heineken employees was either provided by local governments (e.g., Western Europe) or through insurance provided by Heineken. In contrast, Heineken Africa operated a system of on-site clinics. This was typical for multinational companies operating in Africa, in part because the provision of health-care services had historically been a requirement for companies in francophone Africa (where some of Heineken's operations were located). Furthermore, the limited health-care infrastructure in many African countries made a dedicated corporate clinic the best way to serve employees. South Africa, with its more developed health-care system, was an exception; thus, large South African employers provided health care in a variety of ways, some through on-site clinics and others through insurance.

A corporate medical group based in Amsterdam worked closely with the local staff to manage Heineken's African medical facilities. The corporate staff played a key advisory role for medical staff and operations managers, disseminating information to regional staff, assisting in policy and program development, and evaluating challenging medical situations that arose in the field. Increasingly, corporate staff was faced with difficult medical and ethical dilemmas, as employees infected by the opportunistic diseases associated with AIDS approached Heineken doctors and managers for help treating their illnesses. Everyone knew of a case where a manager had chosen to pay out of his or her own pocket for a company or household employee. The long-term outcome of such a charitable intervention always remained uncertain, and the medical staff knew that those who were receiving this type of assistance were only a fortunate few.

Existing HIV/AIDS programs at Heineken

Heineken had started AIDS prevention and education programs for employees in its African operations as early as 1989, with a program developed jointly with WHO and Project Sida of Antwerp University. In 2000, Heineken developed a program in the Congo with GTZ through its private-public partnership program. Through this partnership and the independent efforts of Heineken, prevention and education were well integrated into the workplace by 2001.

Heineken also treated employees and their families for the opportunistic infections associated with AIDS, such as T.B., in its on-site clinics. As of July 2001, Heineken stopped short of providing the treatment required to extend the lives of those infected by HIV/AIDS. Heineken was not yet administering ARVs at its African health facilities.

Evaluating the Possibility of a Treatment Program

> *When ARV drug prices fell from $10,000 to around $1,000 per year, we could begin to consider it as a possibility. Before that we couldn't even consider treatment for our African workers.*
>
> —Stefaan van der Borght, corporate medical advisor

In July 2000, Stefaan van der Borght attended the 12th International AIDS Conference in Durban, South Africa. He learned that most of the other companies present were also struggling to develop an effective workplace response to the AIDS epidemic. However, there were still only a handful of multinational companies with significant African operations represented[20] in the more than 10,000 delegates from across the globe. "It was Joep Lange's[21] speech in Durban that really changed my perception of what our company could do," expressed Van der Borght. "He challenged the major employers in Africa, more explicitly the beer brewers and mining companies, to treat their workers. For a cost of less than $5 per day, he argued that it was companies, more than the public sector, that had the capacity to roll out AIDS treatment programs." Van der Borght waited for Lange after his speech and invited him for a meeting in Amsterdam. Shortly thereafter, Van der Borght, Rijckborst, and Wesseling met with Lange in Amsterdam. Van der Borght felt that this "… was a turning point. Lange convinced us to seriously consider offering ARV treatment in Africa, and he offered to help us set up the program."

Heineken would be the first multinational firm to offer treatment to all of its workers across the continent. Even in South Africa, which had a significantly more developed medical infrastructure than the countries where Heineken operated, many companies were yet to offer treatment to all employees. Wesseling realized this made Heineken's decision not only more challenging, but also, more important. They would be setting a precedent that other firms would look to when considering the launch of a full-scale treatment program.

In February 2001, Wesseling first presented HIV/AIDS as a major workplace issue in Africa to the board. The board agreed that a team would be formed to investigate Heineken's options to respond.

Exhibit 6 Countries with Heineken operations in Sub-Saharan Africa – national statistics (1999).

Country	*Population (million)*	*GDP per capita (purchasing power parity adjusted)*	*AIDS Infection rate (adults)*[a]	*Human development index (scale 1 = highest, 162 = lowest)*
Burundi	6.3	$578	11.3%	160
Rwanda	7.1	$885	11.2%	152
Congo-Brazzaville	2.9	$727	6.4%	126
Democratic Republic of Congo	49.6	$801	5.1%	142
Nigeria	110.8	$853	5.1%	136
Ghana	18.9	$1881	3.6%	119
Sierra Leone	4.3	$448	3.0%	162
Angola	12.8	$3179	2.8%	146
Chad	7.6	$850	2.7%	155
Reunion	0.74	$4800	N/A	N/A

Source: UNAIDS, UN Human Development Report, 2001.

[a] Infection rate of adults aged 15–49.

Assessing the Risks and Developing the Case For Treatment

> *The Board wanted us to look at the worst-case scenario.* We *had to have those discussions.*
>
> —Henk Rijckborst, director of medical services

Wesseling immediately sought to form a cross-functional team to evaluate the possibility of launching a treatment program. "When we began to consider developing a treatment program, I knew that we needed to engage people from across all departments to evaluate the possibility," expressed Wesseling. The team consisted of an operations manager from the Africa region, an operations manager from Asia, Wesseling (representing corporate human resources), a global marketing manager, and Rijckborst and Van der Borght from the corporate medical group.

There were numerous factors and concerns that the team needed to consider to win board approval. The team focused its evaluation on four primary issues: (1) social and economic impact of the AIDS epidemic in Heineken's regions of operations; (2) cost of treatment and feasibility of implementation; (3) cost savings and other benefits of treatment; and (4) Heineken's corporate social responsibility.

Social and economic impact of the AIDS epidemic in Heineken's regions of operations

By mid-2001, business executives in Europe had at least some knowledge of the AIDS epidemic in Africa, according to repeated reports in the media. However, the extent of the epidemic's impact on everyday life, and the frequent death of friends, family, and colleagues that were increasingly becoming the norm in certain regions, was not well understood by those living far removed from the epidemic. Similarly, the long-term economic impact had received far less public attention than the growing infection rates. Wesseling and his colleagues needed to understand the full impact of the epidemic and communicate it to the board.

Thus, they began to gather research and data from organizations such as UNAIDS and the World Bank, who had conducted detailed assessments of the social and economic impact of HIV/AIDS. Wesseling was also able to tap into the existing expertise of the corporate medical staff. Rijckborst had been involved in WHO meetings on AIDS and nondiscrimination in the workplace as early as 1988. Van der Borght had been treating HIV/AIDS victims and educating high-risk populations since 1991, first in Angola, then in

Exhibit 7 Estimated laboratory equipment, testing and staff training costs.

Item	*Initial (Year 1) investment*	*Recurring cost*
Testing and lab equipment	$515,000	HIV test: $8/test CD4 count: $15/test (only used if employee tests HIV+)
Training	$180,000	$65,000
Data management	$160,000	$67,500

Source: Heineken company documents.

Cambodia and throughout Southeast Asia, working for Doctors Without Borders/Médecins Sans Frontières. He had experienced firsthand the way AIDS was affecting entire regions and he also knew that taking action to fight the disease was becoming increasingly possible, even in the poorest of settings.[22]

After completing this background research, "it became clear that AIDS is not just a disease – it is a social disaster," expressed Wesseling. The team felt that this was sufficient justification for them to conduct a feasibility study to evaluate an ARV treatment program for all of the African operations.

Cost of intervention and feasibility of implementation

Evaluating the cost and management requirements for an ARV treatment program was the crucial next step. By using existing estimates of the general population's infection rate, and by applying this to the workforce and their spouses, a five-year model for expected number of employees infected, employees needing treatment,[23] and treatment was developed. The model included the estimated costs of treatment and monitoring, training, and continuous prevention activities. The newly reduced costs, from $1,000 to $2,000 per year, were used to estimate the cost of antiretroviral treatment. (See Exhibit 7 for an estimate of investment costs for the program.)

Upon completion of this analysis in February 2001, the team became convinced that it would be feasible for Heineken to implement an ARV treatment program in all of its African subsidiaries – but at a cost to the firm, of course. To convince the board to approve the program would require a more comprehensive analysis of both the costs and benefits of intervention.

Cost savings and other benefits of intervention

> *For our general managers, it is a terrible situation.... [They] are never trained to deal with these type of situations ... to choose whether a worker will live or die.*
>
> —Henk Rijckborst, director of medical services

The clearest benefit of intervention was saving the lives of workers. To corroborate Van der Borght's analysis and further quantify the benefits of intervention, Heineken hired the Futures Group, a consulting firm with experience in the design and evaluation of health programs, to do an independent assessment of the proposed program. The consultants identified three quantifiable areas where cost-savings would result from treating AIDS-infected workers: (1) sick days; (2) training of new workers; and (3) death benefits and funeral costs. They also identified several qualitative benefits of treatment including worker and management morale, productivity, and relationship with external stakeholders, but did not include these benefits as cost-savings in their analysis.

Based on the quantifiable cost-savings associated with treatment, the consultants began to estimate the net present value (NPV) of offering AIDS treatment to all workers, their spouses, and their children. The consultants studied three Heineken plants, two of which were in Africa and one in Thailand.

Heineken's corporate social responsibility

As the team evaluated the impact of the disease on Heineken, and more broadly, in regions across Africa, difficult questions began to arise about Heineken's corporate social responsibility. "We had to put some of the broader corporate responsibility questions about our role in society aside during the evaluation, but some had to be considered for our assessment to be complete," expressed Wesseling. Two issues became particularly important areas of discussion and risk analysis: inclusion of spouses and children in the program, and the continuation of treatment after a worker is laid off or fired.

At the end of 2000, there were no existing national government or internationally funded treatment programs in the communities where Heineken operated in Africa. Until there were such programs, the team concluded that from both a medical and ethical perspective, the program proposed to the board would need to provide treatment to spouses, children, and terminated workers. The nature of AIDS was such that lifelong treatment was required or the infected person would face certain death. The team included these provisions when modeling the costs of the program.[24]

A final concern raised by team members involved the risk of associating the Heineken brands with HIV/AIDS. "We don't deny that alcohol is a risk factor associated with unsafe sex. We have a very strict alcohol policy internally and externally," expressed Rijckborst. The team recognized that this fact made addressing HIV/AIDS as a company both important and sensitive.

The Board Meeting

Wesseling's case to the board focused on two main points: corporate social responsibility and feasibility. The investigation by the medical team, with the input and support of the cross-functional team assembled by Wesseling, had shown that it *was feasible* to implement the program. The expertise existed or was learnable by staff, and the costs and risks were manageable. Furthermore, Wesseling and his colleagues had become convinced that Heineken needed to make its contribution, where possible, to combating the growth and impact of this devastating epidemic.

The one issue he had to frankly address was that this program *would not be NPV positive*. Based on the study conducted by external consultants, the measurable costs of running a treatment program did not outweigh the measurable savings associated with keeping an employee with AIDS alive through ongoing treatment. This analysis assumed that current treatment costs would not reduce, did not consider cost-sharing with other regional companies, and only included direct measurable costs to the business. Nonetheless, it meant that Wesseling could not present this as just another profitable investment opportunity for the company.

As he made final revisions to the presentation, Wesseling glanced out of his office window and observed a barge floating by on one of Amsterdam's many canals. The serenity of his surroundings was in stark contrast to his anxious final preparations for the board meeting.

Notes

[1] AIDS data, unless otherwise noted, from UNAIDS; 'AIDS Update-December 2001,' UNAIDS website www.unaids.org epidemic_update/report_dec01/index.html, accessed December 2001.

[2] Jeffrey Lewis and Channing Amdt, "The Macro Implications of HIV/Aids in South Africa: A Preliminary Assessment," The World Bank website, http://www.worldbank.org/afr/wps/wp9.pdf.

[3] Karen A. Stanecki, "The AIDS Pandemic in the 21st Century: The Demographic Impact in Developing Countries," U.S. Census Bureau, July 2000, www.usaid.gov/pop_health/aids/Publications.

[4] Bates Gill, "The Coming AIDS Crisis in China," *The New York Times*, July 16, 2001.

[5] Some sources reported that the actual number of infections was substantially higher than estimated.

[6] John Gittings, "China Finally Wakes Up to AIDS Timebomb," *The Guardian*, Nov. 13, 2001.

[7] Congressional Testimony by Carl W. Ford, Jr., Assistant Secretary of State for Intelligence and Research Department of State, February 6, 2002.

[8] UNAIDS, "AIDS Update: December 2001," UNAIDS website, www.unaids.org/epidemic_update/report_dec01/index.html, accessed December 2001.

[9] It is estimated that fewer than 50,000 of the 4.1 million Africans requiring ARVs are receiving treatment. This and other data on treatment availability can be found in, "A Commitment to Action for Expanded Access to HIV/AIDS Treatment," International HIV Treatment Access Coalition, December 2002, www.who.int.

[10] For more information on the Global Fund to Fight AIDS, Tuberculosis and Malaria, visit www.globalfundatm.org.

[11] Donald McNeil, Jr. "Indian Company Offers to Supply AIDS Drugs at Low Cost in Africa," *The New York Times*, February 7, 2001.

[12] Tina Rosenberg, "Look At Brazil," *The New York Times Magazine*, January 28, 2001. Brazil's national government provides ARV therapy free of charge to all persons infected with AIDS.

[13] Global Business Council on AIDS Web site, www.businessfightsaids.org.

[14] See S. Rosenthan et al., "Care and treatment to extend the working lives of HIV positive employees: calculating the benefits to business," *South African Journal of Science*, June 2000.

[15] The GTZ program involved a range of HIV preventive activities tailored to the private enterprise. Activities included training sessions on HIV, social marketing of condoms, setting up monitoring and evaluation systems and facilitating the formation of a national business committee with local enterprises for sharing experiences in HIV prevention and access to care.

[16] When formed in early 2001, the Private Investor for Africa Group members were Heineken, Coca-Cola, CFAO, Groupe Vilgrain, Guinness, and Unilever. At the end of 2002, Coca-Cola and Groupe Vilgrain had left the group, and Barclays Africa and Stanbic had joined.

[17] AngloAmerican announced in May 2001 that it would treat all of its 100,000+ workers in South Africa, but several months later the pledge was retracted.

[18] Heineken NV annual report, 2000.

[19] Heineken NV website, www.heinekencorp.nl.

[20] With the exception of pharmaceutical companies, who were major participants. Representatives from multinational companies with a significant workforce and manufacturing or mining operations were far fewer in number.

[21] Dr. Joep Lange, President, International AIDS Society.

[22] In early 2001, the Boston-based NGO Partners in Health, run by Harvard Medical School faculty, was already treating AIDS patients with antiretrovirals in a poor rural community in Haiti. David Brown, "Progress in AIDS Programs in Haiti," *The Washington Post*, July 12, 2002, A18.

[23] Persons infected with HIV/AIDS only required treatment during the later stages of infection, when their immune system became compromised and tests showed a low CD4 count. Of those tested HIV+, it was expected that 50% (or less) would require immediate treatment.

[24] Cost of treating children was excluded from the model due to a lack of data on infection rates. It was expected that the yearly cost of treating children would be significantly less than for adults.

Banking
A Crack in the Swiss Vault

Andy Court and Keith Sharman

CBS News

If there's anything that the Swiss take more seriously than the precision of their watches or the quality of their chocolate, it's the secrecy of their banks. The subterranean vaults of Geneva and Zurich have served as sanctuaries for the wealth of dictators and despots, mobsters and arms dealers, corrupt officials and tax cheats of all kinds.

It's a world U.S. law enforcement has rarely been able to penetrate. So the idea that UBS, one of Switzerland's largest banks, would hand over information on thousands of American tax cheats would have been unthinkable just a few years ago.

You'll hear the twisted tale of how it all happened, from a man some people have called one of the most important whistleblowers ever who has been rewarded with a federal prison term and the possibility of endless riches.

Though he was born and raised in the Boston area, Bradley Birkenfeld spent most of the last decade living in Switzerland, helping wealthy Americans hide their money. He was based in Geneva, where he says there may be more money-counting machines than parking meters, in a country that once bragged it had more banks than dentists.

"It's not Swiss money in those banks. It's foreigners'," Birkenfeld told *60 Minutes* correspondent

Andy Court and Keith Sharman, "Banking: A Crack in the Swiss Vault," CBS News, August 15, 2010. Reprinted with permission of CBS News Archives.

Steve Kroft. "You have a culture there that has been ingrained in society about managing people's money, protected by Swiss bank secrecy."

"And who has a right to that information under Swiss law?" Kroft asked.

"Only the banker and the bank itself," Birkenfeld explained.

"How unusual is it for a Swiss banker to come forward and say, 'This is how it works?'" Kroft asked.

"It's never happened before in history. I'm the first one," Birkenfeld replied.

When Birkenfeld, a midlevel banker with an undistinguished employment history, knocked on the door of the U.S. Justice Department in the spring of 2007, he touched off an investigation that would threaten one of the world's largest banks with extinction and shake 300 years of Swiss banking secrecy to the foundations of its underground vaults.

He did it by providing inside information and documentation that his former employer, banking giant UBS, was actively involved in helping its American clients defraud the U.S. Treasury out of billions of dollars in unpaid taxes.

Asked what he thinks is the most valuable thing he gave to the U.S. government, Birkenfeld told Kroft, "The amount of clients and the amount of assets managed by UBS in the United States out of Switzerland."

"And that was how much?" Kroft asked.

"That was 19,000 clients and around 20 billion Swiss francs, which is about $19 billion," Birkenfeld replied.

"Of the percentage of American accounts that you represented, how many would you say were trying to evade taxes?" Kroft asked.

"My own clients?" Birkenfeld replied. "I would say about 90 percent."

Asked if people told him this was their intention when they opened their accounts, Birkenfeld told Kroft, "It was the unwritten rule. You didn't have to discuss it. People wouldn't fly all the way to Switzerland to open accounts just because they wanted to declare their money."

And as a private banker for UBS, Birkenfeld would help his clients invest, spend and move their money. One example he told us about involved withdrawing cash from a customer's account, buying some diamonds in Geneva and then smuggling them into the U.S. for the client inside a toothpaste tube.

Birkenfeld claimed it was legal because the diamonds he said were worth less than $10,000 and didn't have to be declared at customs.

"If it was legal why did you put them in a toothpaste tube? I'm having trouble with that," Kroft said.

"Oh, it was just a way of carrying them so I wouldn't lose them. Where would you put two diamonds?" Birkenfeld replied.

"I think I'd put them in a money belt or I think I'd put them in a case," Kroft said.

"It was a one-time event. That's not my business. I just put them in a toothpaste tube," Birkenfeld replied.

He told Kroft he wasn't trying to hide the diamonds from U.S. Customs. "Not at all," Birkenfeld said.

Buying diamonds and other valuables is just one way of hiding and transporting assets, and Birkenfeld insists that he was just providing a service to his clients, which is what Swiss banking is all about.

"People would ask you to make purchases for them, possibly maybe a car or a chalet, possibly a nice watch. So you would also cater to the client in that regard and then deliver it to them upon their choosing," Birkenfeld explained.

"And what would be their choosing?" Kroft asked.

"It could be in their hotel room. It could be in maybe another country. Could be there in Geneva," Birkenfeld said.

"So you were sort of not just a banker but also a personal shopper?" Kroft asked.

"If you will … at a concierge level," Birkenfeld said.

Birkenfeld claims his motives in going to the Justice Department were mostly altruistic. He offered to wear a wire to gather evidence against high-level UBS executives in exchange for full immunity for his transgressions, but the negotiations broke down.

And Birkenfeld neglected to tell them about his dealings with California real estate developer Igor Olenicoff, who was his biggest client. Birkenfeld helped Olenicoff hide $200 million by introducing him to a consultant who specialized in creating shell companies and sham entities that concealed the ownership of the UBS accounts.

"I don't sign people's tax returns, so what they do with their taxes is not my business. I'm a banker," Birkenfeld argued.

"So you would steer them to somebody who would help them hide their money?" Kroft asked.

"You would recommend them to these service providers. That's correct," Birkenfeld said.

"You must have known deep down that it was illegal," Kroft remarked.

"When you came into the U.S. you felt uncomfortable. That's correct," Birkenfeld said.

But as a gesture of good will, Birkenfeld did give the Justice Department, Senate investigators, IRS agents, and the SEC lots of information about UBS and its secret activities.

"Any transaction that happened on an account was held deep in the vault and sealed until the client came to pick it up personally. Then they would either take it with them, which was generally not the case, or they would tell you to shred it, which we would do on behalf of the client," Birkenfeld said.

Birkenfeld told Kroft that clients were forbidden to have online accounts and that they didn't get statements in the mail.

"So if somebody wanted to know how much money they had in the bank and how their investments were doing, they had to go to Switzerland?" Kroft asked.

"Or maybe see their banker when they came to the U.S.," Birkenfeld explained.

It was those visits to the U.S. which Birkenfeld told the government about that ultimately got UBS in so much trouble. The bank would sponsor lavish events like yacht races in Newport and the Art Basel art festival in Miami Beach to attract wealthy Americans.

Then it flew in its bankers from Switzerland to mingle and to try and drum up new clients and conduct business with existing ones. Because the Swiss bankers weren't licensed to conduct business in the United States, it was a clear violation of American banking laws on U.S. soil, and Birkenfeld provided internal documents that proved the length that UBS would go to in order to avoid detection.

"'Call it a vacation rather than a business trip.' Rather than saying, 'Oh, yes, I'm coming to see my private clients here in the United States. And I'm coming in from Zurich, Switzerland,'" Birkenfeld said.

Asked if he brought records into the country when coming to the U.S., Birkenfeld told Kroft, "Generally, no. I did not. My colleagues brought in encrypted laptops. … So that even if they were discovered you couldn't see what was inside the computers, which were portfolios of the clients and they were product offerings for the clients."

"They were going out of their way to cover their tracks," said Thomas Perrelli, the associate attorney general of the United States.

Perrelli says Birkenfeld was not the only person who provided valuable information to the investigation, but he says Birkenfeld's evidence that UBS executives encouraged illegal behavior was the bank's Achilles' heel.

"They would bring checks or sometimes they would actually carry money from one client to the next, all with the purpose of disguising and avoiding detection of large transfers of money," Perrelli told Kroft.

Perrelli added, "It was certainly surprising that there would be a unit within a major bank that would be behaving in that way."

"And there was?" Kroft asked.

"And there was. And we subsequently learned that senior officials knew about this. They knew it was wrong. They called it 'toxic waste.' But it was very profitable and they didn't stop doing it," Perrelli replied.

Based on information provided by Birkenfeld, the Justice Department and the IRS obtained a court order demanding that UBS turn over records on the 19,000 Americans believed to have secret Swiss accounts.

UBS then enlisted the help of the Swiss government to try and negotiate a settlement, finally agreeing to pay a $780 million fine, cease its offshore banking activities with Americans, and for the first time in history turn over the names of more than 4,000 U.S. citizens suspected of tax fraud.

"I think they knew we had a very strong case," Perrelli said.

"Right. And they did that because the U.S. government said that 'if you don't cooperate, we're going to take away your license to do business in the United States,'" Kroft remarked.

"Well, we certainly told them that we had a strong case for criminal prosecution and that if we couldn't find another way to resolve that, that that's where this was headed," Perrelli replied.

UBS realized that the Justice Department was holding all the cards. UBS had a major presence and

30,000 employees in the U.S., and it could not survive as a global banking power without access to the U.S. market.

"If you had such a strong case, why didn't you get the names and numbers of every American account holder in Switzerland?" Kroft asked associate attorney general Perrelli.

"We got the accounts that really are the core of the fraud, the largest accounts, the accounts that are most clearly, likely to be associated with fraud," he replied.

Since the scandal broke, nervous clients have withdrawn $160 billion from UBS' wealth management operation. And 14,700 Americans have notified the IRS that they had offshore bank accounts, taking advantage of a program that allows them to pay back taxes and penalties and escape prosecution, which should provide a windfall for the U.S. Treasury.

Asked how much tax revenue he thinks the government will have gained from this, Perrelli told Kroft, "I've heard, certainly, the commissioner of the IRS say in the billions of dollars."

With the government claiming victory and UBS breathing a sigh of relief, the only person with grounds to be really unhappy is Bradley Birkenfeld, who the last time we saw him, was wearing an electronic ankle bracelet. The federal government had restricted his movements to the commonwealth of Massachusetts.

"I gave them the biggest tax fraud case in the world. I exposed 19,000 international criminals. And I'm going to jail for that?" Birkenfeld asked.

As it turns out, while the U.S. government was using Birkenfeld's information to go after UBS, the Justice Department was closing in on his biggest client, Igor Olenicoff, for tax evasion.

Olenicoff cooperated with the investigation, and paid $52 million in fines and back taxes and got off with no jail time. But because Birkenfeld hadn't told prosecutors about his relationship with Olenicoff, he was arrested and charged with conspiracy to commit tax fraud.

Birkenfeld pled guilty and has been sentenced to 40 months in prison. And he is not happy about it.

He told Kroft he shouldn't be going to jail.

"Even though you violated the law and you were an enabler? I mean you were the person who was implementing these policies," Kroft pointed out.

"And I'm the only one going to prison. Out of 19,000 accounts and no Swiss bankers?" Birkenfeld replied.

"If he had come forward and told us everything that he knew, a complete and accurate picture in the summer of 2007, we think it's likely he wouldn't have been prosecuted," Thomas Perrelli told Kroft.

"Mr. Birkenfeld says the federal government admits that the prosecution would not have been successful without his participation in this. And yet, he is the only one that is going to jail. Is that fair?" Kroft asked.

"It is not uncommon for someone to engage in criminal activity and to provide us information, but to also go to jail," Perrelli replied.

"The day he walks into prison is the day you will lose a generation of tax whistleblowers," attorney Stephen Kohn told Kroft.

Asked why, Kohn said, "Because no one will blow the whistle."

Kohn is one of Birkenfeld's civil attorneys and the head of the National Whistleblowers Center. He believes there may be one final twist in the case that could give his client the last laugh.

That's because Birkenfeld may well be entitled to collect tens of millions of dollars under a federal law that rewards whistle blowers with up to 30 percent of the money that is recovered as a result of the information they provide, even if they end up going to jail.

"Mr. Birkenfeld has saved the taxpayers billions of dollars, brought thousands of people to justice. They should blow up his check," Kohn said. "The attorney general should shake his hand and look into the camera. And he should say, 'I want [to send] a message to every international banker that works to money launder against America. You come here to America. You'll be protected and you'll be rewarded. Get 20. Get 30 Birkenfelds. Let's fix this problem.

Let's lower everybody's taxes.'"

The IRS will ultimately decide whether Birkenfeld qualifies for the reward. If he does, they will have to mail the check to federal prison, where Birkenfeld is scheduled to report this Friday. But it couldn't be worse than returning to Switzerland, where he is regarded by some as a criminal and a traitor.

Asked if he thinks he'll ever return to Switzerland, Birkenfeld told Kroft, "I don't believe I will."

Will Rewards for Whistleblowers Encourage Ethical Behavior?

Pro: *Matthew Gilley*

Bill Greehey Chair in Business Ethics and Corporate Social Responsibility,
St. Mary's University

The purpose of providing financial rewards to whistleblowers should be to reduce misconduct within organizations and enhance early detection of misconduct that occurs. Moreover, the process should be designed so that it complements, rather than undermines, an organization's existing ethics and compliance functions. Structured properly, a reward system can significantly enhance ethical business behavior.

It is well known that rewards affect behavior. A CEO rewarded with a bonus for increasing earnings per share (EPS), for example, begins to manage for EPS growth. Similarly, employees, realizing that they can potentially earn many times their lifetime wages through the detection of misconduct within their organizations, will be more focused on fraud detection.

Whistleblower bounties might reasonably be viewed as bonus programs for those detecting and reporting misconduct, and those rewards can therefore be expected to affect behavior. This is especially true given the reluctance many people have toward exposing fraud, because retaliation is a real risk whistleblowers face. Whistleblower rewards will cause business leaders to more carefully examine the root causes of retaliation, and they will ultimately lead to less fear in speaking up. The Compliance and Ethics Leadership Council has identified a fear to speak up as a key leading indicator of misconduct within organizations.

Whistleblower rewards have entered the realm of the truly incredible. A whistleblower in the GlaxoSmithKline case received a reward of $96 million, and a whistleblower in a case against Pfizer received more than $50 million. Hundreds of millions of dollars have been awarded to whistleblowers in just the last three years, and the government has granted awards for well over two decades. There can be little doubt that when the rewards for blowing the whistle are significant, individuals within organizations will disclose the facts to authorities.

Given significant rewards for whistleblowers, executives have an incentive to take extra steps to ensure that policies, procedures and organizational culture are such that ethics are embedded into every area of the company. Companies will need to become even more proactive at prevention, and they will be encouraged to enhance detection and reporting mechanisms. Internal communications about ethics and compliance will be improved, and a greater focus on ethical conduct is sure to result.

While not all whistleblowers are motivated by money, rewards for whistleblowers are complementary to well-designed and well-implemented ethics and compliance programs.

Con: *W. Michael Hoffman*

Executive Director, Center for Business Ethics, Bentley University

Nothing is going to make corporations more ethical other than their developing internal strategies to promote a culture conducive to ethical decision making and compliance with law. The government paying bounties to external whistleblowers might stimulate corporations to strengthen their internal helpline/hotline reporting systems or start one for those few who don't yet have one. This much I'll grant; and the government has done much in the way of regulation

Matthew Gilley and W. Michael Hoffman, "Will Rewards for Whistleblowers Encourage Ethical Behavior?," *The CQ Researcher*, 21, May 6, 2011, pp. 409–432. Reprinted with permission.

to influence organizations to take important steps to be good corporate citizens.

However, as in most cases, the devil is in the details, or in this case, in the implementation of paying bounties to whistleblowers who provide information to government prosecutors that results in corporate fines. Take, for example the SEC's new whistleblower program under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. Through large financial awards (up to 30 percent of a corporate fine) and more friendly processing of information received and award claims, this program has ratcheted up the incentives for whistleblowers to provide the SEC, with information about violations of federal securities laws.

This sounds good, but wait. The SEC program will allow a whistleblower to report directly to the government, bypassing all internal reporting structures that corporations over the past three decades have diligently put into place – structures, I might add, that ironically the government itself has required corporations to have to make them more ethical and responsible.

Corporate internal-reporting systems are cornerstones of effective ethics and compliance programs, and employees are duty-bound to follow them as stated in their corporate codes of ethics and business conduct. To incentivize employees to go directly to the government to report wrongdoing, as the SEC program does, undermines the functioning of effective corporate ethics and compliance programs that provide the crucial infrastructure to encourage ethical business behavior.

If employees have tried unsuccessfully to use their corporate reporting system, then of course they should go outside the company to report their concerns.

But to encourage employees to ignore these company avenues is to invite them to act contrary to the duty they owe their organizations and to seriously weaken the very corporate integrity efforts that the government demands and that society so desperately needs.

Boeing Chief is Ousted after Admitting Affair

Leslie Wayne

The chief executive of the Boeing Company, Harry C. Stonecipher, who was brought out of retirement 15 months ago to clean up the company's tarnished image and restore its credibility, was forced to resign yesterday after admitting an affair with a female Boeing executive.

Leslie Wayne, "Boeing Chief is Ousted after Admitting Affair," *The New York Times*, March 8, 2005. Reprinted with permission of Pars International.

The resignation of Mr. Stonecipher, 68, came as a shock to both Wall Street investors and officials in Washington, who had been closely watching the company's ethical travails. The company, the world's second-largest aerospace company and the Pentagon's No. 2 supplier, is struggling to recover from its role in an Air Force procurement scandal, the loss of important government contracts and the jailing of two former top executives.

Mr. Stonecipher, married and with grown children, was forced out for having violated an internal code of conduct that he had imposed on all Boeing employees as he tried to improve the company's actions and image. His predecessor, Philip M. Condit, was forced to resign in 2003 because of ethical lapses, including affairs with employees, and poor business prospects that Mr. Stonecipher was hired to remedy.

The resignation was requested by Boeing's board after an investigation by internal and external lawyers.

Lewis E. Piatt, the chairman of the company, said he had ordered the investigation after receiving an anonymous tip 10 days ago, and said Mr. Stonecipher's resignation was requested "because of actions inconsistent with Boeing's code of conduct, which reflected poorly on his judgment and would impair his ability to lead going forward."

In a telephone conference call with stock analysts and reporters, Mr. Platt said that the code of conduct did not explicitly prohibit affairs between employees, but that "when we looked into it, if certain details were disclosed, it would cause embarrassment to the company." Boeing's code, which the company's 160,000 employees must sign, states that employees "will not engage in conduct or activity" that could embarrass the company or raise questions about its honesty, impartiality and reputation.

Another person close to the board deliberations, but who asked not to be identified, said: "The company had a serious problem with its major customer, the government, on ethics. How can he get up in front of employees and say ethics is Job 1? Here you have a chief executive who couldn't really play this role."

Mr. Platt said that when confronted with evidence of the affair by the board at a meeting last weekend, Mr. Stonecipher readily admitted to it. Mr. Stonecipher had no comment yesterday.

The female executive was not identified, although Mr. Platt said that she did not directly report to Mr. Stonecipher. The woman is still with the company; Mr. Platt declined to say whether she would remain. Mr. Platt added that the woman's relationship with Mr. Stonecipher did not affect her career or salary.

News of Mr. Stonecipher's departure first sent Boeing's stock down in early morning trading, although it recovered by day's end. In the interim, James A. Bell, the company's chief financial officer, will fill in for Mr. Stonecipher as the company begins to search for a new chief executive. Mr. Platt said that both current Boeing employees and those outside the company would be considered. When he returned to Boeing, Mr. Stonecipher was to be a temporary chief executive and had planned to retire in May 2006.

The hiring of Mr. Stonecipher - an executive so decisive that he had earned the nickname "Hatchet Harry" - was aimed at bringing about a turnaround in a company whose fortunes had been hurt by stiff competition in the commercial aviation business from archrival Airbus as well as a series of scandals and missteps as the company tried to gain even more business from the Pentagon.

Under Mr. Stonecipher's tenure, the company's stock had risen by more than 50 percent. His pension will not be affected by his firing. In 2004, he received a base pay of $1.5 million and incentives of around $1.8 million. It is unclear what his compensation will be for 2005. He is also one of Boeing's largest individual shareholders, after having negotiated a merger between Boeing and the McDonnell Douglas Corporation, where he was once the chief executive.

"Under the circumstances, the person who heads Boeing has to be Mr. Clean," said Cai von Rumohr, an analyst with the S. G. Cowen Securities Corporation in Boston. "Basically the firing was done to restore the company's credibility. Performance-wise, the company was on an upswing. This will be yet another change, just when the company was starting to re-establish its momentum."

It was under the watch of Boeing's previous chief executive, Mr. Condit, that a former Boeing chief financial officer, Michael M. Sears, engaged in illegal hiring discussions with a former Air Force official, Darleen A. Druyun, that have resulted in prison terms for both.

The company was also put under a suspension, which the Pentagon just lifted last Friday, and barred from bidding on $1 billion in Air Force rocket launching contracts after Boeing employees were found to have stolen thousands of proprietary documents from a rival, the Lockheed Martin Corporation. At the moment, the company also remains the target of several federal investigations into its Pentagon business.

In addition, a lucrative $20 billion deal to supply aerial refueling tankers to the Air Force collapsed amid charges that Boeing had gotten too cozy with Air Force officials. Mr. Condit's career, too, came to a quick halt when it was also revealed that he had had relationships with Boeing employees between his four marriages.

"Today's chief executives are like political figures or entertainers," said Stephen Mader, vice chairman of Christian & Timbers, an executive search firm based in San Francisco. "If their laundry is out there to dry, it had better be pretty clean." Mr. Mader said that, in years past, such a matter might have been handled "discreetly, quietly" and he praised Boeing's directors for "doing what they needed to do."

Richard Koppes, a corporate governance expert and former general counsel at Calpers, the large California public employees' pension fund, said: "In today's world, Harry Stonecipher ought to know better. Given what Boeing has gone through, it doesn't need this. The board did the right thing."

The internal investigation was prompted by information given to Mr. Platt and other executives by another female employee, said Mr. Platt. Only some of the anonymous information was correct, he added. A person close to the board said it was up to the woman, not Boeing, to identify herself.

For its part, the Air Force said the ouster of Mr. Stonecipher was an internal Boeing matter and would not reverse the Air Force's decision last Friday to allow the company to bid on future rocket launchings. Boeing had been banned from bidding for the last 18 months, the longest suspension in Pentagon history, as a result of the Lockheed document theft episode.

"We're treating this as a Boeing internal issue," said Col. Jay DeFrank, an Air Force spokesman, "and we've seen no ramification at this time that would affect the decision to lift the sanctions."

In Washington, where personal romantic entanglements involving powerful men are not a new story, Mr. Stonecipher's resignation was seen as a necessary step for the company, particularly at the Pentagon.

"Most people see it as a need for Boeing to have higher ethical standards," said Loren B. Thompson, a military analyst at the Lexington Institute, a Washington nonprofit organization that advocates limited government. "The Boeing board does not want to see a return to the lurid rumors surrounding Phil Condit's private life. That was a continuous drag on its image."

At the moment, the two leading internal contenders for Mr. Stonecipher's job are Alan R. Mulally, chief executive of the company's commercial aviation division, and James F. Albaugh, who heads the company's defense business. From the outside, names that several observers suggested include W. James McNerney Jr., chief executive of the 3M Corporation, who was passed over for the chief executive position at General Electric after the resignation of John F. Welch Jr., whose reputation was sullied by a scandal involving lavish expenses that G.E. had paid on his behalf and that came out in his divorce proceedings.

Others with G.E. connections have also been suggested: David L. Calhoun, who heads General Electric's engine business, and Robert L. Nardelli, a former G.E. executive who is now chief executive at Home Depot.

Howard A. Rubel, an equity analyst with Jefferies & Company, said that Mr. Stonecipher's departure was the latest in "a serious of unfortunate events" at the company, having come about just as Mr. Stonecipher's turnaround program appeared to be working. Still, Mr. Stonecipher's sudden departure does not leave the company in the lurch as it seeks another chief executive, he said.

"They were six months away from having to decide what to do to replace Stonecipher," Mr. Rubel said. "This just accelerates the timetable."

Abuse Scandal Inquiry Damns Paterno and Penn State

Ken Belson

In 1998, officials at Penn State, including its president and its legendary football coach, were aware Jerry Sandusky was being investigated by the university's police department for possibly molesting two young boys in the football building's showers. They followed the investigation closely, updating one another along the way.

Ken Belson, "Abuse Scandal Inquiry Damns Paterno and Penn State," *The New York Times*, July 12, 2012. Reprinted with permission of Pars International. Tim Rohan, from State College, Pa.; Zach Berman, from Philadelphia; and Richard Pérez-Peña contributed reporting.

One of those officials, Gary Schultz, articulated in dire terms what the incidents might suggest:

"Is this opening of Pandora's box?" Mr. Schultz wrote in notes that he would keep secret for years. "Other children?"

The officials did nothing. No one so much as spoke to Mr. Sandusky.

Last month, Mr. Sandusky, for three decades one of Joe Paterno's top coaching lieutenants, was convicted of sexually attacking 10 young boys, nine of them after the 1998 investigation, and several of them in the same football building showers.

Louis J. Freeh, the former federal judge and director of the F.B.I. who spent the last seven months examining the Sandusky scandal at Penn State, issued a damning Thursday: The most senior officials at Penn State had shown a "total and consistent disregard" for the welfare of children, had worked together to actively conceal Mr. Sandusky's assaults, and had done so for one central reason: fear of bad publicity. That publicity, Mr. Freeh said Thursday, would have hurt the nationally ranked football program, Mr. Paterno's reputation as a coach of high principles, the Penn State "brand" and the university's ability to raise money as one of the most respected public institutions in the country.

The fallout from Mr. Freeh's conclusions was swift, blunt and often emotional. Phil Knight, the chief executive officer of Nike and an ardent Paterno loyalist, had Mr. Paterno's name removed from a child care center Knight had founded in Oregon; Bobby Bowden, the former football coach at Florida State who is second behind Mr. Paterno in career victories, called on Penn State to take down the statue of Mr. Paterno that stands on its campus in State College, Pa.; and students, faculty and former Penn State players suggested no one could hide from the ugly truth of what they said was a devastating but fair investigation.

Mr. Freeh, in a formal report to the university's board of trustees that ran more than 250 pages, offered graphic evidence of the implications of what he termed "a pervasive fear" of bad publicity: In 2000, a janitor at the football building saw Mr. Sandusky assaulting a boy in the showers. Horrified, he consulted with his colleagues, but decided not to do anything. They were all, Mr. Freeh said, afraid to "take on the football program."

"They said the university would circle around it," Mr. Freeh said of the employees. "It was like going against the president of the United States. If that's the culture on the bottom, then God help the culture at the top."

Indeed, Mr. Freeh's investigation makes clear it was Mr. Paterno, long regarded as the single most powerful official at the university, who persuaded the university president and others not to report Mr. Sandusky to the authorities in 2001 after he had violently assaulted another boy in the football showers.

"We have a great deal of respect for Mr. Paterno," Mr. Freeh said of his investigators. "And condolences to his family for his loss." But of Mr. Paterno, Mr. Freeh added: "He, as someone once said, made perhaps the worst mistake of his life."

"The facts are the facts," Mr. Freeh said. "There's a whole bunch of evidence here. And we're saying that the reasonable conclusion from that evidence is he was an integral part of this active decision to conceal. I regret that based on the damage that it does, obviously, to his legacy."

The investigation's findings doubtless will have significant ramifications – for Mr. Paterno's legacy, for the university's legal liability as it seeks to compensate Mr. Sandusky's victims and perhaps for the wider world of major college athletics.

Already, the reverberations of the scandal have been extraordinary, its effects felt in everything from the shake-up in the most senior ranks of the university to the football program's ability to recruit the country's most talented high school prospects to a growing wariness among parents about the relationships their children have with their sports coaches.

And with the Freeh investigation being made public Thursday – the probe took seven months and involved more than 400 interviews and the review of voluminous e-mail correspondence and other documents – the reverberations seemed destined to deepen.

"The conclusions could not be any more harsh," said Russell Frank, a journalism professor at Penn State. "It's a very powerful indictment of the people in charge."

Lawyers for Mr. Sandusky's victims reacted with a kind of resigned disgust.

"I can't say that anything astonishes us anymore, but it's pretty astonishing," Michael J. Boni, a lawyer for one of Mr. Sandusky's victims, said of the report. "I wouldn't be surprised if these leaders face new criminal charges for failure to report what they knew to the authorities."

Mr. Freeh said he had turned over his evidence to the state attorney general's office, which has handled the criminal investigation of the Sandusky scandal. Two of the senior Penn State officials singled out for blame by Mr. Freeh – Mr. Schultz, who oversaw the campus police, and Tim Curley, the athletic director – are facing criminal trials for having failed to report the 2001 assault and then lying about it under oath.

Mr. Sandusky is set to be sentenced later this summer, perhaps in September.

Certainly, the prospect of the financial hit the university is apt to take became graver with Mr. Freeh's report on his investigation.

"I believe the report is a road map, a resource manual and a guidebook to the civil litigation," said Tom Kline, a lawyer for another of Mr. Sandusky's victims.

One new and central finding of the Freeh investigation is that Mr. Paterno, who died in January, knew as far back as 1998 that there were concerns Mr. Sandusky might be behaving inappropriately with children. It was then that the campus police investigated a claim by a mother that her son had been molested by Mr. Sandusky in a shower at Penn State.

Mr. Paterno, through his family, had insisted after Mr. Sandusky's arrest that he never knew anything about the 1998 case. In fact, he had testified under oath before the grand jury hearing evidence against Mr. Sandusky that he was not aware of the 1998 investigation.

But Mr. Freeh's report asserts that Mr. Paterno not only knew of the investigation, but followed it closely. Local prosecutors ultimately decided not to charge Mr. Sandusky, and Mr. Paterno did nothing.

Mr. Paterno failed to take any action, the investigation found, "even though Sandusky had been a key member of his coaching staff for almost 30 years and had an office just steps away from Mr. Paterno's."

"In order to avoid the consequences of bad publicity," the most powerful leaders of Penn State, Mr. Freeh's group said, "repeatedly concealed critical facts relating to Sandusky's child abuse from the authorities, the board of trustees, the Penn State community and the public at large."

One of the most damning episodes laid out by Mr. Freeh's investigation involved the university's handling of a 2001 report of Mr. Sandusky sexually attacking a 10-year-old boy in the football building's shower.

A graduate assistant had witnessed the assault, and reported it in person to Mr. Paterno the next day. Mr. Paterno said he would figure out how to handle the alarming report, and inform his superiors.

The Freeh investigation suggests that the university's senior administrators – then-president Graham B. Spanier, Mr. Curley and Mr. Schultz – were prepared to formally report Mr. Sandusky to state authorities, but that Mr. Paterno persuaded them to do otherwise.

After Mr. Spanier and Mr. Curley decided to report Mr. Sandusky, the investigation asserted, "the only known, intervening factor" was a conversation between Mr. Curley and Mr. Paterno.

It was then decided the "humane" thing to do would be to speak to Mr. Sandusky, offer him professional help and warn him not to bring children on campus any longer. An e-mail from Mr. Spanier at the time hinted at the potential implications of their actions in 2001.

"This approach is acceptable to me," Mr. Spanier wrote to his colleagues. "The only downside for us is if the message isn't 'heard' and acted upon, and we then become vulnerable for not having reported it."

Lawyers for Mr. Spanier, who was forced to resign along with Mr. Paterno days after Mr. Sandusky's arrest last November, insisted he had never actively sought to conceal anything about Mr. Sandusky's conduct and had never been informed of its full severity.

The Paterno family issued a statement Thursday saying "it could be argued" that Mr. Paterno should have done more in his handling of Mr. Sandusky. But the statement said: "The idea that any sane, responsible adult would knowingly cover up for a child predator is impossible to accept. The far more realistic conclusion is that many people didn't fully understand what was happening and underestimated or misinterpreted events."

The consequences of the lack of action by Mr. Paterno and others, whatever its explanation, were grim. Mr. Freeh said that by allowing Mr. Sandusky to remain a visible presence at Penn State following his retirement from coaching in 1999, he was essentially granted "license to bring boys to campus for 'grooming' as targets for his assaults."

The Freeh investigation also determined that Mr. Sandusky, upon his retirement shortly after the 1998 investigation, received both an unusual compensation package and a special designation of "emeritus" rank that carried special privileges, including access to the university's recreational facilities. With respect to money, Mr. Spanier, the president, approved a lump-sum payment to Mr. Sandusky of $168,000.

Mr. Freeh's investigators interviewed two senior and longtime university officials who said they had never heard of this type of payment being made to any retiring employee.

The N.C.A.A., which is investigating Penn State and has the power to penalize its athletic programs, said it would read the Freeh report, and that Penn State would have to answer for it.

Mr. Freeh was appointed by the university's board of trustees shortly after Mr. Sandusky's arrest and given broad powers to determine how Penn State had failed to adequately act to halt his repeated abuse of young boys. Mr. Freeh included in his final report numerous recommendations for addressing many of the institutional shortcomings his investigation had uncovered.

"One of the most challenging of the tasks confronting the Penn State community is transforming the culture that permitted Sandusky's behavior, as illustrated throughout this report, and which directly contributed to the failure of Penn State's most powerful leaders to adequately report and respond to the actions of a serial sexual predator," Mr. Freeh wrote. "It is up to the entire University community – students, faculty, staff, alumni, the board and the administration – to undertake a thorough and honest review of its culture."

Timeline
The Penn State Scandal

Justin Sablich, Ford Fessenden, and Alan McLean

On June 22, 2012, Jerry Sandusky, a former defensive coordinator for the Penn State football team, was convicted of sexually assaulting 10 boys, completing the downfall of a onetime local hero. All of his victims were children from disadvantaged homes whom Sandusky, using his access to the university's vaunted football program, had befriended and then repeatedly violated. Sandusky, who had worked with needy children through his Second Mile foundation, was prominent both in the college football world and in the university's community. The legendary Penn State coach Joe Paterno was fired after the scandal.

1969 Jerry Sandusky, a starting defensive end at Penn State under Coach Rip Engle from 1963 to 1965, joins Joe Paterno's coaching staff as the defensive line coach.

1977 Sandusky establishes the Second Mile, a foundation to help needy children. The organization plans activities and programs for the children.

1994 A boy identified as Victim 7 in the grand jury report meets Sandusky through the Second Mile at about the age of 10.

Justin Sablich, Ford Fessenden, and Alan McLean, "Timeline: The Penn State Scandal," *The New York Times,* November 11, 2011. Reprinted with permission of Pars International.

1994–1995 A boy identified as Victim 6 meets Sandusky at a picnic put on by the Second Mile when he is 7 or 8.

1995–1996 Victim 5 meets Sandusky through the Second Mile when he is 7 or 8.

1996–1997 Victim 4 meets Sandusky through the Second Mile when he is 12 or 13.

1996–1998 Victim 5 is taken by Sandusky to the locker rooms and showers at Penn State. He was 8 to 10 years old.

Jan. 1,**1998** Victim 4 is listed as a member of the Sandusky family party for the 1998 Outback Bowl.

May 3, **1998** Victim 6 is assaulted in the locker rooms and showers at Penn State when he is 11. His mother reports that Sandusky showered with her son to university police.

May 4–30, 1998 University vice president Gary C. Schultz is informed. His notes of that date say: "Behavior – at best inappriate @ worst sexual improprieties." He also notes, "Is this opening of pandora's box?" and "Other children?"

During the course of the investigation, police listen in on a conversation between the mother and Sandusky, who admits to showering with the boy, and says: "I was wrong. I wish I could get forgiveness. I know I won't get it from you. I wish I were dead."

University police chief Harmon emails Schultz: "We're going to hold off on making any crime log entry. At this point I can justify that decision because of the lack of clear evidence of a crime."

Tim Curley, the athletic director, notifies Schultz that he has told Penn State Coach Joe Paterno about the incident, and later emails: "Anything new in this department? Coach is anxious to know where it stands." Paterno maintained before his death that he didn't know about the incident.

June 1998 A university police detective and a state public welfare caseworker interview Sandusky, who admits hugging Victim 6 in the shower, but says there was nothing "sexual about it." He says he has done this with other children. District Attorney Ray Gricar decides there will be no criminal charges.

May 1999 Paterno informs Sandusky at a meeting that he will not become the team's next head coach. Victim 4 later testifies that Sandusky appeared emotionally upset after the meeting and that he was told by Sandusky to not tell anyone about the meeting.

Summer, 1999 Curley says Paterno gives Sandusky an option to stay on as an assistant, but Sandusky proposes instead running a middle school football camp, and finding "ways to continue to work with young people through Penn State." The university agrees to "work collaboratively" with Sandusky on Second Mile, and gives him free lifetime use of the East Area Locker Room.

July 1999 Victim 3 is assaulted in the athletic department's building and other places several times from July through December 2001.

Dec. 28, **1999** Victim 4 is listed as a member of the Sandusky family party at the 1999 Alamo Bowl, Sandusky's final game as defensive coordinator. Sandusky is said to have threatened to send the boy home after the child resists sexual advances. Sandusky reportedly tells the boy that he can walk on the field with Penn State's football team. The boy is in a photograph with Sandusky that appears in *Sports Illustrated*.

Fall 2000 Jim Calhoun, a janitor, finds Sandusky in the showers of the football building performing oral sex on a boy pinned against a wall. The boy is identified as Victim 8 in the grand jury report. Neither the janitor nor a fellow employee he told about the incident made a report because, according to prosecutors, they were worried about their job security. The janitor's supervisor, who also was informed, did not file a report, either.

Feb. 9, 2001 Mike McQueary, a graduate assistant, enters a Penn State locker room and hears "rhythmic, slapping sounds" that he believes are related to sexual activity. He later says under oath that he sees Sandusky raping a boy who appears to be 10 years old. He leaves and meets with his father and decides to report the incident to Paterno, according to prosecutors.

Feb. 10, 2001 The next morning, McQueary reports what he saw to Paterno. Paterno tells him: "you did what you had to do. It's my job now to figure out what we want to do." Before he died, Paterno insisted McQueary did not tell him of the extent of the assault that McQueary said he witnessed, only that McQueary had seen something inappropriate involving Sandusky and a child.

Feb. 11, 2001 Paterno reports the incident to Schultz and university president Graham B. Spanier on Sunday because he did not "want to interfere with their weekends."

Feb. 25, 2001 Schultz, Spanier and Tim Curley, the athletic director, decide to report the shower incident to the state Department of Public Welfare.

Feb. 27, 2001 Curley informs Shultz and Spanier that he has changed his mind after "talking it over with Joe" Paterno. Instead of reporting the incident, he says they should offer Sandusky "professional help" and tell him to stop bringing guests to the locker room. Spanier worries that if Sandusky continues, "we then become vulnerable for not having reported it," before agreeing the approach is "humane". They do not report the incident.

March 5, 2001 Curley tells Sandusky the university is "uncomfortable" with the incident, and will report it to his foundation. He also tells Sandusky to stop bringing children to the athletic facilities. Sandusky offers to give Curley the boy's name, but Curley did not want to know, according to Sandusky's counsel. McQueary is never questioned by police.

August 2001 Sandusky assaults Victim 5 in the shower at Penn State.

Sept. 21, 2001 The university sells a parcel of land to Second Mile without any disclosure from officials to the Board of Trustees about the Sandusky events. Schultz approves a press release praising Sandusky's work with Second Mile.

2005-2006 Sandusky meets the boy identified as Victim 1 through the Second Mile. He is 11 or 12 years old.

April 2005 Ray Gricar, the former district attorney who chose not to prosecute Sandusky in 1998, disappears. The circumstances are murky: his car is found abandoned, his laptop is recovered months later in a river without a hard drive and his body is never found.

Spring 2008 Victim 1 is now a freshman in a Clinton County high school. His mother calls the school to report a sexual assault, and Sandusky, who was a volunteer coach at the school, is barred from the school district. The matter is reported to the authorities.

Early 2009 An investigation by the Pennsylvania attorney general begins. Victim 1 tells the authorities that Sandusky has inappropriately touched him several times over a four-year period. A grand jury subpoenas university documents in 2010, but no one tells the Board of Trustees of the university's potential complicity.

September 2010 Sandusky steps down from the Second Mile, saying he wants to spend more time with his family and to handle personal matters.

Winter 2011 The grand jury summons Schultz, Spanier, Curley and Paterno to testify in its investigation. On Mar. 31, a newspaper reports their appearance. No report is ever made to the university's Board of Trustees about the events.

May 11, 2011 A trustee who has read the newspaper article inquires about the investigation, and at the May 11 meeting Spanier briefs trustees but does not raise the issue of its impact on the university. The board takes no action to investigate further.

Nov. 5, 2011 Sandusky is arrested on charges of sexually abusing eight boys over a 15-year period. He is arraigned and released on $100,000 bail after being charged with 40 counts.

Curley and Schultz are charged with perjury and failure to report what they knew of the allegations.

Nov. 7, 2011 Penn State announces Curley and Schultz will step down. Curley will take an administrative leave to defend himself against perjury charges, and Schultz will retire.

Nov. 9, 2011 Joe Paterno announces he plans to retire at the end of the football season, but the statement is apparently released without the approval of the university's Board of Trustees.

Later in the day the board fires Paterno and the university's president. The Department of Education says it will investigate the university's handling of the abuse allegations.

Nov. 13, 2011 Jack Raykovitz, the chief executive of the Second Mile for 28 years, resigns. Raykovitz's failure to do more to stop Sandusky had been a focal point of criticism.

Nov. 14, 2011 Sandusky makes his first extended public comments since his arrest. In a phone interview with Bob Costas that is broadcast on the television program "Rock Center," Sandusky says he is innocent of the charges against him and declares that he is not a pedophile. He did say, "I shouldn't have showered with those kids."

Nov. 18, 2011 The Second Mile is preparing to fold as it tries to reconstruct what it knew, and did, about any suspicions or allegations against Sandusky over the years.

Dec. 1, 2011 A lawsuit by Victim 4, which was meant to prevent Second Mile from transferring its assets, is settled. The charity will notify the Pennsylvania attorney general and seek court approval before the transfer of assets or before closing the charity.

Jan. 22, 2012 Joe Paterno dies in State College, Pa. He was 85. The cause was lung cancer.

June 11, 2012 Prosecutors open their sexual abuse case against Jerry Sandusky, who is charged with more than 50 criminal counts of abusing 10 boys over a number of years.

June 21, 2012 Lawyers for one of Jerry Sandusky's adopted children, Matt Sandusky, say that he had been abused by Sandusky and had offered to testify in the case. No details are given why prosecutors did not call Matt Sandusky to testify.

June 22, 2012 Jerry Sandusky is convicted of sexually abusing 10 boys. He was found guilty of 45 of the 48 counts against him.

July 12, 2012 Louis J. Freeh, the former federal judge and director of the F.B.I., releases his report after leading an independent investigation of the scandal. The report accuses Paterno, the university's former president and others of deliberately hiding facts about Sandusky's sexually predatory behavior.

Source

Government and university officials.

You've Been Tagged! (Then Again, Maybe Not)
Employers and Facebook

William P. Smith
Towson University

Deborah L. Kidder
University of Hartford

> *"We have a Facebook page," said one official of the Department of Homeland Security. "But we don't allow people to look at Facebook in the office. So we have to go home to use it. I find this bizarre."*
>
> (Hansell, 2009)

William P. Smith and Deborah L. Kidder, "You've Been Tagged! (Then Again, Maybe Not): Employers and Facebook," *Business Horizons*, 53(5), September–October 2010, pp. 491–499. Reprinted with permission of Elsevier.

> *A co-worker apologized to me recently for being slow on a task. "It's probably just your insomnia from last night," I said. She was confused about how I knew, but I reminded her we were Facebook friends, and that she had posted a 'status update' about her sleeplessness.*
>
> (Cohen, 2008)

> *"I'm 23 years old, and despite the successes I have had in the pool, I acted in a youthful and inappropriate way, not in a manner that people have come to expect from me," Phelps said. "For this, I am sorry. I promise my fans and the public – it will not happen again." – Michael Phelps, following the disclosure of pictures posted to Facebook showing him smoking marijuana*
>
> (CNN, 2009)

1. Logging On: The Emergence of Social Networking

Social networking sites represent a new stage in the evolution of the Internet, what is sometimes termed *Web 2.0*. Web 2.0 and social networking sites are characterized by user-driven content, combined with interactivity with other users; this dynamic electronic environment extends far beyond static personal Web pages. The most popular social networking sites include Facebook, MySpace, LinkedIn, and Twitter. While there are design and feature differences between these platforms, their basic elements are the same. Because of its dominance in the field, we will herein be focusing on Facebook, but our arguments also apply to other social networking sites.

Facebook provides users with a standard format that can be employed to upload desired information (Buffardi and Campbell, 2008). For example, users can post personal photos, contact information, picture galleries, and status updates (i.e., messages declaring what the person is doing at the time). Any picture can be "tagged," which entails listing the names of the people in the shot. Facebook interactivity is facilitated via "friending," or approving access to a user's page content. Individuals can choose other registered users to be friends; once accepted, a friend has access to the user's information (Walther, Van Der Heide, Kim, Westerman, and Tong, 2008). Users can also search for other users, often found through "tags," and ask them to become friends. Friends also have the ability to post messages on the user's "wall," a location designed to display comments from other people besides the user. The status updates of friends are streamed on the user's Facebook page.

There is a growing base of anecdotal information describing how companies augment existing screening tools with information collected from social networking sites such as Facebook. Sometimes these inquiries uncover positive information about potential candidates, such as skills or backgrounds that don't always reveal themselves on a résumé. More interesting cases emerge, however, when the employer discovers a candidate's "dark side" on a Facebook site. In this article, we examine the implications – both good and bad – that Facebook presents for managers making hiring and other employment decisions. Based on this examination, we will also propose some issues that organizations should consider as they evaluate the "Facebook question."

2. Building the Network: Why is Facebook so Popular?

Based on current statistics, Facebook is now the dominant global social networking site. In the brief period spanning August 2008 to April 2009, the number of Facebook users doubled from 100 million to 200 million (Stone, 2009). During a typical week, approximately 5 million new users join Facebook (Hempel, 2009). Facebook was created in 2004 by a Harvard University student who wanted to provide a way for his fellow classmates to interact and stay connected. Once the exclusive domain of the college student population, the number of new users older than age 25 grew 276% during the last 6 months of 2008 (Orenstein, 2009). On average, users spend about 2–3 hours a month on Facebook (Hempel, 2009).

There are two reasons why social networking sites such as Facebook are experiencing wild popularity. The most commonly cited reason revolves around Facebook's intended goal of creating and extending a user's community. In addition, especially for younger users, Facebook is a way to shape personal identities.

2.1. A sense of community

In his book, *Bowling Alone*, political scientist Robert Putnam (2000) observed a worrisome trend in American society: participation in bowling leagues and many other forms of civic participation had dramatically declined over the previous three decades. Other scholars have also lamented the weakening of social capital in the United States (e.g., Ellison, Steinfield, and Lampe, 2007). There are many benefits of social capital, in terms of both strong and weak ties with others. Networks of relationships provide common norms, values, goals, and a common language. In the "good old days," churches, fraternities, and unions provided opportunities to network; this aided individuals in meeting influential people and finding job connections.

Interestingly, the social networking phenomenon emerged shortly after Putnam's provocative book. We are now faced with considering how, and to what extent, social networking sites such as Facebook represent new forms of social capital. The major function of Facebook is to help users connect with people they already know, as well as to make new connections through friends of friends. Facebook provides the ability for individuals who are separated physically to feel close to others in their network. This sense of community is created for all users, regardless of their age, although the experience of community may be different based on generation. For younger users, Facebook provides a way to stay connected with friends as they move forward to college or a new job; in this sense, Facebook acts as an anchor (Zhao, Grasmuck, and Martin, 2008). For older users, Facebook facilitates re-connecting with others with whom they have lost contact, suggesting a nostalgic or backward-looking focus. The most significant difference in the use of Facebook between the generations involves the issue of identity creation.

2.2. A sense of identity

Social Identity Theory is the study of how identities are shaped (Ashforth, Harrison, and Corley, 2008). As part of the growing process, youth explore their identities and experiment with different selves. A positive sense of identity is a critical foundation for the development of self-esteem. Facebook provides the ability to present identity to others via pictures posted, hobbies listed, favorite music highlighted, and other common interests.

Research on Facebook shows that users look upon their profiles as a way to present their hoped-for possible selves (Zhao et al., 2008). Two main identities were branded: the *differentiation* profile (I am unique and different from others), and the *self-enhancing* profile (I am popular and similar to others). The majority of profiles fell under the self-enhancing umbrella (Liu, 2007). According to Ashforth et al. (2008, p. 334), "it is an essential human desire to expand the self-concept to include connections with others and to feel a sense of belonging with a larger group."

3. Beyond Terms and Conditions: Facebook's Social Norms

The raison d'être of social networking sites is such that freedom of expression is not only encouraged, but also essential to create a site that motivates people to join and stay active. Open expression is particularly vital for younger participants such as college students. Research shows that students are more likely to engage in self-disclosure online than in person (Mazer, Murphy, and Simonds, 2007). Users tend to reveal themselves through the selected symbols, in a process that suggests more "show" than "tell" (Zhou et al., 2007). Posted pictures demonstrate a user's popularity, and the number of friends – which is listed on the user's page – is also seen as evidence of a user's social success (Raacke and Bonds-Raacke, 2008).

Job applicants have multiple identities, based on their life experiences (Herriot, 2004). Facebook provides considerable freedom to users to select the type of information they want to present on their profiles. The absence of immediate social controls, coupled with a culture of self-expression, creates community norms that may be inconsistent with most employers' profile of an employee. Community norms toward self-promotion (Buffardi and Campbell, 2008) place pressure on users to project a popular image – including drinking, bragging, and the like – which may suggest to potential employers that the user lacks maturity and responsibility.

In addition to self-promotion norms, a social etiquette exists on Facebook with regard to a user's wall: the space where friends of the user can post comments that are available for others to see. Information on the wall is particularly relevant for our discussion because "things that others say about a target may be more compelling than things an individual says about him- or herself" (Walther et al., 2008, p. 33). According to Walther et al., there is a Facebook norm against deleting comments off a user's wall, even if the comments are inaccurate, as it would violate the rules of "friendship" on which Facebook is based. While job applicants can actively manage the identity that is portrayed by their Facebook site, and older job applicants often do focus on this public identity, Facebook's social norms in general lead to projected identities that job applicants may not wish to be seen by potential employers.

4. With Friends Like These? Employers on Facebook

It is common for many companies to have policies controlling employee use of computers and Internet access while at work. Very few organizations, however, have addressed the questions of how or under what circumstances managers should use social networking sites as a means of evaluating job candidates or current employees. Still, it is clear that employers are using Facebook. There are two basic underlying motivations for this, the less problematic of which involves connecting with potential future employees. Yet, recruiting is just the beginning; employers also use information obtained from Facebook profiles for purposes of assessing applicants. While both treatments are worthy of consideration, the latter presents some potential concerns.

4.1. Recruiting job applicants

More and more organizations are turning to Facebook for recruiting. For example, even the CIA uses a Facebook page as a recruiting tool (Hansell, 2009). For its part, the accounting firm Ernst and Young uses Facebook as a means of attracting new, particularly college-aged, recruits. Job seekers can register for a special Ernst and Young group, post questions, and receive regular updates about job and internship opportunities (White, 2007). Just as individual Facebook users can share their identity with others, so too can organizations develop and effectively utilize their own organizational identity through Facebook.

For occupations which experience shortages of talent, partnering with social networking sites may provide recruiting leads that would otherwise not be available (Berkshire, 2005). LinkedIn, a social networking site with a more professional focus, accepts position listings for a small fee. Employers not only receive résumés and inquiries, but also candidates are matched with any of the firm's employees who are listed as contacts. Some companies provide bonuses to current employees when they agree to post job vacancies on their Facebook page and a referral is hired because of the posting (Zeidner, 2007).

Additionally, Facebook participation is now viewed as desirable for jobs which involve networking and technical skills that are becoming more essential. Proficiency and involvement with these sites indicates candidates possess an ability to work effectively on new technical and media platforms, the ability to work on several projects simultaneously, and/or demonstrate skills such as "the ability to connect with customers through new technologies" (Mattioli, 2007, p. B6).

4.2. Screening job applicants

Once employers have established a pool of qualified applicants, the challenge of weeding through this group takes over. It is usually a straightforward process to determine those applicants that possess the minimum qualifications necessary to do the job. Most of the time, selection goes beyond determining who possesses minimum qualifications to which candidate among the many represents the best fit. This determination, of course, is not an easy one. Considerable information and judgment are necessary.

We are now witnessing a trend where employers are accessing applicants' Facebook information as part of the screening process (Zeidner, 2007). The evidence, to this point, is anecdotal but powerful. For example, a New York-based nonprofit organization rejected the candidacy of one applicant because his Facebook page cited extensive romantic exploits in addition to an interest in violent films; he was deemed a poor fit for the organization. A recent *Newsweek* article (Stone, 2006) also describes a company withdrawing an internship offer from a 19 year old student after the firm discovered a profile picture of her holding a bottle of vodka. Zeidner (2007) reports that 15% of human resource managers surveyed currently use social networking sites to check candidates' backgrounds and of those that currently do not, 40% indicated they are likely or very likely to do so within the next year.

There are several ways that employers can access job applicants' Facebook pages even when these pages are set to "private" security status. HR managers can request to be "friended" by the job applicant. Using the "friends" feature allows employers to find shared connections for a particular candidate. These connections can be used to initiate reference and background checks (Berkshire, 2005). Companies can also ask current employees to report on friends or hire students who are from the same university in order to gain access to the job applicant's page (Brandenberg, 2008).

These sites can provide a more comprehensive overview of candidates than is often available via traditional screening methods such as a résumé or reference checks. Oftentimes, firms seek employees with a broad range of interests or unique backgrounds (Murphy, 2007). Such interests may be revealed through social network topic areas including pastimes, travel, and cultural interests (e.g., music, literature). There can be a benign and even desirable intent on the part of employers to find information that can be used to build a connection during the interview (e.g., "I see you like to read novels. Is there a fictional character that you most admire?"). It may seem like a good idea to do this. However, employers need to be aware of, and concerned about, several issues when deciding whether or not to try to access a job applicant's Facebook page.

5. Hitting the Wall: Problems with Using Facebook

We would like to discuss several concerns about surfing to a job applicant's Facebook page. These include practical, legal, and ethical issues. This section will also focus on the most controversial matter surrounding a company's choice to use Facebook: namely, the concern about privacy.

5.1. Inaccurate tags and posts

It is important to keep in mind the potential inaccuracy of certain information on social networking sites (Epstein, 2008). Job candidates may have information on their Facebook page that is false or wildly exaggerated, in an effort to be humorous or more accepted at a particular point in time as part of their exploration and development of self-identity. Further, a person may enter false information on his/her site about other people. For example, it is possible for someone to alter a picture of an individual holding a bottle of alcohol, and paste another person's face into that photo. The Creative Commons CC-BY-2.0 license gives permission to use a photo without the consent of the individual owner of the picture (Latham, Butzer, and Brown, 2008).

Despite certain safeguards, it remains possible for some "bad" – that is, unfavorable or inaccurate – information to be posted about someone on Facebook without their knowledge or consent. Indeed, damaging information can be posted and remain available until a target becomes aware of it and is in a position to remove or correct it. Hammond (2007) describes a powerful incident involving a library staff member at the University of Kent. Dissatisfied with how this employee enforced noise and conduct rules in the library, students created a Facebook group, "Those Who Hate the Little Fat Library Man." Membership in the group grew rapidly and, for reasons he never exactly understood, the employee became subject to increasingly common incidents of harassment and ridicule. It wasn't until later that another university employee informed him about the hate site. The implication is clear: Individuals may not always control or be aware of information about themselves on Facebook.

5.2. Checking the fine print: Is it legal?

Employers open themselves up for lawsuits when selection devices appear biased, inconsistent, inaccurate, or discriminatory (London and Bray, 1980). For example, a potential concern that could arise from checking out Facebook is that, quite often, users will post pictures of themselves on the site. Employers must be careful that this visual information cannot be used in a way that would be construed as discrimination based on factors such as race, sex, disability, and so forth (Zeidner, 2007).

At the forefront of legal concerns are the requirements set forth in the Fair Credit Reporting Act (FCRA). The FCRA requires job candidates' consent prior to conducting certain types of background checks (Zeidner, 2007). Hence, if employers are using social networking sites as a background check, candidates are legally entitled to have this investigation disclosed to them.

Finally, Facebook's policy pages include statements regarding its non-commercial status, as well as prohibition of user misrepresentation (Brandenberg, 2008). Checking out a job applicant may be considered a commercial use of the website. The terms also require users to not violate rights of third parties, nor show unlawful material. The Stored Communications Act makes it a punishable offense to intentionally access a site like Facebook without permission (Brandenberg, 2008).

5.3. What was that? Interpreting information from Facebook

Even though social networking sites provide a common platform for members to share information about themselves, the resulting profiles are anything but consistent. Two basic but very important questions should be considered here.

First, what if some candidates have Facebook profiles and others do not? As previously noted, some applicants' profiles will disclose information about skills or backgrounds that will make them more attractive to an employer. Perhaps there is information regarding fluency in a particular language, technical proficiencies, creative outlets, or social activities that suggest teamwork skills. The employer may favorably interpret this information; but what about applicants who do not have Facebook pages? The selection process can clearly be skewed in either direction, based on using Facebook information – favorable or unfavorable.

Additionally, exactly what information from a Facebook profile is appropriate for review and how is it to be interpreted? Consider the following scenario: There are 10 recent college graduates applying for the same sales job. Successful sales representatives are typically outgoing and initiate new relationships easily. All the applicants have Facebook pages; nine have extensive friendship networks, ranging from 150 to 500 friends. One applicant has six friends in his/her network. What are we to infer from this disparity? That one applicant is less outgoing and or less likely to be successful in sales? There are several possible explanations for the more limited friendship network of that applicant, such as a relative newness to Facebook or a more discriminating sense of who qualifies as a "friend," neither of which is likely to have a valid association with job success.

Social Identity Theory suggests that identity plays a significant part in this interpretation process. People are naturally attracted to others who are similar to themselves, as it aids in maintaining a consistent and positive self-image (Goldberg, 2005). It is easier to relate to others who have had similar experiences and who share common interests, because it helps to validate one's attitudes and beliefs (Williams and O'Reilly, 1998). Unlike most standard application procedures, the amount and type of information available through Facebook will not be consistent, which suggests that bias due to preference for similar others may arise.

5.4. Confidential job searches

The more frequently employers use social networking sites as a screening tool, the more difficult it becomes for individuals to conduct confidential job searches. This results in fewer potential candidates, and usually the best ones, looking for better opportunities elsewhere. When people seek job opportunities outside their current organizations, controlling the identity of the references – as well as when and under what circumstances they might be contacted – is important. This control can be easily compromised when prospective employers begin reviewing social networks (Athavaley, 2007). To the extent that employees may be using network and computer resources of current employers to seek employment elsewhere, there is little legal protection against the monitoring of those current employees. Statutory and tort law have all lined up to favor employers' monitoring efforts (Smith and Tabak, 2009). Such monitoring may be entirely justified given the employer's right to ensure its resources are being used appropriately. This justification is certainly difficult to challenge. Unfortunately for those people seeking better jobs, the reverse is not true. Social networking information does not distinguish on the basis of whether it was entered at, or away from, work. Depending on a job seeker's particular circumstances, the implications can be quite troublesome. Why begin the risky process of seeking employment elsewhere if there is a significant and immediate danger of losing one's current job? This circumstance may appear favorable to some employers in the short-term, but when viewed more broadly is hardly consistent with a dynamic and productive labor market.

5.5. Poking into an individual's personal life

The concerns we've listed thus far are, for the most part, practical and not contentious. Now we'd like to turn to the vexing issue of privacy. Privacy involves both legal and ethical concerns, and pits the rights of the individual against the rights of the organization. We acknowledge up front that organizations have a legitimate concern about thorough background checks in order to avoid negligent hiring suits. It is true that unscrupulous people can use privacy claims as an opportunity to deceive others (DePaulo, Wetzel, Sternglanz, Weylin, and Walker, 2003); the numerous examples of lies on résumés attest to this fact. Still, it is within an organization's interests that employees and applicants not be required to forfeit all claims to privacy as a condition of work.

At a basic level, privacy refers to how people control access to themselves (Margulis, 2003). It is psychologically important for individuals to have privacy; it allows people to vent in reaction to stressful incidents, as well as cope with unhappy events (Westin, 1967). Some measure of privacy is essential so that individuals feel they can exercise self-control (Velasquez, 2005). It is problematic to state that individuals voluntarily give up their right to privacy when applying for jobs; voluntary implies they would disclose the information without being asked, which is often not the case in terms of job applications (Stone-Romero, Stone, and Hyatt, 2003).

Legally, the extent and boundaries of privacy are unclear. Some court cases show that individuals have the right to privacy, while others suggest individuals accept the risk that personal information will go public when they communicate with other people (Brandenburg, 2008). For employers, 30 states and the District of Columbia all have some level of privacy protection for employees in terms of off-duty behavior (Pagnattaro, 2004). For example, a person might post a picture of himself holding an alcoholic drink or a cigarette. In some states, an employer may legally use that information to disqualify such a person from employment. In other states, employers may not engage in discrimination based on legal off-the-job behaviors or lifestyles.

When asked, Facebook users feel strongly that they have the right to display their information free from observation by unwanted or unwelcomed parties (Walther et al., 2008). Consider the previously mentioned example of the job candidate with an interest in "slasher" types of movies. Within the confines of the social networking site, a person willingly – and even enthusiastically – shares this identity information amongst a defined friendship group, or more publicly in effort to meet others with the same interest. However, it is a reasonable presumption that this candidate would not voluntarily disclose this information to an employer.

The significance of this disparity is amplified to the extent that many social networking participants – mostly young adults – may not have an understanding of, or an appreciation for, the risks of self-disclosure on these sites. Particularly for younger people, such as college students, they may not fully consider or even be aware of who might access information on their network profile. They also may not appreciate the risks of self-disclosure. Acquisti and Gross (2006) surveyed college students and examined relationships between privacy concerns and subsequent information disclosure on Facebook. Overall, while many students expressed privacy concerns, there were significant numbers that remained unaware of how their profile information could be readily accessed by or disclosed to others.

6. A Generational Difference

Different attitudes about using Facebook in the application process clearly demonstrate a generational divide in the workplace. The younger generation – commonly referred to as Millenials – were the first, and remain the dominant group of, Facebook users. Millenials appear much more comfortable with posting private identity information in a public way than do other generations (Epstein, 2008). They also represent the irrepressible optimism of youth. As professors, we encounter their values on a daily basis. Facebook is a significant part of their lives. We repeatedly advise our undergraduate students about the importance of privacy settings in Facebook. One student offered a typical response: "But that's ridiculous. What employer in their right mind would possibly give up the chance for a great job candidate just because of what they saw on my Facebook page?" Even after being informed about the importance of privacy settings, they refuse to take the matter seriously, preferring to believe that their parents and professors worry too much.

The next older generation – commonly known as X-ers – are more private and independent, and less achievement- and self-oriented than Millennials (Lyons, Duxbury, and Higgins, 2007). Most of the hiring managers now come from this generation. Many X-ers do not understand Millennials, and therefore do not identify or empathize with them. We have found, among our MBA students, that X-ers often subscribe to the caveat emptor attitude with regard to using Facebook: if the job applicant is foolish enough to post inappropriate content online, it is acceptable to take advantage of this mistake. In addition, our X-er students have argued that they are helping to teach Millennials a lesson.

Boomers exemplify yet another generational divide, albeit a schizophrenic one. That is to say, our experience with this generation – MBA students with significant workplace experience – shows member individuals tend to fall into one of two camps. On the one hand, we have found Boomers to focus on the vulnerability of Millenials to argue against looking them up on Facebook as job applicants. These students often cite the fact that they would not want their own children to be subject to this potentially biased review process; hence, they are opposed to using Facebook as a selection tool. The second camp of Boomers reflect their generational focus on high involvement in their children's lives, often termed "helicopter parenting." When Boomers hold this attitude, they feel very strongly that employers should monitor Facebook in order to gain insight regarding what their Millennial job applicants are up to.

7. Making Friends with Facebook

Social networking sites such as Facebook represent powerful new ways to build and sustain connections between people. Firms that can both understand and develop strategies that align with these networks may be able to create competitive advantages. Every business function is already being shaped to some degree by online social networks. This trend will certainly continue. Our focus has been on recruiting and selection activities; however, the issues raised here will be just the tip of the iceberg for managers. Opportunities also exist for incorporating social networking as part of orientation, training, and communication areas.

It should be obvious by now that we advise caution when considering using Facebook to review a job applicant's background. We have outlined some practical, legal, and ethical concerns associated with the undisciplined pursuit of social networking information during the hiring process. As noted by one manager: "Facebook is built around a community…you can't afford to abuse the community. Whatever you do has to tap into the cultural values of Facebook" (Murphy, 2007, p. S4).

If an organization chooses to comply with the letter of the law but seek out loopholes, it ignores the intent of the laws that are designed to ensure individual rights. Not only does this create a risk for possible lawsuits, but it also communicates a norm of unethical behavior to current employees and sets a negative tone at work. Consider, for example, those occasions when a manager induces current employees to either share information from their friend networks – information that might have been legitimately considered confidential if it had been protected via privacy settings – or induces employees to extend friendship status to applicants in an effort to gain additional information. In both cases, the employer's actions can be considered deceptive. Such machinations remind us of the old adage: Ask employees to lie for you, and pretty soon they will lie to you. A clear and enforceable policy outlining acceptable and unacceptable use of social networking information is a necessary first step.

8. Before Logging Off: Some Suggestions

Social networking is now so commonplace and its implications sufficiently significant that more formalized approaches are warranted. We argue that it is in most firms' interests to establish policies and guidelines about what constitutes appropriate and inappropriate use of social networking information. EEO policies and codes of conduct are good places to begin a review of necessary changes. We also offer five specific recommendations: four for employers and one for job seekers.

First, firms should take advantage of the opportunity to enhance their organizational identity through the use of Facebook. Creating and maintaining a positive organizational image is critical for maximizing a company's advantages (Fuller, Marler, Hester, Frey, and Relyea, 2006). An individual's work role is one of the central sources of identity in our society (Kammeyer-Mueller, Judge, and Piccolo, 2008), so an organization's social identity can and should be used as a recruiting and retention tool.

Next, organizations should emphasize that use of Facebook information in the selection process must have a clear purpose and be job related. Because there is a strong likelihood of encountering extraneous information related to protected class status, there are two types of risk exposures when managers "troll" social networking sites. The first risk is the potential for EEO violations. The second risk involves the challenging issue of seeking a good fit between the candidate and the organization's culture. Certainly, one of the strong appeals toward using Facebook is that managers can obtain a richer picture of candidates' backgrounds and interests. Organizations must address the following question: How far and under what circumstances should hiring managers consider a candidate's preferred movies, novels, and pastimes as determinants of ability and willingness to do the job? Particular caution must be paid to avoiding discrimination on the basis of legal off-the-job activities such as drinking, smoking, political expression, and the like. As with other job selection tools, the burden to prove this relatedness rests with the employer.

Third, we have noted that social networking information may not always be truthful; in fact, it is the nature of the media that some posted information is deliberately deceptive and – in some cases – may not be the responsibility of a particular user. It is imperative that informational integrity be assessed, especially regarding material that may potentially be disqualifying. We believe a fair policy would require managers to undertake reasonable efforts to validate any damaging information culled from a candidate's Facebook site. At the very least, this might entail asking candidates themselves to affirm the authenticity of this information.

Also, we recommend that when a candidate's profile is set to "private" and is not publicly available, that no one – including current employees and business partners – should be pressured to provide their "friend" privileges for that candidate to the employer. Nor should organizations attempt to gain access to a job applicant's Facebook site without permission. The laws about privacy on the Web are constantly evolving, and are likely to be stricter in the future.

Finally, we endorse the typical cautionary advice for job applicants, in particular for new college graduates and other young people beginning their careers. The customs and laws that regulate hiring also provide employers with rights. It remains largely true that in the United States, being considered for a job is more of a privilege than a right. The employment-at-will concept reminds us that a job belongs to an employer, and it remains the employer's discretion as to who may occupy that position. The observations offered in this article do not fundamentally alter this reality. Managers still possess considerable latitude in determining what type of employee will best represent the organization. Most managers making hiring decisions represent a generation with a distinctly different set of expectations regarding acceptable public personas. These expectations are probably at odds with how many young people live their lives, both online and offline. The generational divide exemplified by using social networking information will probably dwindle over the years, until such time that it is inevitably replaced by a new technology or new social reality. Until then, however, caution is perhaps the best ally, particularly in a tough labor market. Be attentive to what your online profile says about you; focus on presenting the identity of someone that would make an excellent employee.

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Part 4

The Corporation in Society

Introduction

In Part 3 we examined some aspects of the relationship of business to one of its most important internal constituencies, its employees. Here we turn attention to the relationship between business and its external constituencies – that is, between business and its environment. In Chapter 7, we examine the relationship between business and consumers by looking at some of the ethical aspects of marketing and sales as well as product safety; Chapter 8 explores some ethical dimensions of the relation of business to the natural environment; Chapter 9 takes up ethical problems raised by multinational business operations.

Business and Consumers

Business organizations exist by selling goods and services to consumers. Consumers, therefore, are one of business's most important constituencies, literally essential for its survival. Traditionally, the relationship between business and consumers in US society has been defined by the free market, which links business and consumers in what is intended to be a mutually beneficial relationship. Business is free to make as large a profit as possible on its transactions with consumers, but – the theory goes – business succeeds only by giving consumers what they want. Both consumer and business interests are protected by the "invisible hand" of the market. Presumably an unsatisfactory or undesirable product, or one offered at an unreasonable price, will not sell. In such a system, it is often said that "the consumer is king," and sellers must serve the consumer or go out of business.

This system can work in practice, however, only if two conditions are met: (1) there is no deception, and the consumer receives adequate and accurate information about products on the market to make rational market decisions; and (2) the consumer is free to choose what to buy. Does the real world really meet these conditions, however? This question is the takeoff point for some of the most important debates about business and consumer relations in business ethics.

One business activity that has led thinkers to question the accuracy of the traditional picture of business and consumer relations is advertising or marketing. Advertising of some kind is necessary to convey information to consumers and to make them aware of what products are available. But how much information is really conveyed in such slogans as "Coke is the real thing" or "This Bud's for you"? It is not surprising that many observers of advertising conclude that its main purpose is not to inform but to persuade.

Advertisers have been accused not only of failing to inform the public but of creating needs and desires which the consumer otherwise would not have had. This is the charge made by John Kenneth Galbraith in

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his article "The Dependence Effect." Galbraith argues that in the United States the manufacture of consumer demands is as important as, if not more important than, the manufacture of products which satisfy those demands. The same companies that satisfy wants, he claims, also create those wants by advertising, establishing a self-perpetuating cycle of desire and satisfaction. If consumers truly wanted all the products on the market, Galbraith claims, such creation of desire would not be necessary. Genuine desires originate with the consumer and do not need to be created from outside. Galbraith might regard the extensive advertising campaign for cigarettes as an example of this want creation.

If Galbraith is correct, consumers are being manipulated into buying things they do not really want or need. The consumer is not the "king" in this picture, but a pawn. Recalling our discussion of Kant in the General Introduction, we might say that if Galbraith is correct, then consumers are being treated by producers as means to an end rather than as ends in themselves. For rather than responding to consumer needs, producers are creating needs and looking on the consumer as nothing more than an instrument for making profits. Creation of consumer needs is also bad, according to Galbraith, because it encourages the excessive consumption of private goods which are not really essential, and diverts spending away from public goods like clean air, livable cities, parks, and public transportation. People would get a great deal of satisfaction from such public goods, Galbraith believes, but since there is comparatively little advertising to persuade us to spend our money on public goods, private goods tend to dominate. Galbraith feels that although our society is rich in private goods, it is poor in public goods. Also, as noted by Galbraith, advertisers and salespeople are often accused of deceiving and manipulating the public through techniques such as "puffery" or exaggeration, failure to tell the whole truth about a product, misleading pricing and packaging, and appeals to emotion rather than to rational judgment.

But does advertising really manipulate us in the way that Galbraith claims? F. A. von Hayek does not think so. In "The *Non Sequitur* of the 'Dependence Effect'" he agrees that many of our wants are created by production. Living in a society in which many material goods are available generates wants we would not have if we were raised in a different sort of society. But, he claims, this does not mean these wants are not urgent or important. Most of what we regard as our "highest" desires – for art, literature, education – are instilled in us by our culture. If only internally generated wants or needs were legitimate, we would have to conclude that the only important desires are for food, sex, and shelter. Advertising is only one cultural element that shapes our desires, von Hayek concludes. It cannot, by itself, determine our wants.

Another important issue raised by the relationship between business and consumers is that of product safety. If a manufacturer has a responsibility to consumers not to market unsafe products, how far does this responsibility extend? Who should assume the liability if a consumer is injured by a defective product? Here, as in the case of advertising, it is unclear whether the market system by itself really protects the interests of the consumers. If they had adequate information, consumers could freely choose the risks they wish to accept, and products considered too risky would be driven off the market. But in most cases, manufacturers need not make explicit the potential hazards of what they sell. Most consumers lack the expertise to assess the safety of today's technologically sophisticated products and must rely at least to some extent on the impression they are given by sellers. Many purchases are "one-shot" deals, which means that the consumer has no opportunity to benefit from his or her experience in the future. And although we are likely to hear about seriously dangerous products, often their danger does not attract attention until some consumers are injured.

So what should be the extent of a manufacturer's duties to consumers? In exploring the issue, Manuel Velasquez's article on "The Ethics of Consumer Protection" provides an overview of three possible approaches: (1) the contract view; (2) due care theory; and (3) the social costs view. The first approach, the "contract view," represents the "buyer beware" position. Business does have certain minimal obligations under this approach, all based on contract theory. The duties include: compliance with any claims which have been made regarding the product; disclosing any defects or features of the product that would affect the customer's decision to purchase the product; not misrepresenting any features about the product; and not coercing the consumer into buying the product. Velasquez points out the problems with the contract approach, in that manufacturers rarely directly deal or contract with the customer, and can nullify any future liability through the use of disclaimers.

The "due care" approach shifts the stance from "buyer beware" to "let the manufacturer/seller take care." Manufacturers under this approach are required to take adequate steps to prevent whatever injuries they can foresee from the use of their products. Preventative steps can relate to the design, production, or provision of information regarding the product. Velasquez points out the major problems with this approach, including the difficulty in determining when sufficient "due care" has been exercised, and the assumption that risks can be discovered by the manufacturer before the product is bought and used.

The final approach, "social costs," shifts all of the potential liability for injuries to consumers onto the manufacturer. Liability would be incurred by the manufacturer despite the manufacturer taking all possible steps to prevent injury and warning users of every foreseen danger. This approach is based on the legal doctrine of "strict liability." Velasquez indicates that this approach also has its problems. It can be seen as unfair by punishing manufacturers for injuries that they could not foresee or prevent, will lead to an increase in carelessness in consumers and thus more injuries, and will lead to exceedingly high liability insurance policies. Although each of the approaches has strengths as well as problems, Velasquez leaves it up to the reader to assess which duty is appropriate for business.

In the final article, "Marketing and the Vulnerable," George Brenkert attempts to explore the concerns that arise when marketing takes place with respect to particularly vulnerable groups in society. In his article, he first explores the notion of vulnerability in terms of what might characterize a certain target audience. Brenkert attempts to distinguish between normal individuals and those who might be considered "specially vulnerable," along with those who are more susceptible or disadvantaged. Brenkert then argues that marketing to the specially vulnerable necessitates specially designed marketing campaigns to ensure that these individuals are not treated unfairly and thus harmed. He then argues that any marketing programs that treat the vulnerable in an unfair manner are unethical or unscrupulous whether or not those targeted are actually harmed. In other words, one cannot look simply to consumer injury to measure the unfair treatment of the vulnerable. He concludes with the view that just as we need a doctrine of manufacturer's liability, we also need a doctrine of "targeted consumer liability" to which marketers should be held accountable.

The Environment and Sustainability

Some of the most urgent questions faced by society today are those raised by the increasing contamination and depletion of our natural resources. The air pollution present in all major cities increases the incidence of respiratory disease, heart disease, and lung cancer. Toxic wastes find their way into drinking water and pose serious threats to human life and health. The earth's protective ozone layer is deteriorating, leaving us vulnerable to harmful effects from beyond the atmosphere. Researchers predict that if the exponentially rising rate of use of fossil fuels continues, estimated reserves will be depleted rapidly, and global warming is much more likely.

In Chapter 8 we look at some environmental problems raised by the activities of commercial and industrial enterprises. Business is by no means the sole polluter, nor is it the sole consumer of natural resources. But there are several important reasons for focusing on business-related environmental issues.

One reason is that the structure of the free-enterprise system itself has been accused of encouraging pollution. At one time air and water were thought of as unlimited and "free" goods, available for anyone's use without charge. The effects – in terms of pollution – of any particular business's use of air or water were negligible, and we were confident of the ability of the environment to absorb them. Today, we realize that the environment can't absorb them. Air and water pollution are costs of production that business has "externalized," or passed on to society as a whole. Market forces encourage this conversion of private to public costs. However, as increasing pollution and the depletion of natural resources force us to adopt what has been called a "spaceship earth" mentality, it seems clear that pollution must be made less desirable by forcing polluters to internalize environmental costs. It is not surprising that business is resisting such attempts, and that some businesspeople view environmental protection measures as contrary to their interests.

A second reason for examining business's role in the environmental crisis is the pervasiveness of the value placed on consumption, which is an integral part of our business society. Although advanced industrialized nations comprise a fairly small percentage of the world's population, they are responsible for the consumption of the majority of the world's annual energy resources. The link between standard of living, economic growth as measured by the GNP, and high levels of pollution and consumption of natural resources cannot be denied. Business has developed into a powerful force in our society because of its ability to satisfy the appetite for consumption. Whether business is responsible for the pervasiveness of consumption as a social value, as Galbraith would suggest, is not clear. But it is clear that the environmental protection movement presents a challenge to private consumption, and therefore to a very important aspect of business activity.

Some thinkers argue that the environmental challenge to business is limited. For example, Norman Bowie, in his article "Money, Morality, and Motor Cars," argues that business's role should be limited to strict adherence to environmental laws and regulations. Business does not have, he argues, an obligation to protect the environment over and above what is required by law. To expect business to do otherwise, to expect that business go beyond the law in its efforts to protect the environment, makes impossible demands on business and ignores the impact such activities have on profit.

Using automobile production as an analogy, Bowie claims that the moral requirement to prevent harm is satisfied by auto-makers if they adhere to law and regulation. They could, it is true, make a safer car, but society has chosen to make a tradeoff in this area – cars that are less safe are also less expensive. Similarly, society has chosen to endure more pollution and pay less for products than to have less pollution and pay more. Society may decide differently in the future, but until that day comes, business has no special role to play in environmental protection.

Bowie continues, however, by pointing out that business has often acted improperly with regard to the environment in the political arena. Businesses have lobbied strongly against environmental laws and regulation. This is ethically unacceptable, Bowie claims, because it is unwarranted interference with the public's expression of its preferences. Thus, in a sense, business does have an obligation to the environment. But the obligation is not to interfere in the political arena rather than to exceed the requirements of environmental law and regulation.

W. Michael Hoffman expresses a very different view. He argues in "Business and Environmental Ethics" that business has obligations to protect the environment that go beyond the law. As he sees it, business should show moral leadership in this area, and not wait for government action. He also explores "ecological homocentrism," which claims that society, including business, ought to protect the environment solely because doing so prevents harm to human beings and human interests. He argues that a broader and deeper moral perspective is required, one that goes beyond self-interest and grants moral standing to the environment itself. Not to do so risks loss of the very insight that grounds ethical concern for the environment in the first place.

The article by Stuart Hart and Mark Milstein, "Creating Sustainable Value," pushes the notion of sustainability well beyond the typical concerns over protecting the natural environment. Sustainability has now become synonymous with the notion of the 'triple bottom line', whereby firms must be simultaneously concerned with their economic, environmental, and social bottom lines. The key concern for Hart and Milstein is that firms strive to generate "sustainable value" for shareholders. After outlining the various drivers that relate to global sustainability, they provide a framework for firms to achieve the goal of creating sustainable value. Their framework includes four different strategies: (1) pollution prevention; (2) product stewardship; (3) clean technology; and (4) sustainability vision. Corporate examples are given for each quadrant. Hart and Milstein suggest that firms need to assess their degree of balance within the four quadrants, to determine if there are missed opportunities and thus possible vulnerabilities. They conclude with some suggestions regarding the implementation of sustainability strategies.

In the final article of Chapter 8, "Rethinking the Concept of Sustainability" by Alexis J. Bañon Gomis, Manuel Guillén Parra, W. Michael Hoffman, and Robert E. McNulty, the concept of sustainability is reviewed along with its ethical roots. The goal for the authors is to provide the current concept of sustainability with a "sound universalistic ethical rationale". The authors do not believe that standard definitions of sustainability, such as the Brundtland Commission's definition of "development that meets the needs of the present without compromising the ability of future generations to meet their own needs," capture the important aspects of the meaning of sustainability. Relying on a profit-based argument for sustainability is also deficient. Instead, the authors provide a definition of sustainability which they believe is not only based on an Aristotelian perspective including virtues such as courage, prudence, and temperance, but also consistent with Kantianism and utilitarianism as well. In so doing, they view ethics as the key to resolve potential conflicts among the economic, social, and environmental domains. For the authors, sustainability is a matter of ethics, and applies to human beings and their relationship with the world.

International Business

Multinational corporations are business organizations that maintain extensive operations in more than one country. Multinational business faces many of the same ethical issues as domestic business, but the fact that multinationals conduct business across national and cultural lines raises special problems. Legal and cultural standards may differ from culture to culture. Practices that are benign in the United States may be inappropriate or even unethical in other contexts. Because they are so large and widely dispersed, multinational corporations do not come under the complete control of any one government, and some fear that their interests diverge from those of both their home and host countries.

Extensive investment by multinational corporations can help the economies of developing nations, but such investment can have harmful effects as well. Multinational investment can lead to extensive dependence on foreign capital and technology, leaving the developing nation powerless and vulnerable. Many multinationals establish foreign operations to get cheap labor or to engage in hazardous production processes without the expense of conforming to rigorous health and safety and environmental regulations. The natural desire of multinational corporations to do business in a secure investment climate sometimes leads them to support authoritarian and repressive regimes. Multinational industry can stifle local enterprise and submerge the characteristic culture of the nations in which the industry operates. Finally, successful private enterprise does not always lead to the satisfaction of the needs of developing countries.

Richard De George, in his article "Ethical Dilemmas for Multinational Enterprise: A Philosophical Overview," suggests that some of the dilemmas that appear to face multinational corporations doing business in the Third World in fact arise from assuming that US standards are universal moral standards. There are important differences in culture and values between First and Third World countries, De George believes, and these should be respected. In spite of these differences, however, De George believes that there are universal moral norms that can be applied across cultures, and he offers seven principles that might serve as guidelines for evaluating the actions of multinational corporations.

In "International Business, Morality, and the Common Good," ManuelVelasquez questions whether multinational corporations have any moral obligations to contribute to the international common good. He argues that in a restricted but not insignificant portion of international transactions, corporations have no such obligations because doing so will put them at a serious competitive disadvantage. He concludes that this shows the need for an international agency capable of forcing all multinationals to contribute to the global common good.

Thomas Donaldson, in his article "Values in Tension: Ethics Away from Home," continues the discussion on what ethical standards should be adhered to when a business operates abroad. He rejects both extreme positions, that of "cultural relativism" – when in Rome do as the Romans do – and that of "ethical imperialism" – doing everywhere what one does at home. He argues for an approach which balances the two extremes, and provides three guiding principles to do so: (1) respect for core human values, which determine the absolute moral threshold for all business activities; (2) respect for local traditions; and (3) the belief that context matters when deciding what is right and wrong.

The article "The Case for Leveraged-Based Corporate Human Rights Responsibility" by Stepan Wood discusses the issue of corporate responsibilities in the international context. Wood raises the following question: "Should companies' human rights responsibilities arise, in part, from their 'leverage' – their ability to influence others' actions through their relationships?" Wood argues that the potential for 'leverage' is a source of corporate responsibility under several conditions: (1) there is a morally significant connection between the company and a rights-holder or rights violator; (2) the company is able to make a contribution to ameliorating the situation; (3) the company can do so at modest cost; and (4) the threat to human rights is substantial. Wood then adds several qualifiers to the responsibility of firms to exercise leverage to protect human rights even when they have done nothing to negatively contribute to the situation. According to Wood, the responsibility should be graduated, context-specific, practicable, consistent with the social role of business, and should be used to do good and not just to avoid harm.

The next article in Chapter 9 examines a major ethical challenge faced by managers of multinationals abroad: the widespread occurrence of bribery and extortion. In the United States and other countries, bribery of foreign officials is illegal and almost universally regarded as unethical. Following the signing of the Organisation for Economic Co-operation and Development's (OECD) "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions" in December 1997, a number of states have criminalized bribery of foreign public officials. But in many countries, businesses claim, bribery is a way of life, necessary to conducting business. Is it morally permissible to bribe if bribery is a common practice in the culture in which you are doing business? What, really, is wrong with bribery?

In "What's Wrong with Bribery" Scott Turow explains that the essence of bribery is the attempt to corrupt a public official's impartial judgment, giving the briber an unfair advantage over others. Managers of multinationals who bribe to secure a contract are trying to "buy" the loyalty of foreign officials, loyalty that the officials actually owe to their public. It is easy to see that the practice of bribery is hostile to a free-market system. In a free-market system, companies compete to offer consumers the best product at the best price. Bribery shifts the terms of competition from quality and price to the size of the sum of money paid to a government official. Widespread bribery would make fair competition impossible. Bribery also injures the consumer, because the selection of an item on any basis other than quality and price often leads to the purchase of an inferior product.

The final article in the chapter is entitled "Capitalism with a Human Face: The UN Global Compact." In this article Klaus Leisinger discusses international business ethics in relation to the United Nations Global Compact. The UN Global Compact attempts to weave universal values into corporate practices as a means to advance societal goals. The Global Compact includes provisions related to human rights, labor, the environment, and transparency/anti-corruption and has been voluntarily adopted by thousands of firms since its enactment. Leisinger is concerned about the role of non-governmental organizations (NGOs) in working with business to create sustainable solutions. NGOs that fail to recognize the efforts of leading companies in this endeavor risk creating 'corporate responsibility fatigue' leading to more legalistically oriented approaches by firms. Leisinger recommends constructive dialogue to bring corporate managers into the debate over finding appropriate solutions to the various socioeconomic challenges. The UN Global Compact, according to Leisinger, provides a potential platform whereby both business and civil society can work together leading to a more sustainable and inclusive global economy.

7

The Consumer

The Dependence Effect

John Kenneth Galbraith

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The theory of consumer demand, as it is now widely accepted, is based on two broad propositions, neither of them quite explicit but both extremely important for the present value system of economists. The first is that the urgency of wants does not diminish appreciably as more of them are satisfied or, to put the matter more precisely, to the extent that this happens it is not demonstrable and not a matter of any interest to economists or for economic policy. When man has satisfied his physical needs, then psychologically grounded desires take over. These can never be satisfied or, in any case, no progress can be proved. The concept of satiation has very little standing in economics. It is neither useful nor scientific to speculate on the comparative cravings of the stomach and the mind.

The second proposition is that wants originate in the personality of the consumer or, in any case that they are given data for the economist. The latter's task is merely to seek their satisfaction. He has no need to inquire how these wants are formed. His function is sufficiently fulfilled by maximizing the goods that supply the wants.

The notion that wants do not become less urgent the more amply the individual is supplied is broadly repugnant to common sense. It is something to be believed only by those who wish to believe. Yet the conventional wisdom must be tackled on its own terrain. Intertemporal comparisons of an individual's state of mind do rest on doubtful grounds. Who can say for sure that the deprivation which afflicts him with hunger is more painful than the deprivation which afflicts him with envy of his neighbour's new car? In the time that has passed since he was poor his soul may have become subject to a new and deeper searing. And where a society is concerned, comparisons between marginal satisfactions when it is poor and those when it is affluent will involve not only the same individual at different times but different individuals at different times. The scholar who wishes to

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believe that with increasing affluence there is no reduction in the urgency of desires and goods is not without points for debate. However plausible the case against him, it cannot be proved. In the defence of the conventional wisdom this amounts almost to invulnerability.

However, there is a flaw in the case. If the individual's wants are to be urgent they must be original with himself. They cannot be urgent if they must be contrived for him. And above all they must not be contrived by the process of production by which they are satisfied. For this means that the whole case for the urgency of production, based on the urgency of wants, falls to the ground. One cannot defend production as satisfying wants if that production creates the wants.

Were it so that man on arising each morning was assailed by demons which instilled in him a passion sometimes for silk shirts, sometimes for kitchenware, sometimes for chamber-pots, and sometimes for orange squash, there would be every reason to applaud the effort to find the goods, however odd, that quenched this flame. But should it be that his passion was the result of his first having cultivated the demons, and should it also be that his effort to allay it stirred the demons to ever greater and greater effort, there would be question as to how rational was his solution. Unless restrained by conventional attitudes, he might wonder if the solution lay with more goods or fewer demons.

So it is that if production creates the wants it seeks to satisfy, or if the wants emerge *pari passu* with the production, then the urgency of the wants can no longer be used to defend the urgency of the production. Production only fills a void that it has itself created.

The even more direct link between production and wants is provided by the institutions of modern advertising and salesmanship. These cannot be reconciled with the notion of independently determined desires, for their central function is to create desires – to bring into being wants that previously did not exist.[1] This is accomplished by the producer of the goods or at his behest. A broad empirical relationship exists between what is spent on production of consumers' goods and what is spent in synthesizing the desires for that production. A new consumer product must be introduced with a suitable advertising campaign to arouse an interest in it. The path for an expansion of output must be paved by a suitable expansion in the advertising budget. Outlays for the manufacturing of a product are not more important in the strategy of modern business enterprise than outlays for the manufacturing of demand for the product. None of this is novel. All would be regarded as elementary by the most retarded student in the nation's most primitive school of business administration. The cost of this want formation is formidable. In 1956 total advertising expenditure – though, as noted, not all of it may be assigned to the synthesis of wants – amounted to about ten thousand million dollars. For some years it had been increasing at a rate in excess of a thousand million dollars a year. Obviously, such outlays must be integrated with the theory of consumer demand. They are too big to be ignored.

But such integration means recognizing that wants are dependent on production. It accords to the producer the function both of making the goods and of making the desires for them. It recognizes that production, not only passively through emulation, but actively through advertising and related activities, creates the wants it seeks to satisfy.

The businessman and the lay reader will be puzzled over the emphasis which I give to a seemingly obvious point. The point is indeed obvious. But it is one which, to a singular degree, economists have resisted. They have sensed, as the layman does not, the damage to established ideas which lurks in these relationships, As a result, incredibly, they have closed their eyes (and ears) to the most obtrusive of all economic phenomena, namely modern want creation.

This is not to say that the evidence affirming the dependence of wants on advertising has been entirely ignored. It is one reason why advertising has so long been regarded with such uneasiness by economists. Here is something which cannot be accommodated easily to existing theory. More previous scholars have speculated on the urgency of desires which are so obviously the fruit of such expensively contrived campaigns for popular attention. Is a new breakfast cereal or detergent so much wanted if so much must be spent to compel in the consumer the sense of want? But there has been little tendency to go on to examine the implications of this for the theory of consumer demand and even less for the importance of production and productive efficiency. These have remained sacrosanct. More often the uneasiness has been manifested in a general disapproval of advertising and advertising men, leading to the occasional suggestion that they shouldn't exist. Such suggestions have usually been ill received.

And so the notion of independently determined wants still survives. In the face of all the forces of modern salesmanship it still rules, almost undefined, in the textbooks. And it still remains the economist's mission – and on few matters is the pedagogy so firm – to seek unquestioningly the means for filling these wants. This being so, production remains of prime urgency. We have here, perhaps, the ultimate triumph of the conventional wisdom in its resistance to the evidence of the eyes. To equal it one must imagine a humanitarian who was long ago persuaded of the grievous shortage of hospital facilities in the town. He continues to importune the passers-by for money for more beds and refuses to notice that the town doctor is deftly knocking over pedestrians with his car to keep up the occupancy.

And in unravelling the complex we should always be careful not to overlook the obvious. The fact that wants can be synthesized by advertising, catalysed by salesmanship, and shaped by the discreet manipulations of the persuaders shows that they are hot very urgent. A man who is hungry need never be told of his need for food. If he is inspired by his appetite, he is immune to the influence of Messrs. Batten, Barton, Durstine and Osborn. The latter are effective only with those who are so far removed from physical want that they do not already know what they want. In this state alone men are open to persuasion.

The general conclusion of these pages is of such importance for this essay that it had perhaps best be put with some formality. As a society becomes increasingly affluent, wants are increasingly created by the process by which they are satisfied. This may operate passively. Increases in consumption, the counterpart of increases in production, act by suggestion or emulation to create wants. Or producers may proceed actively to create wants through advertising and salesmanship. Wants thus come to depend on output. In technical terms it can no longer be assumed that welfare is greater at an all-round higher level of production than at a lower one. It may be the same. The higher level of production has, merely, a higher level of want creation necessitating a higher level of want satisfaction. There will be frequent occasion to refer to the way wants depend on the process by which they are satisfied. It will be convenient to call it the Dependence Effect.

The final problem of the productive society is what it produces. This manifests itself in an implacable tendency to provide an opulent supply of some things and a niggardly yield of others. This disparity carries to the point where it is a cause of social discomfort and social unhealth. The line which divides our area of wealth from our area of poverty is roughly that which divides privately produced and marketed goods and services from publicly rendered services. Our wealth in the first is not only in startling contrast with the meagerness of the latter, but our wealth in privately produced goods is, to a marked degree, the cause of crisis in the supply of public services. For we have failed to see the importance, indeed the urgent need, of maintaining a balance between the two.

This disparity between our flow of private and public goods and services is no matter of subjective judgment. On the contrary, it is the source of the most extensive comment which only stops short of the direct contrast being made here. In the years following World War II, the papers of any major city – those of New York were an excellent example – told daily of the shortages and shortcomings in the elementary municipal and metropolitan services. The schools were old and overcrowded. The police force was under strength and underpaid. The parks and playgrounds were insufficient. Streets and empty lots were filthy, and the sanitation staff was under-equipped and in need of men. Access to the city by those who work there was uncertain and painful and becoming more so. Internal transportation was overcrowded, unhealthful, and dirty. So was the air. Parking on the streets had to be prohibited, and there was no space elsewhere. These deficiencies were not in new and novel services but in old and established ones. Cities have long swept their streets, helped their people move around, educated them, kept order, and provided horse rails for vehicles which sought to pause. That their residents should have a non-toxic supply of air suggests no revolutionary dalliance with socialism.

The contrast was and remains evident not alone to those who read. The family which takes its mauve and cerise, air-conditioned, power-steered, and power-braked car out for a tour passes through cities that are badly paved, made hideous by litter, blighted buildings, billboards, and posts for wires that should long since have been put underground. They pass on into a countryside that has been rendered largely invisible by commercial art. (The goods which the latter advertise have an absolute priority in our value system. Such aesthetic considerations as a view of the countryside accordingly come second. On such matters we are consistent.) They picnic on exquisitely packaged food from a portable icebox by a polluted stream and go on to spend the night at a park which is a menace to public health and morals. Just before dozing off on an air-mattress, beneath a nylon tent, amid the stench of decaying refuse, they may reflect vaguely on the curious unevenness of their blessings. Is this, indeed, the American genius?

The case for social balance has, so far, been put negatively. Failure to keep public services in minimal relation to private production and use of goods is a cause of social disorder or impairs economic performance. The matter may now be put affirmatively. By failing to exploit the opportunity to expand public production we are missing opportunities for enjoyment which otherwise we might have had. Presumably a community can be as well rewarded by buying better schools or better parks as by buying bigger cars. By concentrating on the latter rather than the former it is failing to maximize its satisfactions. As with schools in the community, so with public services over the country at large. It is scarcely sensible that we should satisfy our wants in private goods with reckless abundance, while in the case of public goods, on the evidence of the eye, we practice extreme self-denial. So, far from systematically exploiting the opportunities to derive use and pleasure from these services, we do not supply what would keep us out of trouble.

The conventional wisdom holds that the community, large or small, makes a decision as to how much it will devote to its public services. This decision is arrived at by democratic process. Subject to the imperfections and uncertainties of democracy, people decide how much of their private income and goods they will surrender in order to have public services of which they are in greater need. Thus there is a balance, however rough, in the enjoyments to be had from private goods and services and those rendered by public authority.

It will be obvious, however, that this view depends on the notion of independently determined consumer wants. In such a world one could with some reason defend the doctrine that the consumer, as a voter, makes an independent choice between public and private goods. But given the dependence effect – given that consumer wants are created by the process by which they are satisfied – the consumer makes no such choice. He is subject to the forces of advertising and emulation by which production creates its own demand. Advertising operates exclusively, and emulation mainly, on behalf of privately produced goods and services.[2] Since management and emulative effects operate on behalf of private production, public services will have an inherent tendency to lag behind. Car demand which is expensively synthesized will inevitably have a much larger claim on income than parks or public health or even roads where no such influence operates. The engines of mass communication, in their highest state of development, assail the eyes and ears of the community on behalf of more beer but not of more schools. Even in the conventional wisdom it will scarcely be contended that this leads to an equal choice between the two.

The competition is especially unequal for new products and services. Every corner of the public psyche is canvassed by some of the nation's most talented citizens to see if the desire for some merchantable product can be cultivated. No similar process operates on behalf of the nonmerchantable services of the state. Indeed, while we take the cultivation of new private wants for granted we would be measurably shocked to see it applied to public services. The scientist or engineer or advertising man who devotes himself to developing a new carburetor, cleanser, or depilatory for which the public recognizes no need and will feel none until an advertising campaign arouses it, is one of the valued members of our society. A politician or a public servant who dreams up a new public service is a wastrel. Few public offenses are more reprehensible.

So much for the influences which operate on the decision between public and private production. The calm decision between public and private consumption pictured by the conventional wisdom is, in fact, a remarkable example of the error which arises from viewing social behavior out of context. The inherent tendency will always be for public services to fall behind private production. We have here the first of the causes of social imbalance.

Notes

[1] Advertising is not a simple phenomenon. It is also important in competitive strategy and want creation is, ordinarily, a complementary result of efforts to shift the demand curve of the individual firm at the expense of others or (less importantly, I think) to change its shape by increasing the degree of product differentiation. Some of the failure of economists to identify advertising with want creation may be attributed to the undue attention that its use in purely competitive strategy has attracted. It should be noted, however, that the competitive manipulation of consumer desire is only possible, at least on any appreciable scale, when such need is not strongly felt.

[2] Emulation does operate between communities. A new school or a new highway in one community does exert pressure on others to remain abreast. However, as compared with the pervasive effects of emulation in extending the demand for privately produced consumers' goods there will be agreement, I think, that this intercommunity effect is probably small.

The *Non Sequitur* of the "Dependence Effect"

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For well over a hundred years the critics of the free enterprise system have resorted to the argument that if production were only organized rationally, there would be no economic problem. Rather than face the problem which scarcity creates, socialist reformers have tended to deny that scarcity existed. Ever since the Saint-Simonians their contention has been that the problem of production has been solved and only the problem of distribution remains. However absurd this contention must appear to us with respect to the time when it was first advanced, it still has some persuasive power when repeated with reference to the present.

The latest form of this old contention is expounded in *The Affluent Society* by Professor J. K. Galbraith. He attempts to demonstrate that in our affluent society the important private needs are already satisfied and the urgent need is therefore no longer a further expansion of the output of commodities but an increase of those services which are supplied (and presumably can be supplied only) by government. Though this book has been extensively discussed since its publication in 1958, its central thesis still requires some further examination.

I believe the author would agree that his argument turns upon the "Dependence Effect" (see earlier in this book). The argument of this chapter starts from the assertion that a great part of the wants which are still unsatisfied in modern society are not wants which would be experienced spontaneously by the individual if left to himself, but are wants which are created by the process by which they are satisfied. It is then represented as self-evident that for this reason such wants cannot be urgent or important. This crucial conclusion appears to be a complete *non sequitur* and it would seem that with it the whole argument of the book collapses.

F. A. von Hayek, "The *Non Sequitur* of the 'Dependence Effect'." Excerpted from "The *Non Sequitur* of the 'Dependence Effect'" by F. A. von Hayek, *Southern Economic Journal*, April 1961, pp. 346–348. Reprinted with permission.

The first part of the argument is of course perfectly true: we would not desire any of the amenities of civilization – or even of the most primitive culture – if we did not live in a society in which others provide them. The innate wants are probably confined to food, shelter, and sex. All the rest we learn to desire because we see others enjoying various things. To say that a desire is not important because it is not innate is to say that the whole cultural achievement of man is not important.

This cultural origin of practically all the needs of civilized life must of course not be confused with the fact that there are some desires which aim, not as a satisfaction derived directly from the use of an object, but only from the status which its consumption is expected to confer. In a passage which Professor Galbraith quotes, Lord Keynes seems to treat the latter sort of Veblenesque conspicuous consumption as the only alternative "to those needs which are absolute in the sense that we feel them whatever the situation of our fellow human beings may be." If the latter phrase is interpreted to exclude all the needs for goods which are felt only because these goods are known to be produced, these two Keynesian classes describe of course only extreme types of wants, but disregard the overwhelming majority of goods on which civilized life rests. Very few needs indeed are "absolute" in the sense that they are independent of social environment or of the example of others, and that their satisfaction is an indispensable condition for the preservation of the individual or of the species. Most needs which make us act are needs for things which only civilization teaches us to exist at all, and these things are wanted by us because they produce feelings or emotions which we would not know if it were not for our cultural inheritance. Are not in this sense probably all our esthetic feelings "acquired tastes"?

How complete a *non sequitur* Professor Galbraith's conclusion represents is seen most clearly if we apply the argument to any product of the arts, be it music, painting, or literature. If the fact that people would not feel the need for something if it were not produced did prove that such products are of small value, all those highest products of human endeavor would be of small value. Professor Galbraith's argument could be easily employed without any change of the essential terms, to demonstrate the worthlessness of literature or any other form of art. Surely an individual's want for literature is not original with himself in the sense that he would experience it if literature were not produced. Does this then mean that the production of literature cannot be defended as satisfying a want because it is only the production which provokes the demand? In this, as in the case of all cultural needs, it is unquestionably, in Professor Galbraith's words, "the process of satisfying the wants that creates the wants." There have never been "independently determined desires for" literature before literature has been produced and books certainly do not serve the "simple mode of enjoyment which requires no previous conditioning of the consumer." Clearly my taste for the novels of Jane Austen or Anthony Trollope or C. P. Snow is not "original with myself." But is it not rather absurd to conclude from this that it is less important than, say, the need for education? Public education indeed seems to regard it as one of its tasks to instill a taste for literature in the young and even employs producers of literature for that purpose. Is this want creation by the producer reprehensible? Or does the fact that some of the pupils may possess a taste for poetry only because of the efforts of their teachers prove that since "it does not arise in spontaneous consumer need and the demand would not exist were it not contrived, its utility or urgency, ex contrivance, is zero?"

The appearance that the conclusions follow from the admitted facts is made possible by an obscurity of the wording of the argument with respect to which it is difficult to know whether the author is himself the victim of a confusion or whether he skillfully uses ambiguous terms to make the conclusion appear plausible. The obscurity concerns the implied assertion that the wants of the consumers are determined by the producers. Professor Galbraith avoids in this connection any terms as crude and definite as "determine." The expressions he employs, such as that wants are "dependent on" or the "fruits of" production, or that "production creates the wants" do, of course, suggest determination but avoid saying so in plain terms. After what has already been said it is of course obvious that the knowledge of what is being produced is one of the many factors on which it depends what people will want. It would scarcely be an exaggeration to say that contemporary man, in all fields where he has not yet formed firm habits, tends to find out what he wants by looking at what his neighbours do and at various displays of goods (physical or in catalogues or advertisements) and then choosing what he likes best.

In this sense the tastes of man, as is also true of his opinions and beliefs and indeed much of his personality, are shaped in a great measure by his cultural environment. But though in some contexts it would perhaps be legitimate to express this by a phrase like "production creates the wants," the circumstances mentioned would clearly not justify the contention that particular producers can deliberately determine the wants of particular consumers. The efforts of all producers will certainly be directed towards that end: but how far any individual producer will succeed will depend not only on what he does but also on what the others do and on a great many other influences operating upon the consumer. The joint but uncoordinated efforts of the producers merely create one element of the environment by which the wants of the consumers are shaped. It is because each individual producer thinks that the consumers can be persuaded to like his products that he endeavours to influence them. But though this effort is part of the influences which shape consumers' tastes, no producer can in any real sense "determine" them. This, however, is clearly implied in such statements as that wants are "both passively and deliberately the fruits of the process by which they are satisfied." If the producer could in fact deliberately determine what the consumers will want, Professor Galbraith's conclusions would have some validity. But though this is skillfully suggested, it is nowhere made credible, and could hardly be made credible because it is not true. Though the range of choice open to the consumers is the joint result of, among other things, the efforts of all producers who vie with each other in making their respective products appear more attractive than those of their competitors, every particular consumer still has the choice between all those different offers.

A fuller examination of this process would, of course, have to consider how, after the efforts of some producers have actually swayed some consumers, it becomes the example of the various consumers thus persuaded which will influence the remaining consumers. This can be mentioned here only to emphasize that even if each consumer were exposed to pressure of only one producer, the harmful effects which are apprehended from this would soon be offset by the much more powerful example of his fellows. It is of course fashionable to treat this influence of the example of others (or, what comes to the same thing, the learning from the experience made by others) as if it amounted all to an attempt of keeping up with the Joneses and for that reason was to be regarded as detrimental. It seems to me that not only the importance of this factor is usually greatly exaggerated but also that it is not really relevant to Professor Galbraith's main thesis. But it might be worthwhile briefly to ask what, assuming that some expenditure were actually determined solely by a desire of keeping up with the Joneses, that would really prove? At least in Europe we used to be familiar with a type of persons who often denied themselves even enough food in order to maintain an appearance of respectability or gentility in dress and style of life. We may regard this as a misguided effort, but surely it would not prove that the income of such persons was larger than they knew how to use wisely. That the appearance of success, or wealth, may to some people seem more important than many other needs, does in no way prove that the needs they sacrifice to the former are unimportant. In the same way, even though people are often persuaded to spend unwisely, this surely is no evidence that they do not still have important unsatisfied needs.

Professor Galbraith's attempt to give an apparent scientific proof for the contention that the need for the production of more commodities has greatly decreased seems to me to have broken down completely. With it goes the claim to have produced a valid argument which justifies the use of coercion to make people employ their income for those purposes of which he approves. It is not to be denied that there is some originality in this latest version of the old socialist argument. For over a hundred years we have been exhorted to embrace socialism because it would give us more goods. Since it has so lamentably failed to achieve this where it has been tried, we are now urged to adopt it because more goods after all are not important. The aim is still progressively to increase the share of the resources whose use is determined by political authority and the coercion of any dissenting minority. It is not surprising, therefore, that Professor Galbraith's thesis has been most enthusiastically received by the intellectuals of the British Labour Party where his influence bids fair to displace that of the late Lord Keynes. It is more curious that in this country it is not recognized as an outright socialist argument and often seems to appeal to people on the opposite end of the political spectrum. But this is probably only another instance of the familiar fact that on these matters the extremes frequently meet.

The Ethics of Consumer Protection

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Introduction

Motor vehicles annually kill 34,000 Americans including pedestrians (traffic crashes are the leading cause of death for Americans between 2 and 34 years of age), incapacitate 260,000, and injure 2.2 million others,[1] while firearms kill 32,000 and injure an additional 65,000.[2] The cigarettes that Phillip Morris, American Brands, RJ Reynolds, B. A. T., Loews, and Liggett companies sell kill 440,000 of their U.S. customers each year, almost as many Americans as AIDS has killed during its *entire 30-year* history.[3] Worldwide cigarettes kill 5 million customers a year, more than twice what AIDS kills. Prescription painkillers cause about 12,000 U.S. deaths each year and hospitalize another 300,000 people.[4] Two hundred thousand children are injured annually by playground equipment and 147 die of their injuries.[5] All-terrain vehicles (ATVs) kill between 600 and 800 people a year and injure about 130,000.[6]

The number of product deaths and injuries would be much greater if the U.S. government did not regularly require companies to recall defective or harmful products. Here is a small sample from among the millions of defective products that have to be recalled each year:

Baby Slings – Infantino (2010) In this recent case, approximately 1 million Infantino baby slings were recalled due to breathing hazards that arise from the product's design. Infantino's "SlingRider" and "Wendy Bellissimo" models were called back because The soft material and "C" curve could push a baby's head forward, making it very difficult – if not impossible – for a baby to breathe.

High Chairs – Graco (2010) The U.S. Consumer Product Safety Commission (CPSC) issued a recall of Graco's Harmony model of high chair after the chair's design was deemed unsafe. Approximately 1.2 million high chairs were recalled in March 2010, in response to the reported 24 injuries. In January, Graco recalled approximately 1.5 million strollers due to fingertip amputation and laceration hazards.

Faulty Pedals and Floor Mats –Toyota (2010) In January 2010, Toyota issued a second recall in three months for various models of Toyota and Lexus cars due to problems with faulty pedals and floor mats that, in some cases, led to sudden and unintended acceleration. The automaking giant recalled a total of more than 9 million vehicles, and the company faced congressional probes looking into the matter.

Window Blinds – 2009 In December 2009, all Roman-style shades and rollup blinds were recalled after reports that babies and toddlers had died of strangulation after getting caught in the loose cords of the window coverings.… In total, nearly 50 million blinds were affected and recalled.

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Cruise Control – Ford (2009) In October 2009, Ford added an additional 4.5 million vehicles to its largest ever product recall, which spanned an entire decade. The models recalled in October 2009 brought the staggering grand total to more than 14 million recalled vehicles. The cars were recalled due to faulty cruise-control switches that were linked to an estimated 550 vehicle fires across the U.S.[7]

Americans are exposed daily to astonishingly high levels of risk from the use of consumer products. Each year on average 33.6 million people suffer injuries related to consumer products (not counting motor vehicles) and about 28,200 of them are killed.[8] The Consumer Product Safety Commission estimates that the total cost of product related injuries in a single year is about $800 billion.

However, product injuries make up only one category of costs imposed on unwary consumers. Consumers must also bear the costs of deceptive selling practices, shoddy product construction, products that immediately break down, and warranties that are not honored. For example, several years ago, the engine of Martha and George Rose's General Motors (GM) station wagon began hissing and white smoke poured out of the tailpipe as she drove it 6 miles to work. When their mechanic inspected it, he found a crack in the engine block so the car needed an expensive new engine. But they were not worried since the engine was still under GM's "5-year or 50,000-mile" warranty. However, when a GM mechanic inspected their car, he concluded that the radiator thermostat had stuck shut so no coolant had reached the engine. Because the thermostat was only under a "12-month or 12,000-miles" warranty that had by then expired, and because the faulty thermostat had caused the engine to overheat and the engine block to crack, GM concluded it had no responsibility under its "5-year or 50,000-mile" warranty.[9]

The practices of AT&T Inc. and its subsidiaries illustrate the difficulties consumers face. In 2003, AT&T's California division, then called "Pacific Bell," paid $15 million in fines for "deceptive" marketing of its telephone services. The deception was almost identical to what the company had done a few years earlier, when it had to pay a $17 million fine for duping telephone customers into buying an expensive package of optional features without telling them the features did not have to be purchased as part of the company's basic service. The company's policy, according to one of its sales representatives, was that "People should be intelligent enough to ask; why should it be PacBell's job to tell them?"[10] In 2003 the company renamed an expensive package of optional services "The Basics" so that when new customers called asking for "basic" telephone service, sales representatives sold them the expensive package without telling them cheaper basic service was available. In 2010 AT&T was accused of "fraud and deceit" in a class action lawsuit that claimed the company "intentionally, knowingly and artificially inflates the data usage" of its cell phone customers by "an amount that is three to five times the actual data usage … then bills the customer based upon the inflated data usage … not the actual data used … by that customer." [11] According to the lawsuit, when Guardian Corporation, an AT&T customer, became suspicious of its cell phone bills, it hired an expert to go through AT&T's internal engineering reports and discovered that Guardian's "actual data usage and data transfer… were, as a matter of corporate policy, being misrepresented by AT&T's system." By inflating a customer's usage, the suit said, AT&T was also able to charge higher "overage" fees for usage beyond the amount the customer's plan contract allowed, even when the customer stayed within the usage allowed by the plan. Ordinary consumers could not check the accuracy of their bills because they did not have access to AT&T's internal engineering reports nor to an expert who could understand those reports. AT&T has had to settle other charges of deceptive consumer practices in New York, Florida, Washington, Texas, Louisiana, West Virginia, North Carolina, and several other states as well as charges of nationwide deceptive practices.

Consumers are also bombarded daily by an endless series of advertisements urging them to buy numerous products. Although sometimes defended as sources of information, advertisements are also criticized on the grounds that they rarely do more than give the barest indications of the basic function a product is meant to serve and sometimes misrepresent and exaggerate its qualities. Economists argue that advertising expenditures are a waste of resources and sociologists bemoan the cultural effects of advertising.[12]

This chapter examines the many ethical issues raised by product quality and advertising. The first few sections discuss various approaches to consumer issues, and the last sections deal with consumer advertising. We begin with a focus on what is perhaps the most urgent issue: consumer product injuries and the responsibilities of manufacturers.

Markets and Consumer Protection

Consumer advocates point out that each year there are more than 500,000 injuries requiring hospital treatment inflicted on youngsters and adults using toys, nursery equipment, and playground equipment; close to 290,000 people are mangled using home workshop equipment; over 2,800,000 people need emergency treatment for injuries involving home furnishings; and over 3,000,000 people require treatment for injuries involving home construction materials.[13] Non-fatal injuries from motor vehicle accidents in 2009 averaged 51,000 each week and deaths averaged over 90 people per day.[14] A 2010 study concluded that the financial losses from motor vehicle accidents total more than $99 billion a year.[15]

It is sometimes argued that consumers will be protected from injury by the operations of the free market and that neither governments nor businesspeople should intervene in markets to require product safety.[16] The market approach to consumer protection argues that consumer safety can be provided efficiently through the free market because sellers must respond to consumer demands if they are to make a profit. If consumers want products to be safer, they will indicate this preference in markets by willingly paying more for safer products and showing a preference for manufacturers of safe products while turning down the goods of those who make unsafe products. Manufacturers will respond to this demand by building more safety into their products or they risk losing customers to competitors who cater to the safety preferences of consumers. Thus, if consumers want safety the market will provide it and sellers will price it according to how much it costs to provide it (indicated by their supply curve) and how much consumers think its worth (indicated by their demand curve). As a result, the market will provide safety at a fair price, in a way that respects customers' free choices, and with an efficient use of society's resources.

On the other hand, if consumers do not place a high value on safety and demonstrate neither a willingness to pay more for safety nor a preference for safer products, then it is wrong for government to force manufacturers to build more safety into their products. Forcing manufacturers to provide more safety than consumers want increases manufacturing costs which leads to higher consumer prices so that ultimately consumers are forced to pay for a product feature they did not want in the first place. Such government interference also distorts markets by leading manufacturers to invest society's resources where there is little demand, and forcing consumers to pay prices that unfairly charge them for a product quality they do not value. Only consumers can say what value they place on safety, the market approach argues, and they should be allowed to register their preferences through their free choices in markets and not be coerced by businesses or governments into paying for safety levels they do not want. Such coercion leads to unfairness, does not respect the consumer's right of free choice, and reduces society's utility.

Critics of this market approach to safety respond, however, that the market approach assumes consumer markets are perfectly competitive, but in fact they rarely are. As we saw in Chapter 4, we can claim that markets are fair, respectful of negative rights, and efficiently maximize utility only when they have the seven characteristics that make them perfectly competitive. When markets are not perfectly competitive because they lack some of these characteristics, it's hard to say whether they are fair, are respectful of rights, or maximize utility. In particular, we can say consumer markets will respond efficiently and fairly to consumer preferences only if buyers have adequate information about what they are buying, are *rational utility maximizers*, and have the other characteristics of the perfectly competitive market. However, buyers are not always adequately informed about the goods they are buying, nor are they always rational, and most markets lack some of the other characteristics of perfectly competitive markets.

Consumers are often uninformed about the products they buy simply because many products are so complex only an expert can be knowledgeable about them, and because the manufacturer, who is most knowledgeable about the product, may not voluntarily share this knowledge with consumers. And it may be too expensive and impractical for consumers to conduct the research needed to learn enough about a particular product to make an informed purchase decision.[17]

Moreover, research shows that we become highly inept, irrational, and inconsistent when we make purchase decisions based on estimates about the probability that a product carries no major risk of injury or the probability it will serve our purposes.[18] We typically underestimate the risks of common life-threatening activities, such as driving, smoking, eating fried foods, or being injured by the products we use, and we overestimate the probabilities of unlikely but memorable events such as tornadoes or attacks by grizzly bears in national parks.[19] Studies have shown that our probability judgments go astray for a number of reasons, including: we ignore or discount important information about a product, we make broad generalizations on the basis of small samples, we believe in a self-correcting but nonexistent "law of averages," and we believe that we exert control over purely chance events.[20] A number of researchers have also shown that people are irrational and inconsistent when weighing choices based on probability estimates about the future, sometimes ranking one future choice as being both better and worse than another and sometimes paying more for the choice they least prefer.[21]

Finally, as several critics have pointed out, many, perhaps most, consumer markets are not competitive but are, instead, monopolies or oligopolies in which sellers can manipulate price and supply. For example, the markets for automobiles, cigarettes, air travel, soft drinks, televisions, cell phones, gasoline, movies, music, books, breakfast cereals, beer, health insurance, fast food, electronic goods, television cable services, wireless phone service, pharmaceutical drugs, computers, television entertainment, etc., are all oligopolies.

On balance, then, it does not appear that market forces by themselves can deal with all consumer concerns for safety, freedom from risk, and value. Market failures, characterized by inadequate consumer information, irrationality in the choices of consumers, and concentrated markets, undercut arguments that try to show that markets alone can provide adequate consumer protection. Instead, consumers must be protected through the legal structures of government and through the voluntary initiatives of responsible businesspeople. We turn then to examining several views about the responsibilities of businesses toward consumers – views that have formed the basis of many of our consumer laws and of increased calls for greater acceptance of responsibility for consumer protection on the part of business.

It is clear, of course, that part of the responsibility for consumer injuries must rest on consumers. Individuals are often careless in their use of products. "Do-it-your-selfers" use power saws without guards attached or use flammable liquids near open flames. People often use tools and instruments that they do not have the skill, knowledge, or experience to handle. But consumer responsibility is only part of the story. Injuries also arise from flaws in product design, in the materials out of which products are made, and in the processes used to construct products. Insofar as manufacturing defects are the source of product-related injuries, consumer advocates claim, minimizing injuries is the responsibility of manufacturers because they are in the best position to know the hazards a product carries and to eliminate the hazards at the point of manufacture.

Where, then, does the consumers' duty to protect his or her own interests end, and where does the manufacturer's duty to protect consumers' interests begin? Three different theories on the ethical duties of manufacturers have been developed, each of which strikes a different balance between consumers' duty to protect themselves and the manufacturer's duty to protect consumers: the contract view, the "due care" view, and the social costs view. The contract view would place the greater responsibility on the consumer, whereas the due care and social costs views place the larger measure of responsibility on the manufacturer. We examine each of these in turn.

The Contract View of Business Firm's Duties to Consumers

According to the *contract view of the business firm's duties to its customers*, the relationship between a business firm and its customers is essentially a contractual relationship, and the firm's moral duties to the customer are those created by this contractual relationship.[22] When a consumer buys a product, this view holds, the consumer voluntarily enters into a "sales contract" with the business firm. The firm freely and knowingly agrees to give the consumer a product with certain characteristics, and the consumer in turn freely and knowingly agrees to pay a certain sum of money to the firm for the product. By virtue of having voluntarily entered this agreement, the firm then has a duty to provide a product with those characteristics, and the consumer has a correlative right to get a product with those characteristics.

The contract theory of the business firm's duties to its customers rests on the view that a contract is a free agreement that imposes on the parties the basic duty of complying with the terms of the agreement. We examined this view earlier and noted the two justifications Kant provided for the view: A person has a duty to do what the person contracts to do because failure to adhere to the terms of a contract is a practice that (a) cannot be universalized, and (b) treats the other person as a means and not as an end.[23] Rawls's theory also provides a justification for the view, but one that is based on the idea that our freedom is expanded by the recognition of contractual rights and duties: An enforced system of social rules that requires people to do what they contract to do will provide them with the assurance that contracts will be kept. Only if they have such assurance will people feel able to trust each other's word and, on that basis, to secure the benefits of the institution of contracts.[24]

We also noted that traditional moralists have argued that the act of entering into a contract is subject to several secondary moral constraints:

1. Both of the parties to the contract must have full knowledge of the nature of the agreement they are entering.
2. Neither party to a contract must intentionally misrepresent the facts of the contractual situation to the other party.
3. Neither party to a contract must be forced to enter the contract under duress or undue influence.

These secondary constraints can be justified by the same sorts of arguments that Kant and Rawls use to justify the basic duty to perform one's contracts. Kant, for example, easily shows that misrepresentation in the making of a contract cannot be universalized, and Rawls argues that if misrepresentation were not prohibited, fear of deception would make members of a society feel less free to enter contracts. However, these secondary constraints can also be justified on the grounds that a contract cannot exist unless these constraints are fulfilled. A contract is essentially a free agreement struck between two parties. Because an agreement cannot exist unless both parties know what they are agreeing to, contracts require full knowledge and the absence of misrepresentation. Because freedom implies the absence of coercion, contracts must be made without duress or undue influence.

Hence, the contractual theory of business firms' duties to consumers claims that a business has four main moral duties: the basic duty of (1) complying with the terms of the sales contract and the secondary duties of (2) disclosing the nature of the product, (3) avoiding misrepresentation, and (4) avoiding the use of duress and undue influence. By acting in accordance with these duties, a business respects the right of consumers to be treated as free and equal persons – that is, in accordance with their right to be treated only as they have freely consented to be treated.

The duty to comply

The most basic moral duty that a business firm owes its customers, according to the contract view, is the duty to provide consumers with a product that lives up to those claims that the firm expressly made about the product, which led the customers to enter the contract freely and which formed the customers' understanding concerning what they were agreeing to buy. Winthrop Laboratories, for example, marketed a painkiller that it advertised as nonaddictive. Subsequently, a patient using the painkiller became addicted to it and shortly died from an overdose. A court found Winthrop Laboratories liable for the patient's death because, although it had expressly stated that the drug was nonaddictive, Winthrop Laboratories had failed to live up to its duty to comply with this express contractual claim.[25] As this example suggests, our legal system has incorporated the moral view that firms have a duty to live up to the express claims they make about their products. The Uniform Commercial Code (a model set of laws regulating commercial transactions that have been completely or partially adopted by all 50 states), for example, states in Section 2–314:

> Any affirmation of fact or promise made by the seller to the buyer that related to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

In addition to the duties that result from the express claims a seller makes about the product, the contract view also holds that the seller has a duty to carry through on any implied claims knowingly made about the product. For example, the seller has the moral duty to provide a product that can be used safely for the ordinary and expected purposes for which the customer, relying on the seller's judgment, has been led to believe it can be used. Sellers are morally bound to do whatever they know the buyers understood the sellers were promising because at the point of sale, sellers should have corrected any misunderstandings of which they were aware.[26] This idea of an implied agreement has also been incorporated into the law. Section 2–315 of the Uniform Commercial Code, for example, reads:

> Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is … an implied warranty that the goods shall be fit for such purpose.

The express or implied claims that a seller might make about the qualities possessed by the product range over a variety of areas and are affected by a number of factors. Frederick Sturdivant classified these areas in terms of four variables: "The definition of product quality used here is: the degree to which product performance meets predetermined expectations with respect to (1) reliability, (2) service life (3) maintainability, and (4) safety."[27]

Reliability Claims of reliability refer to the probability that a product will function as the consumer is led to expect that it will function. If a product incorporates a number of interdependent components, then the probability that it will function properly is equal to the result of multiplying together each component's probability of proper functioning.[28] As the number of components in a product multiplies, therefore, the manufacturer has a corresponding duty to ensure that each component functions in such a manner that the total product is as reliable as it is implicitly or expressly claimed to be. This is especially the case when malfunction poses health or safety hazards. The U.S. Consumer Product Safety Commission lists hundreds of examples of product hazards on its web site.[29]

Service Life Claims concerning the life of a product refer to the period of time during which the product will function as effectively as the consumer is led to expect it to function. Generally, the consumer implicitly understands that service life will depend on the amount of wear and tear to which one subjects the product. In addition, consumers also base some of their expectations of service life on the explicit guarantees the manufacturer attaches to the product.

A more subtle factor that influences service life is the factor of obsolescence.[30] Technological advances may render some products obsolete when a new product appears that carries out the same functions more efficiently. Purely stylistic changes may make last year's product appear dated and less desirable. The contract view implies that sellers who know that a certain product will become obsolete have a duty to correct any mistaken beliefs they know buyers will form concerning the service life they may expect from the product.

Maintainability Claims of maintainability are claims concerning the ease with which the product can be repaired and kept in operating condition. Claims of maintainability are often made in the form of an express warranty. Whirlpool Corporation, for example, appended this express warranty on one of its products:

> During your first year of ownership, all parts of the appliance (except the light bulbs) that we find are defective in materials or workmanship will be repaired or replaced by Whirlpool free of charge, and we will pay all

> labor charges. During the second year, we will continue to assume the same responsibility as stated above except you pay any labor charges.[31]

But sellers often also imply that a product may be easily repaired even after the expiration date of an express warranty. In fact, however, product repairs may be costly, or even impossible, because of the unavailability of parts.

Product Safety Implied and express claims of product safety refer to the degree of risk associated with using a product. Because the use of virtually any product involves some degree of risk, questions of safety are essentially questions of acceptable and known level of risk. That is, a product is safe if its attendant risks are known and judged to be "acceptable" or "reasonable" by the buyer in view of the benefits the buyer expects to derive from using the product. This implies that sellers comply with their part of a free agreement if the sellers provide a product that involves only those risks they say it involves, and buyers purchase it with that understanding. The National Commission on Product Safety, for example, has characterized *reasonable risk* in these terms:

> Risks of bodily harm to users are not unreasonable when consumers understand that risks exist, can appraise their probability and severity, know how to cope with them, and voluntarily accept them to get benefits they could not obtain in less risky ways. When there is a risk of this character, consumers have reasonable opportunity to protect themselves; and public authorities should hesitate to substitute their value judgments about the desirability of the risk for those of the consumers who choose to incur it. But preventable risk is not reasonable (a) when consumers do not know that it exists; or (b) when, though aware of it, consumers are unable to estimate its frequency and severity; or (c) when consumers do not know how to cope with it, and hence are likely to incur harm unnecessarily; or (d) when risk is unnecessary in that it could be reduced or eliminated at a cost in money or in the performance of the product that consumers would willingly incur if they knew the facts and were given the choice.[32]

Thus, the seller of a product (according to the contractual theory) has a moral duty to provide a product whose use involves no greater risks than those the seller expressly communicates to the buyer, or those the seller implicitly communicates by the implicit claims made when marketing the product for a use whose normal risk level is well known. If the label on a bottle, for example, indicates only that the contents are highly toxic ("Danger: Poison"), the product should not include additional risks from flammability. If a firm makes and sells skis, use of the skis should not carry risks other than the well-known risks that attend skiing (e.g., it should not involve the added possibility of being pierced by splinters should the skis fracture). In short, sellers have a duty to provide a product with a level of risk that is no higher than they expressly or implicitly claim it to be and that consumers freely and knowingly contract to assume.

The duty of disclosure

An agreement cannot bind unless both parties to the agreement know what they are doing and freely choose to do it. This implies that the seller who intends to enter a contract with a customer has a duty to disclose exactly what the customer is buying and what the terms of the sale are. At a minimum, this means the seller has a duty to inform the buyer of any characteristics of the product that could affect the customer's decision to purchase the product. For example, if the product the consumer is buying possesses a defect that poses a risk to the user's health or safety, the consumer should be so informed. Some have argued that sellers should also disclose a product's components or ingredients, its performance characteristics, costs of operation, product ratings, and any other applicable standards.[33]

Behind the claim that entry into a sales contract requires full disclosure is the idea that an agreement is free only to the extent that one knows what alternatives are available: Freedom depends on knowledge. The more the buyer knows about the various products available on the market and the more comparisons the buyer is able to make among them, the more one can say that the buyer's agreement is voluntary.[34]

The view that sellers should provide a great deal of information for buyers, however, has been criticized on the grounds that information is costly and, therefore, should be treated as a product for which the consumer should either pay or do without. In short, consumers should freely contract to purchase information as they freely contract to purchase goods, and producers should not have to provide it for them.[35] The problem with this criticism is that the information on which a person bases a decision to enter a contract is a rather different kind of entity from the product exchanged through the contract. Because a contract must be entered into freely and free choice depends on knowledge, contractual transactions must be based on an open exchange of information. If consumers had to bargain for such information, the resulting contract would hardly be free.

The duty not to misrepresent

Misrepresentation, even more than the failure to disclose information, renders freedom of choice impossible. That is, misrepresentation is coercive: The person who is intentionally misled acts as the deceiver wants the person to act and not as the person would freely have chosen to act if the person had known the truth. Because free choice is an essential ingredient of a binding contract, intentionally misrepresenting the nature of a commodity is ethically wrong.

Sellers misrepresent a commodity when they represent it in a way deliberately intended to deceive the buyer into thinking something about the product that the seller knows is false. The deception may be created by a verbal lie, as when a used model is described as new, or it may be created by a gesture, as when an unmarked used model is displayed together with several new models. The deliberate intent to misrepresent by false implication is as wrong as the explicit lie.

The varieties of misrepresentation seem to be limited only by the ingenuity of the greed that creates them.[36] A computer software or hardware manufacturer may market a product it knows contains "bugs" without informing buyers of that fact; a manufacturer may give a product a name that the manufacturer knows consumers will confuse with the brand name of a higher-quality competing product; the manufacturer may write *wool* or *silk* on material made wholly or partly of cotton; the manufacturer may mark a fictitious "regular price" on an article that is always sold at a much lower "sale" price; a business may advertise an unusually low price for an object that the business actually intends to sell at a much higher price once the consumer is lured into the store; a store may advertise an object at an unusually low price, intending to "bait and switch" the unwary buyer over to a more expensive product; and a producer may solicit paid "testimonials" from professionals who have never really used the product. Sellers can be astonishingly creative. We return to some of these issues when we discuss advertising.

The duty not to coerce

People often act irrationally when under the influence of fear or emotional stress. When a seller takes advantage of a buyer's fear or emotional stress to extract consent to an agreement that the buyer would not make if the buyer were thinking rationally, the seller is using duress or undue influence to coerce. An unscrupulous funeral director, for example, may skillfully induce guilt-ridden and grief-stricken survivors to invest in funeral services they cannot afford. Because entry into a contract requires freely given consent, the seller has a duty to refrain from exploiting emotional states that may induce buyers to act irrationally against their own best interests. For similar reasons, the seller also has the duty not to take advantage of gullibility, immaturity, ignorance, or any other factors that reduce or eliminate the buyer's ability to make free rational choices.

Problems with the contractual theory

The main objections to the contract theory focus on the unreality of the assumptions on which the theory is based. First, critics argue, the theory unrealistically assumes that manufacturers make direct agreements with consumers. Nothing could be farther from the truth. Normally, a series of wholesalers and retailers stands between the manufacturer and the ultimate consumer. The manufacturer sells the product to the wholesaler, who sells it to the retailer, who finally sells it to the consumer. The manufacturer never enters into any direct contract with the consumer. How then can one say that manufacturers have contractual duties to the consumer?

Advocates of the contract view of manufacturers' duties have tried to respond to this criticism by arguing that manufacturers enter into *indirect* agreements with consumers. Manufacturers promote their products through their own advertising campaigns. These advertisements supply the promises that lead people to purchase products from retailers, who merely function as "conduits" for the manufacturer's product. Consequently, through these advertisements, the manufacturer forges an indirect contractual relationship not only with the immediate retailers who purchase the manufacturer's product, but also with the ultimate consumers of the product. The most famous application of this doctrine of broadened indirect contractual relationships is to be found in a 1960 court opinion, *Henningsen v. Bloomfield Motors*.[37] Mrs. Henningsen was driving a new Plymouth when it suddenly gave off a loud cracking noise. The steering wheel spun out of her hands and the car lurched to the right and crashed into a brick wall. Mrs. Henningsen sued the manufacturer, Chrysler Corporation. The court opinion read:

> Under modern conditions the ordinary layman, on responding to the importuning of colorful advertising, has neither the opportunity nor the capacity to inspect or to determine the fitness of an automobile for use; he must rely on the manufacturer who has control of its construction, and to some degree on the dealer who, to the limited extent called for by the manufacturer's instructions, inspects and services it before delivery. In such a marketing milieu his remedies and those of persons who properly claim through him should not depend "upon the intricacies of the law of sales". The obligation of the manufacturer should not be based alone on privity of contract [that is, on a direct contractual relationship]. It should rest, as was once said, upon '"the demands of social justice"' *Mazetti v. Armons & Co.* (1913). "If privity of contract is required," then, under the circumstances of modern merchandising, "privity of contract exists in the consciousness and understanding of all right-thinking persons…." Accordingly, we hold that under modern marketing conditions, when a manufacturer puts a new automobile in the stream of trade and promotes its purchase by the public, an implied warranty that it is reasonably suitable for use as such accompanies it into the hands of the ultimate purchaser.

Thus, the car manufacturer was found liable for Mrs. Henningsen's injuries on the grounds that its advertising had created a contractual relationship with Mrs. Henningsen and this contract created an "implied warranty" about the car, which the manufacturer had a duty to fulfill.

A second objection to the contract theory focuses on the fact that a contract is a two-edged sword. If a consumer can freely agree to buy a product with certain qualities, the consumer can also freely agree to buy a product without those qualities. That is, freedom of contract allows a manufacturer to be released from contractual obligations by explicitly disclaiming that the product is reliable, serviceable, safe, and so on. Many manufacturers put such disclaimers on their products. The Uniform Commercial Code, in fact, stipulates in Section 2–316:

a. Unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults," or other language that in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no warranty, and

b. When the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired, or has refused to examine the goods, there is no implied warranty with regard to defects that on examination ought in the circumstances to have been revealed to him.

The contract view, then, implies that if the consumer has ample opportunity to examine the product and the seller's disclaimers of responsibility and voluntarily consents to buy it anyway, the consumer assumes the responsibility for the defects disclaimed by the manufacturer, as well as for any defects the customer may carelessly have overlooked. Disclaimers can effectively nullify all contractual duties of the manufacturer.

A third objection to the contract theory criticizes the assumption that buyer and seller meet each other as equals in the sales agreement. The contractual theory assumes that buyers and sellers are equally skilled at evaluating the quality of a product and that buyers are able to adequately protect their interests against the seller. This is the assumption built into the requirement that contracts must be freely and knowingly entered into: Both parties must know what they are doing and neither must be coerced into doing it. This equality between buyer and seller that the contractual theory assumes derives from the laissez-faire ideology that accompanied the historical development of contract theory.[38] Classical laissez-faire ideology held that the economy's markets are competitive and that in competitive markets the consumer's bargaining power is equal to that of the seller. Competition forces the seller to offer the consumer as good or better terms than the consumer could get from other competing sellers, so the consumer has the power to threaten to take business to other sellers. Because of this equality between buyer and seller, it was fair that each be allowed to try to outbargain the other and unfair to place restrictions on either. In practice, this laissez-faire ideology gave birth to the doctrine of *caveat emptor*: Let the buyer beware.

In fact, sellers and buyers do not exhibit the equality that these doctrines assume. A consumer who must purchase hundreds of different kinds of commodities cannot hope to be as knowledgeable as a manufacturer who specializes in producing a single product and who has greater bargaining power. Consumers generally have neither the expertise nor the time to acquire and process the information on which they must base their purchase decisions. Consequently, consumers must usually rely on the word and the judgment of the seller in making their purchase decisions and are particularly vulnerable to being harmed by the seller. Equality, far from being the rule, as the contract theory assumes, is usually the exception.

The Due Care Theory

The "*due care" theory of the manufacturer's duties to consumers* is based on the idea that consumers and sellers do not meet as equals and that the consumer's interests are particularly vulnerable to being harmed by the manufacturer who has a knowledge and an expertise that the consumer lacks. Because manufacturers are in a more advantaged position, they have a duty to take special care to ensure that consumers' interests are not harmed by the products that they offer them. The doctrine of *caveat emptor* is here replaced with a weak version of the doctrine of *caveat vendor*. Let the seller beware. A New York court decision neatly described the advantaged position of the manufacturer and the consequent vulnerability of the consumer:

> Today as never before the product in the hands of the consumer is often a most sophisticated and even mysterious article. Not only does it usually emerge as a sealed unit with an alluring exterior rather than as a visible assembly of component parts, but its functional validity and usefulness often depend on the application of electronic, chemical, or hydraulic principles far beyond the ken of the average consumer. Advances in the technologies of materials, of processes, of operational means have put it almost entirely out of the reach of the consumer to comprehend why or how the article operates, and thus even farther out of his reach to detect when there may be a defect or a danger present in its design or manufacture. In today's world it is often only the manufacturer who can fairly be said to know and to understand when an article is suitably designed and safely made for its intended purpose. Once floated on the market, many articles in a very real practical sense defy detection of defect, except possibly in the hands of an expert after laborious, and perhaps even destructive, disassembly. By way of direct illustration, how many automobile purchasers or users have any idea how a power steering mechanism operates or is intended to operate, with its "circulating work and piston assembly and its cross shaft splined to the Pitman arm"? We are accordingly persuaded that from the standpoint of justice as regards the operating aspect of today's products, responsibility should be laid on the manufacturer, subject to the limitations we set forth.[39]

The "due care" view holds, then, that because consumers must depend on the greater expertise of the manufacturer, the manufacturer not only has a duty to deliver a product that lives up to the express and implied claims about it, but also has a duty to exercise due care to prevent others from being injured by the product even if the manufacturer explicitly disclaims such responsibility and the buyer agrees to the disclaimer. The manufacturer violates this duty and is negligent when there is a failure to exercise the care that a reasonable person could have foreseen would be necessary to prevent others from being harmed by use of the product. Due care must enter into the design of the product, the choice of reliable materials for constructing the product, the manufacturing processes involved in putting the product together, the quality control used to test and monitor production, and the warnings, labels, and instructions attached to the product. In each of these areas, according to the due care view, the manufacturer, in virtue of a greater expertise and knowledge, has a positive duty to take whatever steps are necessary to ensure that when the product leaves the plant it is as safe as possible, and the customer has a right to such assurance. Failure to take such steps is a breach of the moral duty to exercise due care and a violation of the injured person's right to expect such care – a right that rests on the consumer's need to rely on the manufacturer's expertise.

The respected scholar of management, Edgar Schein, sketched out the basic elements of the "due care" theory when he noted that "it is the *vulnerability of the client* that has necessitated the development of moral and ethical codes surrounding the relationship" between a professional and his client. A professional – like a lawyer, a doctor, a real estate agent, or an engineer – has knowledge or expertise that he or she exercises in the interests of the client and the client has to trust the professional to protect and advance those interests. But this makes the client vulnerable to being exploited by the more knowledgeable professional. This vulnerability, Schein claims, led to the development of professional codes of ethics that impose on professionals the ethical duty to use their skills only to serve and protect the interests of the client. But the consumer is likewise "in a relatively vulnerable position" relative to the manager of a company from which the consumer buys a product, since the consumer lacks the expertise to adequately evaluate the product. Managers have "knowledge and skills" that they exercise on behalf of the consumer and they can use their knowledge and skills to take advantage of the vulnerable consumer's lack of expertise. Therefore, Schein argues, managers, like professionals, must be charged with the ethical duty to use their knowledge and skills to serve and protect the interests of the vulnerable consumer.[40]

The due care view, of course, rests on the principle that agents have a moral duty not to harm or injure other parties by their acts and that this duty is particularly stringent when those other parties are vulnerable and dependent on the judgment of the agent. This principle can be supported from a variety of different moral perspectives, but it is most clearly implied by the requirements of an ethic of care. The principle follows almost immediately, in fact, from the requirement that one should care for the well-being of those with whom one has a special relationship, particularly a relationship of dependence, such as a child has on its mother. Moreover, an ethic of care imposes the requirement that one should carefully examine the particular needs and characteristics of the person with whom one has a special relationship to ensure that one's care for that person is tailored to that person's particular needs and qualities. This emphasis on carefully examining the specific needs and characteristics of a vulnerable party is also an explicit and essential part of the due care view.

Although the demands of an ethic of care are aligned with the due care principle that manufacturers have a duty to protect vulnerable consumers, the principle has also been defended from other moral perspectives. Rule utilitarians have defended the principle on the grounds that if the rule is accepted, everyone's welfare will be advanced.[41] It also has been argued for on the basis of Kant's theory because the principle seems to follow from the categorical imperative that people should be treated as ends and not merely as means – that is, from the principle that people have a positive right to be helped when they cannot help themselves.[42] Rawls has argued that individuals in the "original position" would agree to the principle because it would provide the basis for a secure social environment.[43] The judgment that individual producers have a duty not to harm or injure vulnerable parties, therefore, is solidly based on several ethical perspectives.

The duty to exercise due care

According to the due care theory, manufacturers exercise sufficient care only when they take adequate steps to prevent whatever injurious effects they can foresee that the use of their product may have on consumers after having conducted inquiries into the way the product will be used and after having attempted to anticipate possible misuses of the product. A manufacturer is not morally negligent, however, when others are harmed by a product and the harm was not one that the manufacturer could have possibly foreseen or prevented. Nor is a manufacturer morally negligent after having taken all reasonable steps to protect the consumer and ensure that the consumer is informed of any irremovable risks that might still attend the use of the product. For example, a car manufacturer cannot be said to be negligent from a moral point of view when people carelessly misuse the cars the manufacturer produces. A car manufacturer would be morally negligent only if it had allowed unreasonable dangers to remain in the design of the car, i.e., dangers that consumers cannot be expected to know about or cannot guard against on their own.

What specific responsibilities does the duty to exercise due care impose on the producer? In general, the producer's responsibilities would extend to the following three areas:[44]

Design The manufacturer should ascertain whether the design of an article conceals any dangers, whether it incorporates all feasible safety devices, and whether it uses materials that are adequate for the purposes the product is intended to serve. The manufacturer is responsible for being thoroughly acquainted with the design of the item and to conduct research and tests extensive enough to uncover any risks that many be involved in employing the article under various conditions of use. This requires researching consumers and analyzing their behavior, testing the product under different conditions of consumer use, and selecting materials strong enough to stand up to all probable usages. The effects of aging and wear should also be analyzed and taken into account in designing an article.

In determining the safeguards that should be designed into a product, the manufacturer must also take into consideration the capacities of the persons who will use the product. If a manufacturer anticipates that a product will be used by persons who are immature, mentally deficient, or too inexperienced to be aware of the dangers attendant on the use of the product, the manufacturer owes them a greater degree of care than if the anticipated users were of ordinary intelligence and prudence. For example, children cannot be expected to realize the dangers involved in using electrical equipment. Consequently, if a manufacturer anticipates that an electrical item will probably be used by children, steps must be taken to ensure that a person with a child's understanding will not be injured by the product.

Production The production manager should control the manufacturing processes so as to eliminate any defective items, identify any weaknesses that become apparent during production, and ensure that shortcuts, substitution of weaker materials, or other economizing measures are not taken during manufacture that would compromise the safety of the final product. To ensure this, there should be adequate quality controls over materials that are to be used in the manufacture of the product and over the various stages of manufacture.

Marketing The manufacturer should attach labels, notices, or instructions on the product that will warn the user of all dangers involved in using or misusing the item and that will enable the user to adequately guard against harm or injury. These instructions should be clear and simple, and warnings of any hazards involved in using or misusing the product should also be clear, simple, and prominent. In the case of drugs, manufacturers have a duty to warn physicians of any risks or dangerous side effects that research or prolonged use have revealed. It is a breach of the duty not to harm or injure if the manufacturer attempts to conceal or downplay the dangers related to drug usage. A firm should not oppose regulation of the sale of a product when regulation is the only effective means of ensuring that the users of the product are fully aware of the risks its use involves.

If the possible harmful effects of using a product are serious or if they cannot be adequately understood without expert opinion, then sale of the product should be carefully controlled. Products should not be marketed to users who do not have the capacity to understand the dangers of the product or are unable to protect themselves against its risks or are otherwise unable to use the product safely.

Problems with "due care"

The basic difficulty raised by the "due care" theory is that there is no clear method for determining when one has exercised enough "due care." That is, there is no hard-and-fast rule for determining how far a firm must go to ensure the safety of its product. Some authors have proposed this general utilitarian rule: The greater the probability of harm and the larger the population that might be harmed, the more the firm is obligated to do. However, this fails to resolve some important issues. Every product involves at least some small risk of injury. If the manufacturer should try to eliminate even low-level risks, this would require that the manufacturer invest so much in each product that the product would be priced out of the reach of most consumers. Moreover, even attempting to balance higher risks against added costs involves measurement problems; for example, how does one quantify risks to health and life?

A second difficulty raised by the "due care" theory is that it assumes that the manufacturer can discover the risks that attend the use of a product before the consumer buys and uses it. In fact, in a technologically innovative society, new products whose defects cannot emerge until years or decades have passed will continually be introduced into the market. Only years after thousands of people were using and being exposed to asbestos, for example, did a clear correlation emerge between the incidence of cancer and exposure to asbestos. Although manufacturers may have greater expertise than consumers, their expertise does not make them omniscient. Who, then, is to bear the costs of injuries sustained from products whose defects neither the manufacturer nor the consumer could have uncovered beforehand?

Third, the "due care" view appears to some to be paternalistic: It assumes that the manufacturer should be the one who makes the important decisions for the consumer, at least with respect to the levels of risks that are proper for consumers to bear. One may wonder whether such decisions should not be left up to the free choice of consumers, who can decide for themselves whether they want to pay for additional risk reduction.

The Social Costs View of the Manufacturer's Duties

A third theory on the duties of the manufacturer would extend the manufacturer's duties beyond those imposed by contractual relationships and beyond those imposed by the duty to exercise due care in preventing injury or harm. This third theory, *the social costs view of the manufacturer's duties to consumers* holds that a manufacturer should pay the costs of any injuries sustained through any defects in the product, even when the manufacturer exercised all due care in the design and manufacture of the product and has taken all reasonable precautions to warn users of every foreseen danger. According to this third theory, a manufacturer has a duty to assume the risks of even those injuries that arise out of defects in the product that no one could reasonably have foreseen or eliminated. The theory is a strong version of the doctrine of *caveat vendor*: Let the seller beware.

This third theory, which has formed the basis of the legal doctrine *strict liability*, is founded on utilitarian arguments.[45] The utilitarian arguments for this third theory hold that the "external" costs of injuries resulting from unavoidable defects in the design of an artifact constitute part of the costs society must pay for producing and using an artifact. By having the manufacturer bear the external costs that result from these injuries as well as the ordinary internal costs of design and manufacture, all costs are internalized and added on as part of the price of the product. Internalizing all costs in this way, according to proponents of this theory, will lead to a more efficient use of society's resources. First, because the price will reflect all the costs of producing and using the artifact, market forces will ensure that the product is not overproduced and resources are not wasted on it. (Whereas if some costs were not included in the price, then manufacturers would tend to consume resources to produce more than is needed.) Second, because manufacturers have to pay the costs of injuries, they will be motivated to exercise greater care and thereby reduce the number of accidents. Therefore, manufacturers will strive to cut down the social costs of injuries, and this means a more efficient use of our resources. To produce the maximum benefits possible from our limited resources, therefore, the social costs of injuries from defective products should be internalized by passing them on to the manufacturer even when the manufacturer has done all that could be done to eliminate such defects. Third, internalizing the costs of injury in this way enables the manufacturer to distribute losses among all the users of a product instead of allowing losses to fall on a few injured individuals who otherwise would have to bear all the costs of injury. Such a distribution of costs would seem to be more fair than imposing the costs on a few victims.

Underlying this third theory on the duties of the manufacturer are the standard utilitarian assumptions about the values of efficiency. The theory assumes that an efficient use of resources is so important for society that social costs should be allocated in whatever way will lead to a more efficient use and care of our resources. On this basis, the theory argues that a manufacturer should bear the social costs for injuries caused by defects in a product even when no negligence was involved and no contractual relationship existed between the manufacturer and user.

Criticisms of the social costs view

The major criticism of the social costs view of the manufacturer's duties is that it is unjust.[46] It is unjust, the critics charge, because it violates the basic canons of compensatory justice. Compensatory justice implies that a person should have to compensate an injured party only if the person could have foreseen and prevented the injury. By forcing manufacturers to pay for injuries they could neither foresee nor prevent, the social costs theory (and the legal theory of "strict liability" that flows from it) treats manufacturers unjustly. Moreover, insofar as the social costs theory encourages passing the costs of injuries on to all consumers (in the form of higher prices), consumers are also being treated unfairly since they had nothing to do with the injuries.

A second criticism of the social costs theory attacks the assumption that passing the costs of all injuries on to manufacturers will reduce the number of accidents.[47] On the contrary, critics claim, by relieving consumers of the responsibility of paying for their own injuries, the social costs theory will encourage carelessness in consumers. An increase in consumer carelessness will lead to an increase in consumer injuries.

A third argument against the social costs theory focuses on the financial burdens the theory imposes on manufacturers and insurance carriers. Critics claim that a growing number of consumers successfully sue manufacturers for compensation for any injuries sustained while using a product even when the manufacturer took all due care to ensure that the product was safe.[48] Not only have the number of "strict liability" suits increased, critics claim, but the amounts awarded to injured consumers have also escalated. Moreover, they continue, the rising costs of the many liability suits that the theory of "strict liability" has created have precipitated a crisis in the insurance industry because insurance companies end up paying the liability suits brought against manufacturers. These high costs have imposed heavy losses on insurance companies and have forced many insurance companies to raise their rates to levels that are so high that many manufacturers can no longer afford insurance. Thus, critics claim, the social costs or "strict liability" theory wreaks havoc with the insurance industry, forces the costs of insurance to climb to unreasonable heights, and forces many valuable firms out of business because they can no longer afford liability insurance, nor can they afford to pay for the many and expensive liability suits they must now face.

Defenders of the social costs view, however, have replied that in reality the costs of consumer liability suits are not large. Studies have shown that the number of liability suits filed in state courts has increased at a fairly low rate.[49] Less than 1 percent of product-related injuries results in suits, and successful suits average payments of only a few thousand dollars.[50] Defenders of the social costs theory also point out that insurance companies and the insurance industry as a whole have remained quite profitable; they also claim that higher insurance costs are due to factors other than an increase in the amount of liability claims.[51]

The arguments for and against the social costs theory deserve much more discussion than we can give them here. The theory is essentially an attempt to come to grips with the problem of allocating the costs of injuries between two morally innocent parties: the manufacturer who could not foresee or prevent a product-related injury and the consumer who could not guard against the injury because the hazard was unknown. This allocation problem will arise in any society that, like ours, has come to rely on technology whose effects do not become evident until years after the technology is introduced. Unfortunately, it is also a problem that may have no "fair" solution.

Notes

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Marketing and the Vulnerable

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I. Introduction

Contemporary marketing is commonly characterized by the marketing concept which enjoins marketers to determine the wants and needs of customers and then to try to satisfy them. This view is standardly developed, not surprisingly, in terms of normal or ordinary consumers. Much less frequently is attention given to the vulnerable customers whom marketers also (and increasingly) target. Though marketing to normal consumers raises many moral questions, marketing to the vulnerable also raises many moral questions which are deserving of greater attention.

This paper has three objectives. First, it explores the notion of vulnerability which a target audience might (or might not) have. I argue that we must distinguish those who are specially vulnerable from normal individuals, as well as the susceptible and the disadvantaged – two other groups often distinguished in marketing literature. Second, I contend that marketing to the specially vulnerable requires that marketing campaigns be designed to ensure that these individuals are not treated unfairly, and thus possibly harmed. Third, I maintain that marketing programs which violate this preceding injunction are unethical or unscrupulous whether or not those targeted are harmed in some further manner. Accordingly, social control over marketing to the vulnerable cannot simply look to consumer injury as the measure of unfair treatment of the vulnerable.

The upshot of my argument is that, just as we have a doctrine of product liability to which marketers are accountable, we also need a corresponding doctrine of targeted consumer liability to which marketers should be held. By this I refer to the moral liability of marketers for the manner in which they market to consumers. Marketing to the specially vulnerable without making appropriate allowances for their vulnerabilities is morally unjustified.

II. On Being Vulnerable

The notion of vulnerability is complex and slippery. Most simply, to be "vulnerable" is to be susceptible to being wounded; liable to physical hurt" (Barnhart, 1956). More generally being vulnerable is being susceptible to some harm or other. One can be vulnerable to man-made or natural harms: one can also be vulnerable to harms from actions or omissions (Goodin, 1985: 110). In each of these cases, the threatened harm is to one's "welfare" or "interests."

The vulnerability of the person who may be harmed by others may be a permanent, or temporary, condition. Clearly, vulnerability is a matter of degree. Typically only those who are subject to some substantial level of harm are referred to as "vulnerable." This vulnerability may arise due to their own peculiar characteristics, those of the agents who are said to impose the harm on them, or the system within which certain acts impose harm on them. Accordingly, vulnerability is a four place relation: Some person (P) is vulnerable to another (moral or causal) agent (A) with respect to some harm (H) in a particular context (C). As such "vulnerability is inherently object and agent specific" (Goodin, 1985: 112).

The relation of vulnerability to two related concepts – susceptibility and disadvantage – used in marketing literature may serve to further clarify its nature.

Vulnerability is distinct from susceptibility, in that a person might be susceptible to something or someone and still not be vulnerable to that thing or person. "Susceptibility" merely implies that one is "capable of being affected, especially easily" by something or someone. It is true that one who is susceptible may

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also be vulnerable. Clearly, one who is vulnerable is susceptible. But one need not be vulnerable if one is susceptible, since one's susceptibility may not be to some harm or other. An overweight, under-exercised adult might be susceptible through flattery or positive remarks to certain suggestions made by friends to exercise and moderate food intake. But this person would not, thereby, be vulnerable to such suggestions. Hence, vulnerability and susceptibility are different.

The vulnerable also differ from those with "unusual susceptibilities," a term of art in marketing for those "who have idiosyncratic reactions to products that are otherwise harmless when used by most people" (Morgan et al., 1995: 267). People who are "unusually susceptible" are those who are atypically harmed by various products. Accordingly, "unusual susceptibility" has been linked with vulnerability. However, in any ordinary sense, a person might have "unusual susceptibilities" to some experiences (e.g., changes in air pressure or moisture), the suggestions of others, clothing styles, etc., and this might not involve harm to the person but, perhaps, that person's heightened sensitivity to those influences. Further, people may be vulnerable in ways other than that they may be atypically harmed by the products they use. Vulnerable groups such as young children, the grieving or the elderly, are not necessarily atypically harmed by the products they use. Nevertheless, they are vulnerable.

Finally, the vulnerable are also distinct from the disadvantaged. Though marketers quite frequently speak of disadvantaged populations or market segments, they have given little analysis of this concept. Most discussants simply give examples of those whom they consider to be disadvantaged. This extensive, diverse and confused list includes: the poor, immigrants, the young married, teenagers, the elderly, children, racial minorities, the physically handicapped, ethnic minorities, and even women shopping for automobiles.

Generally we are told that members of this list are disadvantaged because they are impaired in their transactions in the marketplace. For some this means not getting their full consumer dollar (Andreasen, 1975: 6). For others this means confronting an imbalance in the marketplace (Barnhill; Morgan and Riordan). Andreasen says "the disadvantaged" are "those who are unequal in the marketplace because of characteristics that are not of their own choosing, including their age, race, ethnic minority status, and (sometimes) gender" (Andreasen, 1993: 273).

It is clear, then, that the vulnerable and the disadvantaged also constitute different, though overlapping, groups. The disadvantaged are impaired or unequal with regard to their attempt to obtain various goods and services. This may occur relative to other groups (normal consumers) competing for various goods, or to those from whom they seek to purchase those goods. On the contrary, those who are vulnerable are not vulnerable with regard to others who are competing for similar goods, but with regard to the harm they might suffer from those who market those goods to them. As such, the notion of vulnerability suggests the harm which one might receive, whether or not, one is competing for a particular good, but due to the manner of obtaining some good (or service). Further, this harm need not come from paying more or being deceived. The vulnerable may get exactly what they want, but what they want may unwittingly and unfairly harm them (as well as their family and/or community).

Accordingly, the vulnerable are not simply the susceptible or the disadvantaged. They constitute a distinct group which deserves our close attention.

III. Vulnerability and Marketing

What moral responsibilities do marketers have when they consider marketing to the vulnerable? Since anyone might be said to be vulnerable in a variety of ways, and since some people might willingly place themselves in competitive situations where their vulnerabilities are exposed, we must specify the manner(s) in which various forms of vulnerability are significant from the standpoint of marketing. Otherwise, if it were morally unjustified to market to those who are vulnerable in any sense, moral marketing would not exist. It would be an oxymoron.

We might begin by reflecting on the fact that vulnerability is not simply a relational but also a relative notion. Individuals may be more or less vulnerable. It might be claimed, then, that those who are vulnerable to an especial degree are those to whom marketers owe a special responsibility of protection and avoidance. Drawing upon this characteristic of vulnerability, Goodin has proposed a general analysis of our responsibility to the vulnerable.[1] He defends the following basic moral principle: "If A's interests are vulnerable to B's actions and choices, B has a special responsibility to protect A's interests; the strength of this responsibility depends strictly upon the degree to which B can affect A's interests" (Goodin, 1985: 118). Thus, if the interests of children, the poor, and the grieving are vulnerable to the actions of marketers, then they have a special responsibility to protect the interests of those individuals. Accordingly, society might seek to control those marketers who, by imposing substantial harm on consumers violate this special responsibility.

There are, however, (at least) two problems with adopting Goodin's suggestion for present purposes. First, his principle is not, as formulated, applicable in the marketplace. For example, a competitor's interests might well be specially vulnerable to the actions and choices of another competitor. The first firm's interests include gaining a certain amount of market share; but the second firm might be a much larger firm which can undercut the first competitor and prevent it from gaining market share. Surely it does not follow that the second firm has a special responsibility to protect the first firm's interests.

Second, if a consumer's interests are vulnerable to some marketer, it does not follow that the marketer has a special responsibility to protect that consumer's interests *simpliciter*. Suppose a person's health interests are vulnerable to a tobacco marketer's actions and choices. It is far from obvious that the tobacco marketer now has a special responsibility to protect that person's health interests without any further specification. At most, a marketer has a responsibility not to harm those interests which may be affected by that marketer's marketing campaign.

Another standard to which we might turn for the responsibilities of marketers to the vulnerable, refers hot to the degree of their vulherability, but to the effects on all those relevantly affected by marketing to these individuals. In short, harm to the vulnerable by marketing programs might be balanced by countervailing benefits for all other consumers and competitors. Thus, the responsibilities of marketers to the vulnerable would depend upon which course of action would maximize all relevant utilities.

However, appeal to a simple utilitarian standard is ethically unacceptable in that it would allow a few vulnerable individuals to substantially suffer because a certain action or policy maximized total utilities. For example, it might be that other marketers are more vulnerable (they might go out of business) than some of the individuals (they might be harmed by the products or the form of marketing targeting them) to whom those marketers and others sought to sell their goods. Hence, in order to protect vulnerable marketers (and their employees, suppliers, etc.), the proposed standard might permit targeting various vulnerable market segments because the total harm they sustained was less than that of those engaged in producing and marketing products to them. This could unleash a tide of manipulative and exploitative marketing.

Similarly, suppose that a particular means of marketing did not make allowances for the fact that those targeted were vulnerable in that they significantly lacked a capacity to make judgments regarding economic exchanges (e.g., children, the senile, or the retarded). Though the marketing efforts took advantage of this vulnerability, it nevertheless maximized total utilities. We might suppose that these customers were not dissatisfied and the marketers were pleased with their successes. To argue that this means of marketing is, nevertheless, morally acceptable runs afoul of important moral and market principles. To begin with, those targeted are not competent to evaluate the product marketed to them. They might not be aware of problems with the products they use. As such, this justification of marketing to the vulnerable permits treating some individuals simply as means to the ends of others. It denies them moral respect. It runs afoul of basic ethical and market principles, even though those targeted do not suffer a direct harm.

The difficulty with Goodin's approach is that he treats vulnerability as simply a quantitative matter without recognizing that each form of vulnerability occurs within a particular context. The market is one such context. In it some individuals may justifiedly seek, in recognized forms of competition, to exploit the vulnerabilities of others. The problem with the consequential first approach is that it does not consider the nature of people's vulnerabilities except insofar as they portend certain consequences for everyone. Not the ability of the person to participate, but the effects on society are its concern. Instead, we need to be able to identify those who are specially vulnerable within a market situation, but whose vulnerability is not the occasion for justified competitive attacks. In short, we need a different approach which takes account both of the context within which marketers address the vulnerable as well as the nature of their vulnerabilities.

IV. Marketing to the Vulnerable

The necessary features for morally (not merely legally) justified market relations are commonly stated in terms of the nature of the relations or interactions which participants in the market enjoy.[2] Thus, we are told that among the relevant characteristics a morally justified market requires are the following: (a) Competition is free, i.e., participants in the market do so voluntarily, when each believes they can benefit; (b) Competition is open, i.e., "access to the market is not artificially limited by any power, government, or group" (DeGeorge, 1982: 101); and (c) Deception or fraud are not used in market competition (Friedman, 1962).

These conditions spell out some of the necessary conditions for a justified form of competition among those we may call "market participants," i.e., those who willingly and knowingly engage in market relations. The activity of these marketplace competitors is strongly determined by their need to derive a profit. To be a market participant is to place oneself in competition with other participant capitalists in which one recognizes that one may succeed or fail. It is to engage in these relations in order to produce various goods or services for sale. It is to acknowledge that all participants, including oneself, have strengths and weaknesses, formidable powers and vulnerabilities. The endeavor of each participant is to compete such that their own strengths and powers will outweigh those of others, or that their weaknesses and vulnerabilities are less significant than those of others.

Second, though these conditions are important for a morally justified market, they make no direct reference to the conditions or characteristics which those individuals who engage in market relations as ultimate consumers – call them "market clients" – must have in order to do so. However, morally and legally justified market relations also make assumptions about the nature of these participants since not just anyone can be a market client. To take the most obvious cases, the severely mentally ill, incompetent elderly and young children cannot be market visitors. Someone else must visit the market on their behalf.

Those who would visit the market as consumers do so not under a concern to derive a profit, but in order to satisfy various needs and wants they have. Accordingly, they must have certain market competencies such as the following: (a) They know they should shop around and are able to do so, (b) They are competent to determine differences in quality and best price, (c) They are aware of their legal rights (Schnapper), (d) They have knowledge of the products and their characteristics, and (e) They have the resources to enter into market relations.[3]

These conditions, conjoined with the preceding, spell out essential requirements for individuals to be market clients. It is assumed that those who fulfill these conditions are able to protect their own interests and that their self-interested behavior in the market will work towards greater wealth or well-being for all. Accordingly, when these conditions are fulfilled (*ceteris paribus*), market relations between market participants and clients will be fair or just. Thus, these conditions for market clients (or consumers) have been recognized not simply as moral restrictions, but also as the source of various legal regulations regarding children, the elderly, and the grieving.

Third, the preceding market client conditions are not fulfilled by consumers wholly independently of marketers. On the contrary, marketers seek to foster the fulfillment of these conditions. "Ultimately," a marketing text reminds us, "the key objective [for marketers] must be to influence customer behavior" (Assael, 1993: 592). Thus, marketers extend credit or loans to prospective individuals so that they may have the needed resources to enter the market. They advertise to foster the knowledge and desire of their products. They seek to identify unfulfilled needs, wants and interests among potential consumers or clients, and endeavor to find ways to satisfy them. Marketers seek to draw into the market those who might not otherwise enter the market, or do so only in different ways and under different conditions. Thus, one marketing researcher comments that "marketers have failed to develop strategies designed to attract the elderly consumer market" (Bailey, 1987: 213). In short, marketers create not only products to sell to market clients (consumers), but seek to create consumers (clients) out of ordinary, non-market interested people. This is not to say that they create consumers out of whole cloth, as it might seem that they do a product. Nor is it to say that they are always successful, or that whenever a person becomes a market client it is because of some specific action of a marketer. Still, marketers not only create products for consumers, but they also have a hand in creating consumers for their products.

In these various efforts, the marketer has a number of advantages over even the most reasonable consumer (client). These include greater knowledge of the product; expertise on how to market to individual customers and targeted groups; knowledge of what interests, fears, wants and/or needs motivate various market segments; and resources to bring that knowledge to bear on behalf of persuading a customer to buy a product. Indeed, the marketer may be aware of attributes of potential consumers of which they are themselves unaware. These special characteristics, powers and abilities of marketers create special responsibilities for them in the relationships they create with consumers.[4]

Fourth, when marketers, or market participants, compete with each other, the fact that one has a vulnerability may be viewed as an opportunity for another who seeks to take advantage of that vulnerability. There are, obviously, legal and moral limits here. If one firm has temporarily lost its security force and its headquarters are unguarded one evening this does not imply that another firm may use that opportunity to sneak into those headquarters to steal important files. Thus, competing firms ought not to try to exploit those vulnerabilities which would require illegal or immoral acts. On the other hand, vulnerabilities linked to market performance may be the occasion for other firms to try to outperform the vulnerable firm when the acts involved do not transgress the preceding limits. Accordingly, if market participants fail to compete aggressively out of laziness or are indifferent to quality differences, they may be harmed as a result. This is acceptable to the market, since it is intended to encourage participant competitiveness.

However, when a marketer confronts a market client, i.e., an ordinary consumer, the situation is different. Individuals must fulfill the above conditions to be market clients. Those that do so may also be lazy shoppers or indifferent to quality differences. As a consequence, they too may suffer. This is also acceptable within the market. However, some individuals may suffer not through such circumstances, but because they fail to fulfill, in ways which render them specially vulnerable, various conditions to be market clients.

I suggest that we may initially characterize this specially vulnerable group as being constituted by those individuals who are particularly susceptible to harm to their interests because the qualitatively different experiences and conditions that characterize them (and on account of which they may be harmed) derive from factors (largely) beyond their control.

Accordingly, there are three conditions for the specially vulnerable:

1. They are those, in contrast to other normal adults, who are characterized by qualitatively different experiences, conditions and/or incapacities which impede their abilities to participate in normal adult market activities. These characteristics may render them vulnerable in any of four different ways:

A. They may be physically vulnerable if they are unusually susceptible due to physical or biological conditions to products on the market, e.g., allergies or special sensitivity to the chemicals or substances which are marketed.

B. They may be cognitively vulnerable if they lack certain levels of ability to cognitively process information or to be aware that certain information was being withheld or manipulated in deceptive ways. Children, the senile elderly, and even those who lack education and shopping sophistication have been included here.[5]

C. They may be motivationally vulnerable if they could not resist ordinary temptations and/or enticements due to their own individual characteristics. Under the motivationally vulnerable might be brought the grieving and the gravely ill.[6]

D. They may be socially vulnerable when their social situation renders them significantly less able than others to resist various enticements, appeals or challenges which may harm them. Some of those who have been included here are certain groups of the poor, the grieving, and new mothers in developing countries.

2. The qualitatively different conditions and incapacities of specially vulnerable individuals are ones they possess due to factors (largely) beyond their control. In addition, they may be largely unaware of their vulnerability(ies). In either case, they are significantly less able (in any normal sense) to protect themselves against harm to their interests as a result. Thus, the allergic, the child, the elderly, and the grieving all experience their vulnerabilities due to reasons (largely) beyond their control. In certain situations this may also be true of various racial groups. The fact that these factors are largely beyond their control may be due to the weaknesses or inabilities these individuals themselves possess, due to the greater power of marketers which render their characteristics specially weak or incapable, or due to the system within which they find themselves.

3. These special conditions render them particularly susceptible to the harm of their interests by various means which marketers (and others) use but which do not (similarly) affect the normal adult. In short, it is the combination of their special characteristics and the means or techniques which marketers use that render them specially vulnerable. This emphasizes the relational nature of vulnerability.

As so identified, the specially vulnerable are significantly less able than others to protect their own interests and, in some cases, even to identify their own interests. Consequently, they are considerably less able to take appropriate measures to satisfy or fulfill those interests. Central to these difficulties is the special liability (or susceptibility) they have to be swayed, moved or enticed in directions which may benefit others but which may harm their interests.

Accordingly, when market participants face individuals who do not qualify or pass a certain threshold for market competition, the latter are unable to protect their interests in a manner comparable to that of ordinary market clients. If the fulfillment of these conditions or threshold is required to be treated as a market client, then these individuals may not morally be treated as other clients in the market. Further, when this situation arises because these individuals have special vulnerabilities then to market to them in ways which take advantage of their vulnerabilities, i.e., to seek to engage them in the competitive effort to sell them goods through the weaknesses characterizing their vulnerabilities, is to treat them unfairly. Regardless of whether they are actually harmed, they are being taken advantage of. They have little or no control over these features of their behavior. The fact that they may take fun or pleasure in being targeted by marketers is, then, irrelevant since they do not quality, as market clients.[7] And it is this situation which has been cited as one of the criteria for determining unfairness in advertising, i.e., advertising (or marketing) makes unfair claims when those claims "… cause especially vulnerable groups to engage in conduct deleterious to themselves" (Cohen, 1974: 13).[8]

Consequently, since moral marketing must exclude treating customers unfairly, marketers need to "qualify" those they propose to target as genuine market clients before they introduce marketing campaigns which target them. This might involve helping them to become qualified consumers, avoiding marketing to them, or marketing to them in ways which are compatible with their limited abilities and characteristics.

As such, moral marketing requires a theory of targeted consumer liability analogous to the products liability, to which marketers are presently held responsible. A theory of targeted consumer liability would elaborate on and operationalize the conditions noted above under which individuals may play full roles as market clients as well as what lesser roles they may play. In each case, it would tell us what relationships marketers might have with them.

V. Implications

What are the implications of the preceding analysis? A first interpretation might be that marketers may not market to the specially vulnerable at all. This is mistaken. There are obviously cases in which those who are specially vulnerable, e.g., the elderly or the grieving, require various products and services and would benefit from learning about them. The preceding argument contends that any marketing to the vulnerable cannot morally be undertaken in a way which trades upon their vulnerabilities.

In cases when the special vulnerability is temporary, measures could be taken to restrain marketing to them until after such period. Accordingly, the legislatures of some states have introduced and/or passed legislation prohibiting lawyers from "soliciting the business of victims until 30 days after accidents, wrongful deaths and workplace injuries" (Ferrar, 1996). Similarly, for the grieving, some have suggested that "insurance companies may need to be restricted through legislation regarding the nature of their contacts with those in grief; specifically, the payoff of a life insurance policy should not be accompanied by an immediate attempt to encourage the survivor to reinvest. A period of time (i.e., at least a month) should elapse before the insurance company initiates a sales contact" (Gentry et al, 1994: 139). When it is desirable that individuals in this group have certain products or services prior to the vulnerability creating situation abating, other arrangements can be made for advisors to the specially vulnerable to be present or for restraints on the marketing to them.

The situation is different when the vulnerability is not temporary or relatively short-term. In such cases, it might be contended that the preceding analysis implies that the success of moral marketing cannot rely on those characteristics that render individuals specially vulnerable. Once again, this does not follow. This is too weak a claim, since the reasons for the success or failure of any marketing campaign may be difficult to determine. Further, this interpretation would also prevent a marketing program from trying to sensitively adapt to the vulnerabilities of these individuals. Finally, marketing programs which failed could not be criticized on this view. Consequently, it would permit a wide assortment of marketing approaches which attempted to tie into the targeted consumer's vulnerabilities.

Instead, a third, stronger interpretation of the above argument is required. This might be that marketers may not target those who are specially vulnerable in ways such that their marketing campaign depends upon the vulnerabilities of that specially vulnerable group. That is, in the case of the specially vulnerable, no significant aspect of a marketing campaign may rely upon the characteristics that render those individuals specially vulnerable in order to sell a product. Hence, because children are cognitively vulnerable due to their undeveloped abilities, any marketing to children must be done in ways which do not presuppose those vulnerabilities. As such, the FCC's limit on the amount of advertising on children's television programming does not directly address this issue. Instead, the content of those advertisements must be monitored so that children's special vulnerabilities are not taken advantage of. The removal of ads for vitamins and drugs from children's television programming does directly respond to the present point (Guber and Berry, 1993: 145). However, it does not go far enough. Since young children do not understand the purpose of ads (cf. McNeal, 1987: 186), they do not fulfill the qualifications of market clients. Accordingly, it is mistaken to speak of restrictions on marketing to the vulnerable (and particularly children) as violating their rights as consumers (cf. McNeal, 1987: 185). Since vulnerable children do not qualify as market clients or consumers, they cannot be said to have consumer's rights.

Admittedly, vulnerable individuals such as children will witness marketing to competent market clients. There is no way to stop this. Nor is it desirable to try to do so. But this does not mean that marketers can invoke images, symbols, etc., which are designed to persuade or influence this group of noncompetent vulnerable individuals to purchase products (or influence those who do) through the very characteristics which render them unfit to be market clients.

Accordingly, it is not morally acceptable to market goods to specially vulnerable individuals with the intention that they bring pressure to bear on genuine market clients to buy those products and with the expectation that those genuine clients will curb any problems which the use or possession of those products by the specially vulnerable would raise. Such marketing continues to target those who are not fully competent market clients. Further, to depend upon others to prevent harm which the marketing techniques may potentially engender through the purchase of various products is to seek to escape from the responsibility marketers have for the consequences of their actions. It is a case of displaced moral responsibility.

However, the interpretation of the above argument is still incomplete. What about those cases in which marketing takes place to genuine market clients, but the campaigns are (unavoidably) witnessed by the specially vulnerable who positively react upon these campaigns and seek out the marketers' products? Let us assume that R.J. Reynolds use of "Old Joe" is such an example.[9]

If the effects on the specially vulnerable in such cases were not harmful, then few moral problems would be raised. However, when they are harmful, one must ask whether there are other means of marketing the product which would not have these secondary effects? If marketers, as other individuals, are under the general obligation of doing no harm, or minimizing harm, then they should seek to alter those marketing methods even if the harm is an indirect result of the marketer's intentions. On the other hand, if it is not possible to alter the marketing methods, then means might be sought to limit the exposure, of those who are specially vulnerable to these marketing measures. In short, moral marketing requires some response other than simply ignoring the harm done to the vulnerable.

I suggest, then, that a more complete account of marketers and the vulnerable is that marketers may not market their products to target groups (specially vulnerable or not) in such a way that their marketing campaigns significantly affect vulnerable groups through their vulnerabilities. That is, there is nothing in the preceding that says that we must limit the effects of marketers' programs to their intentional aims with regard to a particular target segment. When significant spillover effects arise, they too must be taken into account. In effect, this would be to apply a form of strict targeted consumer liability.

Finally, is it morally justified to use marketing techniques which take advantage of the vulnerabilities of the specially vulnerable but which promote products which members of this group are widely acknowledged to need? For example, may marketers use techniques which young children cannot understand in order to get them to exercise properly or to eat a healthy diet? Or, may marketers use fear appeals to get the elderly to use their medications in a proper manner? Bailey has suggested that public service appeals might use fear appeals to warn certain groups of the elderly about dangers to them (Bailey, 1987: 242). But this misses the point three ways. First, if the use of such appeals violates those who have been rendered specially susceptible to it, then they ought not to be used for good (public service messages) or bad (confidence games) or even ordinary marketing. Second, if some of the elderly are so specially susceptible to messages including fear, then the use of ordinary messages concerning their problems should also reach them. Fear is not needed, they are already concerned about the content of the appeal. Third, public service messages are one kind of "communication", whereas those messages which seek to sell a product or a service are very different. Since the marketing concept speaks of marketers seeking to satisfy consumer needs some seek to use this to slide over into the public message realm. However, this is a slide that rests on an equivocation: public messages solely for the good of the recipient and private messages for the good of the sender, which may also be good for the recipient. In short, if a group is specially vulnerable, the use of unfair techniques which would not ultimately cause them harm is still the use of techniques which treat such individuals unfairly through manipulating them through their vulnerabilities. Only in very special circumstances should such marketing techniques be employed.

VI. Conclusion

A number of years ago Morgan and Riordan noted that "certain [market] segments, because of their unique characteristics or particular problems, may have to be treated with extra care" (Morgan and Riordan, 1983: 88). They went on to note that "the next logical step from a marketing perspective would be to see if the 'garden variety' category [of consumer, as opposed to commercial buyers] could be further subdivided, perhaps into normal and disadvantaged subsets" (Morgan and Riordan, 1983): 88). I have argued that we must at least distinguish between normal and vulnerable subsets.

Those who are vulnerable are subject to significant harm to their interests. However, in a market setting responsibilities to this group cannot be identified simply on the basis of the degree of harm they might experience or the total effects on all those in the market. Instead, we must look to various special conditions which render them particularly susceptible to harm and over which they have little control. Individuals so characterized are unable to fulfill additional conditions required to be market clients (or consumers).

Accordingly, marketers who treat the vulnerable like other market participants or clients treat them unfairly when they take advantage of those characteristics which render them vulnerable. Such unfairness does not require that they be actually harmed, only that they are treated like other qualified market clients. As such, marketers must attempt to understand the behavior of those market segments (or people) which are specially vulnerable and to foresee the kinds of problems and dangers which they will have with their products and marketing programs. In short, marketers must first "qualify" as genuine market clients those whom they target through advertisements, promotions, as well as in personal sales.

It follows that the marketing concept must be framed so as to recognize cases involving groups that are specially vulnerable. As marketers, and businesses more generally, are subject to product liability so too they should be subjected to targeted consumer liability. This moral doctrine would formulate the nature of marketers' responsibilities to the vulnerable. It is an account of moral responsibility that deserves our considerable attention.

Notes

[1] Goodin claims that "A is more vulnerable to B (1) the more control B has over outcomes that affect A's interests and (2) the more heavily A's interests are at stake in the outcomes that B controls. B is defined as having 'less control' the more likely it is that the outcome will occur (or not occur) whatever B does …" (Goodin, 1985: 118). Accordingly, vulnerability is to be interpreted in terms of the lack of control which one agent might have vis-à-vis another agent with regard to the fulfillment of the first agent's interests.

[2] I wish to capture here not the ideal market, but a morally justified imperfect market, filled with real participants. Further, I do not attempt to state all the necessary conditions for a capitalist market system, but only to highlight those most important for present purposes.

[3] I intend that this allows for the use of credit, loans, etc.

[4] It is conceivable that they could transform the vulnerabilities of a normal consumer into special vulnerabilities.

[5] Andreasen writes that "the swindler finds particularly good customers among the disadvantaged, since he expects the consumer not to understand much about contracts and 'formalities', such as confessions of judgment, and to be unlikely to read legal language carefully or to peruse contracts disguised as receipts" (Andreasen, 1975: 204).

[6] Vulnerability, in the grieving, involves a transformation of the self that forces people to face new consumer or market roles when they are least prepared to do so because of the associated stresses (Gentry et al, 1994: 129). This state involves "traumatic confusion" (Ibid.); a passage between two worlds; a "marginalized experience often accompanied by isolation and suspension of social status" (Ibid.).

[7] See McNeal who notes the objection that limiting the market exposure of children would rob them of "the joy of being a consumer" or "the fun and pleasure that comes with being a consumer" (McNeal, 1987: 183–184).

[8] Amongst the members of these specially vulnerable groups which may be treated unfairly by marketers Cohen lists "children, the Ghetto Dweller, the elderly, and the handicapped" (Cohen, 1974: 11).

[9] There is much dispute over whether this is the case. For present purposes I will assume that R.J. Reynolds has not directly targeted children.

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Questions for Discussion

1. The CEO of Consumer Products Unlimited (CPU) opened the annual meeting with a speech about CPU's commitment to "serving the needs of the consumer." At the same meeting, she announced the introduction of a new bath soap into the company's product line, which already contained 11 soaps. She explained that it had the same formula as three of CPU's other soaps, but it would have a French name, would cost more, and would appeal to a more sophisticated consumer. The marketing division, she said, was already beginning an aggressive ad campaign. Do consumers *need* CPU's new soap? Do they want it? If so, in what sense? If not, why not? Would CPU's ads be deceptive if they claimed that the soap contained "unique European skin-care ingredients"? What would Galbraith say?
2. Galbraith claims that US society is rich in private goods, such as those produced by CPU, but poor in public goods such as clean air, parks, and public transportation. According to Galbraith, does this mean that people want public goods less than they want private goods? Explain. Would it make sense to conduct advertising campaigns for public goods? Why or why not?
3. Which ofVelasquez's three views of a business firm's duties to its customers do you agree with: contract view; due care; or social cost? Should we not hold consumers accountable to at least some degree over the careful use of the products they purchase?
4. Evaluate Nestlé's sale of infant formula in developing countries as discussed in the case by James Post in light of Brenkert's discussion of the morality of marketing to vulnerable groups.

8

The Environment and Sustainability

Morality, Money, and Motor Cars

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Environmentalists frequently argue that business has special obligations to protect the environment. Although I agree with the environmentalists on this point, I do not agree with them as to where the obligations lie. Business does not have an obligation to protect the environment over and above what is required by law; however, it does have a moral obligation to avoid intervening in the political arena in order to defeat or weaken environmental legislation. In developing this thesis, several points are in order. First, many businesses have violated important moral obligations, and the violation has had a severe negative impact on the environment. For example, toxic waste haulers have illegally dumped hazardous material, and the environment has been harmed as a result. One might argue that those toxic waste haulers who have illegally dumped have violated a special obligation to the environment. Isn't it more accurate to say that these toxic waste haulers have violated their obligation to obey the law and that in this case the law that has been broken is one pertaining to the environment? Businesses have an obligation to obey the law – environmental laws and all others. Since there are many well-publicized cases of business having broken environmental laws, it is easy to think that business has violated some special obligations to the environment. In fact, what business has done is to disobey the law. Environmentalists do not need a special obligation to the environment to protect the environment against illegal business activity; they need only insist that business obey the laws.

Business has broken other obligations beside the obligation to obey the law and has harmed the environment as a result. Consider the grounding of the Exxon oil tanker *Valdez* in Alaska. That grounding was allegedly caused by the fact that an inadequately trained crewman was piloting the tanker while the captain was below deck and had been drinking. What needs to be determined is whether Exxon's policies and procedures were sufficiently lax so that it could be

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said Exxon was morally at fault. It might be that Exxon is legally responsible for the accident under the doctrine of respondent superior, but Exxon is not thereby morally responsible. Suppose, however, that Exxon's policies were so lax that the company could be characterized as morally negligent. In such a case, the company would violate its moral obligation to use due care and avoid negligence. Although its negligence was disastrous to the environment. Exxon would have violated no special obligation to the environment. It would have been morally negligent.

A similar analysis could be given to the environmentalists' charges that Exxon's cleanup procedures were inadequate. If the charge is true, either Exxon was morally at fault or not. If the procedures had not been implemented properly by Exxon employees, then Exxon is legally culpable, but not morally culpable. On the other hand, if Exxon lied to government officials by saying that its policies were in accord with regulations and/or were ready for emergencies of this type, then Exxon violated its moral obligation to tell the truth. Exxon's immoral conduct would have harmed the environment, but it violated no special obligation to the environment. More important, none is needed. Environmentalists, like government officials, employees, and stockholders expect that business firms and officials have moral obligations to obey the law, avoid negligent behavior, and tell the truth. In sum, although many business decisions have harmed the environment, these decisions violated no environmental moral obligations. If a corporation is negligent in providing for worker safety, we do not say the corporation violated a special obligation to employees; we say that it violated its obligation to avoid negligent behavior.

The crucial issues concerning business obligations to the environment focus on the excess use of natural resources (the dwindling supply of oil and gas, for instance) and the externalities of production (pollution, for instance). The critics of business want to claim that business has some special obligation to mitigate or solve these problems. I believe this claim is largely mistaken. If business does have a special obligation to help solve the environmental crisis, that obligation results from the special knowledge that business firms have. If they have greater expertise than other constituent groups in society, then it can be argued that, other things being equal, business's responsibilities to mitigate the environmental crisis are somewhat greater. Absent this condition, business's responsibility is no greater than and may be less than that of other social groups. What leads me to think that the critics of business are mistaken?

William Frankena distinguished obligations in an ascending order of the difficulty in carrying them out: avoiding harm, preventing harm, and doing good.[1] The most stringent requirement, to avoid harm, insists no one has a right to render harm on another unless there is a compelling, overriding moral reason to do so. Some writers have referred to this obligation as the moral minimum. A corporation's behavior is consistent with the moral minimum if it causes no avoidable harm to others.

Preventing harm is a less stringent obligation, but sometimes the obligation to prevent harm may be nearly as strict as the obligation to avoid harm. Suppose you are the only person passing a 2-foot-deep working pool where a young child is drowning. There is no one else in the vicinity. Don't you have a strong moral obligation to prevent the child's death? Our obligation to prevent harm is not unlimited, however. Under what conditions must we be good Samaritans? Some have argued that four conditions must exist before one is obligated to prevent harm: capability, need, proximity, and last resort.[2] These conditions are all met with the case of the drowning child. There is obviously a need that you can meet since you are both in the vicinity and have the resources to prevent the drowning with little effort; you are also the last resort.

The least strict moral obligation is to do good – to make contributions to society or to help solve problems (inadequate primary schooling in the inner cities, for example). Although corporations may have some minimum obligation in this regard based on an argument from corporate citizenship, the obligations of the corporation to do good cannot be expanded without limit. An injunction to assist in solving societal problems makes impossible demands on a corporation because at the practical level, it ignores the impact that such activities have on profit.

It might seem that even if this descending order of strictness of obligations were accepted, obligations toward the environment would fall into the moral minimum category. After all, the depletion of natural resources and pollution surely harm the environment. If so, wouldn't the obligations business has to the environment be among the strictest obligations a business can have?

Suppose, however, that a businessperson argues that the phrase "avoid harm" usually applies to human beings. Polluting a lake is not like injuring a human with a faulty product. Those who coined the phrase *moral minimum* for use in the business context defined harm as "particularly including activities which violate or frustrate the enforcement of rules of domestic or institutional law intended to protect individuals against prevention of health, safety or basic freedom."[3] Even if we do not insist that the violations be violations of a rule of law, polluting a lake would not count as a harm under this definition. The environmentalists would respond that it would. Polluting the lake may be injuring people who might swim in or eat fish from it. Certainly it would be depriving people of the freedom to enjoy the lake. Although the environmentalist is correct, especially if we grant the legitimacy of a human right to a clean environment, the success of this reply is not enough to establish the general argument.

Consider the harm that results from the production of automobiles. We know statistically that about 50,000 persons per year will die and that nearly 250,000 others will be seriously injured in automobile accidents in the United States alone. Such death and injury, which is harmful, is avoidable. If that is the case, doesn't the avoid-harm criterion require that the production of automobiles for profit cease? Not really. What such arguments point out is that some refinement of the moral minimum standard needs to take place. Take the automobile example. The automobile is itself a good-producing instrument. Because of the advantages of automobiles, society accepts the possible risks that go in using them. Society also accepts many other types of avoidable harm. We take certain risks – ride in planes, build bridges, and mine coal – to pursue advantageous goals. It seems that the high benefits of some activities justify the resulting harms. As long as the risks are known, it is not wrong that some avoidable harm be permitted so that other social and individual goals can be achieved. The avoidable-harm criterion needs some sharpening.

Using the automobile as a paradigm, let us consider the necessary refinements for the avoid-harm criterion. It is a fundamental principle of ethics that "ought" implies "can." That expression means that you can be held morally responsible only for events within your power. In the ought-implies-can principle, the overwhelming majority of highway deaths and injuries is not the responsibility of the automaker. Only those deaths and injuries attributable to unsafe automobile design can be attributed to the automaker. The ought-implies-can principle can also be used to absolve the auto companies of responsibility for death and injury from safety defects that the automakers could not reasonably know existed. The company could not be expected to do anything about them.

Does this mean that a company has an obligation to build a car as safe as it knows how? No. The standards for safety must leave the product's cost within the price range of the consumer ("ought implies can" again). Comments about engineering and equipment capability are obvious enough. But for a business, capability is also a function of profitability. A company that builds a maximally safe car at a cost that puts it at a competitive disadvantage and hence threatens its survival is building a safe car that lies beyond the capability of the company.

Critics of the automobile industry will express horror at these remarks, for by making capability a function of profitability, society will continue to have avoidable deaths and injuries; however, the situation is not as dire as the critics imagine. Certainly capability should not be sacrificed completely so that profits can be maximized. The decision to build products that are cheaper in cost out are not maximally safe is a social decision that has widespread support. The arguments occur over the line between safety and cost. What we have is a classical trade-off situation. What is desired is some appropriate mix between engineering safety and consumer demand. To say there must be some mix between engineering safety and consumer demand is not to justify all the decisions made by the automobile companies. Ford Motor Company made a morally incorrect choice in placing Pinto gas tanks where it did. Consumers were uninformed, the record of the Pinto in rear-end collisions was worse than that of competitors, and Ford fought government regulations.

Let us apply the analysis of the automobile industry to the issue before us. That analysis shows that an automobile company does not violate its obligation to avoid harm and hence is not in violation of the moral minimum if the trade-off between potential harm and the utility of the products rests on social consensus and competitive realities.

As long as business obeys the environmental laws and honors other standard moral obligations, most harm done to the environment by business has been accepted by society. Through their decisions in the marketplace, we can see that most consumers are unwilling to pay extra for products that are more environmentally friendly than less friendly competitive products. Nor is there much evidence that consumers are willing to conserve resources, recycle, or tax themselves for environmental causes.

Consider the following instances reported in the *Wall Street Journal*.[4] The restaurant chain Wendy's tried to replace foam plates and cups with paper, but customers in the test markets balked. Procter and Gamble offered Downey fabric softener in concentrated form that requires less packaging than ready-to-use products; however the concentrate version is less convenient because it has to be mixed with water. Sales have been poor. Procter and Gamble manufactures Vizir and Lenor brands of detergents in concentrate form, which the customer mixes at home in reusable bottles. Europeans will take the trouble; Americans will not. Kodak tried to eliminate its yellow film boxes but met customer resistance. McDonald's has been testing mini-incinerators that convert trash into energy but often meets opposition from community groups that fear the incinerators will pollute the air. A McDonald's spokesperson points out that the emissions are mostly carbon dioxide and water vapor and are "less offensive than a barbecue." Exxon spent approximately $9,200,000 to "save" 230 otters ($40,000 for each otter). Otters in captivity cost $800. Fishermen in Alaska are permitted to shoot otters as pests.[5] Given these facts, doesn't business have every right to assume that public tolerance for environmental damage is quite high, and hence current legal activities by corporations that harm the environment do not violate the avoid-harm criterion?

Recently environmentalists have pointed out the environmental damage caused by the widespread use of disposable diapers. Are Americans ready to give them up and go back to cloth diapers and the diaper pail? Most observers think not. Procter and Gamble is not violating the avoid-harm criterion by manufacturing Pampers. Moreover, if the public wants cloth diapers, business certainly will produce them. If environmentalists want business to produce products that are friendlier to the environment, they must convince Americans to purchase them. Business will respond to the market. It is the consuming public that has the obligation to make the trade-off between cost and environmental integrity.

Data and arguments of the sort described should give environmental critics of business pause. Nonetheless, these critics are not without counter-responses. For example, they might respond that public attitudes are changing. Indeed, they point out, during the Reagan deregulation era, the one area where the public supported government regulations was in the area of environmental law. In addition, *Fortune* predicts environmental integrity as the primary demand of society on business in the 1990s.[6]

More important, they might argue that environmentally friendly products are at a disadvantage in the marketplace because they have public good characteristics. After all, the best situation for the individual is one where most other people use environmentally friendly products but he or she does not, hence reaping the benefit of lower cost and convenience. Since everyone reasons this way, the real demand for environmentally friendly products cannot be registered in the market. Everyone is understating the value of his or her preference for environmentally friendly products. Hence, companies cannot conclude from market behavior that the environmentally unfriendly products are preferred.

Suppose the environmental critics are right that the public goods characteristic of environmentally friendly products creates a market failure. Does that mean the companies are obligated to stop producing these environmentally unfriendly products? I think not, and I propose that we use the four conditions attached to the prevent-harm obligation to show why not. There is a need, and certainly corporations that cause environmental problems are in proximity. However, environmentally clean firms, if there are any, are not in proximity at all, and most business firms are not in proximity with respect to most environmental problems. In other words, the environmental critic must limit his or her argument to the environmental damage a business actually causes. The environmentalist might argue that Procter and Gamble ought to do something about Pampers; I do not see how an environmentalist can use the avoid-harm criterion to argue that Procter and Gamble should do something about acid rain. But even narrowing the obligation to damage actually caused will not be sufficient to establish an obligation to pull a product from the market because it damages the environment or even to go beyond what is legally required to protect the environment. Even for damage actually done, both the high cost of protecting the environment and the competitive pressures of business make further action to protect the environment beyond the capability of business. This conclusion would be more serious if business were the last resort, but it is not.

Traditionally it is the function of the government to correct for market failure. If the market cannot register the true desires of consumers, let them register their preferences in the political arena. Even fairly conservative economic thinkers allow government a legitimate role in correcting market failure. Perhaps the responsibility for energy conservation and pollution control belongs with the government.

Although I think consumers bear a far greater responsibility for preserving and protecting the environment than they have actually exercised, let us assume that the basic responsibility rests with the government. Does that let business off the hook? No. Most of business's unethical conduct regarding the environment occurs in the political arena.

Far too many corporations try to have their cake and eat it too. They argue that it is the job of government to correct for market failure and then use their influence and money to defeat or water down regulations designed to conserve and protect the environment.[7] They argue that consumers should decide how much conservation and protection the environment should have, and then they try to interfere with the exercise of that choice in the political arena. Such behavior is inconsistent and ethically inappropriate. Business has an obligation to avoid intervention in the political process for the purpose of defeating and weakening environmental regulations. Moreover, this is a special obligation to the environment since business does not have a general obligation to avoid pursuing its own parochial interests in the political arena. Business need do nothing wrong when it seeks to influence tariffs, labor policy, or monetary policy. Business does do something wrong when it interferes with the passage of environmental legislation. Why?

First, such a noninterventionist policy is dictated by the logic of the business's argument to avoid a special obligation to protect the environment. Put more formally:

1. Business argues that it escapes special obligations to the environment because it is willing to respond to consumer preferences in this matter.
2. Because of externalities and public goods considerations, consumers cannot express their preferences in the market.
3. The only other viable forum for consumers to express their preferences is in the political arena.
4. Business intervention interferes with the expression of these preferences.
5. Since point 4 is inconsistent with point 1, business should not intervene in the political process.

The importance of this obligation in business is even more important when we see that environmental legislation has special disadvantages in the political arena. Public choice reminds us that the primary interest of politicians is being reelected. Government policy will be skewed in favor of policies that provide benefits to an influential minority as long as the greater costs are widely dispersed. Politicians will also favor projects where benefits are immediate and where costs can be postponed to the future. Such strategies increase the likelihood that a politician will be reelected.

What is frightening about the environmental crisis is that both the conservation of scarce resources and pollution abatement require policies that go contrary to a politician's self-interest. The costs of cleaning up the environment are immediate and huge, yet the benefits are relatively long range (many of them exceedingly long range). Moreover, a situation where the benefits are widely dispersed and the costs are large presents a twofold problem. The costs are large enough so that all voters will likely notice them and in certain cases are catastrophic for individuals (e.g., for those who lose their jobs in a plant shutdown).

Given these facts and the political realities they entail, business opposition to environmental legislation makes a very bad situation much worse. Even if consumers could be persuaded to take environmental issues more seriously, the externalities, opportunities to free ride, and public goods characteristics of the environment make it difficult for even enlightened consumers to express their true preference for the environment in the market. The fact that most environmental legislation trades immediate costs for future benefits makes it difficult for politicians concerned about reelection to support it. Hence it is also difficult for enlightened consumers to have their preferences for a better environment honored in the political arena. Since lack of business intervention seems necessary, and might even be sufficient, for adequate environmental legislation, it seems business has an obligation not to intervene. Nonintervention would prevent the harm of not having the true preferences of consumers for a clean environment revealed. Given business's commitment to satisfying preferences, opposition to having these preferences expressed seems inconsistent as well.

The extent of this obligation to avoid intervening in the political process needs considerable discussion by ethicists and other interested parties. Businesspeople will surely object that if they are not permitted to play a role, Congress and state legislators will make decisions that will put them at a severe competitive disadvantage. For example, if the United States develops stricter environmental controls than other countries do, foreign imports will have a competitive advantage over domestic products. Shouldn't business be permitted to point that out? Moreover, any legislation that places costs on one industry rather than another confers advantages on other industries. The cost to the electric utilities from regulations designed to reduce the pollution that causes acid rain will give advantages to natural gas and perhaps even solar energy. Shouldn't the electric utility industry be permitted to point that out?

These questions pose difficult questions, and my answer to them should be considered highly tentative. I believe the answer to the first question is "yes" and the answer to the second is "no." Business does have a right to insist that the regulations apply to all those in the industry. Anything else would seem to violate norms of fairness. Such issues of fairness do not arise in the second case. Since natural gas and solar do not contribute to acid rain and since the costs of acid rain cannot be fully captured in the market, government intervention through regulation is simply correcting a market failure. With respect to acid rain, the electric utilities do have an advantage they do not deserve. Hence they have no right to try to protect it.

Legislative bodies and regulatory agencies need to expand their staffs to include technical experts, economists, and engineers so that the political process can be both neutral and highly informed about environmental matters. To gain the respect of business and the public, its performance needs to improve. Much more needs to be said to make any contention that business ought to stay out of the political debate theoretically and practically possible. Perhaps these suggestions point the way for future discussion.

Ironically business might best improve its situation in the political arena by taking on an additional obligation to the environment. Businesspersons often have more knowledge about environmental harms and the costs of cleaning them up. They may often have special knowledge about how to prevent environmental harm in the first place. Perhaps business has a special duty to educate the public and to promote environmentally responsible behavior.

Business has no reticence about leading consumer preferences in other areas. Advertising is a billion-dollar industry. Rather than blaming consumers for not purchasing environmentally friendly products, perhaps some businesses might make a commitment to capture the environmental niche. I have not seen much imagination on the part of business in this area. Far too many advertisements with an environmental message are reactive and public relations driven. Recall those by oil companies showing fish swimming about the legs of oil rigs. An educational campaign that encourages consumers to make environmentally friendly decisions in the marketplace would limit the necessity for business activity in the political arena. Voluntary behavior that is environmentally friendly is morally preferable to coerced behavior. If business took greater responsibility for educating the public, the government's responsibility would be lessened. An educational campaign aimed at consumers would likely enable many businesses to do good while simultaneously doing very well.

Hence business does have obligations to the environment, although these obligations are not found where the critics of business place them. Business has no special obligation to conserve natural resources or to stop polluting over and above its legal obligations. It does have an obligation to avoid intervening in the political arena to oppose environmental regulations, and it has a positive obligation to educate consumers. The benefits of honoring these obligations should not be underestimated.

Notes

[1] The title for this chapter was suggested by Susan Bernick, a graduate student in the University of Minnesota philosophy department.

[2] William Frankena, *Ethics*, 2d ed. (Englewood Cliffs, N.J.: Prentice Hall, 1973), p. 47. Actually Frankena has four principles of *prima facie* duty under the principle of beneficence: one ought not to inflict evil or harm; one ought to prevent evil or harm; one ought to remove evil; and one ought to do or promote good.

[3] John G. Simon, Charles W. Powers, and Jon P. Gunneman. *The Ethical Investor: Universities and Corporate Responsibility* (New Haven, Conn.:Yale University Press, 1972), pp. 22–25.

[4] Ibid., p. 21.

[5] Alicia Swasy,"For Consumers, Ecology Comes Second," *Wall Street Journal*, August 23, 1988, p. Bl.

[6] Jerry Alder, "Alaska after Exxon," *Newsweek*, September 18, 1989, p. 53.

[7] Andrew Kupfer, "Managing Now for the 1990s," *Fortune*, September 26, 1988, pp. 46–47.

[8] I owe this point to Gordon Rands, a Ph.D. student in the Carlson School of Management. Indeed the tone of the chapter has shifted considerably as a result of his helpful comments.

Business and Environmental Ethics

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The business ethics movement, from my perspective, is still on the march. And the environmental movement, after being somewhat silent for the past twenty years, has once again captured our attentions – promising to be a major social force in the 1990s. Much will be written in the next few years trying to tie together these two movements.This is one such effort.

Concern over the environment is not new.Warnings came out of the 1960s in the form of burning rivers, dying lakes, and oil-fouled oceans. Radioactivity was found in our food, DDT in mother's milk, lead and mercury in our water. Every breath of air in the North American hemisphere was reported as contaminated. Some said these were truly warnings from Planet Earth of eco-catastrophe, unless we could find limits to our growth and changes in our lifestyle.

Over the past few years Planet Earth began to speak to us even more loudly than before, and we began to listen more than before. The message was ominous, somewhat akin to God warning Noah. It spoke through droughts, heat waves, and forest fires, raising fears of global warming due to the buildup of carbon dioxide and other gases in the atmosphere. It warned

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us by raw sewage and medical wastes washing up on our beaches, and by devastating oil spills – one despoiling Prince William Sound and its wildlife to such an extent that it made us weep. It spoke to us through increased skin cancers and discoveries of holes in the ozone layer caused by our use of chlorofluorocarbons. It drove its message home through the rapid and dangerous cutting and burning of our primitive forests at the rate of one football field a second, leaving us even more vulnerable to greenhouse gases like carbon dioxide and eliminating scores of irreplaceable species daily. It rained down on us in the form of acid, defoliating our forests and poisoning our lakes and streams. Its warnings were found on barges roaming the seas for places to dump tons of toxic incinerator ash. And its message exploded in our faces at Chernobyl and Bhopal, reminding us of past warnings at Three Mile Island and Love Canal.

Senator Albert Gore said in 1988: "The fact that we face an ecological crisis without any precedent in historic times is no longer a matter of any dispute worthy of recognition."[1] The question, he continued, is not whether there is a problem, but how we will address it. This will be the focal point for a public policy debate which requires the full participation of two of its major players – business and government. The debate must clarify such fundamental questions as: (1) What obligation does business have to help with our environmental crisis? (2) What is the proper relationship, between business and government, especially when faced with a social problem of the magnitude of the environment crisis? And (3) what rationale should be used for making and justifying decisions to protect the environment? Corporations, and society in general for that matter, have yet to answer these questions satisfactorily. In the first section of this paper I will briefly address the first two questions. In the final two sections I will say a few things about the third question.

I.

In a 1989 keynote address before the "Business, Ethics and the Environment" conference at the Center for Business Ethics, Norman Bowie offered some answers to the first two questions.

> Business does not have an obligation to protect the environment over and above what is required by law; however, it does have a moral obligation to avoid intervening in the political arena in order to defeat or weaken environmental legislation.[2]

I disagree with Bowie on both counts.

Bowie's first point is very Friedmanesque.[3] The social responsibility of business is to produce goods and services and to make profit for its shareholders, while playing within the rules of the market game. These rules, including those to protect the environment, are set by the government and the courts. To do more than is required by these rules is, according to this position, unfair to business. In order to perform its proper function, every business must respond to the market and operate in the same arena as its competitors. As Bowie puts this:

> An injunction to assist in solving societal problems [including depletion of natural resources. and pollution] makes impossible demands on a corporation because, at the practical level, it ignores the impact that such activities have on profit.[4]

If, as Bowie claims, consumers are not willing to respond to the cost and use of environmentally friendly products and actions, then it is not the responsibility of business to respond or correct such market failure.

Bowie's second point is a radical departure from this classical position in contending that business should not lobby against the government's process to set environmental regulations. To quote Bowie:

> Far too many corporations try to have their cake and eat it too. They argue that it is the job of government to correct for market failure and then they use their influence and money to defeat or water down regulations designed to conserve and protect the environment.[5]

Bowie only recommends this abstinence of corporate lobbying in the case of environmental regulations. He is particularly concerned that politicians, ever mindful of their reelection status, are already reluctant to pass environmental legislation which has huge immediate costs and in most cases very long-term benefits. This makes the obligations of business to refrain from opposing such legislation a justified special case.

I can understand why Bowie argues these points. He seems to be responding to two extreme approaches, both of which are inappropriate. Let me illustrate these extremes by the following two stories.

At the Center's First National Conference on Business Ethics, Harvard Business School Professor George Cabot Lodge told of a friend who owned a paper company on the banks of a New England stream. On the first Earth Day in 1970, his friend was converted to the cause of environmental protection. He became determined to stop his company's pollution of the stream, and marched off to put his newfound religion into action. Later, Lodge learned his friend went broke, so he went to investigate. Radiating a kind of ethical purity, the friend told Lodge that he spent millions to stop the pollution and thus could no longer compete with other firms that did not follow his example. So the company went under, 500 people lost their jobs, and the stream remained polluted.

When Lodge asked why his friend hadn't sought help from the state or federal government for stricter standards for everyone, the man replied that was not the American way, that government should not interfere with business activity, and that private enterprise could do the job alone. In fact, he felt it was the social responsibility of business to solve environmental problems, so he was proud that he had set an example for others to follow.

The second story portrays another extreme. A few years ago "Sixty Minutes" interviewed a manager of a chemical company that was discharging effluent into a river in upstate New York. At the time, the dumping was legal, though a bill to prevent it was pending in Congress. The manager remarked that he hoped the bill would pass, and that he certainly would support it as a responsible citizen. However, he also said he approved of his company's efforts to defeat the bill and of the firm's policy of dumping wastes in the meantime. After all, isn't the proper role of business to make as much profit as possible within the bounds of law? Making the laws – setting the rules of the game – is the role of government, not business. While wearing his business hat the manager had a job to do, even if it meant doing something that he strongly opposed as a private citizen.

Both stories reveal incorrect answers to the questions posed earlier, the proof of which is found in the fact that neither the New England stream nor the New York river was made any cleaner. Bowie's points are intended to block these two extremes. But to avoid these extremes, as Bowie does, misses the real managerial and ethical failure of the stories. Although the paper company owner and the chemical company manager had radically different views of the ethical responsibilities of business, both saw business and government performing separate roles, and neither felt that business ought to cooperate with government to solve environmental problems.[6]

If the business ethics movement has led us anywhere in the past fifteen years, it is to the position that business has an ethical responsibility to become a more active partner in dealing with social concerns. Business must creatively find ways to become a part of solutions, rather than being a part of problems. Corporations can and must develop a conscience, as Ken Goodpaster and others have argued – and this includes an environmental conscience.[7] Corporations should not isolate themselves from participation in solving our environmental problems, leaving it up to others to find the answers and to tell them what not to do.

Corporations have special knowledge, expertise, and resources which are invaluable in dealing with the environmental crisis. Society needs the ethical vision and cooperation of all its players to solve its most urgent problems, especially one that involves the very survival of the planet itself. Business must work with government to find appropriate solutions. It should lobby for good environmental legislation and lobby against bad legislation, rather than isolating itself from the legislative process as Bowie suggests. It should not be ethically quixotic and try to go it alone, as our paper company owner tried to do, nor should it be ethically inauthentic and fight against what it believes to be environmentally sound policy, as our chemical company manager tried to do. Instead business must develop and demonstrate moral leadership.

There are examples of corporations demonstrating such leadership, even when this has been a risk to their self-interest. In the area of environmental moral leadership one might cite DuPont's discontinuing its Freon products, a $750-million-a-year-business, because of their possible negative effects on the ozone layer, and Procter and Gamble's manufacture of concentrated fabric softener and detergents which require less packaging. But some might argue, as Bowie does, that the real burden for environmental change lies with consumers, not with corporations. If we as consumers are willing to accept the harm done to the environment by favoring environmentally unfriendly products, corporations have no moral obligation to change so long as they obey environmental law. This is even more the case, so the argument goes, if corporations must take risks or sacrifice profits to do so.

This argument fails to recognize that we quite often act differently when we think of ourselves as *consumers* than when we think of ourselves as *citizens*. Mark Sagoff, concerned about our over-reliance on economic solutions, clearly characterizes this dual nature of our decision making.[8] As consumers, we act more often than not for ourselves; as citizens, we take on a broader vision and do what is in the best interests of the community. I often shop for things I don't vote for. I might support recycling referendums, but buy products in nonreturnable bottles. I am not proud of this, but I suspect this is more true of most of us than not. To stake our environmental future on our consumer willingness to pay is surely shortsighted, perhaps even disastrous.

I am not saying that we should not work to be ethically committed citizen consumers, and investors for that matter. I agree with Bowie that "consumers bear a far greater responsibility for preserving and protecting the environment than they have actually exercised,"[9] but activities which affect the environment should not be left up to what we, acting as consumers, are willing to tolerate or accept. To do this would be to use a market-based method of reasoning to decide on an issue which should be determined instead on the basis of our ethical responsibilities as a member of a social community.

Furthermore, consumers don't make the products, provide the services, or enact the legislation which can be either environmentally friendly or unfriendly. Grass roots boycotts and lobbying efforts are important, but we also need leadership and mutual cooperation from business and government in setting forth ethical environmental policy. Even Bowie admits that perhaps business has a responsibility to educate the public and promote environmentally responsible behavior. But I am suggesting that corporate moral leadership goes far beyond public educational campaigns. It requires moral vision, commitment, and courage, and involves risk and sacrifice. I think business is capable of such a challenge. Some are even engaging in such a challenge. Certainly the business ethics movement should do nothing short of encouraging such leadership. I feel morality demands such leadership.

II.

If business has an ethical responsibility to the environment which goes beyond obeying environmental law, what criterion should be used to guide and justify such action? Many corporations are making environmentally friendly decisions where they see there are profits to be made by doing so. They are wrapping themselves in green where they see a green bottom line as a consequence. This rationale is also being used as a strategy by environmentalists to encourage more businesses to become environmentally conscientious. In December 1989 the highly respected Worldwatch Institute published an article by one of its senior researchers entitled "Doing Well by Doing Good" which gives numerous examples of corporations improving their pocketbooks by improving the environment. It concludes by saying that "fortunately, businesses that work to preserve the environment can also make a buck."[10]

In a recent Public Broadcast Corporation documentary entitled "Profit the Earth," several efforts are depicted of what is called the "new environmentalism" which induces corporations to do things for the environment by appealing to their self-interest. The Environmental Defense Fund is shown encouraging agribusiness in Southern California to irrigate more efficiently and profit by selling the water saved to the city of Los Angeles. This in turn will help save Mono Lake. EDF is also shown lobbying for emissions trading that would allow utility companies which are under their emission allotments to sell their "pollution rights" to those companies which are over their allotments. This is for the purpose of reducing acid rain. Thus the frequent strategy of the new environmentalists is to get business to help solve environmental problems by finding profitable or virtually costless ways for them to participate. They feel that compromise, not confrontation, is the only way to save the earth. By using the tools of the free enterprise system, they are in search of win-win solutions, believing that such solutions are necessary to take us beyond what we have so far been able to achieve.

I am not opposed to these efforts; in most cases I think they should be encouraged. There is certainly nothing wrong with making money while protecting the environment, just as there is nothing wrong with feeling good about doing one's duty. But if business is adopting or being encouraged to adopt the view that good environmentalism is good business, then I think this poses a danger for the environmental ethics movement – a danger which has an analogy in the business ethics movement.

As we all know, the position that good ethics is good business is being used more and more by corporate executives to justify the building of ethics into their companies and by business ethics consultants to gain new clients. For example, the Business Roundtable's *Corporate Ethics* report states:

> The corporate community should continue to refine and renew efforts to improve performance and manage change effectively through programs in corporate ethics … corporate ethics is a strategic key to survival and profitability in this era of fierce competitiveness in a global economy.[11]

And, for instance, the book *The Power of Ethical Management* by Kenneth Blanchard and Norman Vincent Peale states in big red letters on the cover jacket that "Integrity Pays! You Don't Have to Cheat to Win." The blurb on the inside cover promises that the book "gives hard-hitting, practical, *ethical* strategies that build profits, productivity, and long-term success."[12] Who would have guessed that business ethics could deliver all that! In such ways business ethics gets marketed as the newest cure for what ails corporate America.

Is the rationale that good ethics is good business a proper one for business ethics? I think not. One thing that the study of ethics has taught us over the past 2500 years is that being ethical may on occasion require that we place the interests of others ahead of or at least on par with our own interests. And this implies that the ethical thing to do, the morally right thing to do, may not be in our own self-interest. What happens when the right thing is not the best thing for the business?

Although in most cases good ethics may be good business, it should not be advanced as the only or even the main reason for doing business ethically. When the crunch comes, when ethics conflicts with the firm's interests, any ethics program that has not already faced up to this possibility is doomed to fail because it will undercut the rationale of the program itself. We should promote business ethics, not because good ethics is good business, but because we are morally required to adopt the moral point of view in all our dealings – and business is no exception. In business, as in all other human endeavors, we must be prepared to pay the costs of ethical behavior.

There is a similar danger in the environmental movement with corporations choosing or being wooed to be environmentally friendly on the grounds that it will be in their self-interest. There is the risk of participating in the movement for the wrong reasons. But what does it matter if business cooperates for reasons other than the right reasons, as long as it cooperates? It matters if business believes or is led to believe that it only has a duty to be environmentally conscientious in those cases where such actions either require no sacrifice or actually make a profit. And I am afraid this is exactly what is happening. I suppose it wouldn't matter if the environmental cooperation of business was only needed in those cases where it was also in business' self-interest. But this is surely not the case, unless one begins to really reach and talk about that amorphous concept "long-term" self-interest. Moreover, long-term interests, I suspect, are not what corporations or the new environmentalists have in mind in using self-interest as a reason for environmental action.

I am not saying we should abandon attempts to entice corporations into being ethical, both environmentally and in other ways, by pointing out and providing opportunities where good ethics is good business. And there are many places where such attempts fit well in both the business and environmental ethics movements. But we must be careful not to cast this as the proper guideline for business' ethical responsibility. Because when it is discovered that many ethical actions are not necessarily good for business, at least in the short-run, then the rationale based on self-interest will come up morally short, and both ethical movements will be seen as deceptive and shallow.

III.

What is the proper rationale for responsible business action toward the environment? A minimalist principle is to refrain from causing or prevent the causing of unwarranted harm, because failure to do so would violate certain moral rights not to be harmed. There is, of course, much debate over what harms are indeed unwarranted due to conflict of rights and questions about whether some harms are offset by certain benefits. Norm Bowie, for example, uses the harm principle, but contends that business does not violate it as long as it obeys environmental law. Robert Frederick, on the other hand, convincingly argues that the harm principle morally requires business to find ways to prevent certain harm it causes even if such harm violates no environmental law.[13]

However, Frederick's analysis of the harm principle is largely cast in terms of harm caused to human beings and the violation of rights of human beings. Even when he hints at the possible moral obligation to protect the environment when no one is caused unwarranted harm, he does so by suggesting that we look to what we, as human beings, value.[14] This is very much in keeping with a humanistic position of environmental ethics which claims that only human beings have rights or moral standing because only human beings have intrinsic value. We may have duties with regard to nonhuman things (penguins, trees, islands, etc.) but only if such duties are derived from duties we have toward human beings. Nonhuman things are valuable only if valued by human beings.

Such a position is in contrast to a naturalistic view of environmental ethics which holds that natural things other than human beings are intrinsically valuable and have, therefore, moral standing. Some naturalistic environmentalists only include other sentient animals in the framework of being deserving of moral consideration; others include all things which are alive or which are an integral part of an ecosystem. This latter view is sometimes called a biocentric environmental ethic as opposed to the homocentric view which sees all moral claims in terms of human beings and their interests. Some characterize these two views as deep *versus* shallow ecology.

The literature on these two positions is vast and the debate is ongoing. The conflict between them goes to the heart of environmental ethics and is crucial to our making of environmental policy and to our perception of moral duties to the environment, including business. I strongly favor the biocentric view. And although this is not the place to try to adequately argue for it, let me unfurl its banner for just a moment.

A version of R. Routley's "last man" example[15] might go something like this: Suppose you were the last surviving human being and were soon to die from nuclear poisoning, as all other human and sentient animals have died before you. Suppose also that it is within your power to destroy all remaining life, or to make it simpler, the last tree which could continue to flourish and propagate if left alone. Furthermore you will not suffer if you do not destroy it. Would you do anything wrong by cutting it down? The deeper ecological view would say yes because you would be destroying something that has value in and of itself, thus making the world a poorer place.

It might be argued that the only reason we may find the tree valuable is because human beings generally find trees of value either practically or aesthetically, rather than the atoms or molecules they might turn into if changed from their present form. The issue is whether the tree has value only in its relation to human beings or whether it has a value deserving of moral consideration inherent in itself in its present form. The biocentric position holds that when we find something wrong with destroying the tree, as we should, we do so because we are responding to an intrinsic value in the natural object, not to a value we give to it. This is a view which argues against a humanistic environmental ethic and which urges us to channel our moral obligations accordingly.

Why should one believe that nonhuman living things or natural objects forming integral parts of ecosystems have intrinsic value? One can respond to this question by pointing out the serious weaknesses and problems of human chauvinism.[16] More complete responses lay out a framework of concepts and beliefs which provides a coherent picture of the biocentric view with human beings as a part of a more holistic value system. But the final answer to the question hinges on what criterion one decides to use for determining moral worth – rationality, sentience, or a deeper biocentric one. Why should we adopt the principle of attributing intrinsic value to all living beings, or even to all natural objects, rather than just to human beings? I suspect Arne Naess gives as good an answer as can be given.

> Faced with the ever returning question of 'Why?,' we have to stop somewhere. Here is a place where we well might stop. We shall admit that the value in itself is something shown in intuition. We attribute intrinsic value to ourselves and our nearest, and the validity of further identification can be contested, and *is* contested by many. The negation may, however, also be attacked through a series of 'whys?' Ultimately, we are in the same human predicament of having to start somewhere, at least for the moment. We must stop somewhere and treat where we then stand as a foundation.[17]

In the final analysis, environmental biocentrism is adopted or not depending on whether it is seen to provide a deeper, richer, and more ethically compelling view of the nature of things.

If this deeper ecological position is correct, then it ought to be reflected in the environmental movement. Unfortunately, for the most part, I do not think this is being done, and there is a price to be paid for not doing so. Moreover, I fear that even those who are of the biocentric persuasion are using homocentric language and strategies to bring business and other major players into the movement because they do not think they will be successful otherwise. They are afraid, and undoubtedly for good reason, that the large part of society, including business, will not be moved by arguments regarding the intrinsic value and rights of natural things. It is difficult enough to get business to recognize and act on their responsibilities to human beings and things of human interest. Hence many environmentalists follow the counsel of Spinoza:

> … it is necessary that while we are endeavoring to attain our purpose … we are compelled … to speak in a manner intelligible to the multitude … For we can gain from the multitude no small advantages…[18]

I understand the temptation of environmentalists employing a homocentric strategy, just as I understand business ethicists using the rationale that good ethics is good business. Both want their important work to succeed. But just as with the good ethics is good business tack, there are dangers in being a closet ecocentrist. The ethicists in both cases fail to reveal the deeper moral base of their positions because it's a harder sell. Business ethics gets marketed in terms of self-interest, environmental ethics in terms of human interest.

A major concern in using the homocentric view to formulate policy and law is that nonhuman nature will not receive the moral consideration it deserves. It might be argued, however, that by appealing to the interests and rights of human beings, in most cases nature as a whole will be protected. That is, if we are concerned about a wilderness area, we can argue that its survival is important to future generations who will otherwise be deprived of contact with its unique wildlife. We can also argue that it is important to the aesthetic pleasure of certain individuals or that, if it is destroyed, other recreational areas will become overcrowded. In this way we stand a chance to save the wilderness area without having to refer to our moral obligations to respect the intrinsic value of the spotted owl or of the old-growth forest. This is simply being strategically savvy. To trot out our deeper ecological moral convictions runs the risk of our efforts being ignored, even ridiculed, by business leaders and policy makers. It also runs head-on against a barrage of counter arguments that human interests take precedence over nonhuman interests. In any event it will not be in the best interest of the wilderness area we are trying to protect. Furthermore, all of the above homocentric arguments happen to be true – people will suffer if the wilderness area is destroyed.

In most cases, what is in the best interests of human beings may also be in the best interests of the rest of nature. After all, we are in our present environmental crisis in large part because we have not been ecologically intelligent about what is in our own interest – just as business has encountered much trouble because it has failed to see its interest in being ethically sensitive. But if the environmental movement relies only on arguments based on human interests, then it perpetuates the danger of making environmental policy and law on the basis of our strong inclination to fulfill our immediate self-interests, on the basis of our consumer viewpoints, on the basis of our willingness to pay. There will always be a tendency to allow our short-term interests to eclipse our long-term interests and the long-term interest of humanity itself. Without some grounding in a deeper environmental ethic with obligations to nonhuman natural things, then the temptation to view our own interests in disastrously short-term ways is that much more encouraged. The biocentric view helps to block this temptation.

Furthermore, there are many cases where what is in human interest is not in the interest of other natural things. Examples range from killing leopards for stylish coats to destroying a forest to build a golf course. I am not convinced that homocentric arguments, even those based on long-term human interests, have much force in protecting the interests of such natural things. Attempts to make these interests coincide might be made, but the point is that from a homocentric point of view the leopard and the forest have no morally relevant interests to consider. It is simply fortuitous if nonhuman natural interests coincide with human interests, and are thereby valued and protected. Let us take an example from the work of Christopher Stone. Suppose a stream has been polluted by a business. From a homocentric point of view, which serves as the basis for our legal system, we can only correct the problem through finding some harm done to human beings who use the stream. Reparation for such harm might involve cessation of the pollution and restoration of the stream, but it is also possible that the business might settle with the people by paying them for their damages and continue to pollute the stream. Homocentrism provides no way for the stream to be made whole again unless it is in the interests of human beings to do so. In short it is possible for human beings to sell out the stream.[19]

I am not saying that human interests cannot take precedence over nonhuman interests when there are conflicts. For this we need to come up with criteria for deciding on interspecific conflicts of interests, just as we do for intraspecific conflicts of interest among human beings.[20] But this is a different problem from holding that nonhuman natural things have no interests or value deserving of moral consideration. There are times when causing harm to natural things is morally unjustifiable when there are no significant human interests involved and even when there are human interests involved. But only a deeper ecological ethic than homocentrism will allow us to defend this.

Finally, perhaps the greatest danger that biocentric environmentalists run in using homocentric strategies to further the movement is the loss of the very insight that grounded their ethical concern in the first place. This is nicely put by Lawrence Tribe:

> What the environmentalist may not perceive is that, by couching his claim in terms of human self-interest – by articulating environmental goals wholly in terms of human needs and preferences – he may be helping to legitimate a system of discourse which so structures human thought and feeling as to erode, over the long run, the very sense of obligation which provided the initial impetus for his own protective efforts.[21]

Business ethicists run a similar risk in couching their claims in terms of business self-interest.

The environmental movement must find ways to incorporate and protect the intrinsic value of animal and plant life and even other natural objects that are integral parts of ecosystems. This must be done without constantly reducing such values to human interests. This will, of course, be difficult, because our conceptual ideology and ethical persuasion is so dominantly homocentric; however, if we are committed to a deeper biocentric ethic, then it is vital that we try to find appropriate ways to promote it. Environmental impact statements should make explicit reference to nonhuman natural values. Legal rights for nonhuman natural things, along the lines of Christopher Stone's proposal, should be sought.[22] And naturalistic ethical guidelines, such as those suggested by Holmes Rolston, should be set forth for business to follow when its activities impact upon ecosystems.[23]

At the heart of the business ethics movement is its reaction to the mistaken belief that business only has responsibilities to a narrow set of its stakeholders, namely its stockholders. Crucial to the environmental ethics movement is its reaction to the mistaken belief that only human beings and human interests are deserving of our moral consideration. I suspect that the beginnings of both movements can be traced to these respective moral insights. Certainly the significance of both movements lies in their search for a broader and deeper moral perspective. If business and environmental ethicists begin to rely solely on promotional strategies of self-interest, such as good ethics is good business, and of human interest, such as homocentrism, then they face the danger of cutting off the very roots of their ethical efforts.

Notes

This paper was originally presented as the Presidential Address to the *Society for Business Ethics*, August 10, 1990, San Francisco, CA.

1 Albert Gore, "What is Wrong With Us?" *Time* (January 2, 1989), 66.

2 Norman Bowie, "Morality, Money, and Motor Cars," *Business, Ethics, and the Environment: The Public Policy Debate*, edited by W. Michael Hoffman, Robert Frederick, and Edward S. Petry, Jr. (New York: Quorum Books, 1990), p. 89.

3 See Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits." *The New York Times Magazine* (September 13, 1970).

4 Bowie, p. 91.

5 Bowie, p. 94.

6 Robert Frederick, Assistant Director of the Center for Business Ethics, and I have developed and written these points together. Frederick has also provided me with invaluable assistance on other points in this paper.

7 Kenneth E. Goodpaster, "Can a Corporation have an Environmental Conscience," *The Corporation, Ethics, and the Environment*, edited by W. Michael Hoffman, Robert Frederick, and Edward S. Petry, Jr. (New York: Quorum Books, 1990).

8 Mark Sagoff, "At the Shrine of Our Lady of Fatima, or Why Political Questions Are Not All Economic," found in *Business Ethics: Readings and Cases in Corporate Morality*, 2nd edition, edited by W. Michael Hoffman and Jennifer Mills Moore (New York: McGraw-Hill, 1990). pp. 494–503.

9 Bowie, p. 94.

10 Cynthia Pollock Shea, "Doing Well By Doing Good," *World-Watch* (November/December, 1989), p. 30.

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14 Frederick.

15 Richard Routley, and Val Routley, "Human Chauvinism and Environmental Ethics," *Environmental Philosophy*, Monograph Series, No. 2, edited by Don Mannison, Michael McRobbie, and Richard Routley (Australian National University, 1980), pp. 121 ff.

16 See Paul W. Taylor, "The Ethics of Respect for Nature," found in *People, Penguins, and Plastic Trees*, edited by Donald VanDeVeer and Christine Pierce (Belmont, California: Wadsworth, 1986), pp. 178–83. Also see R. and V. Routley, "Against the Inevitability of Human Chauvinism," found in *Ethics and the Problems of the 21st Century*, edited by K. E. Goodpaster and K. M. Sayre (Notre Dame: University of Notre Dame Press, 1979), pp. 36–59.

17 Arne Naess, "Identification as a Source of Deep Ecological Attitudes," *Deep Ecology*, edited by Michael Tobias (San Marcos, California: Avant Books, 1988), p. 266.

18 Benedict de Spinoza, "On the Improvement of the Understanding," found in *Philosophy of Benedict de Spinoza*, translated by R. H. M. Elwes (New York: Tudor Publishing Co., 1936), p. 5.

19 Christopher D. Stone, "Should Trees Have Standing? – Toward Legal Rights for Natural Objects," found in *People, Penguins, and Plastic Tress*, pp. 86–87.

20 See Donald VanDeVeer, "Interspecific Justice," *People, Penguins, and Plastic Trees*, pp. 51–66.

21 Lawrence H. Tribe, "Ways Not to Think about Plastic Trees: New Foundations for Environmental Law," found in *People, Penguins, and Plastic Trees*, p. 257.

22 Stone, pp. 83–96.

23 Holmes Rolston, III, *Environmental Ethics* (Philadelphia: Temple University Press, 1988), pp. 301–13.

Creating Sustainable Value

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> *"Sustainability is as foreign a concept to managers in capitalist societies as profits are to managers in the former Soviet Union."*
>
> —William Ruckelshaus,
> First EPA Administrator

With the fall of communism over a decade ago, capitalism has emerged as the dominant economic ideology in the world. Unfortunately, the results produced by ten years of global capitalism have not been uniformly positive.[1] Saturation in the developed markets, a widening gap between rich and poor, growing levels of environmental degradation, and concern that the developing world may be losing control over its own destiny have combined to create drag on the global economy.[2] The terrorist attacks in the U.S. on September 11, 2001 made it clear that the world is inextricably interconnected and that poverty, hopelessness, and perceived exploitation in one part of the world will not remain geographically isolated.[3] Increasingly, global capitalism is being challenged to include more of the world in its bounty and protect the natural systems and cultures upon which the global economy depends.[4]

The idea of sustainability has come to represent these rising expectations for social and environmental performance. Global sustainability has been defined as the ability to "meet the needs of the present without compromising the ability of future generations to meet their needs."[5] Similarly, sustainable development "is a process of achieving human development … in an inclusive, connected, equitable, prudent, and secure manner."[6] A sustainable enterprise, therefore, is one that contributes to sustainable development by delivering simultaneously economic, social, and environmental benefits – the so-called triple bottom line.[7]

Beyond this broad consensus on terminology, however, there remains disagreement among managers regarding the specific meaning of and motivation for enterprise level sustainability.[8] For some managers, it is a moral mandate; for others, a legal requirement. For still others, sustainability is perceived as a cost of doing business – a necessary evil to maintain legitimacy and right to operate. A few firms have begun to frame sustainability as a business opportunity, offering avenues for lowering cost and risk, or even growing revenues and market share through innovation.[9]

For most firms, the pursuit of enterprise sustainability remains difficult to reconcile with the objective of increasing shareholder value. Indeed, some have even advocated that creating a more sustainable world will require firms to sacrifice profits and shareholder value in favor of the public good.[10] By starting with legal or moral arguments for firm actions, however, managers inevitably underestimate the strategic business opportunities associated with this important issue. To avoid this problem, managers need to directly link enterprise sustainability to the creation of shareholder value. The global challenges associated with sustainability, viewed through the appropriate set of business lenses, can help to identify strategies and practices that contribute to a more sustainable world and, simultaneously, drive shareholder value; this we define as the creation of sustainable value for the firm.

This article develops the strategic logic for the pursuit of sustainable value. We begin by specifying a multidimensional model of shareholder value creation.

Stuart L. Hart and Mark B. Milstein, "Creating Sustainable Value," *Academy of Management Executive*, 17(2), 2003, pp. 56–69. Reprinted with permission of the Academy of Management.

Next, we describe the emerging challenges associated with global sustainability. Finally, we demonstrate how, through appropriate business strategies and practices, the above challenges are being converted by companies into initiatives to increase shareholder value. We close with some thoughts about how to create truly sustainable value.

Shareholder Value is a Multidimensional Construct

Figure 1 illustrates the basic components for our shareholder-value framework. The model is built using two well-known dimensions that are a source of creative tension for firms. The vertical axis in the model reflects the firm's need to manage today's business while simultaneously creating tomorrow's technology and markets. This dimension captures the tension experienced by the need to realize short-term results while also generating expectations for future growth.[11] The horizontal axis reflects the firm's need to grow and protect internal organizational skills and capabilities while simultaneously infusing the firm with new perspectives and knowledge from the outside. This dimension reflects the tension experienced by the need to buffer the technical core so that it may operate without distraction, while at the same time remaining open to fresh perspectives and new, disruptive models and technologies.[12]

Juxtaposing these two dimensions produces a matrix with four distinct dimensions of performance crucial to generating shareholder value. The lower-left quadrant focuses on those aspects of performance that are primarily internal and near-term in nature: cost and risk reduction. Quarterly earnings growth and reduction in exposure to liabilities and other potential losses are important drivers of wealth creation. Clearly, unless the firm can operate efficiently and reduce its risk commensurate with returns, shareholder value will be eroded.

The lower-right quadrant also focuses on performance dimensions that are near-term in nature but extends to include salient stakeholders external to the firm – suppliers and customers in the immediate value chain, as well as regulators, communities, NGOs, and the media. Without appropriate inclusion of these stakeholder interests, the firm's right to operate may be called into question. Creative inclusion of these stakeholder interests can foster a differentiated position for the firm, leading to the enhanced reputation and legitimacy crucial to the preservation and growth of shareholder value.

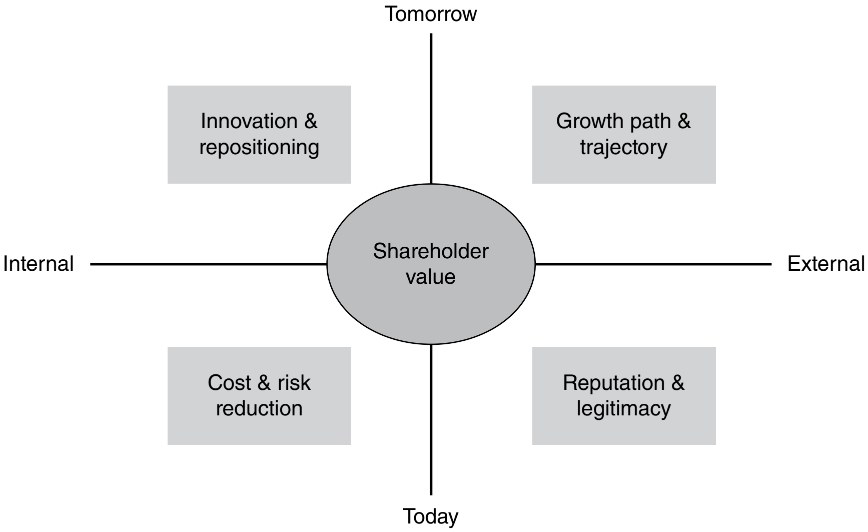

Figure 1 Key dimensions of shareholder value.

Shifting to the upper-left quadrant of the model, the firm must not only perform efficiently in today's businesses but should also be constantly mindful of generating the products and services of the future. Internally, this means developing or acquiring the skills, competencies, and technologies that reposition the firm for future growth. Without such a focus on innovation, it will be difficult for the firm to create the new product and service flow needed to ensure that it prospers well into the future. The creation of shareholder value thus depends upon the firm's ability to creatively destroy its current capabilities in favor of the innovations of tomorrow.

Finally, the upper-right quadrant focuses on the external dimensions associated with future performance. Credible expectations for future growth are key to the generation of shareholder value; this depends upon the firm's ability to articulate a clear vision of what its future growth path and trajectory will be. A convincing growth trajectory requires either that the firm offers new products to existing customers or taps into previously unserved markets. The growth trajectory provides guidance and direction for new technology and product development.

Firms must perform well simultaneously in all four quadrants of the model on a continuous basis if they are to maximize shareholder value over time.[13] Performing within only one or two quadrants is a prescription for suboptimal performance and even failure. Firms like Kodak and Xerox, which failed to adequately invest in digital technology, illustrate how overemphasis on today's business (to the exclusion of tomorrow's technology and markets) may generate wealth for a time but will eventually erode shareholder value as competitors enter with superior products and services.[14] Similarly, the recent experience of many Internet companies stands as testimony to how preoccupation with tomorrow's business (to the exclusion of performing today) may be exciting and challenging, but short-lived.[15] Finally, companies such as Monsanto, which failed to adequately address stakeholder concerns over genetically modified food, demonstrate that overemphasis on the internal aspects of the firm may enable short-term execution but will ultimately blind the firm to the external perspectives that are so important to legitimacy and competitive imagination.[16]

Just as the creation of shareholder value requires performance on multiple dimensions, sustainable development is also a multidimensional challenge. Yet, most managers frame sustainability not as a multidimensional opportunity, but rather as a one-dimensional nuisance.[17] Nevertheless, the multiple challenges associated with global sustainability, seen through the appropriate business lenses, can help to identify strategies and practices which improve performance in all four quadrants of the shareholder-value framework. This, in turn, facilitates the creation of sustainable value for the firm.

Global Drivers of Sustainability

There are four sets of drivers related to global sustainability. A first set of drivers relates to increasing industrialization and its associated material consumption, pollution, and waste generation. Industrial activity has grown to the point where it may now be having irreversible effects on the global environment, including impacts on climate, biodiversity, and ecosystem function.[18] While industrialization has produced tremendous economic benefits, it has also generated significant pollution burdens and continues to consume virgin materials, resources, and fossil fuels at an increasing rate.[19] Resource efficiency and pollution prevention are therefore crucial to sustainable development.

A second set of drivers relates to the proliferation and interconnection of civil society stakeholders. As the power of national governments has eroded in the wake of global trade regimes, non-governmental organizations (NGOs) and other civil society groups have stepped into the breach, assuming the role of monitor and in some cases enforcer of social and environmental standards.[20] At the same time, the spread of the Internet and information technology has enabled these groups to communicate with each other in ways that were unimaginable even a decade ago. Internet-connected coalitions of NGOs are making it increasingly difficult for governments, corporations, or any large institutions to operate in secrecy.[21] Sustainable development thus challenges firms to operate in a transparent, responsive manner due to a very well-informed, active stakeholder base.

A third set of drivers relates to emerging technologies that may provide potent, disruptive solutions that could render the basis of many of today's energy and material-intensive industries obsolete.[22] Genomics, biomimicry, nanotechnology, information technology, and renewable energy all hold the potential to drastically reduce the human footprint on the planet, making the problems of rapid industrialization all but obsolete.[23] For example, bio- and nanotechnology create products and services at the molecular level, holding the potential to eliminate the concept of waste and pollution.[24] Similarly, biomimicry represents an attempt to emulate nature's processes to create novel products and services without having to rely on brute force to hammer out goods from large stocks of virgin raw materials.[25] Information technology and renewable energy are distributed in character, meaning that they can be applied in the most remote and small-scale settings imaginable, eliminating the need for centralized infrastructure and wireline distribution, both of which are environmentally destructive.[26] Distributed technologies thus hold the potential to meet the needs of the billions of rural poor (who have thus far been largely ignored by global business) in a way that dramatically reduces environmental impact.[27] Innovation and technological change are thus key to the pursuit of sustainable development.

Finally, a fourth set of drivers relates to the increases in population, poverty, and inequity associated with globalization. While it took thousands of years for the human population to reach 1 billion, that number has swollen to over 6 billion in just the past two generations.[28] Such rapid population growth has resulted in massive migration from rural areas to cities and growing inequities in income. Today, for example, over 4 billion people survive on less than $1500 per year, the minimum income needed to avoid serious deprivation.[29] The combination of rising population and growing inequity is increasingly recognized as a prescription for accelerating social decay, political chaos, and terrorism.[30] Social development and wealth creation on a massive scale, especially among the world's poorest 4 billion, therefore appear to be essential to sustainable development.[31] However, such development must follow a fundamentally different course if it is not to result in ecological meltdown.[32]

In short, global sustainability is a complex, multidimensional concept that cannot be addressed by any single corporate action. Creating sustainable value thus requires that firms address each of the four broad sets of drivers. First, firms can create value by reducing the level of material consumption and pollution associated with rapid industrialization. Second, firms can create value by operating at greater levels of transparency and responsiveness, as driven by civil society. Third, firms can create value through the development of new, disruptive technologies that hold the potential to greatly shrink the size of the human footprint on the planet. Finally, firms can create value by meeting the needs of those at the bottom of the world income pyramid in a way that facilitates inclusive wealth creation and distribution.

Connecting the Dots: The Sustainable Value Framework[33]

If viewed through the appropriate set of business lenses, it becomes clear how the sustainability drivers discussed above present opportunities for firms to improve all four dimensions of shareholder value. As illustrated in Figure 2 (and described in more detail below), each driver of sustainability, and its associated business strategies and practices, corresponds to a particular dimension of shareholder value. Thinking through the full range of challenges and opportunities is the first step managers can take toward the creation of sustainable value for the corporation.

Growing profits and reducing risk through pollution prevention

The problems of material consumption, waste, and pollution associated with industrialization present an opportunity for firms to lower cost and risk through the development of skills and capabilities in pollution prevention and eco-efficiency.[34] Pollution prevention is focused on improving the environmental efficiency of today's products and processes – that is, reducing waste and emissions from current operations. Less waste means better utilization of inputs, resulting in lower costs for raw materials and waste

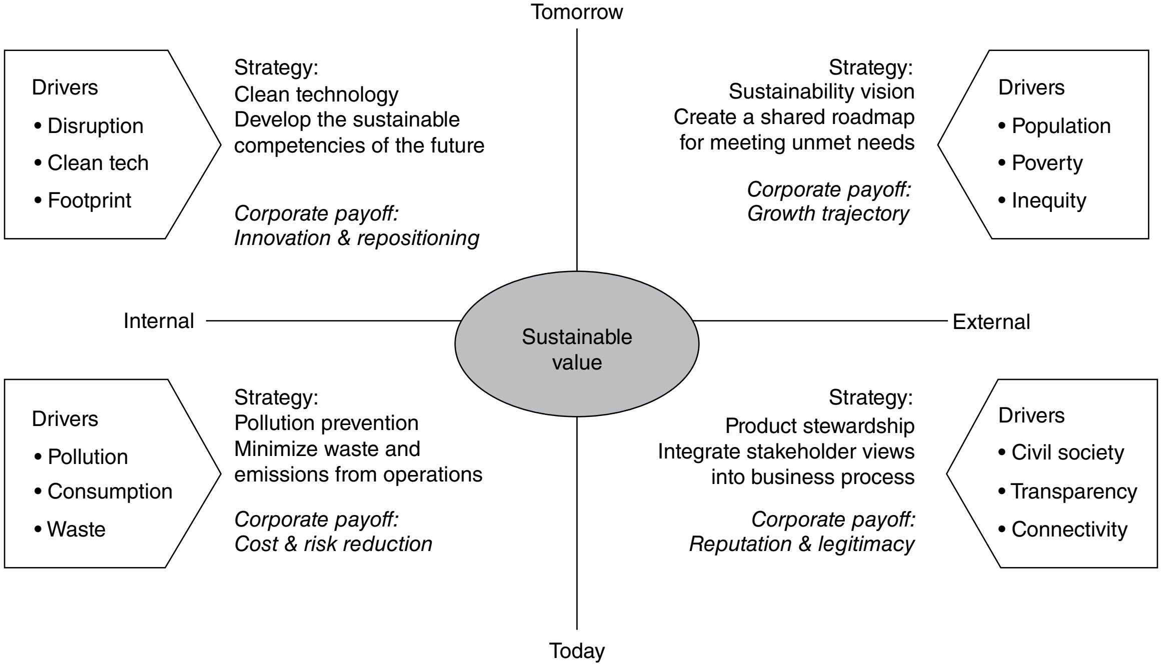
Tomorrow
Drivers
• Disruption
• Clean tech
• Footprint
Strategy:
Clean technology
Develop the sustainable competencies of the future
Corporate payoff:
Innovation & repositioning
Strategy:
Sustainability vision
Create a shared roadmap for meeting unmet needs
Corporate payoff:
Growth trajectory
Drivers
• Population
• Poverty
• Inequity
Internal
Sustainable value
External
Drivers
• Pollution
• Consumption
• Waste
Strategy:
Pollution prevention
Minimize waste and emissions from operations
Corporate payoff:
Cost & risk reduction
Strategy:
Product stewardship
Integrate stakeholder views into business process
Corporate payoff:
Reputation & legitimacy
Drivers
• Civil society
• Transparency
• Connectivity
Today

Figure 2 Sustainable value framework.

disposal. Effective pollution prevention requires extensive employee involvement, along with well-developed capabilities in continuous improvement and quality management.[35] By deriving more saleable product or service per pound of input, pollution prevention can lead to lower costs and reduced risk. Environmental management systems (e.g., ISO 14000) built on total quality principles provide guidance for the development of systematic processes geared toward removing waste and lowering risk throughout a firm's operations.[36]

Programs that reduce waste and emissions through eco-efficiency have been widely adopted by firms over the past decade and include such notable cases as Dow Chemical's Waste Reduction Always Pays (WRAP) and Chevron's Save Money and Reduce Toxics (SMART). Additionally, pollution-prevention programs have proliferated at the industry level and receive a great deal of attention from regulatory bodies both in the United States as well as Europe as potential alternatives to command-and-control regulation.[37] The well-publicized results of pioneering programs like 3M's Pollution Prevention Pays (3P) illustrate the direct, bottom-line benefits that can be realized through pollution prevention.[38] Indeed, between 1975 and 1990, 3M reduced its total pollution by over 530,000 tons (a 50 per cent reduction in total emissions) and, according to company sources, saved over $500 million through lower raw material, compliance, disposal, and liability costs. In 1990, 3M embarked on 3P+ which sought to reduce the remaining waste and emissions by 90 per cent with the ultimate goal being zero pollution.[39]

Extensive empirical work has also now made it evident that, with the appropriate set of skills and capabilities (e.g., employee involvement, continuous improvement), firms pursuing pollution-prevention and waste-reduction strategies actually do reduce cost and increase profits.[40] Pollution prevention thus provides managers with the clearest, fastest way to increase shareholder value by growing the bottom line for existing businesses through reductions in cost and liability.

Enhancing reputation and legitimacy through product stewardship

Whereas pollution prevention focuses on internal operations, product stewardship extends beyond organizational boundaries to include the entire product life cycle – from raw material access, through production processes, to product use and disposal of spent products.[41] Product stewardship thus involves integrating the voice of the stakeholder into business processes through extensive interaction with external parties such as suppliers, customers, regulator, communities, non-governmental organizations, and the media. As such, it offers a way to both lower environmental impacts across the value chain and enhance legitimacy and reputation by involving stakeholders in the conduct of ongoing operations.[42] By constructively engaging stakeholders, firms increase external confidence in their intentions and activities, helping to enhance corporate reputation and catalyze the spread of more sustainable practices within the business system at large.[43]

There are many actions firms can take to increase shareholder value through product stewardship. Cause-related marketing efforts appeal to consumers' desires to associate their actions (purchases) with products that have positive social and environmental benefits.[44] Life-cycle management extends the value chain beyond traditional firm boundaries by including costs and benefits of products from raw materials to production and ultimately to disposal by consumers.[45] Through industrial ecology, firms can even convert the wastes from one operation into the inputs to another.[46] In 1997, for example. Collins & Aikman Floorcoverings became the first carpet manufacturer to develop the capability to convert old carpet and postindustrial PVC waste into new carpet backing for a new product line. Called ER3 (which stands for environmentally Redesigned, Restructured, and Reused), this product has been central to the company's growing reputation for environmentally sustainable products and has helped to fuel gains in market share against competitors.[47]

Companies such as Weyerhaeuser and Shell have increased the use of stakeholder engagement through town hall-style meetings, Internet-based comment boxes, and other tools designed to provide venues for stakeholders to voice their opinions about a firm's operations. In Europe, a strong regulatory environment coupled with a very active NGO community has led firms to pursue more collaborative approaches in addressing business issues. Together with industry, European governments are moving forward with leading legislation concerning take-back laws for electrical, electronic, and appliances manufacturers.[48]

The company Nike serves as a recent, salient example of the value of product stewardship. Faced with growing backlash in the late 1990s regarding its labor and environmental practices, the company turned to product-stewardship strategies to recover its reputation and preserve its right to operate. The company enacted a worldwide monitoring program for all contract factories, using both internal and third-party auditors such as PriceWaterhouseCoopers. Nike also became a charter member of the Fair Labor Association (FLA), a non-profit group that evolved out of an anti-sweatshop coalition of unions, human rights groups, and businesses. Additionally, Nike helped found the Global Alliance, a partnership among the International Youth Foundation, the MacArthur Foundation, and the World Bank dedicated to improving workers' lives in emerging economies.[49]

Aside from taking action on the labor (social) front, Nike also took action environmentally. Footwear designers started evaluating their new prototypes against a product-stewardship scorecard, using life-cycle analysis. Nike also launched the Reuse a Shoe Project to downcycle old, unwanted footwear. Nike retailers collected shoes and shipped them back to the company where they ground and separated the materials. Through partnerships with sports surfacing companies, the outsole rubber and midsole foam were turned into artificial athletic surfaces. Profits from this business generated income for the Nike Foundation and the funding of sport surface donations.[50]

As the Nike case makes clear, firms use product stewardship to demonstrate that stakeholder voices and opinions matter and can affect company behavior. Like pollution prevention, product stewardship is centered on improving existing products and services. As a consequence, changes are immediate and value is realized quickly in the form of improved community relations, legitimacy, and brand reputation.

Accelerating innovation and repositioning through clean technology

Clean technology refers not to the incremental improvement associated with pollution prevention, but to innovations that leapfrog standard routines and knowledge.[51] The rapid emergence of disruptive technologies such as genomics, biomimicry, information technology, nanotechnology, and renewable energy present the opportunity for firms – especially those heavily dependent upon fossil fuels, natural resources, and toxic materials – to reposition their internal competencies around more sustainable technologies.[52] Thus, rather than simply seeking to reduce the negative impacts of their operations, firms strive to solve social and environmental problems through the internal development or acquisition of new capabilities that address the sustainability challenge directly.[53] The sustainable competencies that emerge from the search for clean technologies are central to a firm's efforts to reposition its internal skill set for the development and exploitation of future markets.

A growing number of firms have begun to develop the next generation of clean technology to drive future economic growth. BP and Shell are ramping up investments in solar, wind, and other renewable technologies that might ultimately replace their core petroleum businesses. In the automotive sector,Toyota and Honda have already entered the market with hybrid power systems in their vehicles, which dramatically increase fuel efficiency.They also launched a market experiment in fuel cell vehicles in Japan at the end of 2002. Also in 2002, General Motors launched the AUTOnomy project – a bold $1 billion initiative to reinvent the automobile around hydrogen fuel cell technology. While many automakers have fuel cell initiatives, most see the expensive combination of a fuel cell with a big electric motor as a simple replacement for the engine, which makes such vehicles economically uncompetitive compared to current technology. GM, in contrast, has taken a clean-sheet approach, not only to vehicle design but also to the entire manufacturing system. By radically simplifying the design around a fuel cell which doubles as the vehicle's chassis, GM hopes to compensate for the higher cost of the fuel cell by drastically reducing sourcing and production costs.While many carmakers talk of a transition to alternative power taking 20–30 years, GM, Toyota, and Honda are committed to making it a commercial reality within a decade.[54]

In addition, firms such as General Electric, Honeywell, and United Technologies are investing in technologies that would lead to the development of small-scale, widely distributed energy systems that could make centralized coal-fired and nuclear power plants obsolete. Finally, firms such as Cargill and Dow are exploring the development of biologically based polymers to enable renewable feedstocks such as corn to replace petrochemical inputs in the manufacturing of plastics. Each of these cases is notable for the willingness of firms to disrupt the very core technologies upon which their businesses currently depend.

DuPont is an example of a large corporation with a well-developed clean-technology strategy. In the late 1800s, DuPont transformed itself from a manufacturer of gunpowder and explosives into a chemical company, focused on the production of synthetic materials using petroleum feedstocks. This strategy produced nearly a century of success with such well-known blockbuster products as Nylon, Lycra, Teflon, Corian, and Kevlar.

In the late 1990s, DuPont embarked on its second major transformation – from an energy-intensive petrochemical company to a renewable-resource company focused on sustainable growth.[55] To realize this transformation, the company has pursued an aggressive strategy of acquisition, divestiture, and internal technology development. Over the past decade, for example, DuPont has invested in excess of $15 billion in biotechnology, including the acquisition of Pioneer Hi-Bred, a major player in the agricultural biotech business. It has also divested resource- and energy-intensive businesses such as its oil subsidiary (Conoco) in the 1990s and, most recently, its core Nylon and Lycra businesses in 2003.

In an effort to shrink its footprint dramatically, the company has set bold targets for 2010 – to reduce greenhouse gas emissions by two-thirds while holding total energy use flat, and to increase its use of renewable resources to 10 percent of global energy needs. To hit such ambitious targets while continuing to grow as a company, DuPont must fundamentally reorient its technology base toward biology (e.g., genomics and biomimicry), renewable energy (e.g., fuel cells) and information (i.e., knowledge-intensive rather than resource-intensive products). To accelerate this process. DuPont is creating a venture fund focused on sustainable technology development and innovations aimed at the developing world.

Bold strategies in clean technology continue to be less common among large, established corporations than are activities in pollution prevention or product stewardship. Payoffs from such investments take time and are determined more by trial and error than internal hurdle rates. Entrenched corporate mindsets and standard operating procedures suppress the creation of structures that can catalyze innovation. The risks associated with such investments stand in stark contrast to the risk-reducing efforts associated with the pollution-prevention programs discussed above. Firms that invest in clean-technology solutions tend to pursue more novel approaches to long-term challenges and create organizational environments supportive of the innovation process. Future economic growth will be driven by those firms that are able to develop disruptive technologies that address society's needs. The evidence is increasingly clear that firms that fail to lead the development and commercialization of such technologies are unlikely to be a part of tomorrow's economy.[56]

Crystallizing the firm's growth path and trajectory through a sustainability vision

The growing gap between rich and poor, and the unmet needs of those at the bottom of the economic pyramid, present opportunities for firms to define a compelling trajectory for future growth.[57] The realization of a more inclusive form of capitalism characterized by two-way dialogue and collaboration with stakeholders previously overlooked or ignored by firms (e.g, radical environmentalists, shantytown dwellers, the rural poor in developing countries) can help to open up new pathways for growth in previously unserved markets.[58] Thus, a sustainability vision that facilitates competitive imagination by creating a shared roadmap for tomorrow's business provides guidance to employees in terms of organizational priorities, technology development, resource allocation, and business model design.

The Grameen Bank in Bangladesh is perhaps the best known example of how a sustainability vision can open up a completely new pathway for business growth.[59] Over twenty years ago, Muhammad Yunas, an economics professor at the time, conceived the idea of a bank focused on offering micro-credit loans to the poorest of the poor. Most bankers assumed that laziness or lack of competence were the reasons that so many lived in abject poverty. As a result, they focused their attention on more affluent customers. But Yunas discovered that the poor were, for the most part, energetic, motivated, and knew exactly what they needed to move themselves forward – gaining access to small amounts of credit to launch or expand small enterprises – and built his enterprise to serve this need. By the late 1990s, Grameen Bank was providing microcredit services in more than 40,000 villages, better than half the total number in Bangladesh. The competitive imagination of Grameen Bank has led to a global explosion of institutional interest in microlending over the past decade, including recent entry into this domain by financial giants such as Citigroup.

Increasingly, MNCs are recognizing that listening to the voices of the poor and disenfranchised can be a source of creativity and innovation. For example, Hindustan Lever Ltd. (HLL), a subsidiary of Unilever PLC, has pioneered market development among the rural poor in India. Through product development dedicated specifically to the unique needs of the rural poor, HLL has been able to apply top-class science and technology to bring affordable shampoos and soaps to this large new market.[60] Today, better than half of HLL's revenues come from customers at the bottom of the pyramid. Even more importantly, using the approach to product development, marketing, and distribution pioneered in rural India, Unilever has been able to leverage a rapidly growing and profitable business to other parts of the developing world such as Brazil.[61]

Recognizing that information poverty may be the single biggest roadblock to sustainable development. Hewlett-Packard has begun to focus attention on the needs of the isolated and disconnected through their World e-Inclusion initiative. As part of their strategy, HP has created an R&D laboratory in rural India with the express purpose of coming to understand the particular needs of the rural poor. They have quickly realized that this is not unoccupied space; local companies such as N-Logue and Tarahaat are also developing information technology and business models focused on this enormous potential market. Through shared access (e.g., Internet kiosks), wireless infrastructure, and R&D focused on cost reduction, these companies are dramatically reducing the cost of being connected.[62]

Despite the success of organizations such as Grameen and Unilever, however, most companies continue to mistakenly assume that poor markets possess no value opportunities and have yet to try to understand the possibilities of serving the markets they are used to ignoring. Firms that do take the time appear to recognize that those at the bottom of the pyramid lack attention and capital, not ingenuity and aspiration.[63] Companies like Johnson & Johnson, Dow, DuPont, Coca-Cola, and Procter & Gamble are beginning to take steps to understand how best to leverage their skills and resources to meet the basic nutritional, energy, housing, and communications needs of the world's poorest.[64] Those steps include interacting with a broad range of stakeholders previously assumed to have nothing to offer a multinational corporation (e.g., local NGOs, disenfranchised dwellers of shanty towns, rural villagers, etc.) to highlight what unmet needs exist and how their organization's skills and capabilities might be wielded to meet them. In turn, this understanding can become a catalyst for the development of innovative technologies, products, and services that meet those needs and drive growth at multiple levels within the economy.[65] Thus, firms that take the time to create a compelling sustainability vision have the potential to unlock future markets of immense scale and scope.

Toward Sustainable Value

At this point it should be clear that the challenge of global sustainability is complex, multidimensional, and emergent in character. Firms are challenged to minimize waste from current operations (pollution prevention), while simultaneously reorienting their competency portfolios toward more sustainable technologies and skill sets (clean technology). Firms are also challenged to engage in extensive interaction and dialogue with external stakeholders, regarding both current offerings (product stewardship) as well as how they might develop economically sound solutions to social and environmental problems for the future (sustainability vision).

Taken together, as a portfolio, such strategies and practices hold the potential to reduce cost and risk; enhance reputation and legitimacy; accelerate innovation and repositioning; and crystallize growth path and trajectory – all of which are crucial to the creation of shareholder value. The challenge for the firm is to decide which actions and initiatives to pursue and how best to manage them. Accordingly, we recommend the following specific steps in the pursuit of sustainable value: diagnosis (taking stock of the company portfolio), opportunity assessment (strengths and weaknesses in capability), and implementation (the design of projects and experiments).

Each is explored in more depth below.

Diagnosis

The sustainable-value framework can be used as a simple but important diagnostic tool. By assessing a company's (or SBU's) activity in each of the four quadrants of the framework, managers can assess the degree of portfolio balance. Extreme portfolio imbalance suggests missed opportunities – and vulnerability. Our research suggests that few incumbent firms seem to recognize – let alone exploit – the full range of sustainable business opportunities available.[66] Most focus their time and attention only on the bottom half of the matrix – short-term solutions tied to existing products and stakeholder groups.

Indeed, programs in pollution prevention and product stewardship are well institutionalized within most MNCs today and have saved hundreds of millions of dollars over the past decade. U.S.-based companies have been especially focused on the efficiency gains and cost savings associated with pollution prevention. Highly publicized crises at companies such as Monsanto and Nike, who failed to successfully engage the views of stakeholders, have also caused growing number of firms to explore strategies for product stewardship. European companies have been particularly proactive in this regard, actively pursuing strategies for stakeholder dialogue, extended producer responsibility, and more inclusive forms of corporate governance.

Opportunity assessment

Relatively few established companies, however, have begun to exploit the opportunities associated with the upper half of the model – the portion focused on building new capabilities and markets. Indeed, most clean technologies today are being developed and commercialized by small, often under-capitalized, new ventures – not by the MNCs that possess the financial resources for doing so successfully. Similarly, most business experiments at the bottom of the economic pyramid have been initiated by NGOs or small local firms while the emerging market plays of MNCs have been limited largely to the elites or emerging middle classes in the developing world.[67] Given that pursuit of clean technology and markets at the bottom of the pyramid is disruptive in character, perhaps we should not be surprised that large incumbent firms have not actively blazed these trails or that entrepreneurs have been likely to seek opportunities to leapfrog existing competitors and claim underserved market space.

Yet, it need not be this way. Just as particular competencies predispose some companies to be more effective than others in implementing pollution prevention and product stewardship (e.g., quality management, continuous improvement, boundary-spanning capability), some MNCs will be better positioned than others to pursue clean technologies and bottom-of-the-pyramid markets – those with demonstrated ability in acquiring new skills, working with unconventional partners, incubating disruptive innovations, shedding obsolete businesses, and creatively destroying existing product portfolios, to name just a few. Incumbent firms with these skill sets possess a potentially powerful first-mover advantage compared to those firms more oriented toward defending base businesses.

Implementation

To make this opportunity a reality, however, it is necessary to organize the range of possible activities into discrete projects and business experiments. Given the nascent nature of clean technology and bottom-of-the-pyramid markets, many small experiments are far preferable to a single big investment. These initiatives must be evaluated for funding using a separate set of criteria and metrics, since they will almost never meet the short-term revenue and profitability targets associated with projects designed to expand existing businesses.

We recommend using a real-options approach rather than the more conventional discounted-cash-flow logic.[68] Real-options thinking introduces the logic of the private equity market into the firm, with an expected payoff in the 5–7 year time frame, rather than the excessively short-term logic associated with conventional capital budgeting or the excessively long-term logic associated with traditional R&D.[69] We also recommend creating a separate pool of investment capital to fund these initiatives and a separate organizational entity to house the business experiments aimed at opening up new markets. Without this early protection, the logic of short-term performance in today's business will almost certainly guarantee failure.[70] Only a small percentage of the projects and business experiments have to succeed to more than justify the investment in terms of new capability development and revenue growth.

Sustainable Value: A Huge Opportunity

The opportunity to create sustainable value – shareholder wealth that simultaneously drives us toward a more sustainable world – is huge, but yet to be fully exploited. The sustainable-value framework makes clear the nature and magnitude of the opportunities associated with sustainable development and connects them to dimensions of value creation for the firm. The framework's simplicity, however, should not be mistaken for ease of execution: understanding the connections is not the same thing as successfully implementing the strategies and practices involved. The tasks are very challenging and complex indeed, suggesting that only a few firms will be able to successfully carry out activities in all four quadrants simultaneously, especially those that require the greatest efforts in terms of vision, creativity, and patience.

Stagnant economic growth and stale business models present formidable challenges to corporations in the years ahead. Focusing on incremental improvements to existing products and businesses is an important step but neglects the vastly larger opportunities associated with clean technology and the underserved markets at the bottom of the economic pyramid. Indeed, addressing the full range of sustainability challenges can help to create shareholder value and may represent one of the most under-appreciated avenues for profitable growth in the future.

Notes

1 See Stiglitz, I. 2002. *Globalization and its discontents.* New York: W.W. Norton.

2 See the National Research Council. 1999. *Our common journey*, Washington, DC: National Academy Press.

3 Soros, G. 2002. *George Soros on globalization*. New York: Public Affairs.

4 Protests at the World Trade Organization, World Bank, World Economic Forum, G8, and other meetings in places like Seattle, Washington, DC, Davos, and Rome have become the most visible examples of the frustration felt by many who view globalization as inequitable exploitation. See Nye, J. 2001. Globalization's democratic deficit. *Foreign Affairs*, 80(4): 2–6.

5 World Commission on Environment and Development. 1987. *Our common future*. Oxford: Oxford University Press, p. 8.

6 Gladwin, T., Kennelly, J., & Krause, T. 1985. Shifting paradigms for sustainable development: Implications for management theory and research. *Academy of Management Review*, 20(4): 878–907.

7 See Elkington, J. 1994. Towards the sustainable corporation: Win-win-win business strategies for sustainable development. *California Management Review*, 36(3): 90–100.

8 We use the terms "global sustainability", "sustainable world," and "sustainable development" interchangeably to refer to the global-scale drivers of sustainability. Similarly, we use the terms "sustainable enterprise," "corporate sustainability," and "enterprise sustainability" interchangeably to refer to firm-level strategies and practices to build value by moving toward a more sustainable world.

9 See Holliday, C. 2001. Sustainable growth, the DuPont way. *Harvard Business Review*, 79(8): 129–132.

10 See Friedman, M. The social responsibility of business is to increase profits. *The New York Times Magazine*, 13 September 1970, for the classic argument representing this point of view.

11 See Christensen, C. 1998. *The innovator's dilemma*. Boston, MA: Harvard Business School Press for a detailed discussion of the paradox of focusing on short- versus long-term value. The concept of "creative destruction" was first introduced by Joseph Schumpeter (1942) in *Capitalism, socialism and democracy*. New York: Harper Torchbooks. More recently, the growing importance of creative destruction to competitive success has been persuasively argued in Foster, R., & Kaplan, S. 2001. *Creative destruction*. New York: Doubleday.

12 See Thompson, J. 1967. *Organisations in action*, New York: McGraw Hill for the classic discussion of balancing the need both to sustain and destroy the technological core underlying a firm's business model. More recently, these ideas have received growing attention in the form of work on "core rigidities" (e.g., Leonard-Barton, D. 1992. Core capabilities and core rigidities: A paradox in managing new product development. *Strategic Management Journal*, 13(SSI): 111–125) and "dynamic capabilities" (e.g., Teece, D., Pisano, G., & Shuen, A. 1997. Dynamic capabilities and strategic management. *Strategic Management Journal,* 18(7): 509–533).

13 This idea is similar to the balanced scorecard (see Kaplan, R., & Norton, D. 1992. The balanced scorecard – measures that drive performance. *Harvard Business Review* 72(1): 71–79) and other tools that emphasize the need to balance a portfolio of actions to drive firm value over time.

14 Christensen, C., op. cit.

15 The experiences of Enron and the numerous dot-bombs of the tech wreck serve as the most recent illustrations that while it can be very glamorous to be viewed as on the cutting edge of the business world, bankruptcy provides a particularly ineffective platform from which to generate future growth.

16 See Hamel, G., & Prahalad, C. K. 1991. Corporate imagination and expeditionary marketing. *Harvard Business Review*, 69(4): 81–92.

17 See Ragman, A. M., & Verbeke, A. 1998: Corporate strategies and environmental regulations: An organizing framework. *Strategic Management Journal,* 19(4): 363–375, which notes that most managerial approaches to environmental issues take a very simple, static view of the problem.

18 National Research Council, op. cit.; and Daily, G. 1997. *Nature's services*: *Societal dependence on natural ecosystems*. Washington, DC; Island Press.

19 See Hawken, P., Lovins, A., & Lovins, H. 1999. *Natural capitalisms: Creating the next industrial revolution*. Boston, MA: Little Brown & Company.

20 Florini, A. (Ed.). 2000. *The third force*: *The rise of transnational civil society*. Washington, DC: Carnegie Endowment for International Peace.

21 Rheingold, H. 2002. *Smart mobs: The next social revolution*. Cambridge, MA: Perseus Publishing.

22 See, for example, Hart, S., & Milstein, M. 1999. Global sustainability and the creative destruction of industries. *Sloan Management Review*, 41(1): 23–33.

23 To be sure, there are many new problems that these technologies may create, making their ultimate contribution to sustainability more unknowable; witness the problems Monsanto encountered in pursuing its agricultural biotechnology strategy in the mid to late 1990s.

24 Drexler, E. 1986. *Engines of creation*. Garden City, NY: Anchor Press.

25 See Benyus, J. 1997. *Biomimicry. Innovation inspired by nature.* New York: Morrow.

26 Christensen, C., Craig, T., & Hart, S. 2001. The great disruption. *Foreign Affairs*, 80(2): 80–95.

27 Coyle, D. 2001. *Paradoxes of prosperity*. New York: Texere Publishing.

28 See World Bank. 2000. *World development report; Attacking poverty*. New York: Oxford University Press.

29 Easterly, W. 2001. *The elusive quest for growth*. Cambridge, MA: MIT Press.

30 National Research Council, op. cit. See also Hammond, A. 1998. *Which world? Scenarios for the 21st century*. Washington, DC: Island Press.

31 See Prahalad, C. R., & Hart, S. 2002. The fortune at the bottom of the pyramid. *Strategy + Business*, Issue 26: 54–87.

32 Von Dieren, W. (Ed.). 1995. *Taking nature into account*. New York: Copernicus.

33 The four strategies developed in this section were first articulated in: Hart, S. 1997. Beyond greening: Strategies for a sustainable world. *Harvard Business Review,* 75(1): 66–76. We would also like to thank our colleagues at the Sustainable Enterprise Academy – in particular Brian Kelly, David Wheeler, Bryan Smith, John Ehrenfeld, Chris Galea, Art Hanson, David Bell, Nigel Roome, Jim Leslie and Pat Delbridge – for helping us to clarify our thinking regarding how the drivers of sustainability, viewed through the proper set of business lenses, influence shareholder value.

34 The most comprehensive treatment of eco-efficiency was done by the World Business Council for Sustainable Development in: DeSimone, L., & Popoff, F. 1987. *Eco-efficiency: The business link to sustainable development*. Cambridge: MIT Press. See also James, P., & Bennett, M. 1994. *Environment-related performance measurement in business: From emissions to profit and sustainability?* Ashridge Management Group Publication.

35 Hart, S. 1995. A natural resource-based view of the firm. *Academy of Management Review*, 20(4): 988–1014.

36 Darnall, N. 2002. *Why firms signal green: Environmental management system certification in the United* States. Unpublished Ph.D. dissertation, University of North Carolina, Chapel Hill.

37 See Marcus, A. 2002. Reinventing environmental regulation. Washington, DC: RFF Press. For more information on European pollution prevention programs, see European Integrated Pollution Prevention and Control Bureau (http://eippcb.jrc.esl), the UK government's Enviro Wise Programme (http.//www.envirowise.gov.uk), and the Implementation and Enforcement of Environmental Law (IMPEL) (http://europa.eu.int/comm/environment/impel//index.htm). U.S. pollution-prevention programs are documented by the U.S. Environmental Protection Agency (http://www.epa.gov/epahotne/p2pgram.htm).

38 For more information on these and other programs, see Smart, B. 1992. *Beyond counpliance*: *A new industry view of the environment*. Washington. DC: World Resources Institute.

39 3M Company. 1992. *Pollution prevention pays*, videotape.

40 See, for example, Christmann, P. 1998. Effects of 'best practices' of environmental management on cost advantage: The role of complementary assets. *Academy of Management Journal,* 43(4): 663–680; and Sharma, S., & Vredenburg, H. 1998. Proactive corporate environmental strategy and the development of competitively valuable organizational capabilities *Strategic Management Journal*, 19(8): 729–753.

41 Through early adoption of extended producer responsibility requirements, European governments and firms have pioneered efforts in product stewardship. See, for example, Roome, N., & Hinnells, M. 1993. Environmental factors in the management of new product development. *Business Strategy and the Environment,* 2(1): 12–27; Welford, R. 1995. *Environmental strategy and sustainable development*. London: Routledge; and Steger, U. 1996. Managerial issues in closing the loop. *Business Strategy and the Environment*, 5(4): 252–258.

42 Wheeler, D., & Sillanpaa, M. 1997. *The Stakeholder corporation*: London: Pittman Publishing.

43 Elkington, J. 1998. *Cannibals with forks.* Gabriala Island: New Society Publishing.

44 Hoeffler, S., & Keller, K. 2002. Building brand equity through corporate societal marketing. *Journal of Public Policy and Marketing*, 21(1): 78-89.

45 Fiksel, J. 1995. *Design for environment: Creating eco-efficient products and processes*. New York: McGraw-Hill.

46 For a leading example of industrial ecology, refer to Graedel, T., & Allenby, B. 1995. *Industrial ecology*. Eaglewood Cliffs: Prentice Hall.

47 Buffington, J., Hart, S., & Milstein, M. 2002. *Tandas 2010: Race to sustainability*. Center for Sustainable Enterprise, University of North Carolina: Chapel Hill.

48 See *Proposal For a Directive of the European Parliament and of the Council on Waste Electrical and Electronic Equipment and on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment*. Com #(2000)347 available at http://europa.eu.int/comm/environment/docum/00347 htm.

49 McDonald, H., London, T., & Hart, S. 2002. *Expanding the playing field. Nike's World Shoe project*. Washington, DC: World Resources Institute.

50 Ibid.

51 See, for example, Vergragt, P., & van Grootveld, G. 1994. Sustainable technology development in the Netherlands: The first phase of the Dutch STD programme. *Journal of Cleaner Production*, 2(3/4): 133–139; Fussler, C. 1998. *Driving eco-innovation*. London: Pittman Publishing; and von Weizsacker, E., Lovins, A., & Lovins, H. 1997. *Factor four*. London: Earthscan Publishing.

52 See Hart, S., & Milstein, C., op. cit.

53 McDonough, W., & Braungart, M. 2002. *Cradle to cradle*. New York: North Point Press.

54 Baum, D. 2002. GM's billion-dollar bet (Wired.com./www.wired.com/wired/archive/10.08/fuelcellcars.html).

55 Holliday, C., op. cit.

56 Hamel, G. 2000. *Leading the revolution*. Boston: Harvard Business School Press; Foster, R., & Kaplan, S., op. cit.; and Christensen, C., Craig, T., & Hart, S., op. cit.

57 See von Dieron, W., op. cit.; Prahalad, C. K., & Hart, S., op. cit.; and Prahalad, C. K., & Hammond, A., 2002. Serving the world's poor, profitably. *Harvard Business Review,* 80(9): 4–11.

58 Hart, S., & Sharma, S. 2002. Radical transactiveness and competitive imagination. Presented at the Academy of Management Annual Meeting, Denver CO, August 2002.

59 Counts, A. 1996. *Give us credit*. New York: Times Books.

60 Balu, R. 2002. Strategic innovation: Hindustan Lover. *Fast Company*, 47: 120–125.

61 Prahalad, C. K., & Hart, S., op. cit.

62 Prahalad, C. K., & Hammond. A., op. cit.

63 See de Soto, H. 2000. *The mystery of capital*. New York: Basic, for a discussion about the value that resides in informal economies.

64 These companies and others including Hewlett-Packard and Ford have joined the Base of the Pyramid Learning Laboratory at the University of North Carolina's Kenan Flogler Businees School to explore ways to enter the underserved markets of the world in ways that are culturally appropriate and environmentally sustainable.

65 Hart, S., & Christensen, C. 2002. The great leap: Driving innovation from the base of the pyramid. *Sloan Management Review*, 44(1): 51–56.

66 Hart, S., & Milstein, M., op. cit.

67 Hart, S., & Christensen, C., op. cit.

68 See Amram, M., & Kulartilaka, N. 1999. *Real options*. Boston: Harvard Business School Press; and Milstein, M., & Alessandri, T. New tools for new times: Using real options to identify value in strategies for sustainable development. Presented at the Academy of Management Annual Meeting, Toronto, Canada, August 2000.

69 Foster, R., & Kaplan, S., op. cit.

70 Christensen, C., op. cit.

Rethinking the Concept of Sustainability

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Introduction: In Search of the Justification for Sustainability

From Rio to Kyoto, Bali, and Copenhagen, one of the defining concepts of our contemporary global culture is "sustainability." But what is sustainability and how is it justified? What are we trying to sustain? Obviously, not everything that is sustainable is worth sustaining. So what makes some things worth sustaining and others not? Different answers have been given by different groups that reflect their own interests. How are we to judge among competing interests? To answer these questions, we will argue that sustainability is, at its heart, a matter of ethics. To some, this view may seem obvious. However, it is often overlooked or assumed without question. The problem with this situation is that when ethical views are left unspoken and assumed, the door is opened for counterproductive disputes. The goal of this article is to explore the ethical foundation of sustainability and highlight its essential importance.

We will argue that sustainability is not simply a trend or fashion that has gained currency because of circumstantial conditions. What gives sustainability its importance is not as an engineering, environmental, or management concept, but as an ethical concept that can and should guide conduct. The perspective we will advance is that sustainability is integral to the way in which we as humans rationally order our experience of the world through the lens of ethics. We will argue that sustainability can most readily be understood if interpreted from an Aristotelian perspective of that which is conducive to a flourishing life, but it is also consistent with other major philosophical systems of ethics. Therefore, we hold that sustainability should be recognized as belonging to the canon of ethical concepts, such as courage, prudence, and temperance.

Examining the Record: How is Sustainability Understood?

The term "sustainability" is a relatively new addition to the popular vernacular, but the concept has ancient and universal roots. In the earliest days of Chinese civilization, the Taoists and Confucians showed a deep respect for nature by advocating an approach to life that was understood to be in accord with an ordered and balanced world. The Hebrew Scriptures affirmed the idea that human righteousness involved not only having the right relationship with God and other people, but careful stewardship of the earth. And around the world, we can find many examples of people such as the Native Americans who emphasized notions of harmony with nature as a sacred duty of human life. More recently, because of the emergence of serious problems associated with the human impact on the environment, the idea of sustainability has taken on an unprecedented significance, and the seriousness of this problem only seems to grow by the day.

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Within the last 40 years, one publication that stands out as a landmark in ushering in what could be called the "sustainability movement" is the 1972 book *The Limits to Growth* (Meadows and Club of Rome 1972).[1] Although the word "sustainability" did not appear in the book, the book conveyed a simple message: the contemporary mode of massive economic consumerism, on which the industrialized economies were based, was unsustainable, and humankind had to choose between creating a self-inflicted global catastrophe or adopting a path of sustainability. It turned out that the predictions made by the book failed to materialize, but the threat to society was accurate. As a result, this book contributed to a growing awareness of the perils facing the environment, society, and economy, brought about by widespread societal actions that were incompatible with sustainability.

In recent decades, with the expanding awareness of the threat of global warming, the public awareness of sustainability or sustainable development has grown steadily and spread around the world. How is the term understood? There are numerous definitions of the word "sustain." In its everyday use, the term refers to that which is able to be "supported," "borne up," "endured," or "maintained" over time. When we use the term "sustainability" in this article, we will be referring specifically to the idea of "sustainable development." The British sustainability scholar, John Blewitt, defined sustainable development as "the idea that the future should be a better healthier place than the present" (Blewitt 2008, p. ix). In an often-cited study, another scholar, William M. Adams, noted that the Brundtland Report defined sustainability as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (Adams 2006, pp. 1–2).[2]

Although these definitions serve a functional purpose, we will argue that they fail to capture important aspects of the meaning of sustainability. Before explaining what we see as the deficiency in these interpretations and proffering an alternative, we want to also point out that there are extensive ramifications of this popular view of sustainability as it has been operationalized by academics working in various fields, such as business, economics, the sciences, and various social sectors. For example, there has been an explosion of literature in which sustainability is the main concern and is used to describe matters pertaining to technology, economic development, and approaches to management in areas such as "sustainable business," "sustainable technology," "sustainable agriculture," "sustainable economics," etc. In virtually all of these cases, sustainability is understood in terms of technologies and practices in which the human impact on the environment – primarily through its "carbon footprint," and other such measures – is minimized. The literature therefore tends to be descriptive of problems regarding the negative human impact on the environment, or prescriptive in the sense of describing methods to reduce the deleterious impact of human actions on the world – i.e., "how to" be sustainable.

As an example, in a study from the journal *Land Economics*, the authors try to engage in a cross-disciplinary analysis from the fields of ecology and economics. One of the key issues discussed in this article pertains to the "contrasts between the views of ecologists and economists on the issues of resource substitutability and the reversibility of the consequences of ecological change" (Norton and Toman 1997, p. 555). In another article in the popular press, and with a less theoretical orientation, BBC News recently reported on the city of Masdar being built from the ground up in Abu Dhabi with the aim of being the world's first "zero-carbon city," powered entirely by the sun. In describing how the "eco-city" is being designed to martial the latest in technologies in order to maximize sustainability, the article quotes one of the architects, Gerard Evenden, as saying, "Lunar technology has begun to influence our thinking" (Heap 2010). These are examples of sustainability expressed through research and technology, and in such articles, the ethical goodness of sustainability is a subtext that is assumed and not questioned, and the focus is on how to solve the empirical problem at hand.

In the area of management, sustainability or "going green" is increasingly seen as a central component of business strategy. For example, a 2010 Accenture-Global Compact study reports that "93% of [chief executive officers] CEOs believe that sustainability issues will be critical to the future success of their business," and "96% of CEOs believe that sustainability issues should be fully integrated into the strategy and operations of a company (up from 72% in 2007)" (Lacy et al. 2010, pp. 13–14). But what does it mean if business leaders embrace sustainability? Typically, in the business literature, the justification for supporting sustainability is couched in economic or management terms, such as profit or strategic advantage. As an example, in a *Time Magazine* article, "GE's Green Awakening," it is stated that "GE has a history of opposing environmental regulations that don't suit the firm." And yet, according to the article, the company's new CEO, Jeff Immelt, is pushing the company in areas associated with sustainability. "Is Immelt responding to a guilty corporate conscience?" the article asks. "Nope. He's seizing a blossoming opportunity: Green is where the green is" (Fonda 2005). Taking this idea even further, in a *Harvard Business Review* article, Nidumolu, Prahald, and Rangaswami state: "Our research shows that sustainability is a mother lode of organizational and technological innovations that yield both bottom-line and top-line returns" (Nidumolu et al. 2009, pp. 57–58). Here and in countless examples in the current business literature we find the idea that the business justification for sustainability can be found in terms of profitability and strategic advantage.

It is virtually universally the case that the literature on sustainability follows on the assumption that "sustainability is good." But why? The problem we see in all the descriptions of sustainability is that either it is understood as an essentially amoral engineering or economic concept, or the ethics is assumed with little or no philosophical justification. Is sustainability "good" because it is conducive to profit or strategic advantage? We think not. Some might assert that there is no need to justify sustainability because the ethics is self-evident. Again, we disagree. Moreover, we argue that if the ethics of sustainability is not philosophically defensible, then it may be nothing more than platitudes and wishful thinking. This would render the entire ethics of sustainability suspect and easily manipulated to serve purposes that, in fact, are not ethical.

In light of this, we believe that to understand the meaning of sustainability, it needs to be seen as a matter of ethics, and even as a kind of virtue similar to the Aristotelian notion of "temperance." With this in mind, we offer the following as a provisional definition of sustainability:

> Sustainability refers to a moral way of acting, and ideally habitual, in which the person or group intends to *avoid* deleterious effects on the environmental, social, and economic domains, and which is consistent with a harmonious relationship with those domains that is conducive to a flourishing life.

During the remainder of this article we attempt to show why we think this provides a more adequate understanding of sustainability as an ethical concept.

On the Multiplicity of Rationalities and the Experienced World

Although the idea of sustainability or sustainable development has gained near universal acceptance, the reasons for supporting it vary based on the interest or perspective of different groups. In this case, we will argue that there is a risk that the pursuit of sustainability could lead to conflicts among competing interests. On what basis can such conflicts be reconciled? To answer this question we ask whether there is any basic, philosophically defensible reason for advocating sustainability as an ethical good, or is it instrumental, serving only to support the objectives of other interests, whatever they may be?

To get at the ethical nature of sustainability, let us reconsider how it is often interpreted. We think that a very good report on sustainability is that written by William Adams: "The Future of Sustainability: Re-thinking Environment and Development in the Twenty-first Century." According to Adams, sustainability is often illustrated as a condition that is supported upon the three pillars of environment, society, and economy (Figure 1).

But he suggests that a better illustration uses "the three interlocking circles model" in which there is "balance" between the dimensions of sustainability" (Adams 2006, p. 2).[3] The three circles to which he is referring are depicted in Figure 2.

This illustration, or the idea it conveys, has been widely adopted in many publications. There are many things that we find valuable about this illustration. Most importantly, this graphic attempts to communicate two important points: first, the three circles capture in a simple manner three essential domains of the world experienced by humans[4]; and, second, this illustration is meant to suggest that sustainability is or

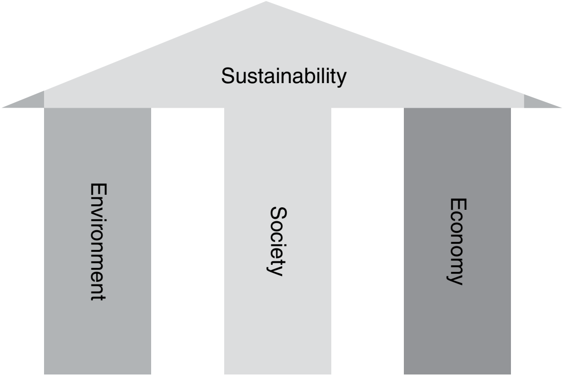

Figure 1 The three pillars of sustainability (Adams 2006, p. 2).

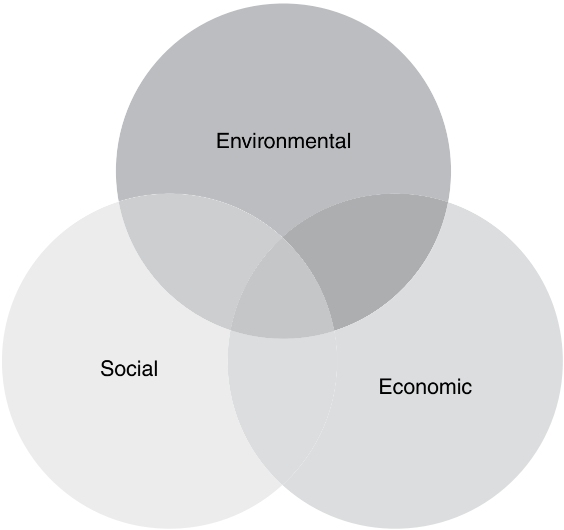

Figure 2 The three interlocking circles of human experience interconnected through sustainability.

could be seen as the mutual intersecting of these domains.[5] Later in this article, we will reflect more on the qualities of the three identified domains, but for now, suffice it to say that this description is intended to provide a simple, yet comprehensive schema that covers some of the major domains of the world as experienced by people. We agree that sustainability can provide a bridging rationality among the three depicted domains. However, the reason why is unclear. The reason we suggest necessitates that we recognize that these domains have their own characteristic rationalities and that sustainability ethically construed serves to bridge these domains. To clarify this point, we will elaborate on the ideas of "multiple rationalities" and the "experienced world."

To understand sustainability, we need to understand its underlying rationality, but what do we mean by "rationality?" Rationality is a mode of thinking according to which we order the world. We distinguish the "experienced world" from the "world" as a general term, because the world as we experience it gains its meaning based on the way in which it is ordered through human rationality. The experienced world of a bat, a shark, and a spider are very different from that of a typical human being.[6]

Our use of the term "rationality" needs some explication. The term "rationality" is often equated with reason and as such is thought to be unitary and universal, as exemplified in areas such as symbolic logic or mathematics. In these cases, for example, the principles of modus ponens or equations such as $1 + 1 = 2$ are considered not to be domain specific, but true in all possible worlds. Logic and mathematics may serve as the prototypes for the universality of reason, but in the course of everyday life, "rationality," at least as we are using the term, is domain specific. It would be more accurate therefore to speak of multiple "rationalities," rather than a unitary and universal "rationality."

To elaborate, we will use the term "rationality" to refer to a way of thinking that exhibits its own "internal logic" or consistency and the rules or principles that are applied to the interpretation of phenomena within a particular domain of experience. Here we are not denying the objectivity of reality and the capacity of human reason to understand and explain this reality. What we mean is that in different contexts the same reality is interpreted from different points of view. "Rationality" in this sense refers to a phenomenological gestalt or "worldview," held together by its own loosely related principles, rules, interests, and goals that are used to interpret, organize, and evaluate phenomena.[7] It is through such rationalities that our experiences are interpreted and, in the process, our world is ordered.

To give a simple illustration, let us consider professional sports as a domain. Within this domain, we can distinguish many sub-domains, each of which is organized around distinct principles that give the sport its character. These principles and rules form the rationality that characterizes the sport. Boxing and figure skating are both sub-domains of the parent domain of Olympic sports. As such, both sub-domains are found in Olympic competitions and both are judged with awards that lead to bronze, silver, and gold medals. However, the rationality that leads to the gold in figure skating is very different than that associated with boxing. If figure skaters started throwing punches at their partners or if boxers started dancing in romantic embrace, the rationality of both sports would have been violated and such incidents would be disqualified as inadmissible aberrations that violate the rationalities of each of the sports.

Unlike boxing or even sports in general, sustainability is a domain that is so broad and basic that its rationality is linked to the entire spectrum of human experience, and this, we would suggest, contributes to the lack of clarity regarding the justification thereof. In analyzing arguments pertaining to sustainability, we will find that in some instances people will be arguing based on the rationality of economics, while another person may be arguing in terms of environmental security, and so on. Moreover, one person may move between domains of rationality without even being aware of doing so. This change may be appropriate because one form of rationality may be more suited from one perspective than another. But, this may add to a lack of clarity. Metaphorically, one person may be arguing about apples, while the other is concerned with oranges, and a third may be focusing on fruit generally.

If sustainability is, as is often suggested, found at the intersection of the domains of environment, society, and economy, it must follow from an underlying rationality that is common to all three and more basic than that which is peculiar to each one individually.[8] We argue that this unifying underlying rationality is ethics.

For our analysis, we will stay with the widely used schema of the world as divided into three domains of environment, society, and economy.[9] One might think of this as an elaborate way of referring to what more simply could be referred to with just one term, such as the "world," or "earth," or "environment." However, that is not the case because when we say that sustainability refers to the "experienced world," we are referring to the world as experienced by people through the intermediation of the rationalities specifically associated with the environmental, social, and economic experiences. Sustainability, we would suggest, only applies to this *experienced world*, not to a world outside the domain of human rationality. Consider this: the sun will eventually burn itself into extinction, and along with it the earth as we know it will cease to exist. And yet, it would be a misuse of the term if we referred to the sun as an example of non-sustainability in the way we are using it. Sustainability doesn't apply to the physical environment in itself, but rather our human relationship with the world.[10]

We have stated our central question as, "Why sustainability?" We are now ready to begin to offer an answer, which is that sustainability is part of the answer to the ancient and central question of ethics, "How are we to live?" As such, sustainability is a matter of ethics, and as with ethics generally, it applies to humans qua conscious beings and our relationship with the world, by which we mean the "experienced world," understood in terms of three major domains: the environment, society, and the economy.

Let us briefly elaborate on what is meant by each of these domains, beginning with the "*environment*." By "environment" we are not referring simply to an "external ecosystem," but an *experienced* ecosystem with which we as persons have a conscious and deliberate relationship. The experienced environment is the complex ecosystem which has at its center conscious human life. It is not simply a planet cloaked in gases; it is one in which air quality can be assessed as good or bad. *Society* consists in the complex web of relations that together constitute our personal and collective lives, which may include a variety of characteristics such as parents, football fans, or members of a political party. The *economy* refers to all those relationships in which there is an exchange of goods and services usually through the financial system, but it may also be through alternative means, such as barter.

On the Ethics of Sustainability Within the Domains of Rationality

We have suggested that the ethics of sustainability can serve as a bridging rationality among the three domains. Let us now consider how this is the case. To do so, we first need to better understand the nature of the rationalities that characterize the three domains and consider how the domains may interact with each other. As we will show, there can be conflicts within and among the different domains, but the ethics of sustainability can serve as a bridging rationality that reconciles competing interests.[11]

To begin, let us consider the place of interests within domains. Among the three domains – society, environment, and economy – the one that is most easily grasped is the economic. In the *economic domain*, as in others, the relevant variations on economic rationalities are not limited in a strict and singular manner, but cluster around a variety of economic perspectives that differ according to the individual's interests and experiences. The rationality of the consumer seeks to maximize the value of expenditures; the rationality of the shareholder is one that seeks to maximize profit, and so forth. Among the cluster of economic rationalities, there may be some people who will be so obsessively profit driven that all other interests will be sacrificed. Such a person would not hesitate to sacrifice the interests of other stakeholders in order to maximize profit. Naturally, someone who exercised his or her economic rationality in this way would run into very serious conflicts either with others who hold to different interests in the economic domain or with others concerned with defending interests associated with other domains.

Similarly, the *environmental domain* is a function of the rationalities that cluster around environmental interests. At one end of the spectrum, a person may be so focused on environmental protection that virtually every deliberate action he or she does would be done with a view of eliminating or minimizing the impact on the environment. But there are other specific rationalities associated with the environmental domain, such as aesthetics and security. The aesthetic perspective would focus on the beauty associated with the natural world, whereas the security perspective would focus on the environment as it pertains to human survival. Consider the practice of open-pit mining: an environmental rationality that emphasized security might permit open-pit mining so long as certain security standards were not violated, whereas an aesthetically oriented environmental rationality might object to open-pit mining on aesthetic grounds.

Finally, the rationalities associated with the social domain cluster around what is in the interest of a particular society or community, which could be defined according to many criteria. For example, society may be drawn very widely so as to embrace all of humanity or narrowly to a small group, such as one's clan, nation, or any number of subgroups. The way a society is identified follows from a defining rationality. While every member of society is guided by a social rationality, political leaders have a particularly prominent role not only in carrying out civic duties, but also in influencing public opinion regarding how to interpret the defining characteristics of membership in a society and the rights and duties associated therewith.[12] To illustrate, at one extreme, persons such as Martin Luther King Jr. and Nelson Mandela dedicated their lives for the sake of a social rationality that accords political rights to all people irrespective of race; at the other extreme, the Nazi party used ethnicity as the defining criterion in their social rationality and based thereon launched the Holocaust. Clearly, the conflict of interest between the inclusive Mandela type rationality and an exclusive Nazi rationality is categorical and of paramount importance because what is at stake may be human survival.

Generally, as with ethics, an individual can act as a "free-rider" by violating the norm of sustainability, but if a society did so in an extreme way, it would risk collapse. Easter Island is an example of a society that violated environmental sustainability to a point that was irreversible. A nonsustainable economy would be one that depended on activities that led to irreversible exhaustion; some have argued that the Roman Empire was such an example. And similarly, a nonsustainable society would be one that failed to meet the needs and interests of its members. One example might be the Shakers, a society in which all the members were expected to be celibate. If new members joined in sufficient numbers, the group could have survived, but this seems not to have been the case and so the group is almost, if not completely, extinct.

Many or most interests can be carried out without engendering conflict. Every day people cultivate flowers in their gardens without having to engage in battles with multinational corporations. Towns pay teachers in their schools without engendering protests from other town employees or entangling themselves

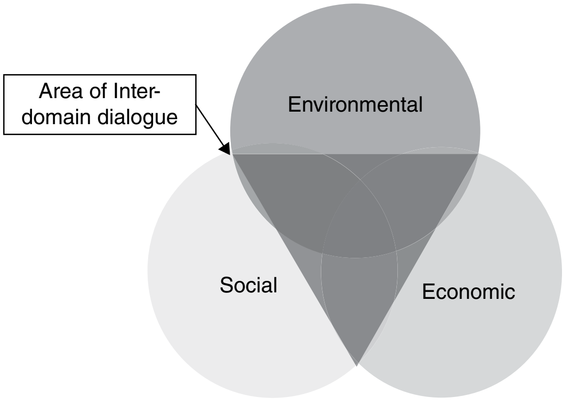

Figure 3 Area of inter-domain dialogue.

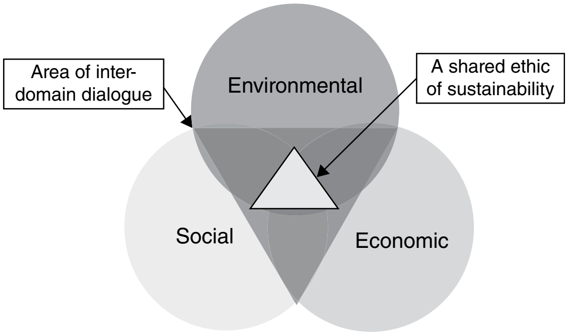
Area of inter-domain dialogue
Environmental
A shared ethic of sustainability
Social
Economic

Figure 4 A shared ethic of sustainability.

in disputes involving acceptable automobile emission levels. It is not that some connection cannot be imagined, but in the practical course of events, the two interests do not intersect. When interests do intersect, then, they must be moderated and the process of moderating among competing interests is called *dialogue*. We illustrate this dialogue among interests across domains as occurring within "the area of inter-domain dialogue" (Figure 3).

If there is opportunity for conflict within a domain, the opportunity for conflict is even greater between domains. An advocate for environmental issues may be completely unconcerned with the implications for business, and someone advocating on behalf of a particular social group may consider environmentalists to be nothing but insufferable nuisances. How can competing interests be reconciled? We would suggest that between the alternatives of nonintersecting interests and conflicting interests, there is an area of convergent interests and this is the area of shared ethics of sustainability, which is depicted in Figure 4.

What should be stressed is that when there is a conflict among interests within a domain or between domains, sustainability when interpreted as an ethic provides the common framework of human flourishing for moderating and adjudicating among competing demands. It provides the same standard that can be applied to both sides in a conflict and offers a convergent and universal bottom-line resolution across all three domains.

Let us make a qualification: we are not saying that convergence occurs only in an ethic of sustainability, nor are we saying that sustainability is the only form of ethics. However, we are saying that all three domains must share in an ethic of sustainability, and if this were not the case, the world as experienced would, by necessity, fall apart. Why? If a domain is unsustainable, it will fail and if any domain fails, then the lived world will fail, just as no stool can stand on two legs. The world as experienced most obviously needs the environment, but while it may be less obvious, without society, a person would lack the resources to be a person in the sense of a language-speaking, civilization-building creature, and the same would hold true if there were no economy.

Sustainability: Does it Embody the Criteria to Qualify as an Ethic?

We have maintained that the three domains of environment, society, and economy are a schematic representation of much of the experienced world of human beings. Furthermore, only when sustainability is present in all three domains can we talk about a holistically lived world. This is relevant to understanding the current pervasive focus on the issue of sustainability. Problems of nonsustainability that are manifested in issues such as global warming cannot be limited to a single domain, but affect the entire experienced world. And, unlike isolated examples of small societies such as that of Easter Island that suffered demise because, at least in large part, of environmental nonsustainability, the current problem of global warming affects the entire planet. This situation has forced an awakening within us that sustainability is central to human flourishing.

We can now see that sustainability pertains to an attitude or respect toward the world that leads to a prudential interaction with and among the environmental, social, and economic domains. This is not simply a matter of engineering efficiency, it is a way of life, and as such, it is a matter of ethics. This ethical connection is further elucidated when we consider sustainability from the perspective of the major ethical schools of thought. There is, for example, an obvious connection between this view of sustainability and Aristotelian ethics, although the connection can also be seen in terms of other schools of ethics. According to Aristotle, the virtues are "a mean between two vices, one of excess and the other of deficiency" (Aristotle 1976, pp. 108–109). Crucially, it is those "excellences," that is, virtues that ultimately are conducive to *eudaimonia*, the happiness[13] associated with human flourishing. Human flourishing therefore is the ultimate indicator of Aristotelian ethics. Similarly, we see sustainability as a virtue that consists in the mean between the extremes of wasteful excess and an emaciating deficiency in our encounter with the three domains. As we see it, although Aristotle did not identify it as such, sustainability could be seen as a "virtue" similar in nature to prudence or practical reason (*phronesis*) and temperance. And, as with all virtues, the virtue of sustainability is one that is conducive to creating the happiness that follows from a world in balance, which is essential to human flourishing.[14]

It is important to stress that if sustainability is not understood as an ethical concept, and as such as a kind of virtue, then it could not be called on to adjudicate among competing interests. If considered solely as a descriptive term, rather than a prescriptive term, sustainability would apply equally to things that are from various ethical perspectives generally regarded as either patently moral or immoral. Consider the example of slavery. It is a practice that has existed for millennia and continues to do so in certain areas. Now, if sustainability were not a notion that was bound up with ethical signification, then the persistence of slavery over the millennia would be sufficient to qualify it as consistent with sustainability. However, if we see sustainability as an ethical concept, then it could not be used to describe certain phenomena despite their persistence. We do not use the term "sustainable" to describe slavery, because despite its persistence, slavery is a clear violation of human dignity and as such it is simply another example of the persistence of various forms of human evil across the millennia. Sustainability, by contrast, only makes sense if it is understood as that which is conducive to human flourishing; in other words, the concept of "sustainability" is only appropriately applied to those phenomena that are understood as what *ought* to persist.

Following Aristotelian tradition, moral goods can be distinguished from useful or pleasant goods, and among them we find human motives such as justice, truthfulness, honesty, or peace. These goods are associated with anything that contributes to the flourishing of human beings and their moral character (Ryff and Singer 1998), but also with meaningful purpose and transcendent principles (Dent 1984; Roberts 1988). Sustainability therefore would be classified among this kind of moral good.

Significantly, this interpretation of sustainability qua ethic is not limited to an Aristotelian outlook but is consistent with many of the major systems of ethics. For example, sustainability is consistent with the Kantian categorical imperative. The first form of Kant's categorical imperative is, "Act only according to the maxim whereby you can at the same time will that it should become a universal law (G 420)" (Kant 1983, p. 29). Certainly, we can universalize the principle of sustainability, but could not do so with nonsustainability. Sustainability is also consistent with the Kantian notion of "universal dignity" according to which, one is enjoined to "Act in such a way that you treat humanity whether in your own person or in the person of another, always at the same time as an end and never simply as a means (G 429)" (Kant 1983, p. 36). Sustainability honors the dignity of others (in this generation as well as generations to come), by treating the world as experienced as our collective inheritance. Nonsustainability clearly violates the dignity of others because a person who pursues nonsustainable actions may benefit him or herself but in doing so may be violating the needs and interests of others.

Sustainability is also consistent with the core moral precept of utilitarianism as expressed by John Stuart Mill as the "Greatest Happiness Principle." According to this view, the "good" is understood as that which contributes the greatest happiness to the greatest number (Mill 1993, p. 3). This too may be most readily seen via the negative interpretation, because actions that are unsustainable may lead to serious adverse effects on others, whereas sustainable actions should generally provide benefits to the actor without inflicting negative consequences on the majority of others.

Sustainability conforms to notions of reciprocity expressed in the Golden Rule, "Do unto others as you would have them do unto you," because by consciously acting sustainably one is consciously regulating one's behavior in such a way that shows similar consideration both to the needs and interests oneself and others.

Finally, it is worth noting that while sustainability is not specifically mentioned in the Universal Declaration of Human rights, it is implied in such aspects as Article 1, which affirms the universal dignity and rights of all people, and Article 3, which states, "Everyone has the right to life, liberty and security of person." Without sustainability, none of these rights can be honored.

Concluding Thought

What do we mean when we take something for granted? Often what we mean is couched in terms of regret; namely, that we overlooked or tailed to give proper recognition to something that we knew to be true and essential to, say, a relationship. This occurs, for example, when one fails to tell or express one's love to a "significant other." If we take for granted that which is essential to it, the relationship can be damaged. Sometimes it is recoverable, sometimes not.

It may be true that most would agree with us that ethics is essential to a proper understanding of sustainability, and even that at its core sustainability itself is an ethical concept. However, we fear that too often this truth is taken for granted, and in doing so, our understanding of sustainability may be flawed. And we see this as posing a risk that the sustainability movement may lose its way or even fail entirely.

We have tried in this article not only to reaffirm and clarify why and how ethics is the justifying rationale of sustainability, but also to underscore that, in the final analysis, ethics is the key by which disputes and conflicts among the rationalities of the economic, social, and environmental domains can and ought to be resolved. We are not saying that these are the only domains of rationality that are important to a complete understanding and proper implementation of sustainability, but that they are crucial domains and the ones referred to most often in the current sustainability discussion. Nor are we saying that the ethical rationality is fully sufficient to solve all the problems of the sustainability movement.

However, we are saying that if we fail to recognize the essential ethical grounding of sustainability, or if we take it for granted, then sustainability can easily lose its way and will, in the end, fail to be justified. To say this is simple, and perhaps too easy. To keep ethics as the sustainability movement's polestar will continue to be demanding and difficult.

Notes

[1] The authors state, "It is the predicament of mankind that man can perceive the problematique, yet, despite his considerable knowledge and skills, he does not understand the origins, significance, and interrelationships of its many components and thus is unable to devise effective responses." We agree and would suggest that almost 40 years later, the significance of the problem of sustainability is not adequately understood.

[2] Adams drew this idea from the World Commission on Environment and Development's *Our Common Future*, Oxford University Press, 1987, p. 43. (Adams 2006, pp. 1–2)

[3] The use of three interlocking circles to represent the idea that sustainability is the intersecting point among the domains of the environment, society, and economy is repeated in many publications. What we think

is not adequately explained, however, is why this is the case.

4 By illustrating the world as experienced by human beings in terms of three domains, we are not suggesting that this is a complete picture. There are other major domains, such as religion, that could be added. For the sake of simplicity, however, we have limited our schema to three domains.

5 For another discussion that interprets sustainability in terms of the intersection of the domains of environment, society, and economy, see the publications by Goodland and Daly 1996 and Sarkis et al. 2006 (p. 751).

6 Indeed, although not its main point, this is in keeping with Nagel's seminal article, "What Is It Like to Be a Bat?"

7 The idea of domains of rationality as we are describing it bears much in common with Wittgenstein's "language games." According to Wittgenstein, within our ordinary language we can find usages, which he calls "language games," that are guided by a grammar and syntax that helps to give meaning to that particular language game. Nevertheless, these interpretations of the world through the intermediation of different rationalities are just that: interpretations. We are not denying the reality of the world itself and the human capacity to access such a reality. What we suggest is that there are different phenomenological approaches to the same reality.

8 In our discussion thus far, we have focused on the idea of multiple rationalities that are domain specific. Sustainability, we are suggesting, is the rationality that represents a point of convergence among the three rationalities. As such it constitutes a kind of bridging or unifying rationality.

9 Sometimes the same idea is expressed with different terms, as is the case with the idea of Elkington's well-known idea of "triple bottom line." See, for example (Elkington 1998) and (Fisk 2010).

10 Just as we would not attribute sustainability to the physical environment, so too, we would not apply it to animals. For example, ecology books have many examples of over-predation, whereby, for example, a hypothetical wolf population is so successful against its main prey that its food supply is diminished and the wolf's population is forced to decline. Although an ecologist might predict that the wolf population was not sustainable in its ecosystem, we would not criticize the wolf for acting in a way that violates sustainability (or "sustainable development"). We may think it unfortunate for the wolf, but two important points apply: first, we would accept that as a part of the way nature maintains balance, and second, we would refrain from critical thoughts against the wolf because it cannot be held accountable for understanding its own impact on the ecosystem. The rise and fall of its population has nothing to do with sustainability in the sense of sustainable development any more than does a tree's shedding of leaves in the autumn.

11 In the following paragraphs we will illustrate the idea of competing interests by describing the situation as if individual persons represented one particular interest. This may be the case. However, it may also be the case that within the mind of an individual, different interests will be represented in the way that a person reasons through a problem.

12 In this sense, we are using the term "politician" to mean "a leading civil servant."

13 The term happiness is the translation of the Greek concept *eudaimonia* and cannot be understood in its contemporaneous meaning of "happiness" because eudaimonia has not just a sentimental or affective meaning; it refers to human flourishing or human fulfillment.

14 At the level of the individual, Aristotle describes eudaimonia as "an activity of the soul in accordance with virtue" (Aristotle 1976, p. 76). When applying this to society in general, according to Sarah Broadie, "A true, articulate, substantial conception of the human good, such as he means to present in *Ethics*, is in Aristotle's view an instrument to aid the statesman in his work of maintaining and developing a flourishing human community (1094 a 22–24)" (Broadie 1991, p. 204).

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Questions for Discussion

1. Do people have a "right to a livable environment"? If so, is this a barrier right (from the section on rights in the General Introduction) or a welfare right? Depending on your answer, what would this imply about business's responsibility to the environment?
2. What do you believe to be the main point of disagreement between Bowie and Hoffman? Do you think that most businesspeople would agree with Hoffman's proposal about business's responsibility to the environment? Why or why not?
3. What do Hart and Milstein mean by "creating sustainable value"? How would they go about determining when this was achieved?
4. In their article, Gomis, Parra, Hoffman, and McNulty suggest that ethics is the key by which disputes and conflicts among the economic, social, and environmental domains can and ought to be resolved. Do you agree with this position? For a businessperson, shouldn't the focus be on simply understanding how the social and environmental domains of sustainability help improve the economic bottom line?

9

International Business

Ethical Dilemmas for Multinational Enterprise
A Philosophical Overview

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First World multinational corporations (MNCs) are both the hope of the Third World and the scourge of the Third World. The working out of this paradox poses moral dilemmas for many MNCs. I shall focus on some of the moral dilemmas that many American MNCs face.

Third World countries frequently seek to attract American multinationals for the jobs they provide and for the technological transfers they promise. Yet when American MNCs locate in Third World countries, many Americans condemn them for exploiting the resources and workers of the Third World. While MNCs are a means for improving the standard of living of the underdeveloped countries, MNCs are blamed for the poverty and starvation such countries suffer. Although MNCs provide jobs in the Third World, many criticize them for transferring these jobs from the United States. American MNCs usually pay at least as high wages as local industries, yet critics blame them for paying the workers in underdeveloped countries less than they pay American workers for comparable work. When American MNCs pay higher than local wages, local companies criticize them for skimming off all the best workers and for creating an internal brain-drain. Multinationals are presently the most effective vehicle available for the development of the Third World. At the same time, critics complain that the MNCs are destroying the local cultures and substituting for them the tinsel of American life and the worst aspects of its culture. American MNCs seek to protect the interests of their shareholders by locating in an environment in which their enterprise will be safe from destruction by revolutions and confiscation by socialist regimes. When they do so, critics complain that the MNCs thrive in countries with strong, often right-wing, governments.[1]

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The dilemmas the American MNCs face arise from conflicting demands made from opposing, often ideologically based, points of view. Not all of the demands that lead to these dilemmas are equally justifiable, nor are they all morally mandatory. We can separate the MNCs that behave immorally and reprehensibly from those that do not by clarifying the true moral responsibility of MNCs in the Third World. To help do so, I shall state and briefly defend five theses.

Thesis 1: Many of the moral dilemmas MNCs face are false dilemmas which arise from equating United States standards with morally necessary standards.

Many American critics argue that American multinationals should live up to and implement the same standards abroad that they do in the United States and that United States mandated norms should be followed.[2] This broad claim confuses morally necessary ways of conducting a firm with United States government regulations. The FDA sets high standards that may be admirable. But they are not necessarily morally required. OSHA specifies a large number of rules which in general have as their aim the protection of the worker. However, these should not be equated with morally mandatory rules. United States wages are the highest in the world. These also should not be thought to be the morally necessary norms for the whole world or for United States firms abroad. Morally mandatory standards that no corporation – United States or other – should violate, and moral minima below which no firm can morally go, should not be confused either with standards appropriate to the United States or with standards set by the United States government. Some of the dilemmas of United States multinationals come from critics making such false equations.

This is true with respect to drugs and FDA standards, with respect to hazardous occupations and OSHA standards, with respect to pay, with respect to internalizing the costs of externalities, and with respect to foreign corrupt practices. By using United States standards as moral standards, critics pose false dilemmas for American MNCs. These false dilemmas in turn obfuscate the real moral responsibilities of MNCs.

Thesis 2: Despite differences among nations in culture and values, which should be respected, there are moral norms that can be applied to multinationals.

I shall suggest seven moral guidelines that apply in general to any multinational operating in Third World countries and that can be used in morally evaluating the actions of MNCs. MNCs that respect these moral norms would escape the legitimate criticisms contained in the dilemmas they are said to face.

1. *MNCs should do no intentional direct harm*. This injunction is clearly not peculiar to multinational corporations. Yet it is a basic norm that can be usefully applied in evaluating the conduct of MNCs. Any company that does produce intentional direct harm clearly violates a basic moral norm.
2. *MNCs should produce more good than bad for the host country*. This is an implementation of a general utilitarian principle. But this norm restricts the extent of that principle by the corollary that, in general, more good will be done by helping those in most need, rather than by helping those in less need at the expense of those in greater need. Thus the utilitarian analysis in this case does not consider that more harm than good might justifiably be done to the host country if the harm is offset by greater benefits to others in developed countries. MNCs will do more good only if they help the host country more than they harm it.
3. *MNCs should contribute by their activities to the host country's development*. If the presence of an MNC does not help the host country's development, the MNC can be correctly charged with exploitation, or using the host country for its own purposes at the expense of the host country.
4. *MNCs should respect the human rights of its employees*. MNCs should do so whether or not local companies respect those rights. This injunction will preclude gross exploitation of workers, set minimum standards for pay, and prescribe minimum standards for health and safety measures.
5. *MNCs should pay their fair share of taxes*. Transfer pricing has as its aim taking advantage of different tax laws in different countries. To the extent that it involves deception, it is itself immoral. To the

extent that it is engaged in to avoid legitimate taxes, it exploits the host country, and the MNC does not bear its fair share of the burden of operating in that country.

6. *To the extent that local culture does not violate moral norms, MNCs should respect the local culture and work with it, not against it.* MNCs cannot help but produce some changes in the cultures in which they operate. Yet, rather than simply transferring American ways into other lands, they can consider changes in operating procedures, plant planning, and the like, which take into account local needs and customs.
7. *MNCs should cooperate with the local government in the development and enforcement of just background institutions.* Instead of fighting a tax system that aims at appropriate redistribution of incomes, instead of preventing the organization of labor, and instead of resisting attempts at improving the health and safety standards of the host country, MNCs should be supportive of such measures.

Thesis 3: Wholesale attacks on multinationals are most often overgeneralizations. Valid moral evaluations can be best made by using the above moral criteria for context-and-corporation-specific studies and analysis.

Broadside claims, such that all multinationals exploit underdeveloped countries or destroy their culture, are too vague to determine their accuracy. United States multinationals have in the past engaged – and some continue to engage – in immoral practices. A case by case study is the fairest way to make moral assessments. Yet we can distinguish five types of business operations that raise very different sorts of moral issue: (1) banks and financial institutions; (2) agricultural enterprises; (3) drug companies and hazardous industries; (4) extractive industries; and (5) other manufacturing and service industries.

If we were to apply our seven general criteria in each type of case, we would see some of the differences among them. Financial institutions do not generally employ many people. Their function is to provide loans for various types of development. In the case of South Africa they do not do much – if anything – to undermine apartheid, and by lending to the government they usually strengthen the government's policy of apartheid. In this case, an argument can be made that they do more harm than good – an argument that several banks have seen to be valid, causing them to discontinue their South African operations even before it became financially dangerous to continue lending money to that government. Financial institutions can help and have helped development tremendously. Yet the servicing of debts that many Third World countries face condemns them to impoverishment for the foreseeable future. The role of financial institutions in this situation is crucial and raises special and difficult moral problems, if not dilemmas.

Agricultural enterprises face other demands. If agricultural multinationals buy the best lands and use them for export crops while insufficient arable land is left for the local population to grow enough to feed itself, then MNCs do more harm than good to the host country – a violation of one of the norms I suggested above.

Drug companies and dangerous industries pose different and special problems. I have suggested that FDA standards are not morally mandatory standards. This should not be taken to mean that drug companies are bound only by local laws, for the local laws may require less than morality requires in the way of supplying adequate information and of not producing intentional, direct harm.[3] The same type of observation applies to hazardous industries. While an asbestos company will probably not be morally required to take all the measures mandated by OSHA regulations, it cannot morally leave its workers completely unprotected.[4]

Extractive industries, such as mining, which remove minerals from a country, are correctly open to the charge of exploitation unless they can show that they do more good than harm to the host country and that they do not benefit only either themselves or a repressive elite in the host country.

Other manufacturing industries vary greatly, but as a group they have come in for sustained charges of exploitation of workers and the undermining of the host country's culture. The above guidelines can serve as a means of sifting the valid from the invalid charges.

Thesis 4: On the international level and on the national level in many Third World countries

the lack of adequate just background institutions makes the use of clear moral norms all the more necessary.

American multinational corporations operating in Germany and Japan, and German and Japanese multinational corporations operating in the United States, pose no special moral problems. Nor do the operations of Brazilian multinational corporations in the United States or Germany. Yet First World multinationals operating in Third World countries have come in for serious and sustained moral criticism. Why?

A major reason is that in the Third World the First World's MNCs operate without the types of constraints and in societies that do not have the same kinds of redistributive mechanisms as in the developed countries. There is no special difficulty in United States multinationals operating in other First World countries because in general these countries *do* have appropriate background institutions.[5]

More and more Third World countries are developing controls on multinationals that insure the companies do more good for the country than harm.[6] Authoritarian regimes that care more for their own wealth than for the good of their people pose difficult moral conditions under which to operate. In such instances, the guidelines above may prove helpful.

Just as in the nations of the developed, industrial world the labor movement serves as a counter to the dominance of big business, consumerism serves as a watchdog on practices harmful to the consumer, and big government serves as a restraint on each of the vested interest groups, so international structures are necessary to provide the proper background constraints on international corporations.

The existence of MNCs is a step forward in the unification of mankind and in the formation of a global community. They provide the economic base and substructure on which true international cooperation can be built. Because of their special position and the special opportunities they enjoy, they have a special responsibility to promote the cooperation that only they are able to accomplish in the present world.

Just background institutions would preclude any company's gaining a competitive advantage by engaging in immoral practices. This suggests that MNCs have more to gain than to lose by helping formulate voluntary, UN (such as the code governing infant formulae),[7] and similar codes governing the conduct of all multinationals. A case can also be made that they have the moral obligation to do so.

Thesis 5: The moral burden of MNCs does not exonerate local governments from responsibility for what happens in and to their country. Since responsibility is linked to ownership, governments that insist on part or majority ownership incur part or majority responsibility.

The attempts by many underdeveloped countries to limit multinationals have shown that at least some governments have come to see that they can use multinationals to their own advantage. This may be done by restricting entry to those companies that produce only for local consumption, or that bring desired technology transfers with them. Some countries demand majority control and restrict the export of money from the country. Nonetheless, many MNCs have found it profitable to engage in production under the terms specified by the host country.

What host countries cannot expect is that they can demand control without accepting correlative responsibility. In general, majority control implies majority responsibility. An American MNC, such as Union Carbide, which had majority ownership of its Indian Bhopal plant, should have had primary control of the plant. Union Carbide, Inc. can be held liable for the damage the Bhopal plant caused because Union Carbide, Inc. did have majority ownership.[8] If Union Carbide did not have effective control, it is not relieved of its responsibility. If it could not exercise the control that its responsibility demanded, it should have withdrawn or sold off part of its holdings in that plant. If India had had majority ownership, then it would have had primary responsibility for the safe operation of the plant.

This is compatible with maintaining that if a company builds a hazardous plant, it has an obligation to make sure that the plant is safe and that those who run it are properly trained to run it safely. MNCs cannot simply transfer dangerous technologies without consideration of the people who will run them, the local culture, and similar factors. Unless MNCs can be reasonably sure that the plants they build will be run safely, they cannot morally build them. To do so would be to will intentional, direct harm.

The theses and guidelines that I have proposed are not a panacea. But they suggest how moral norms can be brought to bear on the dilemmas American multinationals face and they suggest ways out of apparent or false dilemmas. If MNCs observed those norms, they could properly avoid the moral sting of their critics' charges, even if their critics continued to level charges against them.

Notes

1 The literature attacking American MNCs is extensive. Many of the charges mentioned in this paper are found in Richard J. Barnet and Ronald E. Muller, *Global Reach: The Power of the Multinational Corporations*, New York: Simon & Schuster, 1974, and in Pierre Jalee, *The Pillage of the Third World*, translated from the French by Mary Klopper, New York and London: Modern Reader Paperbacks, 1968.

2 The position I advocate does not entail moral relativism, as my third thesis shows. The point is that although moral norms apply uniformly across cultures, U.S. standards are not the same as moral standards, should themselves be morally evaluated, and are relative to American conditions, standard of living, interests, and history.

3 For a fuller discussion of multinational drug companies see Richard T. De George, *Business Ethics*, 2nd ed., New York: Macmillan, 1986, pp. 363–367.

4 For a more detailed analysis of the morality of exporting hazardous industries, see my *Business Ethics*, 367–372.

5 This position is consistent with that developed by John Rawls in his *A Theory of Justice*, Cambridge, Mass.: Harvard University Press, 1971, even though Rawls does not extend his analysis to the international realm. The thesis does not deny that United States, German, or Japanese policies on trade restrictions, tariff levels, and the like can be morally evaluated.

6 See, for example, Theodore H. Moran, "Multinational Corporations: A Survey of Ten Years' Evidence," Georgetown School of Foreign Service, 1984.

7 For a general discussion of UN codes, see Wolfgang Fikentscher, "United Nations Codes of Conduct: New Paths in International Law," *The American Journal of Comparative Law*, 30 (1980), pp. 577–604.

8 The official Indian Government report on the Bhopal tragedy has not yet appeared. The Union Carbide report was partially reprinted in the *New York Times*, March 21, 1985, p. 48. The major *New York Times* reports appeared on December 9, 1984, January 28, 30, and 31, and February 3, 1985.

International Business, Morality, and the Common Good

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During the last few years an increasing number of voices have urged that we pay more attention to ethics in international business, on the grounds that not only are all large corporations now internationally structured and thus engaging in international transactions, but that even the smallest domestic firm is increasingly buffeted by the pressures of international competition.[1] This call for increased attention to international business ethics has been answered by a slowly growing collection of ethicists who have begun to address issues in this field. The most comprehensive work on this subject to date is the recent book *The Ethics of International Business* by Thomas Donaldson.[2]

I want in this article to discuss certain realist objections to bringing ethics to bear on international transactions, an issue that, I believe, has not yet been either sufficiently acknowledged nor adequately addressed but that must be resolved if the topic of international business ethics is to proceed on solid foundations. Even so careful a writer as Thomas Donaldson fails to address this issue in its proper complexity. Oddly enough, in the first chapter where one would expect him to argue that, in spite of realist objections, *businesses* have international moral obligations, Donaldson argues only for the less pertinent claim that, in spite of realist objections, *states* have international moral obligations.[3] But international business organizations, I will argue, have special features that render realist objections quite compelling. The question I want to address, here, then, is a particular aspect of the question Donaldson and others have ignored: Can we say that businesses operating in a competitive international environment have any moral obligations to contribute to the international common good, particularly in light of realist objections? Unfortunately, my answer to this question will be in the negative.

My subject, then, is international business and the common good. What I will do is the following. I will begin by explaining what I mean by the common good, and what I mean by international business. Then I will turn directly to the question whether the views of the realist allow us to claim that international businesses have a moral obligation to contribute to the common good. I will first lay out the traditional realist treatment of this question and then revise the traditional realist view so that it can deal with certain shortcomings embedded in the traditional version of realism. I will then bring these revisions to bear on the question of whether international businesses have any obligations toward the common good, a question that I will answer in the negative. My hope is that I have identified some extremely problematic issues that are both critical and disturbing and that, I believe, need to be more widely discussed than they have been because they challenge our easy attribution of moral obligation to international business organizations.

I should note that what follows is quite tentative. I am attempting to work out the implications of certain arguments that have reappeared recently in the literature on morality in international affairs. I am not entirely convinced of the correctness of my conclusions, and offer them here as a way of trying to get clearer about their status. I should also note that although I have elsewhere argued that it is improper to attribute *moral responsibility* to corporate entities, I here set these arguments aside in order to show that even if we ignore the issue of moral responsibility, it is still questionable whether international businesses have obligations toward the common good.

I. The Common Good

Let me begin by distinguishing a weak from a strong conception of the common good, so that I might clarify what I have in mind when I refer to the common good.

What I have in mind by a weak conception of the common good is essentially the utilitarian notion of the common good. It is a notion that is quite clearly stated by Jeremy Bentham:

> The interest of the community then is – what? The sum of the interests of the several members who compose it. … It is vain to talk of the interest of the community, without understanding what is the interest of the individual. A thing is said to promote the interest or to be for the interest of an individual, when it tends to add to the sum total of his pleasure; or what comes to the same thing, to diminish the sum total of his pains.[4]

On the utilitarian notion of the common good, the common good is nothing more than the sum of the utilities of each individual. The reason why I call this the "weak" conception of the common good will become clear, I believe, once it is contrasted with another, quite different notion of the common good.

Let me describe, therefore, what I will call a strong conception of the common good, the conception on which I want to focus in this essay. It is a conception that has been elaborated in the Catholic tradition, and so I will refer to it as the Catholic conception of the common good. Here is how one writer, William A. Wallace, O.P., characterizes the conception:

> A common good is clearly distinct from a *private* good, the latter being the good of one person only, to the exclusion of its being possessed by any other. A common good is distinct also from a *collective* good, which, though possessed by all of a group, is not really participated in by the members of the group; divided up, a collective good becomes respectively the private goods of the members. A true *common* good is universal, not singular or collective, and is distributive in character, being

> communicable to many without becoming anyone's private good. Moreover, each person participates in the whole common good, not merely in a part of it, nor can any one person possess it wholly.[5]

In the terms used by Wallace, the utilitarian conception of the common good is actually a "collective" good. That is, it is an aggregate of the private goods (the utilities) of the members of a society. The common good in the utilitarian conception is divisible in the sense that the aggregate consists of distinct parts and each part is enjoyable by only one individual. Moreover, the common good in the utilitarian conception is not universal in the sense that not all members of society can enjoy all of the aggregate; instead, each member enjoys only a portion of the aggregate.

By contrast, in the Catholic conception that Wallace is attempting to characterize, the common good consists of those goods that (1) benefit all the members of a society in the sense that all the members of the society have access to each of these goods, and (2) are not divisible in the sense that none of these goods can be divided up and allocated among individuals in such a way that others can be excluded from enjoying what another individual enjoys. The example that Wallace gives of one common good is the "good of peace and order."[6] Other examples are national security, a clean natural environment, public health and safety, a productive economic system to whose benefits all have access, a just legal and political system, and a system of natural and artificial associations in which persons can achieve their personal fulfillment.

It is this strong notion of the common good that the Catholic tradition has had in mind when it has defined the common good as "the sum total of those conditions of social living whereby men are enabled more fully and more readily to achieve their own perfection."[7] It is also the conception that John Rawls has in mind when he writes that "Government is assumed to aim at the common good, that is, at maintaining conditions and achieving objectives that are similarly to everyone's advantage," and "the common good I think of as certain general conditions that are in an appropriate sense equally to everyone's advantage."[8]

The Catholic conception of the common good is the conception that I have in mind in what follows. It is clear from the characterization of the common good laid out above that we can think of the common good on two different levels. We can think of the common good on a national and on an international level. On a national level, the common good is that set of conditions within a certain nation that are necessary for the citizens of that nation to achieve their individual fulfillment and so in which all of the citizens have an interest.

On an international level, we can speak of the global common good as that set of conditions that are necessary for the citizens of all or of most nations to achieve their individual fulfillment, and so those goods in which all the peoples of the world have an interest. In what follows, I will be speaking primarily about the global common good.

Now it is obvious that identifying the global common good is extremely difficult because cultures differ on their views of what conditions are necessary for humans to flourish. These differences are particularly acute between the cultures of the lesser developed third world nations who have demanded a "new economic order," and the cultures of the wealthier first world nations who have resisted this demand. Nevertheless, we can identify at least some elements of the global common good. Maintaining a congenial global climate, for example is certainly part of the global common good. Maintaining safe transportation routes for the international flow of goods is also part of the global common good. Maintaining clean oceans is another aspect of the global common good, as is the avoidance of a global nuclear war. In spite of the difficulties involved in trying to compile a list of the goods that qualify as part of the global common good, then, it is nevertheless possible to identify at least some of the items that belong on the list.

II. International Business

Now let me turn to the other term in my title: international business. When speaking of international business, I have in mind a particular kind of organization: the multinational corporation. Multinational corporations have a number of well known features, but let me briefly summarize a few of them. First, multinational corporations are businesses and as such they are organized primarily to increase their profits within a competitive environment. Virtually all of the activities of a multinational corporation can be explained as more or less rational attempts to achieve this dominant end. Secondly, multinational corporations are bureaucratic organizations. The implication of this is that the identity, the fundamental structure, and the dominant objectives of the corporation endure while the many individual human beings who fill the various offices and positions within the corporation come and go. As a consequence, the particular values and aspirations of individual members of the corporation have a relatively minimal and transitory impact on the organization as a whole. Thirdly, and most characteristically, multinational corporations operate in several nations. This has several implications. First, because the multinational is not confined to a single nation, it can easily escape the reach of the laws of any particular nation by simply moving its resources or operations out of one nation and transferring them to another nation. Second, because the multinational is not confined to a single nation, its interests are not aligned with the interests of any single nation. The ability of the multinational to achieve its profit objectives does not depend upon the ability of any particular nation to achieve its own domestic objectives.

In saying that I want to discuss international business and the common good, I am saying that I want to discuss the relationship between the global common good and multinational corporations, that is, organizations that have the features I have just identified.

The general question I want to discuss is straightforward: I want to ask whether it is possible for us to say that multinational corporations with the features I have just described have an obligation to contribute toward the global common good. But I want to discuss only one particular aspect of this general question. I want to discuss this question in light of the realist objection.

III. The Traditional Realist Objection in Hobbes

The realist objection, of course, is the standard objection to the view that agents – whether corporations, governments, or individuals – have moral obligations on the international level. Generally, the realist holds that it is a mistake to apply moral concepts to international activities: morality has no place in international affairs. The classical statement of this view, which I am calling the "traditional" version of realism, is generally attributed to Thomas Hobbes. I will assume that this customary attribution is correct; my aim is to identify some of the implications of this traditional version of realism even if it is not quite historically accurate to attribute it to Hobbes.

In its Hobbesian form, as traditionally interpreted, the realist objection holds that moral concepts have no meaning in the absence of an agency powerful enough to guarantee that other agents generally adhere to the tenets of morality. Hobbes held, first, that in the absence of a sovereign power capable of forcing men to behave civilly with each other, men are in "the state of nature," a state he characterizes as a "war … of every man, against every man."[9] Secondly, Hobbes claimed, in such a state of war, moral concepts have no meaning:

> To this war of every man against every man, this also is consequent; that nothing can be unjust. The notions of right and wrong, justice and injustice have there no place. Where there is no common power, there is no law: where no law, no injustice.[10]

Moral concepts are meaningless, then, when applied to state of nature situations. And, Hobbes held, the international arena is a state of nature, since there is no international sovereign that can force agents to adhere to the tenets of morality.[11]

The Hobbsian objection to talking about morality in international affairs, then, is based on two premises: (1) an ethical premise about the applicability of moral terms and (2) an apparently empirical premise about how agents behave under certain conditions. The ethical premise, at least in its Hobbsian form, holds that there is a connection between the meaningfulness of moral terms and the extent to which agents adhere to the tenets of morality: If in a given situation agents do not adhere to the tenets of morality, then in that situation moral terms have no meaning. The apparently empirical premise holds that in the absence of a sovereign, agents will not adhere to the tenets of morality: they will be in a state of war.

This appears to be an empirical generalization about the extent to which agents adhere to the tenets of morality in the absence of a third-party enforcer. Taken together, the two premises imply that in situations that lack a sovereign authority, such as one finds in many international exchanges, moral terms have no meaning and so moral obligations are nonexistent.

However, there are a number of reasons for thinking that the two Hobbsian premises are deficient as they stand. I want next, therefore, to examine each of these premises more closely and to determine the extent to which they need revision.

IV. Revising the Realist Objection: The First Premise

The ethical premise concerning the meaning of moral terms, is, in its original Hobbsian form, extremely difficult to defend. If one is in a situation in which others do not adhere to any moral restraints, it simply does not logically follow that in that situation one's actions are no longer subject to moral evaluation. At most what follows is that since such an extreme situation is different from the more normal situations in which we usually act, the moral requirements placed on us in such extreme situations are different from the moral requirements that we obtain in more normal circumstances. For example, morality requires that in normal circumstances I am not to attack or kill my fellow citizens. But when one of those citizens is attacking me in a dark alley, morality allows me to defend myself by counterattacking or even killing that citizen. It is a truism that what moral principles require in one set of circumstances is different from what they require in other circumstances. And in extreme circumstances, the requirements of morality may become correspondingly extreme. But there is no reason to think that they vanish altogether.

Nevertheless, the realist can relinquish the Hobbsian premise about the meaning of moral terms, replace it with a weaker and more plausible premise, and still retain much of Hobbes' conclusion. The realist or neo-Hobbsian can claim that although moral concepts can be meaningfully applied to situations in which agents do not adhere to the tenets of morality, nevertheless it is not morally wrong for agents in such situations to also fail to adhere to those tenets of morality, particularly when doing so puts one at a significant competitive disadvantage.

The neo-Hobbsian or realist, then, might want to propose this premise: When one is in a situation in which others do not adhere to certain tenets of morality, and when adhering to those tenets of morality will put one at a significant competitive disadvantage, then it is not immoral for one to likewise fail to adhere to them. The realist might want to argue for this claim, first, by pointing out that in a world in which ail are competing to secure significant benefits and avoid significant costs, and in which others do not adhere to the ordinary tenets of morality, one risks significant harm to one's interests if one continues to adhere to those tenets of morality. But no one can be morally required to take on major risks of harm to oneself. Consequently, in a competitive world in which others disregard moral constraints and take any means to advance their self-interests, no one can be morally required to take on major risks of injury by adopting the restraints of ordinary morality.

A second argument the realist might want to advance would go as follows. When one is in a situation in which others do not adhere to the ordinary tenets of morality, one is under heavy competitive pressures to do the same. And, when one is under such pressures, one cannot be blamed – i.e., one is excused – for also failing to adhere to the ordinary tenets of morality. One is excused because heavy pressures take away one's ability to control oneself, and thereby diminish one's moral culpability.

Yet a third argument advanced by the realist might go as follows. When one is in a situation in which others do not adhere to the ordinary tenets of morality it is not fair to require one to continue to adhere to those tenets, especially if doing so puts one at a significant competitive disadvantage. It is not fair because then one is laying a burden on one party that the other parties refuse to carry.

Thus, there are a number of arguments that can be given in defense of the revised Hobbsian ethical premise that when others do not adhere to the tenets of morality, it is not immoral for one to do likewise.

The ethical premise of the Hobbsian or realist argument, then, can be restated as follows:

> In situations in which other agents do not adhere to certain tenets of morality, it is not immoral for one to do likewise when one would otherwise be putting oneself at a significant competitive disadvantage.

In what follows, I will refer to this restatement as the ethical premise of the argument. I am not altogether convinced that this premise is correct. But it appears to me to have a great deal of plausibility, and it is, I believe, a premise that underlies the feelings of many that in a competitive international environment where others do not embrace the restraints of morality, one is under no obligation to be moral.

V. Revising the Realist Objection: The Second Premise

Let us turn, then, to the other premise in the Hobbsian argument, the assertion that in the absence of a sovereign, agents will be in a state of war. As I mentioned, this is an apparently empirical claim about the extent to which agents will adhere to the tenets of morality in the absence of a third-party enforcer.

Hobbes gives a little bit of empirical evidence for this claim. He cites several examples of situations in which there is no third party to enforce civility and where, as a result, individuals are in a "state of war."[12] Generalizing from these few examples, he reaches the conclusion that in the absence of a third-party enforcer, agents will always be in a "condition of war." But the meager evidence Hobbes provides is surely too thin to support his rather large empirical generalization. Numerous empirical counterexamples can be cited of people living in peace in the absence of a third-party enforcer, so it is difficult to accept Hobbes' claim as an empirical generalization.

Recently, the Hobbsian claim, however, has been defended on the basis of some of the theoretical claims of game theory, particularly of the Prisoner's Dilemma. Hobbes' state of nature, the defense goes, is an instance of a Prisoner's Dilemma, and *rational* agents in a Prisoner's Dilemma necessarily would choose not to adhere to a set of moral norms. Rationality is here construed in the sense that is standard in social theory: having a coherent set of preferences among the objects of choice, and selecting the one(s) that has the greatest probability of satisfying more of one's preferences rather than fewer.[13] Or, more simply, always choosing so as to maximize one's interests.

A Prisoner's Dilemma is a situation involving at least two individuals. Each individual is faced with two choices: he can cooperate with the other individual or he can choose not to cooperate. If he cooperates and the other individual also cooperates, then he gets a certain payoff. If, however, he chooses not to cooperate, while the other individual trustingly cooperates, the noncooperator gets a larger payoff while the cooperator suffers a loss. And if both choose not to cooperate, then both get nothing.

It is a commonplace now that in a Prisoner's Dilemma situation, the most rational strategy for a participant is to choose not to cooperate. For the other party will either cooperate or not cooperate. If the other party cooperates, then it is better for one not to cooperate and thereby get the larger payoff. On the other hand, if the other party does not cooperate, then it is also better for one not to cooperate and thereby avoid a loss. In either case, it is better for one to not cooperate.

Now Hobbes' state of nature, the neo-Hobbsian realist can argue, is in fact a Prisoner's Dilemma situation. In Hobbes' state of nature each individual must choose either to cooperate with others by adhering to the rules of morality (like the rule against theft), or to not cooperate by disregarding the rules of morality and attempting to take advantage of those who are adhering to the rules (e.g., by stealing from them). In such a situation it is more rational (in the sense defined above) to choose not to cooperate. For the other party will either cooperate or not cooperate. If the other party does not cooperate, then one puts oneself at a competitive disadvantage if one adheres to morality while the other party does not. On the other hand, if the other party chooses to cooperate, then one can take advantage of the other party by breaking the rules of morality at his expense. In either case, it is more rational to not cooperate.

Thus, the realist can argue that in a state of nature, where there is no one to enforce compliance with the rules of morality, it is more rational from the individual's point of view to choose not to comply with morality than to choose to comply. Assuming – and this is obviously a critical assumption – that agents behave rationally, then we can conclude that agents in a state of nature will choose not to comply with the tenets of ordinary morality. The second premise of the realist argument, then, can, tentatively, be put as follows:

> In the absence of an international sovereign, all rational agents will choose not to comply with the tenets of ordinary morality, when doing so will put one at a serious competitive disadvantage.

This is a striking, and ultimately revealing, defense of the Hobbsian claim that in the absence of a third-party enforcer, individuals will choose not to adhere to the tenets of morality in their relations with each other. It is striking because it correctly identifies, I think, the underlying reason for the Hobbsian claim. The Hobbsian claim is not an empirical claim about how most humans actually behave when they are put at a competitive disadvantage. It is a claim about whether agents that are *rational* (in the sense defined earlier) will adopt certain behaviors when doing otherwise would put them at a serious competitive disadvantage. For our purposes, this is significant since, as I claimed above, all, most, or at least a significant number of multinationals are rational agents in the required sense: all or most of their activities are rational means for achieving the dominant end of increasing profits. Multinationals, therefore, are precisely the kind of rational agents envisaged by the realist.

But this reading of the realist claim is also significant. I think, because it reveals certain limits inherent in the Hobbsian claim, and requires revising the claim so as to take these limits into account.

As more than one person has pointed out, moral interactions among agents are often quite unlike Prisoner's Dilemmas situations.[14] The most important difference is that a Prisoner's Dilemma is a single meeting between agents who do not meet again, whereas human persons in the real world tend to have repeated dealings with each other. If two people meet each other in a Prisoner's Dilemma situation, and never have anything to do with each other again, then it is rational (in the sense under discussion) from each individual's point of view to choose not to cooperate. However, if individuals meet each other in repeated Prisoner's Dilemma situations, then they are able to punish each other for failures to cooperate, and the cumulative costs of noncooperation can make cooperation the more rational strategy.[15] One can therefore expect that when rational agents know they will have repeated interactions with each other for an indefinite future, they will start to cooperate with each other even in the absence of a third party enforcer. The two cooperating parties in effect are the mutual enforcers of their own cooperative agreements.

The implication is that the realist is wrong in believing that in the absence of a third-party enforcer, rational individuals will always fail to adhere to the tenets of morality, presumably even when doing so would result in serious competitive disadvantage. On the contrary, we can expect that if agents know that they will interact with each other repeatedly in the indefinite future, it is rational for them to behave morally toward each other. In the international arena, then, we can expect that when persons know that they will have repeated interactions with each other, they will tend to adhere to ordinary tenets of morality with each other, assuming that they tend to behave rationally, even when doing so threatens to put them at a competitive disadvantage.

There is a second important way in which the Prisoner's Dilemma is defective as a characterization of real world interactions. Not only do agents repeatedly interact with each other, but, as Robert Frank has recently pointed out, human agents signal to each other the extent to which they can be relied on to behave morally in future interactions.[16] We humans can determine more often than not whether another person can be relied on to be moral by observing the natural visual cues of facial expression and the auditory cues of tone of voice that tend to give us away; by relying on our experience of past dealings with the person; and by relying on the reports of others who have had past dealings with the person. Moreover, based on these appraisals of each other's reliability, we then choose to interact with those who are reliable and choose not to interact with those who are not reliable. That is, we choose to enter Prisoner's

Dilemmas situations with those who are reliable, and choose to avoid entering such situations with those who are not reliable. As Robert Frank has shown, given such conditions it is, under quite ordinary circumstances, rational to habitually be reliable since reliable persons tend to have mutually beneficial interactions with other reliable persons, while unreliable persons will tend to have mutually destructive interactions with other unreliable persons.

The implication again is that since signaling makes it rational to habitually cooperate in the rules of morality, even in the absence of a third-party enforcer, we can expect that rational humans, who can send and receive fairly reliable signals between each other, will tend to behave morally even, presumably, when doing so raises the prospect of competitive disadvantage.

These considerations should lead the realist to revise the tentative statement of the second premise of his argument that we laid out above. In its revised form, the second premise would have to read as follows:

> In the absence of an international sovereign, all rational agents will choose not to comply with the tenets of ordinary morality, when doing so will put one at a serious competitive disadvantage, provided that interactions are not repeated and that agents are not able to signal their reliability to each other.

This, I believe, is a persuasive and defensible version of the second premise in the Hobbsian argument. It is the one I will exploit in what follows.

VI. Revised Realism, Multinationals, and the Common Good

Now how does this apply to multinationals and the common good? Can we claim that it is clear that multinationals have a moral obligation to pursue the global common good in spite of the objections of the realist?

I do not believe that this claim can be made. We can conclude from the discussion of the realist objection that the Hobbsian claim about the pervasiveness of amorality in the international sphere is false when (1) interactions among international agents are repetitive in such a way that agents can retaliate against those who fail to cooperate, and (2) agents can determine the trustworthiness of other international agents.

But unfortunately, multinational activities often take place in a highly competitive arena in which these two conditions do not obtain. Moreover, these conditions are noticeably absent in the arena of activities that concern the global common good.

First, as I have noted, the common good consists of goods that are indivisible and accessible to all. This means that such goods are susceptible to the free rider problem. Everyone has access to such goods whether or not they do their part in maintaining such goods, so everyone is tempted to free ride on the generosity of others. Now governments can force domestic companies to do their part to maintain the national common good. Indeed, it is one of the functions of government to solve the free rider problem by forcing all to contribute to the domestic common good to which all have access. Moreover, all companies have to interact repeatedly with their host governments, and this leads them to adopt a cooperative stance toward their host government's objective of achieving the domestic common good.

But it is not clear that governments can or will do anything effective to force multinationals to do their part to maintain the global common good. For the governments of individual nations can themselves be free riders, and can join forces with willing multinationals seeking competitive advantages over others. Let me suggest an example. It is clear that a livable global environment is part of the global common good, and it is clear that the manufacture and use of chloroflurocarbons is destroying that good. Some nations have responded by requiring their domestic companies to cease manufacturing or using chloroflurocarbons. But other nations have refused to do the same, since they will share in any benefits that accrue from the restraint others practice, and they can also reap the benefits of continuing to manufacture and use chloroflurocarbons. Less developed nations, in particular, have advanced the position that since their development depends heavily on exploiting the industrial benefits of chloroflurocarbons, they cannot afford to curtail their use of these substances. Given this situation, it is open to multinationals to shift their operations to those countries that continue to allow the manufacture and use of chloroflurocarbons. For multinationals, too, will reason that they will share in any benefits that accrue from the restraint others practice, and that they can meanwhile reap the profits of continuing to manufacture and use chloroflurocarbons in a world where other companies are forced to use more expensive technologies. Moreover, those nations that practice restraint cannot force all such multinationals to discontinue the manufacture or use of chloroflurocarbons because many multinationals can escape the reach of their laws. An exactly parallel, but perhaps even more compelling, set of considerations can be advanced to show that at least some multinationals will join forces with some developing countries to circumvent any global efforts made to control the global warming trends (the so-called "greenhouse effect") caused by the heavy use of fossil fuels.

The realist will conclude, of course, that in such situations, at least some multinationals will seek to gain competitive advantages by failing to contribute to the global common good (such as the good of a hospitable global environment). For multinationals are rational agents, i.e., agents bureaucratically structured to take rational means toward achieving their dominant end of increasing their profits. And in a competitive environment, contributing to the common good while others do not, will fail to achieve this dominant end. Joining this conclusion to the ethical premise that when others do not adhere to the requirements of morality it is not immoral for one to do likewise, the realist can conclude that multinationals are not morally obligated to contribute to such global common goods (such as environmental goods).

Moreover, global common goods often create interactions that are not iterated. This is particularly the case where the global environment is concerned. As I have already noted, preservation of a favorable global climate is clearly part of the global common good. Now the failure of the global climate will be a one-time affair. The breakdown of the ozone layer, for example, will happen once, with catastrophic consequences for us all; and the heating up of the global climate as a result of the infusion of carbon dioxide will happen once, with catastrophic consequences for us all. Because these environmental disasters are a one-time affair, they represent a non-iterated Prisoner's Dilemma for multinationals. It is irrational from an individual point of view for a multinational to choose to refrain from polluting the environment in such cases. Either others will refrain, and then one can enjoy the benefits of their refraining; or others will not refrain, and then it will be better to have also not refrained since refraining would have made little difference and would have entailed heavy losses.

Finally, we must also note that although natural persons may signal their reliability to other natural persons, it is not at all obvious that multinationals can do the same. As noted above, multinationals are bureaucratic organizations whose members are continually changing and shifting. The natural persons who make up an organization can signal their reliability to others, but such persons are soon replaced by others, and they in turn are replaced by others. What endures is each organization's single-minded pursuit of increasing its profits in a competitive environment. And an enduring commitment to the pursuit of profit in a competitive environment is not a signal of an enduring commitment to morality.

VII. Conclusions

The upshot of these considerations is that it is not obvious that we can say that multinationals have an obligation to contribute to the global common good in a competitive environment in the absence of an international authority that can force all agents to contribute to the global common good. Where other rational agents can be expected to shirk the burden of contributing to the common good and where carrying such a burden will put one at a serious competitive disadvantage, the realist argument that it is not immoral for one to also fail to contribute is a powerful argument.

I have not argued, of course, nor do I find it persuasive to claim that competitive pressures automatically relieve agents of their moral obligations, although my arguments here may be wrongly misinterpreted as making that claim. All, that I have tried to do is to lay out a justification for the very narrow claim that *certain very special kinds of agents, under certain very limited and very special conditions, seem to have no obligations with respect to certain very special kinds of goods.*

This is not an argument, however, for complete despair. What the argument points to is the need to establish an effective international authority capable of forcing all agents to contribute their part toward the global common good. Perhaps several of the more powerful autonomous governments of the world, for example, will be prompted to establish such an international agency by relinquishing their autonomy and joining together into a coherently unified group that can exert consistent economic, political, or military pressures on any companies or smaller countries that do not contribute to the global common good. Such an international police group, of course, would transform the present world order, and would be much different from present world organizations such as the United Nations. Once such an international force exists, of course, then both Hobbes and the neo-realist would say that moral obligations can legitimately be attributed to all affected international organizations.

Of course, it is remotely possible but highly unlikely that multinationals themselves will be the source of such promptings for a transformed world order. For whereas governments are concerned with the well-being of their citizens, multinationals are bureaucratically structured for the rational pursuit of profit in a competitive environment, not the pursuit of citizen well-being. Here and there we occasionally may see one or even several multinationals whose current cadre of leadership is enlightened enough to regularly steer the organization toward the global common good. But given time, that cadre will be replaced and profit objectives will reassert themselves as the enduring end built into the on-going structure of the multinational corporation.

Notes

[1] See for example, the articles collected in W. Michael Hoffman, Ann E. Lange, and David A. Fedo. eds., *Ethics and the Multinational Enterprise* (New York: University Press of America, 1986).

[2] Thomas Donaldson, *The Ethics of International Business* (New York: Oxford University Press, 1989).

[3] Donaldson discusses the question whether *states* have moral obligations to each other in *op. cit.*, pp. 10–29. The critical question, however, is whether *multinationals*, i.e., profit-driven types of international organizations, have moral obligations. Although Donaldson is able to point out without a great deal of trouble that the realist arguments against morality among nations are mistaken (see pp. 20–23, where Donaldson points out that if the realist were correct, then there would be no cooperation among nations; but since there is cooperation, the realist must be wrong), his points leave untouched the arguments I discuss below which acknowledge that while much cooperation among nations is possible, nevertheless certain crucial forms of cooperation will not obtain among multinationals with respect to the global common good.

[4] J. Bentham, *Principles of Morals and Legislation*. 1.4–5.

[5] William A. Wallace O.P., *The Elements of Philosophy, A Compendium for Philosophers and Theologians* (New York: Alba House, 1977), pp. 166–67.

[6] *Ibid.*, p. 167.

[7] "Common Good," *The New Catholic Encyclopedia*.

[8] John Rawls, *A Theory of Justice* (Cambridge, MA: Harvard University Press, 1971), pp. 233 and 246.

[9] Thomas Hobbes, *Leviathan, Parts I and II*, [1651] (New York: The Bobbs-Merrill Company, Inc., 1958), p. 108.

[10] *Ibid.* As noted earlier, I am simply assuming what I take to be the popular interpretation of Hobbes' view on the state of nature. As Professor Philip Kain has pointed out to me, there is some controversy among Hobbes scholars about whether or not Hobbes actually held that moral obligation exists in the state of nature. Among those who hold that moral obligation does not exist in Hobbes' state of nature is M. Oakeshott in "The Moral Life in the Writings of Thomas Hobbes" in his *Hobbes on Civil Association* (Berkeley–Los Angeles: University of California Press, 1975), pp. 95–113; among those who hold that moral obligation does exist in Hobbes' state of nature is A. E. Taylor in "The Ethical Doctrine of Hobbes" in *Hobbes Studies*, ed. K. C. Brown (Cambridge: Harvard, 1965), p. 41 ff. Kain suggests that Hobbes simply contradicts himself – holding in some passages that moral obligation does exist in the state of nature and holding in others that it does not – because of his need to use the concept of the state of nature to achieve purposes that required incompatible conceptions of the state of nature; see his "Hobbes, Revolution and the Philosophy of History," in "*Hobbes's 'Science of Natural Justice*,'" ed. C. Walton and P. J. Johnson (Boston: Martinus Nijhoff

Publishers, 1987), pp. 203–18. In the present essay I am simply assuming without argument the traditional view that Hobbes made the claim that moral obligation does not exist in the state of nature; my aim is to pursue certain implications of this claim even if I am wrong in assuming that is Hobbes.

[11] See *ibid.*, where Hobbes writes that "yet in all times kings and persons of sovereign authority, because of their independency" are in this state of war.

[12] *Ibid*, pp. 107–8.

[13] See Amartya K. Sen, *Collective Choice and Social Welfare* (San Francisco: Holden-Day, Inc., 1970), pp. 2–5.

[14] See, for example, Gregory Kavka, "Hobbes' War of All against All," *Ethics*, 93 (January, 1983), pp. 291–310; a somewhat different approach is that of David Gauthier, *Morals by Agreement* (Oxford: Clarendon Press, 1986) and Russell Hardin, *Morality within the Limits of Reason* (Chicago: University of Chicago Press, 1988).

[15] See Robert Axelrod, *The Evolution of Cooperation* (New York: Basic Books, Inc., 1984), pp. 27–69.

[16] Robert Frank, *Passions within Reason* (New York: W. W. Norton & Company, 1988).

Values in Tension
Ethics Away from Home

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When we leave home and cross our nation's boundaries, moral clarity often blurs. Without a backdrop of shared attitudes, and without familiar laws and judicial procedures that define standards of ethical conduct, certainty is elusive. Should a company invest in a foreign country where civil and political rights are violated? Should a company go along with a host country's discriminatory employment practices? If companies in developed countries shift facilities to developing nations that lack strict environmental and health regulations, or if those companies choose to fill management and other top-level positions in a host nation with people from the home country, whose standards should prevail?

Even the best-informed, best-intentioned executives must rethink their assumptions about business practice in foreign settings. What works in a company's home country can fail in a country with different standards of ethical conduct. Such difficulties are unavoidable for businesspeople who live and work abroad.

But how can managers resolve the problems? What are the principles that can help them work through the maze of cultural differences and establish codes of conduct for globally ethical business practice? How can companies answer the toughest question in global business ethics: What happens when a host country's ethical standards seem lower than the home country's?

Competing Answers

One answer is as old as philosophical discourse. According to cultural relativism, no culture's ethics are better than any other's; therefore there are no international rights and wrongs. If the people of Indonesia tolerate the bribery of their public officials, so what? Their attitude is no better or worse than that of people in Denmark or Singapore who refuse to offer or accept bribes. Likewise, if Belgians fail to find insider trading morally repugnant, who cares? Not enforcing insider-trading laws is no more or less ethical than enforcing such laws.

The cultural relativist's creed – When in Rome, do as the Romans do – is tempting, especially when failing to do as the locals do means forfeiting business

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opportunities. The inadequacy of cultural relativism, however, becomes apparent when the practices in question are more damaging than petty bribery or insider trading.

In the late 1980s, some European tanneries and pharmaceutical companies were looking for cheap waste-dumping sites. They approached virtually every country on Africa's west coast from Morocco to the Congo. Nigeria agreed to take highly toxic polychlorinated biphenyls. Unprotected local workers, wearing thongs and shorts, unloaded barrels of PCBs and placed them near a residential area. Neither the residents nor the workers knew that the barrels contained toxic waste.

We may denounce governments that permit such abuses, but many countries are unable to police transnational corporations adequately even if they want to. And in many countries, the combination of ineffective enforcement and inadequate regulations leads to behavior by unscrupulous companies that is clearly wrong. A few years ago, for example, a group of investors became interested in restoring the *SS United States*, once a luxurious ocean liner. Before the actual restoration could begin, the ship had to be stripped of its asbestos lining. A bid from a U.S. company, based on U.S. standards for asbestos removal, priced the job at more than $100 million. A company in the Ukranian city of Sevastopol offered to do the work for less than $2 million. In October 1993, the ship was towed to Sevastopol.

A cultural relativist would have no problem with that outcome, but I do. A country has the right to establish its own health and safety regulations, but in the case described above, the standards and the terms of the contract could not possibly have protected workers in Sevastopol from known health risks. Even if the contract met Ukranian standards, ethical businesspeople must object. Cultural relativism is morally blind. There are fundamental values that cross cultures, and companies must uphold them. (For an economic argument against cultural relativism, see the box "The Culture and Ethics of Software Piracy.")

At the other end of the spectrum from cultural relativism is ethical imperialism, which directs people to do everywhere exactly as they do at home. Again, an understandably appealing approach but one that is clearly inadequate. Consider the large U.S. computer-products company that in 1993 introduced a course on sexual harassment in its Saudi Arabian facility. Under the banner of global consistency, instructors used the same approach to train Saudi Arabian managers that they had used with U.S. managers: the participants were asked to discuss a case in which a manager makes sexually explicit remarks to a new female employee over drinks in a bar. The instructors failed to consider how the exercise would work in a culture with strict conventions governing relationships between men and women. As a result, the training sessions were ludicrous. They baffled and offended the Saudi participants, and the message to avoid coercion and sexual discrimination was lost.

The theory behind ethical imperialism is absolutism, which is based on three problematic principles. Absolutists believe that there is a single list of truths, that they can be expressed only with one set of concepts, and that they call for exactly the same behavior around the world.

The first claim clashes with many people's belief that different cultural traditions must be respected. In some cultures, loyalty to a community – family, organization, or society – is the foundation of all ethical behavior. The Japanese, for example, define business ethics in terms of loyalty to their companies, their business networks, and their nation. Americans place a higher value on liberty than on loyalty; the U.S. tradition of rights emphasizes equality, fairness, and individual freedom. It is hard to conclude that truth lies on one side or the other, but an absolutist would have us select just one.

The second problem with absolutism is the presumption that people must express moral truth using only one set of concepts. For instance, some absolutists insist that the language of basic rights provides the framework for any discussion of ethics. That means, though, that entire cultural traditions must be ignored. the notion of a right evolved with the rise of democracy in post-Renaissance Europe and the United States, but the term is not found in either Confucian or Buddhist traditions. We all learn ethics in the context of our particular cultures, and the power in the principles is deeply tied to the way in which they are expressed. Internationally accepted lists of moral principles, such as the United Nations' Universal Declaration of Human Rights, draw on many cultural and religious traditions. As philosopher Michael Walzer has noted, "There is no Esperanto of global ethics."

The Culture and Ethics of Software Piracy

Before jumping on the cultural relativism bandwagon, stop and consider the potential economic consequences of a when-in-Rome attitude toward business ethics. Take a look at the current statistics on software piracy: In the United States, pirated software is estimated to be 35% of the total software market, and industry losses are estimated at $2.3 billion per year. The piracy rate is 57% in Germany and 80% in Italy and Japan; the rates in most Asian countries are estimated to be nearly 100%.

There are similar laws against software piracy in those countries. What, then, accounts for the differences? Although a country's level of economic development plays a large part, culture, including ethical attitudes, may be a more crucial factor. The 1995 annual report of the Software Publishers Association connects software piracy directly to culture and attitude. It describes Italy and Hong Kong as having " 'first world' per capita incomes, along with 'third world' rates of piracy." When asked whether one should use software without paying for it, most people, including people in Italy and Hong Kong, say no. But people in some countries regard the practice as less unethical than people in other countries do. Confucian culture, for example, stresses that individuals should share what they create with society. That may be, in part, what prompts the Chinese and other Asians to view the concept of intellectual property as a means for the West to monopolize its technological superiority.

What happens if ethical attitudes around the world permit large-scale software piracy? Software companies won't want to invest as much in developing new products, because they cannot expect any return on their investment in certain parts of the world. When ethics fail to support technological creativity, there are consequences that go beyond statistics – jobs are lost and livelihoods jeopardized.

Companies must do more than lobby foreign governments for tougher enforcement of piracy laws. They must cooperate with other companies and with local organizations to help citizens understand the consequences of piracy and to encourage the evolution of a different ethic toward the practice.

The third problem with absolutism is the belief in a global standard of ethical behavior. Context must shape ethical practice. Very low wages, for example, may be considered unethical in rich, advanced countries, but developing nations may be acting ethically if they encourage investment and improve living standards by accepting low wages. Likewise, when people are malnourished or starving, a government may be wise to use more fertilizer in order to improve crop yields, even though that means settling for relatively high levels of thermal water pollution.

When cultures have different standards of ethical behavior – and different ways of handling unethical behavior – a company that takes an absolutist approach may find itself making a disastrous mistake. When a manager at a large U.S. specialty-products company in China caught an employee stealing, she followed the company's practice and turned the employee over to the provincial authorities, who executed him. Managers cannot operate in another culture without being aware of that culture's attitudes toward ethics.

If companies can neither adopt a host country's ethics nor extend the home country's standards, what is the answer? Even the traditional litmus test – What would people think of your actions if they were written up on the front page of the newspaper? – is an unreliable guide, for there is no international consensus on standards of business conduct.

Balancing the Extremes: Three Guiding Principles

Companies must help managers distinguish between practices that are merely different and those that are wrong. For relativists, nothing is sacred and nothing is wrong. For absolutists, many things that are different are wrong. Neither extreme illuminates the real world of business decision making. The answer lies somewhere in between.

When it comes to shaping ethical behavior, companies must be guided by three principles.

- Respect for core human values, which determine the absolute moral threshold for all business activities.
- Respect for local traditions.
- The belief that context matters when deciding what is right and what is wrong.

Consider those principles in action. In Japan, people doing business together often exchange gifts – sometimes expensive ones – in keeping with long-standing Japanese tradition. When U.S. and European companies started doing a lot of business in Japan, many Western business people thought that the practice of gift giving might be wrong rather than simply different. To them, accepting a gift felt like accepting a bribe. As Western companies have become more familiar with Japanese traditions, however, most have come to tolerate the practice and to set different limits on gift giving in Japan than they do elsewhere.

Respecting differences is a crucial ethical practice. Research shows that management ethics differ among cultures; respecting those differences means recognizing that some cultures have obvious weaknesses – as well as hidden strengths. Managers in Hong Kong, for example, have a higher tolerance for some forms of bribery than their Western counterparts, but they have a much lower tolerance for the failure to acknowledge a subordinate's work. In some parts of the Far East, stealing credit from a subordinate is nearly an unpardonable sin.

People often equate respect for local traditions with cultural relativism. That is incorrect. Some practices are clearly wrong. Union Carbide's tragic experience in Bhopal, India, provides one example. The company's executives seriously underestimated how much on-site management involvement was needed at the Bhopal plant to compensate for the country's poor infrastructure and regulatory capabilities. In the aftermath of the disastrous gas leak, the lesson is clear: companies using sophisticated technology in a developing country must evaluate that country's ability to oversee its safe use. Since the incident at Bhopal, Union Carbide has become a leader in advising companies on using hazardous technologies safely in developing countries.

Some activities are wrong no matter where they take place. But some practices that are unethical in one setting may be acceptable in another. For instance, the chemical EDB, a soil fungicide, is banned for use in the United States. In hot climates, however, it quickly becomes harmless through exposure to intense solar radiation and high soil temperatures. As long as the chemical is monitored, companies may be able to use EDB ethically in certain parts of the world.

Defining the Ethical Threshold: Core Values

Few ethical questions are easy for managers to answer. But there are some hard truths that must guide managers' actions, a set of what I call *core human values*, which define minimum ethical standards for all companies.[1] The right to good health and the right to economic advancement and an improved standard of living are two core human values. Another is what Westerners call the Golden Rule, which is recognizable in every major religious and ethical tradition around the world. In Book 15 of his *Analects*, for instance, Confucius counsels people to maintain reciprocity, or not to do to others what they do not want done to themselves.

Although no single list would satisfy every scholar, I believe it is possible to articulate three core values that incorporate the work of scores of theologians and philosophers around the world. To be broadly relevant, these values must include elements found in both Western and non-Western cultural and religious traditions. Consider the examples of values in Table 1 "What Do These Values Have in Common?"

At first glance, the values expressed in the two lists seem quite different. Nonetheless, in the spirit of what philosopher John Rawls calls *overlapping consensus*, one can see that the seemingly divergent values converge at key points. Despite important differences between Western and non-Western cultural and religious

Table 1 What do these values have in common?

Non-Western	*Western*
Kyosei (Japanese): Living and working together for the common good	Individual liberty
Dharma (Hindu): The fulfillment of inherited duty	Egalitarianism
Santutthi (Buddhist): The importance of limited desires	Political participation
Zakat (Muslim): The duty to give alms to the Muslim poor	Human rights

traditions, both express shared attitudes about what it means to be human. First, individuals must not treat others simply as tools; in other words, they must recognize a person's value as a human being. Next, individuals and communities must treat people in ways that respect people's basic rights. Finally, members of a community must work together to support and improve the institutions on which the community depends. I call those three values *respect for human dignity, respect for basic rights*, and *good citizenship*.

Those values must be the starting point for all companies as they formulate and evaluate standards of ethical conduct at home and abroad. But they are only a starting point. Companies need much more specific guidelines, and the first step to developing those is to translate the core human values into core values for business. What does it mean, for example, for a company to respect human dignity? How can a company be a good citizen?

I believe that companies can respect human dignity by creating and sustaining a corporate culture in which employees, customers, and suppliers are treated not as means to an end but as people whose intrinsic value must be acknowledged; and by producing safe products and services in a safe workplace. Companies can respect basic rights by acting in ways that support and protect the individual rights of employees, customers, and surrounding communities, and by avoiding relationships that violate human beings' rights to health, education, safety, and an adequate standard of living. And companies can be good citizens by supporting essential social institutions, such as the economic system and the education system, and by working with host governments and other organizations to protect the environment.

The core values establish a moral compass for business practice. They can help companies identify practices that are acceptable and those that are intolerable – even if the practices are compatible with a host country's norms and laws. Dumping pollutants near people's homes and accepting inadequate standards for handling hazardous materials are two examples of actions that violate core values.

Similarly, if employing children prevents them from receiving a basic education, the practice is intolerable. Lying about product specifications in the act of selling may not affect human lives directly, but it too is intolerable because it violates the trust that is needed to sustain a corporate culture in which customers are respected.

Sometimes it is not a company's actions but those of a supplier or customer that pose problems. Take the case of the Tan family, a large supplier for Levi Strauss. The Tans were allegedly forcing 1,200 Chinese and Filipino women to work 74 hours per week in guarded compounds on the Mariana Islands. In 1992, after repeated warnings to the Tans, Levi Strauss broke off business relations with them.

Creating an Ethical Corporate Culture

The core values for business that I have enumerated can help companies begin to exercise ethical judgment and think about how to operate ethically in foreign cultures, but they are not specific enough to guide managers through actual ethical dilemmas. Levi Strauss relied on a written code of conduct when figuring out how to deal with the Tan family. The company's Global Sourcing and Operating Guidelines, formerly called the Business Partner Terms of Engagement, state that Levi Strauss will "seek to identify and utilize business partners who aspire as individuals and in the conduct of all their businesses to a set of ethical standards not incompatible with our own." Whenever intolerable business situations arise, managers should be guided by precise statements that spell out the behavior and operating practices that the company demands.

Ninety percent of all *Fortune 500* companies have codes of conduct, and 70% have statements of vision and values. In Europe and the Far East, the percentages are lower but are increasing rapidly. Does that mean that most companies have what they need? Hardly. Even though most large U.S. companies have both statements of values and codes of conduct, many might be better off if they didn't. Too many companies don't do anything with the documents; they simply paste them on the wall to impress employees, customers, suppliers, and the public. As a result, the senior managers who drafted the statements lose credibility by proclaiming values and not living up to them. Companies such as Johnson & Johnson, Levi Strauss, Motorola, Texas Instruments, and Lockheed Martin, however, do a great deal to make the words meaningful. Johnson & Johnson, for example, has become well known for its Credo Challenge sessions, in which managers discuss ethics in the context of their current business problems and are invited to criticize the company's credo and make suggestions for changes. The participants' ideas are passed on to the company's senior managers. Lockheed Martin has created an innovative site on the World Wide Web and on its local network that gives employees, customers, and suppliers access to the company's ethical code and the chance to voice complaints.

Codes of conduct must provide clear direction about ethical behavior when the temptation to behave unethically is strongest. The pronouncement in a code of conduct that bribery is unacceptable is useless unless accompanied by guidelines for gift giving, payments to get goods through customs, and "requests" from intermediaries who are hired to ask for bribes.

Motorola's values are stated very simply as "How we will always act: [with] constant respect for people [and] uncompromising integrity." The company's code of conduct, however, is explicit about actual business practice. With respect to bribery, for example, the code states that the "funds and assets of Motorola shall not be used, directly or indirectly, for illegal payments of any kind." It is unambiguous about what sort of payment is illegal: "the payment of a bribe to a public official or the kickback of funds to an employee of a customer ..." The code goes on to prescribe specific procedures for handling commissions to intermediaries, issuing sales invoices, and disclosing confidential information in a sales transaction – all situations in which employees might have an opportunity to accept or offer bribes.

Codes of conduct must be explicit to be useful, but they must also leave room for a manager to use his or her judgment in situations requiring cultural sensitivity. Host-country employees shouldn't be forced to adopt all home-country values and renounce their own. Again, Motorola's code is exemplary. First, it gives clear direction: "Employees of Motorola will respect the laws, customs, and traditions of each country in which they operate, but will, at the same time, engage in no course of conduct which, even if legal, customary, and accepted in any such country, could be deemed to be in violation of the accepted business ethics of Motorola or the laws of the United States relating to business ethics." After laying down such absolutes, Motorola's code then makes clear when individual judgment will be necessary. For example, employees may sometimes accept certain kinds of small gifts "in rare circumstances, where the refusal to accept a gift" would injure Motorola's "legitimate business interests." Under certain circumstances, such gifts "may be accepted so long as the gift inures to the benefit of Motorola" and not "to the benefit of the Motorola employee."

Striking the appropriate balance between providing clear direction and leaving room for individual judgment makes crafting corporate values statements and ethics codes one of the hardest tasks that executives confront. The words are only a start. A company's leaders need to refer often to their organization's credo and code and must themselves be credible, committed, and consistent. If senior managers act as though ethics don't matter, the rest of the company's employees won't think they do, either.

Conflicts of Development and Conflicts of Tradition

Managers living and working abroad who are not prepared to grapple with moral ambiguity and tension should pack their bags and come home. The view that all business practices can be categorized as either ethical or unethical is too simple. As Einstein is reported to have said, "Things should be as simple as possible – but no simpler." Many business practices that are considered unethical in one setting may be ethical in another. Such activities are neither black nor white but exist in what Thomas Dunfee and I have called *moral free space*.[2] In this gray zone, there are no tight prescriptions for a company's behavior. Managers must chart their own courses – as long as they do not violate core human values.

Consider the following example. Some successful Indian companies offer employees the opportunity for one of their children to gain a job with the company in school. The companies honor this commitment even when other applicants are more qualified than an employee's child. The perk is extremely valuable in a country where jobs are hard to find, and it reflects the Indian culture's belief that the West has gone too far in allowing economic opportunities to break up families. Not surprisingly, the perk is among the most cherished by employees, but in most Western countries, it would be branded unacceptable nepotism. In the United States, for example, the ethical principle of equal opportunity holds that jobs should go to the applicants with the best qualifications. If a U.S. company made such promises to its employees, it would violate regulations established by the Equal Employment Opportunity Commission. Given this difference in ethical attitudes, how should U.S. managers react to Indian nepotism? Should they condemn the Indian companies, refusing to accept them as partners or suppliers until they agree to clean up their act?

Despite the obvious tension between nepotism and principles of equal opportunity, I cannot condemn the practice for Indians. In a country, such as India, that emphasizes clan and family relationships and has catastrophic levels of unemployment, the practice must be viewed in moral free space. The decision to allow a special perk for employees and their children is not necessarily wrong – at least for members of that country.

How can managers discover the limits of moral free space? That is, how can they learn to distinguish a value in tension with their own from one that is intolerable? Helping managers develop good ethical judgment requires companies to be clear about their core values and codes of conduct. But even the most explicit set of guidelines cannot always provide answers. That is especially true in the thorniest ethical dilemmas, in which the host country's ethical standards not only are different but also seem lower than the home country's. Managers must recognize that when countries have different ethical standards, there are two types of conflict that commonly arise. Each type requires its own line of reasoning.

In the first type of conflict, which I call a *conflict of relative development*, ethical standards conflict because of the countries' different levels of economic development. As mentioned before, developing countries may accept wage rates that seem inhumane to more advanced countries in order to attract investment. As economic conditions in a developing country improve, the incidence of that sort of conflict usually decreases. The second type of conflict is a *conflict of cultural tradition*. For example, Saudi Arabia, unlike most other countries, does not allow women to serve as corporate managers. Instead, women may work in only a few professions, such as education and health care. The prohibition stems from strongly held religious and cultural beliefs; any increase in the country's level of economic development, which is already quite high, is not likely to change the rules.

To resolve a conflict of relative development, a manager must ask the following question: Would the practice be acceptable at home if my country were in a similar stage of economic development? Consider the difference between wage and safety standards in the United States and in Angola, where citizens accept lower standards on both counts. If a U.S. oil company is hiring Angolans to work on an offshore Angolan oil rig, can the company pay them lower wages than it pays U.S. workers in the Gulf of Mexico? Reasonable people have to answer yes if the alternative for Angola is the loss of both the foreign investment and the jobs.

Consider, too, differences in regulatory environments. In the 1980s, the government of India fought hard to be able to import Ciba-Geigy's Entero Vioform, a drug known to be enormously effective in fighting dysentery but one that had been banned in the United States because some users experienced side effects. Although dysentery was not a big problem in the United States, in India, poor public sanitation was contributing to epidemic levels of the disease. Was it unethical to make the drug available in India after it had been banned in the United States? On the contrary, rational people should consider it unethical not to do so. Apply our test: Would the United States, at an earlier stage of development, have used this drug despite its side effects? The answer is clearly yes.

But there are many instances when the answer to similar questions is no. Sometimes a host country's standards are inadequate at any level of economic development. If a country's pollution standards are so low that working on an oil rig would considerably increase a person's risk of developing cancer, foreign oil companies must refuse to do business there. Likewise, if the dangerous side effects of a drug treatment outweigh its benefits, managers should not accept health standards that ignore the risks.

When relative economic conditions do not drive tensions, there is a more objective test for resolving ethical problems. Managers should deem a practice permissible only if they can answer no to both of the following questions: Is it possible to conduct business successfully in the host country without undertaking the practice? and Is the practice a violation of a core human value? Japanese gift giving is a perfect example of a conflict of cultural tradition. Most experienced businesspeople, Japanese and non-Japanese alike, would agree that doing business in Japan would be virtually impossible without adopting the practice. Does gift giving violate a core human value? I cannot identify one that it violates. As a result, gift giving may be permissible for foreign companies in Japan even if it conflicts with ethical attitudes at home. In fact, that conclusion is widely accepted, even by companies such as Texas Instruments and IBM, which are outspoken against bribery.

Does it follow that all nonmonetary gifts are acceptable or that bribes are generally acceptable in countries where they are common? Not at all. (See the box "The Problem with Bribery.") What makes the routine practice of gift giving acceptable in Japan are the limits in its scope and intention. When gift giving moves outside those limits, it soon collides with core human values. For example, when Carl Kotchian, president of Lockheed in the 1970s, carried suitcases full of cash to Japanese politicians, he went beyond the norms established by Japanese tradition. That incident galvanized opinion in the United States Congress and helped lead to passage of the Foreign Corrupt Practices Act. Likewise, Roh Tae Woo went beyond the norms established by Korean cultural tradition when he accepted $635.4 million in bribes as president of the Republic of Korea between 1988 and 1993.

Guidelines for Ethical Leadership

Learning to spot intolerable practices and to exercise good judgment when ethical conflicts arise requires practice. Creating a company culture that rewards ethical behavior is essential. The following guidelines for developing a global ethical perspective among managers can help.

Treat corporate values and formal standards of conduct as absolutes. Whatever ethical standards a company chooses, it cannot waver on its principles either at home or abroad. Consider what has become part of company lore at Motorola. Around 1950, a senior executive was negotiating with officials of a South American government on a $10 million sale that would have increased the company's annual net profits by nearly 25%. As the negotiations neared completion, however, the executive walked away from the deal because the officials were asking for $1 million for "fees." CEO Robert Galvin not only supported the executive's decision but also made it clear that Motorola would neither accept the sale on any terms nor do business with those government officials again. Retold over the decades, this story demonstrating Galvin's resolve has helped cement a culture of ethics for thousands of employees at Motorola.

Design and implement conditions of engagement for suppliers and customers. Will your company do business with any customer or supplier? What if a customer or supplier uses child labor? What if it has strong links with organized crime? What if it pressures your company to break a host country's laws? Such issues are best not left for spur-of-the-moment decisions. Some companies have realized that. Sears, for instance, has developed a policy of not contracting production to companies that use prison labor or infringe on workers' rights to health and safety. And BankAmerica has specified as a condition for many of its loans to developing countries that environmental standards and human rights must be observed.

The Problem with Bribery

Bribery is widespread and insidious. Managers in transnational companies routinely confront bribery even though most countries have laws against it. The fact is that officials in many developing countries wink at the practice, and the salaries of local bureaucrats are so low that many consider bribes a form of remuneration. The U.S. Foreign Corrupt Practices Act defines allowable limits on petty bribery in the form of routine payments required to move goods through customs. But demands for bribes often exceed those limits, and there is seldom a good solution.

Bribery disrupts distribution channels when goods languish on docks until local handlers are paid off, and it destroys incentives to compete on quality and cost when purchasing decisions are based on who pays what under the table. Refusing to acquiesce is often tantamount to giving business to unscrupulous companies.

I believe that even routine bribery is intolerable. Bribery undermines market efficiency and predictability, thus ultimately denying people their right to a minimal standard of living. Some degree of ethical commitment – some sense that everyone will play by the rules – is necessary for a sound economy. Without an ability to predict outcomes, who would be willing to invest?

There was a U.S. company whose shipping crates were regularly pilfered by handlers on the docks of Rio de Janeiro. The handlers would take about 10% of the contents of the crates, but the company was never sure which 10% it would be. In a partial solution, the company began sending two crates – the first with 90% of the merchandise, the second with 10%. The handlers learned to take the second crate and leave the first untouched. From the company's perspective, at least knowing which goods it would lose was an improvement.

Bribery does more than destroy predictability; it undermines essential social and economic systems. That truth is not lost on businesspeople in countries where the practice is woven into the social fabric. CEOs in India admit that their companies engage constantly in bribery, and they say that they have considerable disgust for the practice. They blame government policies in part, but Indian executives also know that their country's business practices perpetuate corrupt behavior. Anyone walking the streets of Calcutta, where it is clear that even a dramatic redistribution of wealth would still leave most of India's inhabitants in dire poverty, comes face-to-face with the devastating effects of corruption.

Allow foreign business units to help formulate ethical standards and interpret ethical issues. The French pharmaceutical company Rhone-Poulenc Rorer has allowed foreign subsidiaries to augment lists of corporate ethical principles with their own suggestions. Texas Instruments has paid special attention to issues of international business ethics by creating the Global Business Practices Council, which is made up of managers from countries in which the company operates. With the over-arching intent to create a "global ethics strategy, locally deployed," the council's mandate is to provide ethics education and create local processes that will help managers in the company's foreign business units resolve ethical conflicts.

In host countries, support efforts to decrease institutional corruption. Individual managers will not be able to wipe out corruption in a host country, no matter how many bribes they turn down. When a host country's tax system, import and export procedures, and procurement practices favor unethical players, companies must take action.

Many companies have begun to participate in reforming host-country institutions. General Electric, for example, has taken a strong stand in India, using the media to make repeated condemnations of bribery in business and government. General Electric and others have found, however, that a single company usually cannot drive out entrenched corruption. Transparency International, an organization based in Germany, has been effective in helping coalitions of companies, government officials, and others work to reform bribery-ridden bureaucracies in Russia, Bangladesh, and elsewhere.

Exercise moral imagination. Using moral imagination means resolving tensions responsibly and creatively. Coca-Cola, for instance, has consistently turned down requests for bribes from Egyptian officials but has managed to gain political support and public trust by sponsoring a project to plant fruit trees. And take the example of Levi Strauss, which discovered in the early 1990s that two of its suppliers in Bangladesh were employing children under the age of 14 – a practice that violated the company's principles but was tolerated in Bangladesh. Forcing the suppliers to fire the children would not have ensured that the children received an education, and it would have caused serious hardship for the families depending on the children's wages. In a creative arrangement, the suppliers agreed to pay the children's regular wages while they attended school and to offer each child a job at age 14. Levi Strauss, in turn, agreed to pay the children's tuition and provide books and uniforms. That arrangement allowed Levi Strauss to uphold its principles and provide long-term benefits to its host country.

Many people think of values as soft; to some they are usually unspoken. A South Seas island society uses the word *mokita*, which means, "the truth that everybody knows but nobody speaks." However difficult they are to articulate, values affect how we all behave. In a global business environment, values in tension are the rule rather than the exception. Without a company's commitment, statements of values and codes of ethics end up as empty platitudes that provide managers with no foundation for behaving ethically. Employees need and deserve more, and responsible members of the global business community can set examples for others to follow. The dark consequences of incidents such as Union Carbide's disaster in Bhopal remind us how high the stakes can be.

Notes

[1] In other writings, Thomas W. Dunfee and I have used the term *hypernorm* instead of *core human value*.

[2] Thomas Donaldson and Thomas W. Dunfee, "Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory," *Academy of Management Review*, April 1994; and "Integrative Social Contracts Theory: A Communitarian Conception of Economic Ethics," *Economics and Philosophy*, Spring 1995.

The Case for Leverage-Based Corporate Human Rights Responsibility

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Introduction

In the field of business and human rights, should a company's "leverage" over other actors with whom it has a relationship – that is, its ability to influence their decisions or activities for better or worse – give rise to responsibility, rendering it answerable for its exercise or failure to exercise such leverage? I argue that the answer is a qualified yes: leverage is one factor giving rise to responsibility even where the company is not itself contributing adverse human rights impacts. The case for leverage-based responsibility has not been articulated clearly in the scholarly literature. Instead this issue tends to be subsumed in debates about "sphere of influence" (SOI) and complicity, with which it overlaps only partially. One of the few commentators to address the issue head-on is the Special Representative of the United Nations Secretary General on business and human rights, Professor John Ruggie ("SRSG"), who explicitly rejected leverage as a basis for the business responsibility to respect human rights (United Nations 2008b: 18; United Nations 2008a). In this article I attempt to supply the missing normative argument in favour of leverage-based responsibility and in the process answer the SRSG's critique.

It is necessary first to distinguish three issues that are often obscured in debates about leverage and SOI: first, the relationship between companies' impacts on human rights and their leverage over other actors; second, the relationship between negative and positive forms of responsibility; and third, the relationship between companies' human rights obligations and their optional efforts to support human rights. I examine these distinctions in the first section. Next, I provide a concrete context for my argument by describing how the debate about leverage and SOI was brought into relief in the recent encounter between the SRSG's three-part "Protect, Respect and Remedy" framework (United Nations 2008b) and the International Organization for Standardization's ISO 26000 guide on social responsibility (International Organization for Standardization 2010).

I then turn to the normative case for leverage-based responsibility. I start by identifying some limitations of an impact-based conception of social responsibility. I then propose that leverage-based responsibility should arise when four criteria are satisfied: (a) there is a morally significant connection between the company and either the perpetrator of human rights abuse or the human rights-holder, (b) the company is able to make a difference to the state of affairs, (c) it can do so at an acceptable cost to itself, and (d) the actual or potential invasion of human rights at issue is sufficiently serious. I argue that such responsibility (e) is qualified rather than categorical, (f) is a matter of degree rather than a binary choice, (g) is context-specific, (h) can be both negative and positive in character, (i) satisfies the practicality criterion, and (j) is appropriate to the specialized social function of business organizations.

Varieties of Responsibility

Three interwoven distinctions are often obscured or conflated in the debate about corporate leverage and SOI: influence as "impact" versus influence as "leverage," negative versus positive responsibility, and obligatory versus optional human rights practices (Wood 2011a, 2011b). To understand the debate it is necessary to tease apart these distinctions. First, as the SRSG points out, the SOI concept conflates two very different meanings of "influence":

> One is "impact," where the company's activities or relationships are causing human rights harm. The other is whatever "leverage" a company may have over actors that are causing harm or could prevent harm. (United Nations 2008a: 5)

These two forms of influence have different practical and moral implications, and correspond to two different conceptions of responsibility. Impact-based responsibility attaches to an organization's direct and indirect contributions to social or environmental impacts. Leverage-based responsibility, by contrast, arises from an organization's ability to influence the actions of other actors through its relationships, regardless of whether the impacts of those other actors' actions can be traced to the organization. The business responsibility to respect human rights, as defined by the SRSG, is primarily impact-based. The SRSG initially rejected leverage-based responsibility (United Nations 2008b: 18; United Nations 2008a), but as I will show, his final Guiding Principles on Business and Human Rights endorse a limited version of it (United Nations 2011b).

The second distinction needing attention is that between negative and positive responsibility. I use these terms to refer, respectively, to a responsibility to "do no harm" and a responsibility to "do good" (Griffin 2004: 19; Moore 2009: 34). This is not the same as a responsibility not to act and a responsibility to act, as is often thought. The distinction between negative rights entailing negative obligations to refrain from certain actions, and positive rights entailing positive obligations to take action, is artificial and inconsistent with social reality. As Arnold points out, "it is not possible to protect a person from harm without taking proactive steps," for example by designing, establishing, staffing, financing and operating the necessary institutions. As a result, the notion of negative versus positive rights loses its meaning: "There are only rights and corresponding obligations, but the obligations that correspond to these rights are both negative and positive" (Arnold 2009: 65–66). The business responsibility to respect human rights, as articulated by the SRSG, is a negative responsibility to avoid causing or contributing to human rights violations, rather than a positive responsibility to fulfill or support the realization of human rights. That said, the SRSG recognizes that negative responsibilities may require an actor to take affirmative steps to discharge its responsibility (not least, by conducting human rights due diligence) and that consequently a company can fail to discharge its responsibility by both omission and action (United Nations 2008b: 17; United Nations 2011b: 14).

The intersection of these two distinctions generates four types of social responsibility:

1. Impact-based negative responsibility: Companies have the responsibility to avoid contributing to negative social or environmental impacts directly or through their relationships;
2. Leverage-based negative responsibility: Companies have the responsibility to use their leverage to prevent or reduce the negative social or environmental impacts of other actors with whom they have relationships regardless of whether the companies themselves have contributed or are contributing to such impacts;
3. Impact-based positive responsibility: Companies have the responsibility to contribute to positive social or environmental impacts directly or through their relationships; and
4. Leverage-based positive responsibility: Companies have the responsibility to use their leverage to increase or maximize the positive social or environmental impacts of other actors with whom they have relationships. (Wood 2011a)

The SRSG's framework for business and human rights endorses impact-based negative responsibility, leaves a little room for leverage-based negative responsibility, and rejects both forms of positive responsibility. I will argue in favour of all four varieties of responsibility.

The third distinction at work in the debate about corporate leverage and spheres of influence is between companies' inescapable human rights obligations and optional practices which organizations may choose or be encouraged to adopt. Some commentators, the SRSG included, suggest that exercising leverage to support or fulfill human rights is an optional matter, not an obligation (Sorell 2004:140; United Nations 2010:13; United Nations 2008a: 5). In this article I am concerned only with defining the boundaries of the obligations owed by business to society. Following Goodpaster, I define corporate responsibility as "the acknowledged or unacknowledged obligations that every company has as it pursues its economic objectives" (Goodpaster 2010: 126; Cragg 2010: 283–84). No one disagrees that organizations may as a discretionary matter, on a voluntary basis and subject to certain caveats, use their leverage to promote positive social or environmental outcomes, or prevent or mitigate negative outcomes. I will argue that in certain circumstances they have an obligation to do so.

The "Sphere of Influence" Debate

Emergence of the SOI concept

One of the abiding questions regarding corporate social responsibility is where to draw the boundaries of an organization's responsibility when other actors with whom it is connected engage in human rights abuses or other socially irresponsible conduct. In what circumstances and to what degree, for example, should an apparel company be responsible for violations of workers' rights in its suppliers' factories; should a mining company be responsible for illegal killings by security forces contracted to protect its assets and personnel; should a battery manufacturer be responsible for contamination caused by leaching of toxins when its products are disposed improperly; should a firearms manufacturer be responsible when police use its products to shoot at citizens assembled peacefully; should banks be responsible when the proponents of projects they finance displace indigenous people forcibly; or should makers of fuels, solvents or adhesives be responsible when children sniff their products to get high?

The concept of "sphere of influence" (SOI) was introduced into social responsibility discourse in 2000 by the United Nations Global Compact in an effort to answer this question. The Global Compact urges member companies to embrace, support and enact ten principles of socially responsible conduct "within their sphere of influence" (United Nations Global Compact Office [no date]). According to Professor Ruggie, the main drafter of the Global Compact before he became the SRSG, SOI can be a useful metaphor for thinking about a company's responsibilities beyond the workplace (United Nations 2008a: 6). The concept of a "sphere" reflects two core propositions: first, that organizations have the ability, within certain limits, to influence actions and outcomes outside their own organizational boundaries through their relationships with other actors, and secondly, that business firms and states perform distinct social functions in distinct social domains, giving rise to distinct roles and responsibilities (de Schutter 2006: 12).

The SOI is often depicted as a series of concentric circles with the organization's workplace at the centre, followed by its supply chain, marketplace, the communities in which it operates, and finally an outermost sphere of government and politics (United Nations 2008a: 4). This model assumes that a company's influence diminishes with distance from the centre of its sphere (United Nations 2008a: 4), an idea often operationalized in terms of "proximity":

> The closer a company is to actual or potential victims of human rights abuses, the greater will be its control and the greater will be the expectation on the part of stakeholders that the company is expected to support and respect the human rights of proximate populations. Similarly, the closeness of a company's relationship with authorities or others that are abusing human rights may also determine the extent to which a company is expected by its stakeholders to respond to such abuse. (Business Leaders Initiative on Human Rights, United Nations Global Compact Office, and Office of the United Nations High Commissioner for Human Rights [no date])

The draft United Nations Norms on the responsibilities of transnational corporations in relation to human rights employed the SOI concept in a literal sense to define corporate obligations: "Within their respective spheres of activity and influence, transnational corporations and other business enterprises have the obligation to promote, secure the fulfilment of, respect, ensure respect of and protect human rights" (United Nations 2003: Article A.l). The potential significance of this direct, obligatory application of the SOI concept was magnified by two facts: first, the Norms defined corporate responsibility as including positive obligations to protect, promote and secure the fulfilment of human rights, not just a negative responsibility to avoid violating them; and second, the corporate human rights obligations identified by the Norms were of the same general type and scope as those of States, leaving the concept of "spheres of activity and influence" to do most of the work to distinguish between them.

The UN Human Rights Commission gave the Draft Norms a chilly reception in 2004, noting that it had not requested them and that they had no legal standing. It nevertheless asked the Office of the High Commissioner to prepare a report on existing standards related to business and human rights that would identify outstanding issues and make recommendations for strengthening such standards and their implementation. The resulting 2005 report endorsed the use of the sphere of influence concept to define the boundaries of business responsibility for human rights. Noting that the concept sets limits on responsibility according to a business entity's power to act, it concluded that it could "help clarify the boundaries of responsibilities of business entities in relation to other entities in the supply chain … by guiding an assessment of the degree of influence that one company exerts over a partner in its contractual relationship – and therefore the extent to which it is responsible for the acts or omissions of a subsidiary or a partner down the supply chain" (United Nations 2005a: 14). The High Commissioner also concluded that the SOI concept should help draw boundaries between the responsibilities of States and businesses, and to ensure that small businesses "are not forced to undertake over-burdensome human rights responsibilities, but only responsibilities towards people within their limited sphere of influence" (United Nations 2005a: 14). The report recommended that the

Commission consider and further develop the SOI concept.

The Commission welcomed the High Commissioner's report and requested that the UN Secretary-General appoint a Special Representative on business and human rights for an initial period of two years, with a mandate to "identify and clarify standards of corporate responsibility and accountability for transnational corporations and other business enterprises with regard to human rights" (United Nations 2005b: para. 1(a)). One of the SRSG's tasks would be to clarify the implications of the concept of sphere of influence (ibid., para. 1(c)).

The SRSG's rejection of SOI

In his early research, the SRSG found that many companies' human rights policies and practices mirrored the Global Compact's sphere of influence model (United Nations 2007: 21), and that its assumption of responsibility declining gradually as one moves outward from the workplace "appears to reflect an emerging consensus view among leading companies" (United Nations 2006:10). He nevertheless rejected the use of SOI to define the scope of the business responsibility for human rights (United Nations 2008a: 6; see also Ruggie 2007: 825–26; Ruggie 2008: 202–03).

The SRSG argued that while the SOI concept may have sufficed when the Global Compact was first introduced, companies now needed a clearer and more precise guide to their responsibilities, especially after SOI was incorporated in the draft UN Norms (United Nations 2008a: 5). According to the SRSG, the SOI concept's conflation of "influence as impact" with "influence as leverage" was problematic because imposing responsibility whenever a company has leverage would require assuming, inappropriately, that "can implies ought" (United Nations 2008a: 5). The SRSG concluded, to the contrary, that "companies cannot be held responsible for the human rights impacts of every entity over which they may have some leverage, because this would include cases in which they are not contributing to, nor are a causal agent of the harm in question" (United Nations 2008a: 5). Moreover, requiring companies to act wherever they have leverage would invite political interference and strategic manipulation (United Nations 2008a: 5–6, 2008b: 20; Ruggie 2007: 826).

The SRSG also took issue with the tendency to operationalize SOI in terms of "proximity," noting that its most intuitive meaning, geographic, is often misleading since companies' activities can have effects very far away (United Nations 2008a: 6). The SRSG concluded that "it is not proximity that determines whether or not a human rights impact falls within the responsibility to respect, but rather the company's web of activities and relationships"(United Nations 2008a: 6). In short,

> the scope of due diligence to meet the corporate responsibility to respect human rights is not a fixed sphere, nor is it based on influence. Rather, it depends on the potential and actual human rights impacts resulting from a company's business activities and the relationships connected to those activities.
>
> (United Nations 2008a: 8)

The SRSG also rejected the Norms' contention that corporations have positive human rights duties, defining the business responsibility to respect human rights in negative terms of avoiding harm (United Nations 2008b). The Human Rights Council welcomed the SRSG's reports and extended his mandate for a further three years to elaborate and operationalize the framework (United Nations 2008c). As a result of this endorsement, the SRSG's three-part Protect, Respect and Remedy framework is widely referred to as the "UN framework."

In short, according to the SRSG, the UN Norms, positive responsibility, sphere of influence and leverage were "out" as bases for defining business human rights responsibilities, while impacts and negative responsibility were "in." This did not mean, however, that leverage was irrelevant. While rejecting leverage as a basis for defining the scope of responsibility, he emphasized that responsibility arises not only from the impacts of a company's own decisions and activities, but also from the impacts generated through its relationships (United Nations 2010: 13). The SRSG thus contemplated responsibility arising in situations where the company itself was not contributing to negative impacts, but its relationships were. Responsibility in such circumstances would have to attach to the company's ability to influence other actors' contributions to negative impacts through its relationships rather than to its own contribution to such impacts, since such contribution is absent. This opens the door to a leverage-based conception of responsibility.

SOI and the drafting of ISO 26000

The SRSG's scepticism and the apparent demise of the draft UN Norms notwithstanding, the SOI approach remained very much alive in international CSR discourse and practice. In early 2005 the International Organization for Standardization (ISO) began to work on a guide on social responsibility, to be known as ISO 26000. ISO, a federation of the national standards bodies of approximately 160 countries, is the leading source of voluntary consensus standards for business (Murphy and Yates 2009). The guide was developed by the ISO Working Group on Social Responsibility (WGSR), a multi-stakeholder body made up, ultimately, of 450 representatives of business, labour, government, NGOs and other interests from ninety-nine ISO member countries and forty-two international organizations (International Organization for Standardization [no date]). Notably, no major international human rights organizations participated directly in the negotiations.

Sphere of influence featured prominently in the draft guide from the start, drawing on the Global Compact, the draft UN Norms and other sources. After several rounds of drafting, a near-final version known as a Draft International Standard (DIS) was circulated for ballot in 2009, more than a year after the SRSG published his views on sphere of influence and "leverage" (International Organization for Standardization 2009). The DIS continued to give the SOI concept a central role. In several passages it stated that leverage over other actors can give rise to responsibility, and that generally, the greater an organization's leverage, the greater its responsibility to exercise it (ibid., clauses 5.2.3, 7.3.2, 6.4.3.2, 6.3.10.12, 6.5).

These passages did not escape the SRSG's attention. In November, 2009, he sent a letter to the WGSR expressing concern about the DIS's treatment of leverage and sphere of influence (United Nations 2009). While acknowledging that the use of the sphere of influence concept in the human rights portion of ISO 26000 (clause 6.3) was broadly consistent with the UN Framework, he cautioned that its use in the rest of the document was not, and that this would send confusing messages to companies and stakeholders (United Nations 2009: 2). He reiterated his previously published concerns about leverage and sphere of influence (summarized above), and urged the working group to bring the Guide into closer alignment with the UN Framework.

The WGSR leadership took the SRSG's advice, substantially rewriting the definition of sphere of influence and the main clauses elaborating upon the concept in consultation with the SRSG's team. Many references to responsibility arising from and increasing with the ability to influence other actors' decisions and activities were removed, and replaced with a stronger emphasis on influence as "impact." The changes were endorsed by the WGSR at its last meeting in Copenhagen in 2010, and later that year the final version of ISO 26000 was approved by a large majority of ISO member bodies and published (International Organization for Standardization 2010).

The final version of ISO 26000

Despite these last minute changes, influence and leverage continue to feature prominently in the published version of ISO 26000. The term "sphere of influence" appears thirty-four times in the guide and is integral to its definition of and approach to social responsibility (Wood 2011a, 2011b). ISO 26000 describes the relationship between impacts, leverage and responsibility as follows:

> An organization does not always have a responsibility to exercise influence purely because it has the ability to do so. For instance, it cannot be held responsible for the impacts of other organizations over which it may have some influence if the impact is not a result of its decisions and activities. However, there will be situations where an organization will have a responsibility to exercise influence. These situations are determined by the extent to which an organization's relationship is contributing to negative impacts. (International Organization for Standardization 2010: clause 5.2.3)

Emphasizing that organizations have a choice about the kinds of relationships they enter, the Guide warns that "There will be situations where an organization has the responsibility to be alert to the impacts created by the decisions and activities of other organizations and to take steps to avoid or to mitigate the negative impacts connected to its relationship with such organizations" (International Organization for Standardization 2010: clause 5.2.3). Where organizations are not causing or contributing to human rights violations or other negative impacts directly or through their relationships, ISO 26000 notes that exercising influence to minimize negative impacts or enhance positive impacts is an optional opportunity, not a responsibility, and warns that exercising leverage can also have negative or unintended consequences (ibid., clauses 5.2.3, 6.3.2.2, 6.3.7.2, 7.3.2). In these respects ISO 26000 is aligned with the UN framework.

Other parts of ISO 26000, however, suggest that business responsibility is not just negative but also positive, contrary to the SRSG's formulation. The clause on general principles of social responsibility calls upon organizations, for example, to "respect and, where possible, promote" fundamental human rights (International Organization for Standardization 2010: clause 4.1). Even the human rights clause urges organizations (among other things) to contribute to promoting and defending the overall fulfilment of human rights; promote gender equality; contribute to disabled people's enjoyment of dignity, autonomy and full participation in society; promote respect for the rights of migrant workers; and make efforts to advance vulnerable groups and eliminate child labour (ibid., clause 6.3.4.2, 6.3.7.2, 6.3.10.3).

ISO 26000 recognizes that fulfillment of such positive responsibilities will often require organizations to exercise leverage over other actors. The clause on fair operating practices urges organizations to use their relationships with other organizations to promote the adoption of social responsibility throughout their sphere of influence, encourage the development of public policies that benefit society at large, and raise the awareness of organizations with which they have relationships about principles and issues of social responsibility (International Organization for Standardization 2010: clauses 6.6.1.2, 6.6.4 and 6.6.6). A passage on labour practices even asserts that "a high level of influence is likely to correspond to a high level of responsibility to exercise that influence" (clause 6.4.3.2).

Other passages of ISO 26000 suggest that in some circumstances an organization may have a responsibility to contribute to solving problems caused by others. For example, it urges organizations to take action to reduce and minimize pollution, prevent the use of certain toxic chemicals, and reduce greenhouse gas emissions by organizations within their sphere of influence (International Organization for Standardization 2010: clauses 6.5.3.2,6.5.5.2.1). Finally, an organization may have a responsibility to refrain from exercising its leverage in particular ways, regardless of whether such exercise would have any impact. Thus organizations should not engage in misinformation, intimidation, threats, efforts to control politicians, or other activity that can undermine the public political process, regardless of whether such nefarious activity actually bears fruit (ibid., clause 6.6.4). Similarly it is irresponsible to offer bribes or engage in other corrupt practices regardless of whether such bribes are accepted or such illicit efforts at influencing others' decisions and activities succeed (ibid., clause 6.6.3).

In short, ISO 26000 contains a mix of negative, positive, impact-based and leverage-based responsibility, although the passages on human rights tend to emphasize the negative, impact-based variety (Wood 2011a). In this respect it is more like the UN Global Compact, which exhorts companies to "embrace, support and enact" the ten principles within their spheres of influence, than the UN Framework, which defines the business responsibility for human rights as negative and based on contribution to impacts.

Influence and leverage in the SRSG's guiding principles

In March 2011, the SRSG submitted his final report to the UN Human Rights Council (United Nations 2011b). The report proposes Guiding Principles for implementing the UN Framework. What is most interesting about the Guiding Principles for present purposes is their acknowledgement that a company may be responsible for human rights violations to which it has not contributed:

> The responsibility to respect human rights requires that business enterprises:… Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, *even if they have not contributed to those impacts*. (United Nations 2011b: 14, emphasis added)

The operational guidance provided by the Principles distinguishes between three scenarios: where a business enterprise causes or may cause an adverse human rights impact, where it contributes or may contribute to an adverse human rights impact, and where it "has not contributed to an adverse human rights impact, but that impact is nevertheless directly linked to its operations, products or services by its business relationship" (United Nations 2011b: 18). In other words, in the Guiding Principles a company's responsibility is not defined solely by its own contribution to impacts. Companies have a responsibility to prevent or mitigate negative human rights impacts to which they have not contributed, if these impacts are "directly linked" to the company via its business relationships. In such circumstances responsibility must attach to the company's ability to influence other actors through its relationships, since the company is not making any contribution to negative impacts. In this way, the Guiding Principles embrace a modest version of leverage-based responsibility.

The Human Rights Council endorsed the Guiding Principles enthusiastically in a June, 2011 resolution co-sponsored by several countries and supported almost unanimously by Council members (United Nations 2011a). With the Special Representative's work done, the Council's focus will turn now to promoting the effective and comprehensive dissemination and implementation of the UN Framework and Guiding Principles. Elaborating the circumstances in which the link between a company and a negative human rights impact is sufficiently "direct" to give rise to responsibility even where the company has not contributed to the impact will be one of the issues requiring attention as this work proceeds.

The Case for Leverage-based Responsibility

Insofar as the SRSG's Guiding Principles move toward accepting leverage-based responsibility, they make a step in the right direction. They do not go far enough, however. A comprehensive leverage-based conception of responsibility is needed. I make three assumptions for purposes of this argument. The first is that business organizations bear responsibilities to society other than to maximize returns to their shareholders. While this assumption still has its critics, it is shared widely by the UN framework, ISO 26000, and many commentators, and I do not intend to question it here. The second assumption is that the moral case of the individual can be projected onto the organization for purposes of social responsibility. Such projection raises difficult issues but is sufficiently accepted in the social responsibility and business ethics literature that it provides a workable starting point, provided that certain morally relevant differences between organizations and individuals are borne in mind (Archard 2004: 55; Palmer 2004: 69; Voiculescu 2007: 412–18; Goodpaster 2010: 131).

My third assumption is that responsibility is individual rather than collective – that is (keeping in mind my second assumption, above), it attaches to individual organizations rather than to groups of organizations whose actions collectively advance or infringe human rights or environmental integrity. Many commentators, the SRSG included (Ruggie 2007: 839), have noted the inadequacy of individualist accounts of responsibility in view of the often collective, networked character of human rights violations and other social evils (e.g., Kutz 2000; Voiculescu 2007; Weissbrodt 2008: 387; Wettstein 2010c; Young 2004). A collective theory of responsibility may ultimately be necessary to respond to this reality. In this article, however, I confine myself to exploring how we might address this challenge within an individualist conception of responsibility.

Finally, my defence of leverage-based responsibility should not be mistaken for a defence of the SOI approach. Like the SRSG, I consider the spatial metaphor of nested spheres radiating out from the workplace inapt and potentially misleading, and its tendency to conflate "influence as impact" with "influence as leverage" unhelpful. It should be replaced with a metaphor that is truer to social reality, such as the "web of activities and relationships" suggested by the SRSG himself.

The limitations of impact-based responsibility

The moral case for impact-based responsibility is strong. It is based on the moral intuition that we are responsible for the results of our own actions, barring exceptional situations such as incapacity or involuntariness (Moore 2009: 30–33, 95; Hart and Honoré 1985: 63–65). Our degree of culpability (e.g., intending or recklessly risking a result versus bringing about unforeseen results by mistake) and of contribution (e.g., being a necessary and sufficient cause versus a substantial factor, or making a causal contribution versus non-causally occasioning an outcome) may affect the degree of blameworthiness or praiseworthiness attached to our conduct, but the "ethical bottom-line," as Wiggen and Bomann-Larsen put it, "is simple: you are responsible for the actual harm you cause or contribute to, no matter where you operate" (Wiggen and Bomann-Larsen 2004: 7).

An impact-based account of responsibility must overcome two challenges: unintended side effects and interactive social outcomes. The first challenge arises where an actor's decisions and activities bring about negative results that the actor did not intend. The principle of double effect offer one response to this challenge. Under this venerable doctrine, actors have a responsibility to prevent unintended but foreseeable side-effects and take measures to minimize the harm caused (Bomann-Larsen 2004: 91). Action that produces harmful side-effects is nevertheless permissible provided that the primary goal of the action is legitimate, the side-effects are neither part of the end sought by the actor nor means to this end, the actor aims to prevent or minimize them, and no alternative courses of action are available that would result in fewer or no side-effects (Wiggen and Bomann-Larsen 2004: 5). The issue of unintended side-effects, however important for business ethics, is not relevant to this article because regardless of how one treats them, both the problem and its solution fall clearly within the domain of impact-based responsibility and no question of leverage-based responsibility arises (Wiggen and Bomann-Larsen 2004: 10–11).

The second challenge facing impact-based responsibility is the prevalence of interactive social outcomes. Many social and environmental conditions are the products of complex social interactions in which chains of causation are long and convoluted, outcomes are not within the control of individual actors, and contributions are difficult or impossible to tease apart. This does not fit well with a traditional conception of moral responsibility according to which "one can only be held responsible for that over which one has control" (Beckmann and Pies 2008: 91). This criterion of individual outcome control is an instantiation of the maxim "ought implies can": "you can only have a moral obligation if it is causally possible for you to carry it out" (Banerjee, Bowie, and Pavone 2006: 313). If we were to apply this criterion rigidly to require individual control of social outcomes as a condition for moral responsibility, no one would be responsible for many outcomes in today's complex world.

One response to this problem is to relax the causation requirement. This can be done in two ways. First, the relation between the agent's conduct and the outcome might be diluted from "but-for" causation to "substantial factor" or some otherwise lowered threshold of causal contribution (Moore 2009: 105, 300). Secondly, contribution can be defined in non-causal terms. Moral responsibility can and often does arise in the absence of causal contribution. Examples of non-causal contributions to undesirable outcomes that may in the right circumstances give rise to moral responsibility include omissions or neglect (in which the operative relationship is one of counterfactual dependence rather than causation), culpable imposition of risk (in which the operative relationship is probabilistic dependence rather than causation), and culpable but unsuccessful efforts to do harm (Hart and Honoré 1985: xlv–xlvi, 63–65; Moore 2009: 54–55, 307–11, 314–17, 444–51; Soule, Hedahl, and Dienhart 2009: 541–43). To be clear, responsibility for omissions is non-causal: an omission does not cause the outcome it failed to prevent (Moore 2009: 54–55, 444–51).

The UN framework reflects both of these general strategies: it rejects a narrow focus on causation in favour of "causing or contributing" (United Nations 2008a: 6; United Nations 2011b), and it embraces both causal and non-causal forms of contribution. To be precise, it emphasizes causal contributions, in the form of the direct and indirect impacts of companies' own decisions and operations (e.g., United Nations 2008b: 20). But it contemplates responsibility for both actions and omissions, and refers to such non-causal contribution as failing to conduct human rights impact assessments, failing to integrate human rights policies throughout a company, failing to monitor human rights performance, and silently encouraging or legitimizing human rights abuses (United Nations 2008a: 12; United Nations 2008b: 18–19, 21; United Nations 2010: 17; United Nations 2011b: 14). The Framework also sometimes uses the language of risk, which appears to imply a non-causal theory of responsibility (United Nations 2011b: 16–17).

Relaxing the causation requirement has the advantages of recognizing that causation is scalar, a matter of continuous variation (Moore 2009: 300), and that non-causal contributions can be morally relevant. It allows responsibility to be graduated to reflect different kinds and degrees of contribution, causal and non-causal. It does not, however, allow responsibility to be imposed in cases where it is impossible to determine individual contributions. Under this approach, if no contribution can be established, there is no responsibility.

Some might say that this is as it should be: no one should be held responsible for a state of affairs to which he or she did not contribute, causally or otherwise. But individual responsibility can arise in the absence of contribution to outcomes, causal or otherwise. Leading examples are role-based responsibilities such as that of a principal for harm caused by an agent, a parent for the actions of a minor, an occupier of property for injuries sustained by visitors, or a captain for the safety of a ship (Hart 1967, 2008; Gibson 2007: 99–100). Another is the responsibility to come to the aid of someone in peril given the right circumstances, an issue to which I will return.

A second response to the problem of interactive social outcomes, which often accompanies the first, is to characterize responsibility as qualified rather than categorical. Faced with the lack of individual outcome control, an actor's responsibility should be defined in terms of what he or she can control – making an effort – rather than what he or she cannot – achieving a particular result. In such a scenario, "even if a company does not have a categorical responsibility, a responsibility to resolve the moral challenge on its own, it can still have a qualified responsibility to make an effort – or to participate in the efforts of others in seeking a collaborative resolution" (Goodpaster 2010: 147). This satisfies the "ought implies can" maxim by defining the moral responsibility in terms of actions a firm can achieve by itself. Qualified responsibility is justified in the complex arena of social responsibility where agency is often diffuse and interdependent, and causal pathways hard to trace.

A third response is to make actors responsible for the institutional order in which interactions occur, rather than for specific interaction outcomes. In this approach, individual actors are responsible for contributing to the creation of the institutional order within which interaction occurs and for participating in a discourse aimed at identifying shared interests (Beckmann and Pies 2008; Pies, Hielscher, and Beckmann 2009; Ulrich 2008). Social interaction outcomes remain no one's responsibility, except in the rare cases where individual outcome control exists. This approach is unsatisfactory insofar as it deflects attention from where it ought to be, on responsibility for the actual outcomes of social interaction.

In conclusion, impact-based responsibility works where a causal connection can be established between an agent's actions and the effects felt by others. It applies, for example, where a company fires employees it suspects of agitating in favour of unionization. In this situation the causal impact of the company's action on the employees' rights is direct and clear. It also applies where a company insists on keeping the prices paid to its suppliers as low as possible, and this insistence contributes to a supplier's decision to require its employees to work uncompensated overtime, in an effort to cut its costs. In this situation the first company's action has an indirect impact, as one causal factor (possibly among many) contributing to the second company's decision. So long as the first company's contribution rises above some *de minimis* threshold, the company will bear responsibility for the harm commensurate with its degree of contribution and culpability. Impact-based responsibility can also apply to cases of non-causal contribution such as omissions and culpable creation of risk, by broadening what we mean by "contribution."

Even with this expansion, a wide variety of situations where harm is being suffered, or good could be done, escape the application of impact-based responsibility because it is impossible to determine individual contributions to outcomes. The only answer impact-based responsibility offers in these situations is that no one is responsible. To say that this is justified because contribution is a prerequisite for responsibility fails to recognize that responsibility can and does arise in the absence not just of causal contribution, but of contribution of any kind. Such situations call for finer-grained moral judgments. Some actors are more closely connected to such situations than others, some act in more blameworthy ways than others, and some have more opportunities to act than others. We need a theory of responsibility that allows us to make these kinds of distinctions. Leverage-based responsibility is one such theory.

Power and responsibility

The kernel of a leverage-based approach is the proposition that, in some circumstances where a company is making no causal or other contribution to a state of affairs, it has a responsibility to exercise its leverage over actors with whom it has relationships in an effort to improve that state of affairs. Lack of contribution may not rule out a responsibility to contribute. The same idea can be expressed in terms of impact: even where a company is having no impact, it may have an obligation to try to have an impact by exercising its leverage over others. The question in such cases is not "are we contributing?" but "could we contribute?" If we are not part of the problem, should we nevertheless be part of the solution?

The case for leverage-based responsibility starts with the fact of the substantial power of business enterprises to influence social conditions, including the enjoyment of human rights (Sorell 2004: 138; Wiggen and Bomann-Larsen 2004; Moon, Crane, and Matten 2008). This power is widely believed to be increasing under contemporary conditions of globalization, while the capacity of governments to protect human rights is under strain (Cragg 2004, 2010; Scherer, Palazzo, and Matten 2009). In many cases corporations have substantial influence over people's material well-being; in some cases they exercise government-like functions, providing such public goods as education, security and health care; in rare cases they have the ability to determine life and death. Not only do they have substantial impacts on society and environment, they often have the leverage to make a difference, for better or worse, to problems not strictly of their own making:

> The claim that businesses have obligations to protect and promote human rights is controversial, but the claim that they have opportunities to do so is not, … Businesses, especially big businesses, are influential, and governments that rely on their investment for economic development, or even for corrupt personal enrichment, will not be unwilling to listen to what businesses have to say about a wide range of topics, including human rights. (Sorell 2004: 129)

What are the moral implications of this power? What is the relation between companies' size, resources and leverage, on one hand, and their human rights obligations, on the other? This is, as Sorell notes, "perhaps rhetorically and practically the hardest thing to get clear about when one discusses the human rights obligations of companies" (Sorell 2004: 138). At the highest level of generalization, we might assert that with corporate power comes responsibility (Windsor 2001; Wiggen and Bomann-Larsen 2004: 3; Scherer and Palazzo 2007; Kobrin 2009: 350). According to Cragg, "With the power of corporations to impact the enjoyment of human rights on the part of those affected by their operations comes the responsibility to protect and respect human rights in the exercise of that power" (Cragg 2010: 288).

Some commentators go farther, arguing not just that power must be exercised responsibly but that there may be a responsibility to exercise power. Campbell identifies companies' capacities, "that is, their ability and opportunity to make a difference to fundamental human interests within and beyond their own core sphere of activity," as one factor defining their human rights responsibilities, and asserts that "concentrating on what it is that different sorts of organisation are capable of achieving gives us a fruitful basis for looking not only to where the duties correlative to human rights may fall, but what those duties may actually be" (Campbell 2004a: 15–16). Sorell argues that "when businesses have the opportunity to promote or protect human rights where they operate, they are often also obliged to do so" (Sorell 2004: 130). Griffin argues that "accidental facts such as being in a position to help can impose moral responsibilities – and nothing more special to the situation may bring the responsibility than that" (Griffin 2004: 39). Do these observations support the proposition that corporations must in some circumstances exercise their leverage over other actors in an effort to ameliorate situations to which they did not contribute?

Some proponents of the sphere of influence approach suggest a simple equation: leverage – understood in terms of a company's size, scale of operations, profits, capacity, financial and human resources, strategic position in particular networks, privileged access to elites, etc. – equals responsibility, and the more leverage, the more responsibility. And size matters: the larger the company, "the larger the sphere of influence is likely to be" (United Nations 2005a: 14). The main author of the UN Draft Norms put it this way:

> [T]he larger the resources of transnational and other businesses, the more opportunities they may have to assert influence. Accordingly, larger businesses, which generally engage in broader activities and enjoy more influence, have greater responsibility for promoting and protecting human rights. (Weissbrodt and Kruger 2003: 912)

Surely this is too simple. If this logic were taken literally it would mean that a large multinational company whose operations and value chain raise very few human rights issues would have greater responsibility than a small company operating in an industry and location with extremely high human rights risks, simply because of its greater resources. It would mean that a prosperous Canadian company with no operations, sources of supply, shareholders or consumers in Cambodia would have a responsibility to help improve the lot of Cambodian children, simply because it can. The SRSG's objection that this would turn the "ought implies can" principle on its head is well-founded (United Nations 2008b: 19–20; see also United Nations 2008a: 5). He also rejected this proposition because leverage-based responsibility might push companies into performing roles that should be played by governments:

> [T]he proposition that corporate human rights responsibilities as a general rule should be determined by companies' capacity, whether absolute or relative to States, is troubling. On that premise, a large and profitable company operating in a small and poor country could soon find itself called upon to perform ever-expanding social and even governance functions – lacking democratic legitimacy, diminishing the State's incentive to build sustainable capacity and undermining the company's own economic role and possibly its commercial viability. Indeed, the proposition invites undesirable strategic gaming in any kind of country context. (United Nations 2010: 13–14)

The danger of such strategic manipulation may be overstated (Wood 2011a: 19), but the underlying point is sound: anchoring responsibility in leverage alone is highly problematic. "Can" does not imply "ought."

Sorell gives three convincing reasons why wealth and power are not, on their own, sources of responsibility. Firstly, a company need not be rich and powerful to discharge many human rights obligations (Sorell 2004: 139). Secondly, the risk of violating human rights and the difficulty of promoting or protecting them vary independently of companies' wealth and power:

> Undifferentiated talk of business obligations to promote human rights, and images of businesses with no specific location in the world but bestriding the world, ignore the greater foreseeable risks of human rights violations that attend some places and some forms of business and the greater obligations of companies in those businesses and those places to attend to human rights problems. (Sorell 2004: 139)

Thirdly, if companies' human rights obligations are tied to their economic fortunes, a small business with a razor-thin profit margin might blamelessly neglect worker safety or suppress unionization, while a huge company that falls on hard times might lose its human rights obligations along with its wealth and power (Sorell 2004: 139). On the contrary, Sorell argues, "a company that loses its wealth and power retains its obligations but may become less and less able to discharge them" (ibid.).

As a result, Sorell and the SRSG suggest that wealth, power and other indicia of leverage are relevant as means of discharging social responsibilities, not as sources of responsibility (Sorell 2004: 139; United Nations 2011b: 14,16,18–19). I would not go this far. Leverage can be a source of responsibility, provided other factors are present. The leading example is the moral duty to come to the aid of those in distress (e.g., Griffin 2004: 39; Sorell 2004: 130–35; Moore 2009: 37).

Good Samaritans

The moral duty to come to the rescue of people in distress is an example of leverage-based responsibility. In such cases, capacity to help is a prerequisite for responsibility, not simply a means of discharging it: someone who cannot swim is not under an obligation to save a drowning baby (Santoro 2010: 292). It is worth repeating Griffin's affirmation that being in a position to help, even if entirely accidental, can impose moral responsibilities (Griffin 2004: 39). Harm and suffering generate objective reasons for everyone to cut them short (Sorell 2004: 135; Nagel 1986: 152–56).

When will such reasons be sufficiently compelling to impose a moral obligation on particular actors (Moore 2009: 37)? Speaking generally, four criteria must be satisfied: urgency, ability, opportunity and affordability (Archard 2004; Griffin 2004; Schmidtz 2000; Sorell 2004; Moore 2009: 37). First, the situation must be urgent. Urgency is a function of the importance of the interest at stake (e.g., life, limb, or basic human rights) and the immediacy and severity of the threat to that interest. Secondly, the putative helper must have the ability to help the person in distress, that is, the requisite knowledge, resources or experience. Thirdly, the putative helper must have the opportunity to help, that is, must be in the right place at the right time to deliver the needed help. As Archard reminds us, there is a critical difference between ability and opportunity:

> I am able to administer First Aid to the victims of a road traffic accident. I can do so because I have secured the appropriate qualification, have the First Aid kit, know what I am doing, and have past experience of providing such help. However I only have the opportunity to render such aid if I am there when a traffic accident has taken place and there is a victim to whom I can give First Aid. (Archard 2004: 58)

Some commentators add that the helper must be uniquely qualified to help – that is, there must be no one in a better position (Schmidtz 2000). Finally, the putative helper must be able to help at modest (some would say insignificant) cost, inconvenience or danger to himself or herself (Archard 2004: 35; Soule, Hedahl, and Dienhart 2009: 547–18).

The duty to rescue applies to anyone and everyone who satisfies these conditions, including total strangers who are in a position to help purely by accident – whether passers-by who come upon a child flailing in a pond, tourists who witness a road accident while driving through a foreign country, or patrons who watch passively as a rape is committed in a bar (Moore 2009: 304). Since it applies to total strangers, it is appropriate that the duty be restricted to situations of urgent threats to fundamental interests, where the cost of helping is relatively small.

There is a good argument that this duty applies to companies (Dunfee 2006; Griffin 2004; Schmidtz 2000; Sorell 2004; Soule, Hedahl, and Dienhart 2009: 547–48). Sorell gives the example of a company learning that, on its doorstep, "people's lives are being threatened, or their labour or land seized at the whim of the local military" (Sorell 2004: 132). The urgency of the victims' needs and the relative scarcity of alternative help put "claims on the resources of the company, even if the company, like a passing tourist, is in no way responsible for the emergency" (ibid., 130). While the analogy between the individual bystander and the company is not perfect, the disanalogy adds force to the argument. Companies that invest directly in a country are more like permanent residents than tourists:

> What goes on in the country has more to do with them than with people who are quickly passing through. The human rights abuses that companies confront do not crop up suddenly and unexpectedly, like the road accident: they often predate the entry of the company and are known in advance to be features of local life. Again, they are not features of life which, like the accident on the road, can pass unnoticed if one's eyes are averted at

> the right moment, or that can be kept at a distance by driving away. (Sorell 2004: 132)

Sorell argues that companies "have obligations to help those whose lives or liberty are under serious threat in their vicinity, because some of these threats put people in urgent and undeniable need of help from anyone who can help, and companies in their vicinity sometimes can" (Sorell 2004: 133).

The SRSG neither explicitly endorses nor rejects a business responsibility to come to the aid of those in distress. He recognizes that in some circumstances, "such as natural disasters or public health emergencies, there may be compelling reasons for any social actor with capacity to contribute temporarily" (United Nations 2010: 14), but he does not develop this idea further in his reports. He does explore the implications of a company's presence in a place where human rights are being violated, but only in the context of defining the scope of complicity and due diligence. Firstly, he concludes that mere presence in a place where human rights violations are occurring does not usually by itself constitute complicity (United Nations 2008a: 12, 21; United Nations 2008b: 21). The question of whether presence "at the scene" makes one complicit in others' abuses is not, however, the same as whether it can give rise to an independent responsibility to come to the aid of those in distress. If nothing else, the shaky moral and metaphysical ground on which the entire edifice of accomplice liability stands (Moore 2009: chap. 13) should lead us to explore other avenues.

The second context in which the SRSG discusses doing business in the presence of human rights violations is in defining the scope of human rights due diligence. Assessing human rights challenges in the specific country contexts where business activities take place is a key element of due diligence (United Nations 2008a: 7; United Nations 2008b: 17; United Nations 2011b: 17). Operating in contexts where human rights abuses occur should raise "red flags" for companies to proceed with caution (United Nations 2008a: 21), but does not on its own violate the responsibility to respect. Again, the question of the scope of due diligence is not the same as that of the existence of a free-standing responsibility to come to the aid of those in distress. Due diligence is the standard against which fulfillment of the responsibility to respect human rights is measured. Defining its content does not tell us whether there may be other duties beside the responsibility to respect, or whether the responsibility to respect should be defined differently.

In conclusion, there are good arguments for the existence of a moral duty on corporations to aid the distressed when they find themselves in the position of capable bystanders, and nothing in the SRSG's reports precludes such a possibility.

Beyond rescue

Even if we accept the existence of a business duty to aid the distressed, it is simultaneously too narrow and too broad to support my argument for a general leverage-based responsibility. It is too narrow because it applies only in situations of immediate and serious threat to such fundamental human interests as life and liberty. Under this logic, leverage-based responsibility would be limited to emergency situations which we can only hope will be marginal and exceptional. It would not apply in mainstream, routine business conditions, except in contexts where abuse of fundamental rights is the norm. On the other hand, it is too broad insofar as it applies to anyone and everyone in a position to help, including total strangers with no connection to the case aside from their fortuitous presence at a given time and place. Restricting the duty to narrowly defined emergencies is justified in light of the potentially unlimited range of duty-bearers, and the potentially unlimited range of duty-bearers is justified by the urgency of the threats at issue. But there is a place for an intermediate form of leverage-based responsibility that is not restricted to dire threats to the most basic interests and does not extend potentially to everyone in the world.

Responsibilities are determined by other moral considerations than just urgency and ability to help. The most important for my purposes is the prior existence of a special relationship between the company, on one hand, and the human rights-holder or rights-violator on the other. By narrowing the range of potential duty-bearers to those with such a relationship, we are justified in broadening the circumstances in which leverage-based responsibility will arise.

The SRSG himself points to this possibility. Recall that the Guiding Principles on Business and Human Rights recognize that business enterprises have a responsibility to "seek to prevent or mitigate adverse human rights impacts that are *directly linked* to their operations, products or services *by their business relationships*, even if they have not contributed to those impacts" (United Nations 2011b: 14, emphasis added). In such cases the company should exercise any leverage it has to prevent or mitigate the adverse impact. If it lacks leverage it should explore ways to increase its leverage by, for example, offering capacity-building to the related entity or collaborating with other actors. If it lacks leverage and is unable to increase its leverage it should consider ending the relationship, taking into account the potential adverse human rights impacts of doing so, the importance of the relationship to the company and the severity of the abuse. "As long as the abuse continues and the enterprise remains in the relationship," the Guidelines warn, "it should be able to demonstrate its own ongoing efforts to mitigate the impact and be prepared to accept any consequences – reputational, financial or legal – of the continuing connection" (United Nations 2011b: 19).

As I showed earlier, this is an example of leverage-based responsibility as I define the term, despite the SRSG's earlier rejection of leverage as a basis for determining the scope of corporate responsibility. Responsibility attaches to the company's ability to influence other actors through its relationships, rather than to its contribution to negative impacts, since it is not making any such contribution. The key factor giving rise to responsibility in this situation is the "direct link" between the enterprise's operations, products or services, on one hand, and human rights impacts, on the other, via its business relationships. The Guiding Principles are silent on what constitutes a "direct link." One of my goals in this article is to specify what kind of link should suffice to ground this form of responsibility, putting some flesh on the bones provided by the Guiding Principles. I consider this issue next.

Criteria for leverage-based responsibility

I argue that leverage-based responsibility arises when four criteria are satisfied: (a) there is a morally significant connection between the company and either the perpetrator of human rights abuse or the human rights-holder, (b) the company is able to make a difference to the state of affairs, (c) it can do so at an acceptable cost to itself, and (d) the actual or potential invasion of human rights at issue is substantial. This list draws inspiration from Wettstein's work on silent complicity and positive moral obligations (Wettstein 2010a, 2012), but extends it beyond the confines of complicity and positive responsibility to the case of corporate leverage more generally. Our proposals, while highly complementary, are also partly grounded in different moral considerations and literatures: mine in the duty to come to the aid of those in distress, Wettstein's in the concept of private political authority. That we reach similar conclusions from somewhat different premises adds force to the central proposition that leverage gives rise to responsibility, in the proper circumstances.

(a) Morally significant connection The first criterion for the existence of a responsibility to exercise leverage is a morally significant connection between the company, on one hand, and the human rights holder or rights violator on the other. In the basic rescue cases the connection is provided by the urgency of the victim's plight and the rescuer's being in the right place at the right time with the right resources. This connection crystallizes only at the moment these factors coincide. Often, however, there is a pre-existing relationship between a company and either the rights-holder or the perpetrator of harm. This can provide the morally significant connection sufficient to generate a broader leverage-based responsibility. For individuals, such relationships may be constituted by love, affection, friendship, vulnerability, family, employment or business; or by shared experiences, places, values, beliefs, interests, etc. Although corporations are not capable of some of these connections they have myriad commercial, contractual, political, cultural and other links to a wide variety of actors. Like individuals, they can have "deep commitments to particular persons, causes, careers, and institutions" (Griffin 2004: 40). They may be tied by investments and commercial relations to a place where human rights abuses are taking place, and they may depend on the services or good will of those who are guilty of the abuses (Sorell 2004: 130). Some of these

connections are created by choice, others arise involuntarily. Some are known to the parties, others are not.

These relationships generate moral responsibilities. The closer the relationship, the stronger the responsibility (Santoro 2010: 292). At the "closer" end of the spectrum are what Moore (2009, 58) refers to as "obligations to the near and dear." Applied to companies this would likely include employees, on-site contractors, consumers of goods and services, direct suppliers, and the communities in which companies operate (Goodpaster 2010: 134). If a company is blatantly and systematically polluting water supplies, exploiting workers or intimidating union organizers in a particular local community, other companies who are also established in that community have a stronger moral obligation to exercise their leverage to get it to desist than companies with no presence there, all else being equal. When public authorities interfere with employees' rights to assembly or expression or take away their land without due process, their employer has a stronger responsibility to intervene than does a stranger. Where security forces use a company's products to commit human rights violations, or where individuals use a company's products (e.g., cough syrups, adhesives, solvents or fuels) to get high, the maker of the product has a stronger responsibility to do something about it than does a company that does not make such products. A company with operations in a specific developing country, employing its inhabitants and contributing to its economy, has more of a responsibility for human rights in that country than it does in a country in which it does no business, and more responsibility than does a company that has no operations in that country (Archard 2004: 58).

Responsibility is not determined solely by the closeness of the relationship to the rights-holder or rights-infringer. The character of the interest at stake also matters. The closer the connection between the interest that is threatened and the company's activities, products or services, the stronger the responsibility. A company has a stronger responsibility to exercise leverage over public officials who interfere with its employees' rights of expression when the subject of such expression concerns the company itself or its economic sector, than when it concerns something completely unrelated to the company, its operations, activities, products, or services. This point can be understood in terms of relevance: the more relevant the interest at stake to the company's activities, products or services, the stronger me responsibility (Sorell 2004: 133).

I have identified two types of connections that can be morally significant: the company's relationship to the person(s) involved and the relevance of the interests at stake to the company's activities, products, and services. Either can be sufficient on its own to generate leverage-based responsibility. If the relationship to the rights-holder or violator is close enough, responsibility will arise regardless of whether the interest at stake concerns the company's activities, products or services. This might be the case, for example, when public authorities or security contractors kill or menace a company's long-time employee for reasons unconnected to the company, such as the employee's alleged political activities; or when a company is so pivotal to a local economy that the taxes and royalties it pays provide a substantial portion of the government's revenue which is then used to repress civil rights. Obversely, if the connection between the interest at stake and the company's activities, products or services is close enough, responsibility will arise even if the relationship between the company and the rights-holder or violator is weak (as, for example, in the case of the glue-sniffing addicts). Responsibility will be strongest where both types of connection are strong, and weak or non-existent where both are weak or absent.

So, for example, a Norwegian oil company with operations in Nigeria does not have a responsibility to protest a Nigerian court's sentencing of a young woman to death by stoning in a different state in which the company has no investments, operations, suppliers or consumers, provided it has no relationship with the case or parties and the case does not concern its activities or products, or those of the oil industry (Bomann-Larsen 2004: 95). Likewise, to cite Lord Macaulay's famous example, "a surgeon need not take a train from Calcutta to Meerut in order to save someone not his patient, even though unless the doctor takes the train that person will die" (Moore 2009: 58–59).

The relationships and connections that form the basis for this form of responsibility are often multiple and interwoven. In any given human rights risk situation, a company might have relationships with workers, labour unions, contractors, suppliers, customers, subsidiaries, affiliates, consumers, local residents, security forces, national public authorities, local governments, competitors, industry associations, non-governmental organizations and more; and the human rights risks at play might be relevant to one or more of the company's products, services, labour practices, or political activities. The metaphor of a "web of relationships," suggested by the SRSG, is apt for describing this interconnecting, networked reality. Even if no single strand in the web is strong enough on its own, responsibility will still arise if the company's relationships with rights-holders or violators and the relevance of the interests at stake to its activities, products or services, taken together, constitute a significant connection. The determination of a morally significant connection should be holistic, considering all the relevant strands in the company's web of relationships.

The general idea I am advancing here, that a company's relationships provide the morally significant connection giving rise to responsibility, is reflected in the Guiding Principles. They state that responsibility arises where a business enterprise has not contributed to an adverse human rights impact, "but that impact is nevertheless directly linked to its operations, products or services by its business relationship with another entity" (United Nations 2011b: 18). "Business relationships" include "relationships with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services" (ibid., 14). This is potentially too restrictive in two ways. First, there is no reason to think that morally significant connections will be restricted to "business" relationships, if this term is understood as excluding "political," "social" or "cultural" relationships. ISO 26000 is on a better track insofar as it speaks of "political, contractual, economic or other relationships" (International Organization for Standardization 2010: clause 2.19). Secondly, the insistence on a "direct link" to the company's operations, products or services is too restrictive if it excludes cases where the connection is mediated through more than one party (for example, via two or three tiers of suppliers). The SRSG's effort to delimit the connection is important, so that responsibility not be all-encompassing. But this connection can arise in two ways, as I have argued: either via the relationship between the company and the rights-holder or violator, or via the relevance of the interest at stake to the company's activities, products and services. The Guiding Principles' "direct link" criterion appears to conflate these two kinds of connection, and potentially to draw the line around responsibility too close to the company, excluding some morally significant connections.

It would nevertheless be inappropriate to draw the line too far from a company. O'Neill (1985,1996: 99) argues, for example, that a moral agent has obligations to everyone whose actions the agent presupposes in conducting his or her own activity. Thus "when I buy a sweatshirt or a pair of shoes, my action presupposes the actions of all the persons connected with the process that transforms raw materials into clothes and brings them to my local store" (Young 2004: 372). As Young acknowledges, this approach might be appropriate for a collective form of responsibility, but it is too broad to fix the responsibilities of individual actors (Young 2004). My approach reaches for middle ground, by focusing on the dual factors of a company's connection to the rights-holder or violator and the relevance of the interest at stake to the company's activities, products or services.

The existence of a morally significant connection also satisfies or partially substitutes for the opportunity criterion that usually applies in rescue cases. A special relationship to the rights-holder or violator or a strong link to the company's activities, products or services, or both, provides the company with the opportunity to act. It is what puts the company in "the right place at the right time" to exercise whatever leverage it has to ameliorate the situation.

To sum up this part, the existence of a morally significant connection between the company and the rights-holder or violator is a prerequisite for leverage-based responsibility. Such connection can be created by a pre-existing relationship between the company and the person(s) involved, or the relevance of the interest at stake to the company's activities, products or services. The stronger these connections, the stronger the company's responsibility. As Arnold (2010: 387) points out, where special relationships exist in the global economy, rights-claims are binding on specific obligation bearers; and wherever corporations do business they are already in special relationships with a variety of stakeholders, such as workers, customers, and local communities. These special connections are the fulcrum of my argument for leverage-based responsibility. To paraphrase Griffin (2004: 40), unless one stresses these connections, my proposal that ability (ie., leverage) can determine where responsibility lies looks distinctly odd.

(b) Ability Campbell (2004a: 15) remarks that companies' ability "to make a difference to fundamental human interests within and beyond their own core sphere of activity" is an essential factor in determining their human rights duties. In line with this observation, the second criterion for leverage-based responsibility is the company's ability to make a difference by exercising influence over others with whom it has relationships. As with the first criterion, the strength of responsibility varies with this ability. The greater the actor's chance of being effective and the greater its capacity to absorb the cost of action, the stronger the correlative responsibility (Santoro 2010: 292).

As in the basic rescue case, ability is a prerequisite for responsibility, not simply a means of discharging it. Unlike in the basic rescue scenario, however, the required degree of ability is modest. In the basic rescue situation, a high degree of ability is usually required for a duty to arise. According to some commentators, the duty to rescue arises only if the putative rescuer is uniquely qualified to relieve the sufferer's plight and success is more or less assured within a limited time (Soule, Hedahl, and Dienhart 2009: 547–48). This high standard may be justified when imposing moral responsibilities on total strangers who are in a position to help purely by accident. When the range of duty-bearers is limited by the requirement of an independent, morally significant connection, a lower threshold is appropriate. It is also appropriate in light of the reality, discussed earlier, that the individual outcome control presumed by the higher threshold is rare in our complex contemporary world. The standard should therefore be that the company has the ability to make an appreciable contribution to ameliorating the situation over a foreseeable period by exercising leverage through its relationships, not that it has a high probability of solving the problem by itself in a short time.

Furthermore, the relevant question is whether the company has the ability to make a difference not just by itself but in combination with others. Moore (2009: 304) cites a case in which bar patrons passively watched a rape, concluding that the patrons "had the *ability* to prevent the rape and did not, and that is sufficient to ground their responsibility." Let us assume that no single patron could have stopped the rape alone. This does not mean that none of them had a responsibility to act. On the contrary, they had a responsibility to make an effort to get other patrons to act jointly to stop the rape. Their ability to make a difference together gave rise to a duty to use their leverage over others toward that end.

The relationships through which companies can exercise leverage are sometimes the same relationships that establish the morally significant connection to the rights-holder or the perpetrator of abuse, sometimes not. For example, a morally significant connection may be established by the company's relationship to its workers or local community members, while leverage may be exercised through the company's relationship to public authorities, industry associations or competitors.

(c) Affordability The third criterion is that the company can make its contribution to ameliorating the situation at an acceptable cost to itself. In the basic rescue scenario there is a duty to rescue only if the cost and inconvenience to the rescuer are insignificant or small (Dunfee 2006; Griffin 2004: 35, 39; Moore 2009: 37, 59; Schmidtz 2000). Soule, Hedahl, and Dienhart (2009: 548) insist that the cost must "not disrupt the business, significantly impact earnings, or compromise other moral obligations," concluding not surprisingly that the duty will arise rarely in a business context. As with the other criteria, however, it is appropriate to relax this criterion when the range of potential duty bearers is limited by the prior existence of a morally significant connection to the rights-bearer or rights-violator. Where there is a special relationship, we can reasonably expect the duty bearer to incur somewhat more cost, inconvenience and risk than we would expect of the total stranger. Moreover, the cost we can expect the company to absorb will increase both with the strength of its morally significant connection to the state of affairs and with its ability to make a difference (Santoro 2010: 292).

As with the first two criteria, determining affordability is more a question of identifying a continuum than drawing a sharp line. The basic rescue principle is at the low end of the continuum, with its insistence on little or no cost to the rescuer. At the other extreme is the proposition that the rescuer must incur any cost consistent with mere survival as an agent (Griffin 2004: 35). As Griffin argues, the former standard is too lax, the latter too demanding. In his view the answer to the question of what cost is acceptable "is inevitably rough, but it is along these lines: at a cost within the capacities of the sort of persons we should want there to be" (ibid.: 36). These sorts of persons – including companies and their managers – would not be utterly impartial, rather they would be committed to specific goals, institutions, relationships, places and people, willing to sacrifice themselves but only up to a point. Their obligation to exercise leverage does not go on until the their marginal loss equals the marginal gain of those they are helping; on the contrary, they are allowed substantially to honour their own commitments and follow their own interests, and these permissions limit their obligations (ibid.: 40). Perhaps the most we can say is that companies have a responsibility to make reasonable efforts at modest risk or cost to themselves (Sorell 2004: 132, 135), and that the cost they are expected to incur will increase with the strength of their morally significant connection to the state of affairs in question.

(d) Urgency The final criterion for the existence of leverage-based responsibility is a substantial threat to or infringement of a human right. Once again, given the requirement of an independent morally significant connection to the rights-holder or rights-infringer, we are justified in relaxing the urgency criterion relative to that which would apply in a basic rescue scenario. Instead of an immediate threat to fundamental rights to life, limb, liberty or basic subsistence – a threat that generates objective reasons for anyone who can to help the affected people – it is sufficient that there be a substantial threat to or interference with any human right. An immediate threat to a fundamental human interest is not a minimum threshold for leverage-based responsibility to arise, but a factor enhancing the strength of the responsibility. The more fundamental the interest at stake and the more severe the harm to that interest, the stronger the responsibility.

Characteristics of leverage-based responsibility

Four implications follow from my argument: that leverage-based responsibility is qualified, not cagetorical; graduated rather than binary; context-specific; and both negative and positive in character. Moreover, it is practicable and appropriate to the specialized social function of business.

(e) Leverage-based responsibility is qualified, not categorical One implication of my analysis is that leverage-based responsibility is qualified. It is a responsibility to make a reasonable effort to influence the behaviour of relevant others through relationships, rather than to achieve defined social interaction outcomes. As Goodpaster (2010: 147) argues, "even if a company does not have a categorical responsibility, a responsibility to resolve the moral challenge on its own, it can still have a qualified responsibility to make an effort – or to participate in the efforts of others in seeking a collaborative resolution." This follows from the lack of individual outcome control in contemporary social interaction and is consistent with the "ought implies can" maxim, which demands that responsibilities be defined in terms of results that are within the capacity of moral agents to achieve.

The Guiding Principles reflect this differentiation. Impact-based responsibility is defined in terms of expected outcomes, while leverage-based responsibility is defined in terms of efforts. Companies have a responsibility to *avoid causing or contributing* to adverse human rights impacts (impact-based responsibility), but where they are not contributing to impacts, their responsibility is limited to *seeking to prevent or mitigate* adverse impacts that are directly linked to their operations, products or services (leverage-based responsibility) (United Nations 2011b: 14).

(f) Leverage-based responsibility is graduated, not binary A second implication is that leverage-based responsibility is a matter of degree, not an "on/off" choice. The strength of responsibility varies positively with the strength of the company's morally significant

connection to the state of affairs in question, its leverage over other actors, and the seriousness of the threat to or infringement of human rights; and negatively with the cost of exercising leverage. The threshold between no responsibility and responsibility is necessarily broad and indistinct. It is defined not by a bright line but by a combination of open-textured standards: a morally significant connection; the ability to make an appreciable contribution at modest cost; and a substantial human rights threat. Paraphrasing what Moore (2009: 105) says of the "substantial factor" test for causation, responsibility is a matter of degree and the break point between no responsibility and responsibility is often arbitrary. The job of a responsibility framework is to set an appropriately vague line below which one's connection to the rights-holder or violator, one's leverage over relevant others, the cost of exercising leverage, and the threat to human rights will be ignored for purposes of assessing responsibility. As an aside, impact-based responsibility is also graduated, since culpability, causation and non-causal contributions are also matters of degree (Moore 2009: 72, 300, 319–20); but this issue is beyond the scope of my argument.

Not only is there graduation within leverage-based responsibility, there is also graduation between leverage-based and impact-based responsibility. All else being equal, a company bears greater responsibility for human rights harms it has caused than those to which it has contributed causally or non-causally (e.g., by omission or risk imposition); and more for problems to which it has contributed than for those to which it has not, but could help solve. The SRSG recognized this when he wrote that the steps a company takes to address the human rights impacts of its own operations may differ from those regarding its relationships with other social actors, and that its actions regarding the human rights impact of a subsidiary may differ from those in response to impacts of suppliers several layers removed (United Nations 2008a: 8). These distinctions are reflected in the Guiding Principles. Responsibility requires different action depending on whether the company causes or may cause human rights impacts, contributes or may contribute to human rights impacts, or does not contribute to impacts but such impacts are nevertheless directly linked to it via its business relationships. In the first situation, the company's responsibility is stringent: to take the necessary steps to stop or prevent the impact. In the second, it is relaxed somewhat: to take the necessary steps to stop or prevent its contribution and use its leverage to mitigate any remaining impact to the greatest extent possible. In the third, its responsibility is relaxed even farther: it should exercise its leverage, if it has any; seek ways to increase its leverage, if it has none; and if it can do neither, it should consider ending the relationship, taking into account the importance of the relationship to the company, the severity of the human rights impacts of the relationship, and the potential human rights impacts of ending it (United Nations 2011b: 18–19). This differentiation reflects the realization that when responsibility is imposed in the absence of contribution to a given state of affairs, it is not appropriate to demand that a company remedy the state of affairs, but it is appropriate to demand that it make reasonable efforts to influence those over whom it has some leverage (for example, by making representations to local officials or home country diplomats) (Sorell 2004: 132).

(g) Leverage-based responsibility is context-specific Although corporate human rights obligations are defined in terms of universal human rights to which all individuals are equally entitled, their concrete content must be determined in relation to a range of contextual factors including the responsible actor's social functions, relationships, impacts, capabilities and environment (Cragg 2010: 272, 289–96). So although the Guiding Principles insist that the responsibility to respect human rights applies fully and equally to all business enterprises regardless of context (United Nations 2011b: 14), the reality is that at any level of concrete detail that has application to actual situations, corporate human rights obligations mean very different things in different contexts (Campbell 2004a: 19).

(h) Leverage-based responsibility is both negative and positive The same moral considerations supporting leverage-based responsibility in general also support positive responsibility. The morally significant connection between the company and the rights-holder or rights-infringer and the ability to contribute to

improving the rights-holder's situation generate not just a negative responsibility to use leverage to avoid or mitigate the negative impacts of other actors with whom the company has relationships, but also a positive responsibility to use leverage to enhance the positive social or environmental impacts of other actors with whom the company has relationships, even though the company did nothing to cause or contribute to the current state of affairs (Wettstein 2010a). As Wettstein argues against Hsieh (2009), such positive obligations cannot be grounded convincingly in a negative responsibility to do no harm, but entail a positive responsibility to protect human rights (Wettstein 2010c).

The idea that corporations have positive human rights obligations – to protect, promote or fulfill human rights – is increasingly prevalent in business and human rights theory and practice despite the UN Framework's rejection of it. Arnold (2009: 66), for example, asserts that corporations "have obligations to both ensure that they do not illegitimately undermine the liberty of any persons, and the additional obligation to help ensure that minimal welfare rights to physical well-being and the development of basic human capacities are met within their sphere of influence." Cragg (2010: 289) claims that the task of the corporation in areas without welldefined human rights laws "is to mitigate the negative human rights impacts of its activities and enhance positive impacts." ISO 26000 and the UN Global Compact are two high profile examples from the realm of practice that embrace both negative and positive corporate responsibility.

I do not attempt a systematic defence of positive corporate human rights responsibilities here. My objective is simply to suggest that the moral considerations giving rise to leverage-based responsibility also support positive responsibility. Nor do I claim that my account exhausts the positive responsibilities of corporations, which might alternatively be grounded in multinational corporations' political authority (Kobrin 2009; Wettstein 2010b, 2010c) or in basic Kantian deontological ethics (Arnold 2009: 66); but these possibilities are beyond the scope of my inquiry.

(i) Leverage-based responsibility satisfies the practicality criterion Any account of corporate human rights obligations must fulfill the criterion of practicality (Archard 2004; Campbell 2004a, 2004b: 35; Cragg 2010; Griffin 2004). At one level this means that the obligations must be within the capacity of the individual obligation bearer to carry out, an issue I have already addressed. It also means that the obligations must be capable of being embedded, operationalized and enforced in a concrete institutional framework. My account of leverage-based responsibility satisfies this requirement. Human rights in general are already concretely institutionalized via many international and national instruments, agencies and tribunals. They have "a tangible, palpable existence, which gives them a social objectivity in an institutional facticity" (Campbell 2004a: 12). Moreover, the UN Framework and Guiding Principles go some way toward providing a concrete framework to institutionalize the human rights obligations of business, both within individual companies and at a broader institutional level. The Guiding Principles may contemplate a narrower form of leverage-based responsibility then I do, but the concrete processes they propose for assessing human rights impacts, exercising or enhancing leverage, ending relationships and providing remedies is, to a first approximation, suitable for the broader responsibility I propose.

Vagueness is the only serious objection that might be raised against my proposal under the heading of practicality. How can companies and other actors implement, monitor and enforce obligations based upon such open-textured standards as "significant," "appreciable," "modest" and "substantial"? One answer is that they do so routinely in other fields, from financial disclosure to environmental impact assessment to risk management to negligence liability. In the field of human rights the open texture of rules and standards is demanded by the moral characteristics of the problems at issue. As I have shown, the criteria giving rise to leverage-based responsibility are continuous rather than dichotomous, and the resulting responsibility is a matter of degree, not an on-off switch. Furthermore, many – perhaps most – of the human rights to which business human rights responsibilities correspond are themselves vague and open-textured. To the extent that this prevents satisfaction of the practicality requirement, this impugns all accounts of business human rights responsibilities, not just mine.

The inherent open-endedness of human rights responsibilities calls for attention to the practical tools and processes by which such responsibilities can be operationalized, a task on which the SRSG's reports, ISO 26000, the UN Global Compact and other initiatives have already made progress. And it calls for recognition that allocation of human rights responsibility, like the identification of a "substantial causal factor" in law, has an irreducible element of arbitrariness that may conflict with what many writers on human rights think (Griffin 2004: 40; Moore 2009: 105). This is as true of the General Principles' "direct link" criterion as it is of my account of leverage-based responsibility. Such arbitrariness can be moderated by operational guidance and institutional practice, but not eliminated.

Leverage-based corporate human rights responsibilities can be and are being embedded in stable, recurring, rule-governed patterns of behaviour, incorporated in corporate management systems, integrated in business operations, monitored, reported and verified (Cragg 2010: 292). It is beyond the scope of this article to provide a detailed description of or prescription for this process of institutionalization; all I do here is to make a *prima facie* case that it is possible.

(j) Leverage-based responsibility is appropriate to the social function of business One of the SRSG's strongest objections to leverage as a basis for allocating responsibility was that it would be inconsistent with the specialized social function of business enterprises. If responsibility arises from leverage, he warned, "a large and profitable company operating in a small and poor country could soon find itself called upon to perform ever-expanding social and even governance functions – lacking democratic legitimacy, diminishing the State's incentive to build sustainable capacity and undermining the company's own economic role and possibly its commercial viability" (United Nations 2010: 14). Corporations are "specialized economic organs, not democratic public interest institutions" and as such, "their responsibilities cannot and should not simply mirror the duties of States" (United Nations 2008b: 15; see also Arnold 2010: 374; Cragg 2010: 287).

This might have been a valid complaint against the Draft UN Norms and some of the more grandiose applications of the SOI approach in which corporate spheres of influence and activity provided the only distinction between business and governmental duties, but it does not apply to my proposal for leverage-based responsibility. My requirement of a context-specific, morally significant connection between the company and the rights-holder or perpetrator of human rights harm, like the Guiding Principles' "direct link" criterion, limits the scope of responsibility and prevents corporations from being called upon, or taking it upon themselves, to become surrogate governments for entire communities or regions. Business enterprises exist primarily to pursue private interests, generating wealth by satisfying demands for goods and services. By restricting their human rights responsibilities to cases where they have a special relationship with the perpetrator or rights-claimant, or where the human rights risk situation is relevant to their activities, products or services, my approach ensures that their responsibility flows from their social role as business enterprises, not simply from their capacity to protect or fulfill human rights.

It is important also to emphasize that leverage-based responsibilities, like business human rights obligations generally, do not arise due to a failure by states to fulfill their own responsibilities. They arise independently, due to moral considerations that make businesses obligation-bearers in their own right (Sorell 2004: 141). Furthermore, the state's responsibility to protect human rights is independent of these business responsibilities, and its failure to fulfill its own responsibility is not excused in the least by companies' actions to fulfill theirs. Finally, if the concern is that firms might misuse their leverage to usurp governments and democratic processes, surely this would be inconsistent with social responsibility however defined. Social responsibility implies responsible political involvement (e.g., International Organization for Standardization 2010: clause 6.6.4). There is no question that abuses occur, but there is also no question that companies are capable of exercising their political influence responsibly. A framework for business human rights responsibility should demand that companies do so, not assume that they will not.

As for the SRSG's concern about leverage-based responsibility undermining a company's commercial viability, this is resolved by the criterion of modest cost. Leverage-based responsibility arises only if and to the extent that the cost to the company of exercising leverage is modest relative to the closeness of the connection to the rights-holder or violator, the severity of the human rights threat, and the company's capacity. By definition, therefore, leverage-based responsibility may not force a company out of business. The same is not true, however, of impact-based responsibility.Where a company is causing or contributing to adverse human rights impacts or has the potential to do so, and the price of avoiding or remedying such impacts is to cease doing business, the company must cease doing business – in that place, in that way, or altogether. A corporation has no right to "life" equivalent to that of an individual. It is not a living organism. This fact, plus its lack of a conscious mind or physical body and its potentially immortality, distinguish it in moral terms from individuals. Despite some commentators' claims to the contrary (e.g., Archard 2004: 57–58), a corporation can and should be expected to take actions that would put it out of business, if such actions are required to fulfill its moral obligation not to cause or contribute to adverse human rights impacts. This distinction between impact- and leverage-based responsibility is justified by the greater moral blameworthiness attached to causing or contributing to harm (Moore 2009), and the correspondingly weaker moral imperative to exercise leverage over others to improve a state of affairs not of one's own making.

Conclusion

The contemporary debate about corporate leverage emerged mainly in response to the sphere of influence ("SOI") approach to corporate responsibility.The SOI metaphor is seriously flawed and should be replaced with one more apt such as a "web of relationships," but the idea of leverage as a determinant of human rights responsibility should be preserved alongside impact-based responsibility. Leverage, understood as a company's ability to contribute to improving a situation by exercising influence over other actors through its relationships, is a consideration in determining who bears corporate human rights obligations. It is not simply a means of discharging responsibility, but can be a source of responsibility where (a) there is a morally significant connection between the company and a rights-holder or rights-violator due either to a relationship to the person or the relevance of the rights-holder's interest to the company's activities, products or services; (b) the company is able, on its own or with others, to make an appreciable contribution to ameliorating the situation by exercising leverage through its relationships; (c) it can do so at modest cost, relative to its resources and the strength of its morally significant connection to the state of affairs; and (d) the threat to the rights-holder's human rights is substantial. In such circumstances companies have a responsibility to exercise their leverage even though they did nothing to contribute to the existing state of affairs. This responsibility is qualified, graduated, context-specific, practicable, and consistent with the specialized social role of business. Moreover, it is not merely a negative responsibility to exercise leverage to avoid or reduce harm, but also a positive responsibility to protect, promote and fulfill human rights.

The Guiding Principles go part of the way toward recognizing leverage-based responsibility, but they restrict it too narrowly and fail to articulate the meaning of the "direct link" between adverse impacts and the company's activities, products or services. This article is an effort to put leverage-based responsibility on firmer normative ground and to elaborate its characteristics, including the nature of the required link. Ultimately, as I have tried to show, while the distinction between impact and leverage is morally significant, it is the strength of the connections constituted by a company's web of activities and relationships that does most of the moral work in setting the scope of corporate human rights responsibilities.

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What's Wrong with Bribery

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The question on the floor is what is wrong with bribery? I am not a philosopher and thus my answer to that question may be less systematic than others, but it is certainly no less deeply felt. As a federal prosecutor I have worked for a number of years now in the area of public corruption. Over that course of time, perhaps out of instincts of self-justification, or, so it seems, sharpened moral insights, I have come to develop an abiding belief that bribery is deeply immoral.

We all know that bribery is unlawful and I believe that the legal concepts in this area are in fact grounded in widely accepted moral intuitions. Bribery, as defined by the state of Illinois and construed by the United States Court of Appeals for the Seventh Circuit in the case of *United States v. Isaacs*, in which the former Governor of Illinois, Otto Kerner, was convicted for bribery, may be said to take place in these instances: Bribery occurs when property or personal advantage is offered, without the authority of law, to a public official with the intent that the public official act favorably to the offeror at any time or fashion in execution of the public official's duties.

Under this definition of bribery, the crime consists solely of an unlawful offer, made or accepted with a prohibited state of mind. No particular act need be specified; and the result is immaterial.

This is merely a matter of definition. Oddly the moral underpinnings of bribery are clearer in the context of another statute – the criminal law against mail fraud. Federal law has no bribery statute of general application; it is unlawful of course to bribe federal officials, to engage in a pattern of bribery, or to engage in bribery in certain other specified contexts, e.g., to influence the outcome of a sporting contest. But unlike the states, the Congress, for jurisdictional reasons, has never passed a general bribery statute, criminalizing *all* instances of bribery. Thus, over time the federal mail fraud statute has come to be utilized as the vehicle for some bribery prosecutions. The theory, adopted by the courts, goes to illustrate what lawyers have thought is wrong with bribery.

Mail fraud/bribery is predicated on the theory that someone – the bribee's governmental or private employer – is deprived, by a bribe, of the recipient's undivided loyalties. The bribee comes to serve two masters and as such is an 'unfaithful servant.' This breach of fiduciary duty, when combined with active efforts at concealment becomes actionable under the mail fraud law, assuming certain other jurisdictional requisites are met. Concealment, as noted, is another essential element of the crime. An employee who makes no secret of his dual service cannot be called to task; presumably his employer is thought to have authorized and accepted the divided loyalties. For this reason, the examples of maitre d's accepting payments from customers cannot be regarded as fully analogous to instances of bribery which depend on persons operating under false pretenses, a claimed loyalty that has in truth been undermined.

Some of the stricter outlines of what constitutes bribery, in the legal view, can be demonstrated by example. Among the bribery prosecutions with which I have spent the most time is a series of mail fraud/bribery cases arising out of corruption at the Cook County Board of Appeals. The Board of Appeals is a local administrative agency, vested with the authority to review and revise local real estate property tax assessments. After a lengthy grand jury investigation, it became clear that the Board of Appeals was a virtual cesspool, where it was commonplace for lawyers practicing before the Board to make regular cash payments to some decision-makers. The persons accused of bribery at the Board generally relied on two defenses. Lawyers and tax consultants who made the payments often contended that the payments were, in a fashion, a necessity; the Board was so busy, so overcome by paperwork, and so many other people were paying, that the only way to be sure cases would

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be examined was to have an 'in' with an official whom payments had made friendly. The first argument also suggests the second: that the payments, whatever their nature, had accomplished nothing untoward, and that any tax reduction petition granted by the bribed official actually deserved the reduction it received.

Neither contention is legally sufficient to remove the payments from the category of bribery. Under the definition above, any effort to cause favorable action constitutes bribery, regardless of the supposedly provocative circumstances. And in practice juries had great difficulty accepting the idea that the lawyers involved had been 'coerced' into making the boxcar incomes – sometimes $300,000 to $400,000 a year – that many of the bribers earned. Nor is the merits of the cases involved a defense, under the above definitions. Again, in practical terms, juries seemed reluctant to believe that lawyers would be passing the Board's deputy commissioners cash under the table if they were really convinced of their cases' merits. But whatever the accuracy of that observation, it is clear that the law prohibits a payment, even to achieve a deserved result.

The moral rationale for these rules of law seems clear to me. Fundamentally, I believe that any payment to a governmental official for corrupt purposes is immoral. The obligation of government to deal with like cases alike is a principal of procedural fairness which is well recognized. But this principal is more than a matter of procedure; it has a deep moral base. We recognize that the equality of humans, their fundamental dignity as beings, demands that each stand as an equal before the government they have joined to create, that each, as Ronald Dworkin has put, has a claim to government's equal concern and respect. Bribery asks that that principal be violated, that some persons be allowed to stand ahead of others, that like cases not be treated alike, and that some persons be preferred. This I find morally repugnant.

Moreover, for this reason, I cannot accept the idea that bribery, which is wrong here, is somehow more tolerable abroad. Asking foreign officials to act in violation of moral principles must, as an abstract matter, be no less improper than asking that of members of our own government; it even smacks of imperialist attitudes. Furthermore, even dealing with the question on this level assumes that there are societies which unequivocally declare that governmental officials may properly deal with the citizenry in a random and unequal fashion. I doubt, in fact, whether any such sophisticated society exists; more than likely, bribery offends the norms and mores of the foreign country as well.

Not only does bribery violate fundamental notions of equality, but it also endangers the vitality of the institution affected. Most bribery centers on persons in discretionary or decision-making positions. Much as we want to believe that bribery invites gross deviations in duty, a prosecutor's experience is that in many cases there are no objectively correct decisions for the bribed official to make. We discovered that this was the case in the Board of Appeals prosecutions where a variety of competing theories of real estate valuation guaranteed that there was almost always some justification, albeit often thin, for what had been done. But it misses the point to look solely at the ultimate actions of the bribed official. Once the promise of payment is accepted, the public official is no longer the impartial decision-maker he is supposed to be. Whatever claims he might make, it is difficult to conceive of a public official who could convince anyone that he entirely disregarded a secret 'gift' from a person affected by his judgments.

Indeed, part of the evil of bribery inheres in the often indetectable nature of some of its results. Once revealed, the presence of bribery thus robs persons affected of a belief in the integrity of *all* prior decisions. In the absolute case, bribery goes to dissolve the social dependencies that require discretionary decision-making at certain junctions in our social scheme. Bribery, then, is a crime against trust; and to the extent that trust, a belief in the good faith of discretionary decision-makers, is essential to certain bureaucratic and governmental structures, bribery is deeply corrosive.

Because of its costs, the law usually deems bribery to be without acceptable justification. Again, I think this is in line with moral intuitions. Interestingly, the law does not regard extortion and bribery as mutually exclusive; extortion requires an apprehension of harm, bribery desire to influence. Often, in fact, the two are coincident. Morally – and legally, perhaps – it would seem that bribery can be justified only if the bribe-giver is truly without alternatives, including the alternative of refusing payment and going to the authorities. Moreover, the briber should be able to show not merely that it was convenient or profitable to pay the bribe, but that the situation presented a choice of evils in which the bribe somehow avoided a greater peril. The popular example in our discussions has been bribing a Nazi camp guard in order to spare concentration camp internees.

Capitalism with a Human Face
The UN Global Compact

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Corporate Responsibility in Context

In spite of nearly half a century of national and international endeavours to alleviate poverty, and despite significant socioeconomic progress, the global community must face the sad reality that more than 2 billion human beings still live on US$2 or less a day. Given the scale and complexity of this, the greatest social challenge of our time, addressing poverty requires that national governments, the international community, business and civil society each contribute a reasonable share of their resources, skills and know-how to achieve sustainable solutions (UN General Assembly 2005; UN Global Compact and Global Public Policy Institute 2005).

Experience shows that a nation's economic and social success is at its greatest where there is a clear division of labour and responsibility between the different members of civil society together with a common understanding and shared values with respect to overall societal goals. No one can assume responsibility for everything; no one can claim sweeping rights; and no one should bear the brunt of all the duties of society.

The primary responsibility for human development continues to rest with national governments and their administrations. Sustainable success depends on governments being as effective as possible with the resources available (Leisinger 2004). Whatever opportunities the global economy offers, whatever resources are made available by the international community, good governance remains the single most important factor for human development; that is: transparency in policy and social decision-making; responsiveness to priority needs; accountability for the policies and work undertaken by state employees; the rule of law; an independent and efficient judicial system; as well as institutional pluralism and participation of the people in all decisions affecting their lives.

Business enterprises, too, have specific duties and responsibilities in society's division of labour. Above all, this is to provide goods and services that succeed in meeting customer demands and can be sold at prices that are competitive and in the best interest of the corporation while adhering to law and regulation. The goods and services made available through markets provide society with many different kinds of social value: for example, in the case of pharmaceutical corporations, medicines that reduce the severity of diseases, protect life by reducing morbidity, improve quality of life for patients (less pain, less disability, fewer side-effects) and allow for a (relatively) normal private and professional life (National Cancer Institute 2003; American Cancer Society 2004).

Successful entrepreneurial engagement is one of the most important drivers of economic growth. Economic growth increases choice, widens opportunities and renders all other development efforts easier to achieve (Birchenhall 2007).[1] By creating employment and income, providing technical and managerial skills,

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generating social benefits, paying taxes, contributing to pension funds and deriving innovative solutions to economic, social and environmental problems, corporate management can be a substantial force for good: 'It is companies, not abstract economic forces or governments, which create and distribute most of a society's wealth, innovate, trade and raise living standards' (Birkinshaw and Piramal 2005). The profits obtained by successful companies are usually not the result of a zero-sum game in which all other actors lose: corporate success stimulates economic growth through linkage effects into other sectors – triggering further economic activities and more income and thus making 'the cake' bigger. In a number of emerging countries, business engagement has created substantial employment and income and thus contributed significantly to poverty reduction (Dollar and Kraay 2002).[2]

Of course, it is not entrepreneurial engagement per se that is desirable. It is entrepreneurial engagement conducted in a responsible manner that makes the development impact positive. Collateral damage of a social, environmental or political kind can tip the development balance sheet to the negative side – as many civil society actors allege is happening on a wide scale.

The State of Corporate Reputation

Corporate conduct is not always as one might want it to be; there have been and still are notorious examples of poor corporate behaviour.[3] This is highly regrettable, mainly because of the harm done to people and the planet – but also because the worst cases have a disproportionately negative impact on the reputation of the private sector as a whole. A majority (59%) of citizens in 47 industrial and emerging countries perceives that global corporations do not work in the best interest of society (GlobeScan 2002, 2004). The concern that globalisation offers incentives for a 'race to the bottom' in social, environmental and other standards remains widespread.

Corporate scandals offer at least part of the explanation of why corporate responsibility belongs to the top five global issues of increasing importance (GlobeScan 2005: 15). Globalisation-critical NGOs, meanwhile, who constitute a driving force behind the debate, rise phoenix-like from the ashes of burned corporate reputations; the same survey underlining distrust of (predominantly multinational) corporations reveals that 65% of interviewees think that NGOs – mainly the corporate 'watchdogs' and anti-globalisation advocates – work in the best interests of society.

But when flagrant individual cases of corporate misconduct are considered with the objectivity they require, it becomes clear that a one-sidedly negative view cannot do justice to the substantially more diverse and subtle reality of globalisation and corporate engagement. As in any complex process, there is light and there is shadow. The business community, states the former UN Secretary-General Kofi Annan, is 'not a monolithic bloc; it has leaders and laggards; and leaders should be encouraged when they take positive steps, even though they may occasionally stumble, and not be frightened off from trying in the first place'.[4] The tarring of all companies with a general brush of suspicion and the assumption that illegitimate corporate behaviour is the rule do not do justice to reality: indeed, a number of in-depth analyses by UNO-ECOSOC (UN Economic and Social Council) come to quite positive conclusions about corporate impact on development.[5]

The challenge for companies competing with integrity[6] is to distance themselves from negative generalisations, to strive for flawless corporate responsibility performance – and to hope for corresponding acknowledgement from society.

Entry-Level Corporate Responsibility: Do No Harm

People may differ in what they aim for in social life, but are very much alike in what they find harmful or strive to avoid. Corporations must thus give priority to the minimisation of harm over other organisational concerns (Keeley 1988).[7] This makes compliance management of vital importance – but corporate responsibility leadership is not just about 'doing no harm'.

A majority of people in modern societies expect leading corporations to achieve benchmark financial results and not only to avoid scandal but to consistently meet social, ecological and political standards that bear the scrutiny of a fair-minded, impartial third person (Smith 1984).[8] In practice, this 'impartial observer' seems to combine rising expectations with a degree of scepticism. A recent Swiss poll shows that a clear majority of the public expects companies to go beyond fulfilling legal duties and to contribute to a better world. Where companies do so, however, few appreciate those efforts as a genuine motive to make the world a better place and instead accuse companies of simply polishing their image (Institut für Nachhaltige Entwicklung der Zürcher Hochschule Winterthur 2006). To overcome this implicit distrust flawless corporate conduct ought to be amended by institutionalised dialogue and better communication.

Enlightened companies have long recognised that unfair labour conditions, destructive environmental standards or 'collateral damage' to human rights are unacceptable. For them, the fact that inadequate national legislation lends low standards 'legality' is not an excuse for deficits in corporate responsibility. Instead, they apply intelligent self-restraint by avoiding morally ambivalent business contexts and paying the costs (investment, training and compliance monitoring) necessary to avoid substandard corporate conduct.

Advanced-Level Corporate Responsibility: Do the Right Thing

Legitimacy and stakeholder awareness

Mainstream business ethics and the bulk of the corporate responsibility literature suggest that acting in a responsible way means favouring a 'legitimacy' over a 'legality' approach. While effective legislation and regulation at the national level are important pillars to prevent corporate ruthlessness, reference to law and regulation alone is a partial solution. Law represents the ethical minimum and legality is in some cases insufficient to lend legitimacy to corporate conduct. Reliance on law alone triggers legalistic, compliance-based attitudes and, where the quality of law is inadequate, entails vulnerabilities even for corporations acting legally. Legitimate corporate conduct, by contrast, is being seen to do the right thing beyond legal minima. Given the diversity of pluralistic societies, however, opinions about what constitutes 'the right thing' vary substantially.

In a European Commission green paper, corporations qualify as socially responsible if they voluntarily take on commitments that go beyond common regulatory and conventional requirements, and if they endeavour to raise the standards of social development, environmental protection, respect fundamental rights and embrace open governance, reconciling the interests of various stakeholders in an overall approach to quality and sustainability (European Commission 2001: 4). Just like the UN Global Compact, the European Commission sees stakeholder relations as an integral part of corporate responsibility. The idea behind a 'stakeholder-aware' corporate responsibility approach is that requests from different societal constituencies become part of corporate policy.

As there is no universally accepted definition of 'the right thing' to do and as the expectations placed on successful companies by modern, pluralistic societies are steadily expanding, the goalposts are constantly moving. Prominent observers have characterised corporate responsibility as a religion with too many priests.[9]

At the root of the problem lies a challenge identified by Archie Carroll many years ago (Carroll 1993: 14). There is a rift between society's expectations *vis-à-vis* business capacity to address social problems and actual corporate performance. A growing number of people in modern societies expect (and most NGOs demand) that large companies become more involved in seeking solutions to broader societal problems such as poverty alleviation or health improvements, which lie outside companies' core competences and direct sphere of influence. Showcasing hands-on examples of corporate responsibility and philanthropic achievements does little to heal this rift: the emergent corporate responsibility is a much more comprehensive concept and should not be confused with straightforward philanthropy.[10]

Trespassing conventional limits

If one looks at the academic literature on corporate responsibility as an early indicator of the trajectory that future stakeholder demands will take, there is a new tendency: given the notion that (especially large, multinational) corporations are institutions as powerful as, if not mightier than, governments (of poor countries), companies will be increasingly expected to assume additional, governmental-like responsibilities (Wettstein 2005). Not only do companies face the obligation to do business responsibly, but must increasingly step outside the boundaries of conventional corporate activity:

- A (large) company is expected to take action where it is capable of influencing an outcome and not 'only' where there is proximity to the problem or a causal link between the problem and the corporation (Kline 2003). While John Kline restricts his arguments, for the time being, to 'political actions', a growing acceptance of the 'capability, not causality or proximity' approach indicates a paradigm change in corporate responsibility thinking
- Corporations enter the arena of citizenship at the point of government failure in the protection of citizenship. More precisely, they are *expected to partly take over those functions with regard to the protection, facilitation and enabling [of] citizen's rights – formerly an expectation placed solely on governments*. [...] If a term such as 'corporate citizenship' makes any sense in the proper meaning of the term, 'corporations' and 'citizenship' in modern society come together at exactly the point where the state ceases to be the only guarantor of citizenship (Matten *et al*. 2003: 116, authors' emphasis)
- Under certain conditions, transnational corporations are seen to have a (moral) 'duty of assistance' to people in 'burdened societies', where socioeconomic circumstances make it difficult or impossible to live decent lives (Hsieh 2004)[11]

The gap between societal expectations and concrete corporate responsibility deliverables poses an issue of societal acceptance of company actions. Just as in the distinction between 'felt' and 'measurable' temperatures, there is a 'measurable' corporate responsibility (expressed by what is actually delivered) and a 'felt' corporate responsibility (assessing what is delivered against what is expected). The proposed solution of changing the corporate social responsibility 'game' through 'focused commitment to reaching a goal that exceeds societal expectations'[12] is easier said than done.

Extending the definition of corporate responsibility raises both valid and vexing questions for even the most enlightened management. Can corporations work from the assumption that 'citizenship' – and therefore 'corporate citizenship' – is first and foremost a normative concept, implying not only economic rights, but also social duties? By refusing to accept such a concept would management by definition be acting irresponsibly? Or, conversely, does such an extended definition represent a waste of corporate resources and therefore bad management practice? Should corporate executives who feel compelled to assume such responsibilities do so not with corporate resources, but instead devote part of their personal income to the causes they personally regard as worthy?[13]

An important part of the answer to these questions lies in the nature of the feedback corporations receive from society for corporate responsibility excellence. But, before turning to this issue, let us have a look at today's most respected common denominator for responsible corporate conduct: the UN Global Compact.

The UN Global Compact as a Framework for Corporate Responsibility

Launched by former United Nations Secretary-General Kofi Annan, the UN Global Compact (UNGC) is a corporate responsibility initiative based on the conviction that weaving universal values into the fabric of open global markets and corporate practices will help advance broad societal goals. By 2007 over 3,000 companies from all regions of the world, along with many international labour and civil society organisations, were engaged under the UNGC.[14] The Global Compact covers internationally accepted norms in the areas of human rights, labour standards, environmental care and anti-corruption. Companies committing to these norms must incorporate them into their corporate policies and management processes. In addition, they should strive to extend adherence to the UNGC philosophy to third parties within their defined sphere of influence (Leisinger 2003).

Responsible corporate conduct is based on ten principles which participating companies are expected to embrace, support and enact in their sphere of influence.

Human rights

- Principle 1. Businesses should support and respect the protection of internationally proclaimed human rights.
- Principle 2. Businesses should make sure they are not complicit in human rights abuses.

Labour

- Principle 3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining.
- Principle 4. The elimination of all forms of forced and compulsory labour.
- Principle 5. The effective abolition of child labour.
- Principle 6. Eliminate discrimination in respect of employment and occupation.

Environment

- Principle 7. Business should support a precautionary approach to environmental challenges.
- Principle 8. Undertake initiatives to promote greater environmental responsibility.
- Principle 9. Encourage the development and diffusion of environmentally friendly technologies.

Transparency and anti-corruption

- Principle 10. Businesses should work against corruption in all its forms, including extortion and bribery.

Applying Global Compact Principles in Business Practice

Define 'the right thing', set goals and achieve these using management processes

For companies competing with integrity the basic question has already been answered: they want to be 'part of the solution' not 'part of the problem'. For such companies, illegal conduct and wilful harm to human beings or the environment are simply not options. But what, in the light of the ten principles, can additionally be expected from a responsible company? The Global Compact principles provide only a grid for reflection, not the precise content of a corporate responsibility strategy.

Socrates once surmised that the 'truth' is in every human being; he or she just needs to recognise it. Here, moral philosophical discourse has been assigned a 'midwife' function to give birth to truth. Self-critical reflection on corporate responsibility in the light of the Global Compact principles can perform precisely this function for companies: all core business ethics aspects are covered by the ten principles. Management can therefore ask itself the following sorts of question:

- What, in the light of the ten principles and beyond legal compliance, are our main weaknesses and vulnerabilities with regard to human rights-related issues, labour and environmental standards as well as in relation to anti-corruption?
- How do we define the 'sphere of influence' within which we acknowledge responsibility for human rights-related, social and environmental standards and where do we draw the limits?
- Who are our relevant stakeholders? What are their stakes and expectations? How do we deal with them?
- How do we proceed if the expectations of civil society conflict with those of the financial community?
- What does 'support and respect the protection of internationally proclaimed human rights' mean in the area of economic, social and cultural rights?

Reflection on such questions by top management is, in my experience, the single most important element of the Global Compact process. Dialogue with internal and external stakeholders helps to reach informed decisions about the content, scope and limits of corporate responsibility. Companies thereby become familiar with the pluralism of demands from different stakeholders. Management is challenged by values, concerns, views of the world and perceptions of corporate obligations that may differ substantially from its own. This learning experience – as challenging as it may sometimes be – enhances the social competence of corporate management. And, as dialogues are reciprocal, civil society stakeholders, too, have the opportunity to learn about the mind-set of managers and their way of making decisions against the background of business fundamentals and hence can better understand the limits and non-negotiable essentials for profit-oriented corporations.

Responsible decisions are usually taken as the result of three steps: making the right value choice, assessing the facts and choosing the right norms.

Making the right value choice

Controversy over what constitutes the right thing to do generally arises from the fact that different parties base their norms on diverging values, personal experiences and vested interests (often held implicitly). What one group holds to be of highest importance, another may dismiss as a minor issue. For example, financial analysts – although increasingly appreciative of 'triple-bottom-line' philosophy – still focus predominantly on the profitability data of businesses when determining benchmarks for measuring best-in-class. For those engaged in the fight against poverty diseases, in marked contrast, profitability issues are of secondary concern when it comes, for example, to ensuring access to drugs for the 2.5 billion people living in absolute poverty. Those who must meet the expectations of financial markets will inevitably question the logic of giving away products at cost or for free – at least under an open-ended and unlimited commitment. The fact that a business manager has to do what is economically right does not make him or her morally inferior to those requesting free medication for the world's poor. Business corporations and NGOs have different tasks to fulfil – both are important. Sustainable solutions for complex issues, however, involve all relevant stakeholders and their resources, and corporations are just one player among many and thus can offer only some of the 'stones' for the composition of the 'solution mosaic'.

Assessing the facts

Even where there is broad consensus over a given value, such as the quality of human life with good health as its precondition, conflicts may arise through a failure to distinguish between perception and real facts. Take the controversy over patents and their impact on lack of access to medicines for poor people in developing countries. The argument that patents are the main obstacle impeding access to medicines for people living in poverty is not borne out by the facts. Of the 319 products on the World Health Organisation's Model List of Essential Drugs, only 17 are patentable (5%) and most are not actually patented, bringing the final proportion of patented drugs to 1.4%, of which most are concentrated on larger markets (Attaran 2004). Those who argue that patents are the main problem for the poor in developing countries tend to ignore or at least underestimate the importance of other critical access issues: the lack of doctors, nurses and laboratories for appropriate diagnosis, lack of logistical essentials (e.g. peripheral warehouses and refrigerators), lack of general health infrastructure (to reduce walking distances for sick people to reach health centres) and assurance of patient compliance with complex and long-term therapies – especially in cases of stigmatised diseases (HIV, TB, leprosy) where lack of compliance can result in resistance to available drugs.

Choosing the right norms

The essence of moral discourse is that it indicates to duty bearers the right course of action. Moral norms are more likely to be filled with practical life if and for as long as they appear self-evident to the party who is expected to act. But what can reasonably be demanded of a company beyond legal compliance and where does the buck stop?[15] While it is evidently morally wrong to accept or initiate human rights violations for the sake of increasing profits, opinion on the corporate obligation to fulfil the 'right to health' of poor people is more divided. It is relatively easy to impose demands on 'Big Pharma' by highlighting the misery of those living in absolute poverty while criticising the size of corporate profits. It is less easy to shoulder the cost of meeting the needs of patients who lack the purchasing power to buy medicines through markets. The 'right to health' debate demonstrates clearly how moral oversimplification can distort a complex human development challenge – and how such distortion affects the way responsible corporate conduct is perceived.[16]

These difficulties notwithstanding, once corporate moral norms have been established they have to be translated into codes of conduct and corporate responsibility guidelines. Thereafter, the implementation process is 'business as usual': that is, making use of normal corporate management procedures (e.g. target setting, performance appraisals, compliance monitoring, verification and reporting).

A Practical Approach to Corporate Responsibilities

To help operationalise the concept of corporate responsibility, a Dahrendorf model with three levels of classification can be used, comprising a *must* dimension, an *ought to* dimension and a *can* dimension – each with specific moral qualities and material content (see Fig. 1).[17]

The *must* dimension covers non-negotiable corporate duties which include, for example, compliance with national law and regulation and avoidance of deception or fraud. This includes protection of the environment, as well as the health and safety of employees, customers and neighbours according to applicable law. Shareholders expect a fair return on their investment and employees expect fair wages. In this dimension, corporate societal responsibilities include the creation of jobs, tax payments and contributions to insurance and pension funds. Where companies provide training and further education on the job, employees improve their employability and value in the job market. Companies also add value to society and the national economy by providing products and services that meet immediate customer needs or enhance their quality of life.

The *ought to* dimension refers to those aspects over and above legal compliance which are commonly expected by people in modern societies. In countries where the quality of law is state-of-the-art and enforced, legality can be deemed to satisfy in large measure the requirements of responsible corporate conduct. In regions where this is not the case, however, responsible companies will exceed legal minima by applying higher corporate norms: for example, through the use of state-of-the-art environmental technology and social policies, even where local law would permit lower standards.[18] Other examples include the provision of free or heavily subsidised meals, corporate health services for employees and their families, nursery schools for single working mothers, free training opportunities using company infrastructure, or scholarship programmes for the children of low-income employees. Finally, companies competing with integrity will strive to avoid profiting from unhealthy or otherwise unfair working conditions of third parties and will bring their influence to bear wherever possible.

The *can* dimension covers philanthropic corporate social investments: for example, through pro bono research, community and neighbourhood programmes, volunteerism and donations. Although such corporate deliverables can engender greatly beneficial outcomes for underprivileged communities – and are therefore often given a high profile in corporate communications – this dimension of the corporate responsibility portfolio will always be voluntary in the sense of being 'nice to have' and would in no way compensate for a lapse of responsible conduct under the two previous dimensions.

The process by which corporate management reflects on what to do and where to set limits will bring up a variety of highly specific issues that would probably not otherwise come to light. If properly done, an open-minded SWOT (strengths, weaknesses, opportunities and threats) analysis can bring elements to management's attention which might otherwise be considered marginal or niche issues beyond the conventional corporate perception. A quick search on the internet highlights numerous incidences where corporate management's perception of potential issues has been at odds with that of civil society. Key words for respective areas are 'human rights and business' issues, 'supply chain responsibilities', or 'fairness' issues, for example with regard to remuneration.

Companies under normal circumstances will look at competitive remuneration to attract the most competent and educated employees. In emerging economies, they might be confronted with minimum wages imposed by the state: for example, for workers in production facilities, on farms or in particular industrial sectors. Appropriate reflection on corporate duties in the context of economic rights, however, will lead

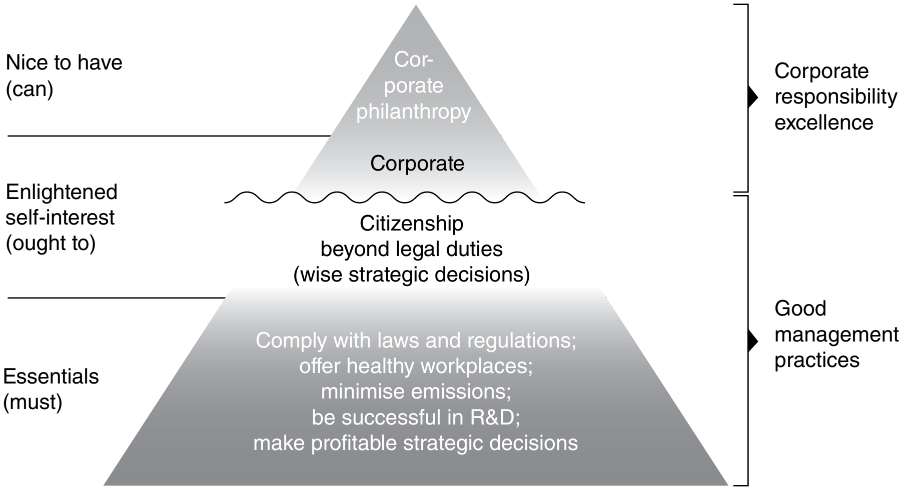
Nice to have
(can)
Enlightened
self-interest
(ought to)
Essentials
(must)
Cor-
porate
philanthropy
Corporate
Citizenship
beyond legal duties
(wise strategic decisions)
Comply with laws and regulations;
offer healthy workplaces;
minimise emissions;
be successful in R&D;
make profitable strategic decisions
Corporate
responsibility
excellence
Good
management
practices

Figure 1 The hierarchy of corporate responsibilities.

management to the concept of *living wages*, raising an entirely new set of questions:[19]

- What is a reasonable definition of a 'living wage' and who says so?
- What constitutes fair content for the basic needs reference basket? For example, should it contain savings or contributions to social security institutions?
- Which parts of a social package considered 'normal' in the corporation's home country (e.g. pension fund) should a company 'export' through its business practices to developing countries with very different average income levels and institutional settings?

While management has no option when it comes to adhering to laws and regulations, and while 'good management practices' may be driven by enlightened self-interest, corporate citizenship deliverables above and beyond a certain standard remain at the sole discretion of management. From a purely economic point of view, it could be argued that every dollar spent on corporate responsibility beyond legal requirements and basic standards of decency is a dollar diverted from potentially profit-generating activity.

In other words, there are opportunity costs associated with corporate responsibilities that extend beyond conventional good management practices – mainly in the form of benefits not realised through alternative investments. Doubt over the question of whether companies should go out of their way to define and promote wider, self-chosen objectives is part of the ongoing corporate responsibility discourse.[20] This is why, eventually, every company has to draw the line on what it can assume responsibility for. While dialogue with open-minded stakeholders will help to sharpen awareness about social, political and environmental problems, the ultimate decision on how far a company extends its 'responsibility frontier' remains the prerogative of informed top management. This frontier, however, can be extended if and when there is a business case for going beyond the conventional border between good management practice and corporate responsibility excellence (represented by the undulating line in Fig. 1).

Returns on Corporate Responsibility Investments

Corporate responsibility literature suggests two sets of reasons for corporations to apply standards higher than the legal minimum: *intrinsic rightness* and the *business case*. Both are valid. It is intrinsically right not to accept in one's sphere of influence the violation of human rights, the exposure of employees to unhealthy and unfair working conditions, the infliction of damage on the environment or corruption as a means to promote business or avoid regulation. The 'moral footprint' matters and is a simple and indisputable fact.

The second set of reasons to encourage greater corporate responsibility is largely instrumental in nature, entailing strategic business advantages such as:

- prevention, or at least reduction, of legal, financial and reputational risks entailing significant punitive damage costs;
- attraction, retention and motivation of above-average employees as well as enhanced corporate morale;
- enhanced corporate reputation and corporate branding;
- creation of goodwill among ethically minded investors and consumers;[21]
- preservation of corporate freedom.

For some observers, the discussion is closed. Marjory Kelly announced in 2004 the discovery of the (statistical) 'Holy Grail' – eagerly sought but previously never found. Kelly argues that *socially responsible companies perform better financially* (Kelly 2004: 4ff.). The way Kelly summarises the meta-analysis performed by Orlitzky *et al.* (2003) is plausible. Indeed, the authors were able to answer in the affirmative the question they picked up from a *Business Week* special section in 1999: 'Can business meet new social, environmental and financial expectations and still win?' A closer look, however, reveals that a number of conceptual issues remain unaddressed. Yet these are of great significance in determining the corporate response to stakeholder demands and, hence, eventually, the extent of social responsibility deliverables (Orlitzky *et al.* 2003). The meta-analysis is unclear about whether the positive statistical correlation is:

- explained by good management practices, i.e. cutting-edge managers taking corporate responsibilities seriously and therefore anticipating and solving problems before they have an impact on the bottom line;

or:

- a result of superior financial performance, allowing for more, deeper and broader corporate responsibility investments.

Orlitzky *et al.* also fail to differentiate between corporate responsibility endeavours that 'do no harm' and those striving to 'do good'.

While there is in all likelihood a corporate responsibility business case, it is far from easy to establish this empirically and make it measurable for neutral observers. Margolis and Walsh found in their analysis that the 'clear signal that emerges from thirty years of academic research – indicating that a positive relationship exists between social performance and financial performance – must be treated with caution' (Margolis and Walsh 2001a: 13).[22] And, according to the Institute of Business Ethics (2003: 9), 'the relationship between good financial performance and other indicators of corporate responsibility … is (at best) positive but not definitive'. Nikolay Dentchev (2004) found 'various positive and negative effects' linked to initiatives meant to contribute to society and the natural environment. The relationship between financial performance and corporate responsibilities extending beyond legal compliance, however, was found to be 'inconclusive, complex and nuanced'. This is no surprise: if the correlation between excellent corporate responsibility and excellence in economic results were so clear-cut and undisputable, there would be no case to argue.

Whereas the 'costs' of beyond-compliance corporate responsibility efforts – sometimes in terms of forgone sales – can, in most cases, be clearly quantified as additional investments,[23] the 'return' on corporate responsibility is difficult to establish, particularly in the short term. The avoided costs of accidents, labour disputes, negative media exposure, public criticism or additional regulatory burdens are as difficult to quantify as the opportunity benefits achieved when disasters are averted and negative issues circumvented through precautionary or preventive investments. Note, for example, the case of environmental expenditure: while the upfront cost is all too clear, the savings gained as a result of environmental accidents that did not happen are unquantifiable.

Fluctuations in share prices, too, can usually be explained more by general bullish or bearish movement on financial markets and sector-wide trends than by the moral quality of a specific corporate action. Notorious cases such as Enron, Arthur Andersen, WorldCom, Tyco and others underscore the ultimate price of non-compliance, however. At the very least, the cost of good management can be viewed as an insurance premium to prevent corporate crises and negative publicity.

Innovation, efficiency, effectiveness, the ability to make the most of market potential and interpret trends correctly, as well as the art of saving unnecessary costs and spending available resources in the right place at the right time, will retain their overriding importance as preconditions for business success. But there is growing plausibility in the view that corporations that assume responsibility beyond the legal minimum (*must* dimension) by applying good management practice well into the *ought to* dimension are likely to run lower risks and fare better with their employees, investors and customers. It also seems logical that companies that are considered by the public as 'part of the solution' will be better placed to argue for entrepreneurial freedom than those considered to be 'part of the problem'.

Corporate responsibility investments along these lines – up to a certain limit (denoted by the undulating line in Fig. 1) – are likely to create a win-win situation for society and the corporation. The societal benefits of higher incomes, better health, education, training and employability are matched by corporate benefits such as higher work motivation, higher productivity and lower absenteeism. Investments up to the point where none of the participating subjects (or institutions) can be made better off without another subject being made worse off (in absolute terms) are therefore good management practices. Economists refer to this point as the Pareto Optimum. So far, so uncontroversial. But this is not the cutting edge of today's corporate responsibility debate.

Stakeholder Feedback on Corporate Responsibility Excellence

Mainstream stakeholder theory suggests that maintaining dialogue with a variety of corporate stakeholder groups, and satisfying their demands to the highest possible degree, will yield positive results for the company.[24] The rationale for this is strategic in nature:

- Closer contact with diverse stakeholders and NGO networks deepens understanding of societal exportations in the context of social, political and ecological issues.
- Dialogue enhances the efficiency of a corporation's adaptation to societal demands.
- Dialogue provides direct knowledge of constituencies and their opinion leaders.
- Dialogue fosters higher sensitivity to broader societal goals through a willingness to assess and address the multiple claims of civil society.

Good stakeholder relations are seen to be advantageous to the company because they serve as an 'early warning system' for societal expectation trends and thus help to develop corporate social competence. Social competence in turn makes a company's top management better able to anticipate external changes and deal with them before they exert a negative impact on its business environment. Finally, accepting and fulfilling stakeholder demands through additional investments of corporate resources is anticipated to have a positive effect on corporate reputation. From this theoretical perspective, commitment to excellence in corporate responsibility should yield even better reputational benefits. Improved reputation can be an advantage with regard to customer loyalty, employee recruitment and retention, investment by ethical investment funds and a company's standing within the political landscape.

Bearing in mind the general state of corporate reputation, however, and recalling the issue Archie Carroll (1993:14) identified many years ago – namely, that society's expectations of business performance *vis-à-vis* the big social problems tend to be far removed from actual corporate performance – there is no simple causal relationship between a corporation's contribution to the common good and its reputation – at least not in the short term. Part of this discrepancy has to do with political dynamics within the NGO community and with the fundamental ideological resistance of some constituencies to the corporate sector, capitalism and globalisation in general. As in the corporate world, there is significant heterogeneity and not every stakeholder is as open-minded or dedicated to the common good as one might wish.

On the one hand …

There can be no doubt that today's world is a better place thanks to the many highly committed people working in dedicated civil society groups to induce changes in public and corporate policies. Putting aside for a moment their immense diversity, these groups will, for simplicity's sake, be summarised here under the term 'NGOs'. NGO initiatives have undeniably contributed significantly towards improvements in the social, environmental and political quality of corporate conduct (e.g. Reverend Leon Sullivan's Principles, the Global Reporting Initiative, the Valdez/CERES Principles or, more recently, Clean Clothes Campaign, Equator Principles, Extractive Industry Transparency Initiative as well as the Business Leadership Initiative for Human Rights). In many cases these initiatives came from small, enlightened minorities. Some, it is true, have resorted to highly unorthodox methods and innovative actions, but many of the causes such NGOs were fighting for 30 years have become standard procedure in enlightened corporations today.

No company or institution is perfect and management can take undue risks or make errors of judgement which – with the benefit of hindsight – are regrettable. No single actor has all the answers. The definition of what is perceived to be 'legitimate' changes over time. Heightened sensitivity and enhanced social competence can help to steer onto the right path policies and procedures which may have been state-of-the-art, but are now outdated. From this point of view, NGOs exposing perceived or actual corporate misdeeds may be regarded as part of a creative societal process which eventually brings about changes for the better. Engaging in strategic stakeholder relations can therefore be considered a good investment of corporate time and resources even if the process is sometimes a difficult one.

… on the other hand

For many NGOs and their spokespersons, globalisation per se is, for a number of cultural, ecological, social and other reasons, an undesirable trend. As a consequence, the multinational corporations, perceived as the main drivers of globalisation, are by definition part of the problem. Multinational companies are commonly perceived as simply being too big and – since size is equated to power – excessively powerful and hence evil.[25] Twinning this view with the 'worst case' misdeeds of a few corporate wrongdoers, some NGOs portray multinational corporations in general as the prime culprits responsible for virtually all political, social and ecological evils. The insinuation is that multinational companies are often run by immoral, unscrupulous and exceedingly greedy managers who enrich themselves at the expense of the common good and the human development opportunities of the world's poor.

Even those companies competing with integrity and striving to put their 'house' in order by closing the gap between legality and legitimacy are not, as a rule, exempt from this broad-brush criticism. Perversely, 'good' companies can find themselves the focus of negative attention and suspicion, their motives questioned by a mind-set that essentially denies 'earned reputation' for responsible conduct.[26] Particularly in Europe, even corporate philanthropy activities may be attacked with allegations of 'hidden market agendas', 'PR in the guise of charity', 'diversion tactics to mask poor corporate conduct' or 'profit motives masquerading as altruism'.[27]

Maintaining independence versus outright rejection

Of course, NGOs need to maintain their independence from the corporate and political sectors and, in a free society, anyone has the right to demand greater corporate responsibility – as long as this is done in a non-violent way. NGOs engaged in joint projects with companies must, moreover, tread a fine line in their dealings with the corporate world if they want to avoid 'capture' and minimise the risk of being smothered in a corporate public relations embrace. As self-appointed corporate watchdogs and whistle-blowers, NGOs run a risk to their own credibility by appearing to be too close to the very institutions they set out to monitor and hold accountable. Finally, it is a fact that the media prefer scandal, controversy and accusations over reports on corporate 'good deeds'; as media attention is a significant tool in the NGO fight for financial contributions, the temptation to manipulate it is considerable. Given the media-savvy nature of many activists, the result is that media coverage of 'anti' NGOs is much more extensive than that of more moderate institutions whose campaign tactics are less confrontational and more partnership-oriented.

Well-founded criticism of reckless corporate behaviour underpinned by informed public debate is quite distinct from generalised corporate bashing on ideological grounds.[28] Some more even-handed NGOs silently condone being perceived as part of the fundamentalist faction; others signal semi-public support for particular critical positions so long as this helps them to raise their profile. Within some public interest groups individuals particularly gifted at articulating radical demands and accusations are sometimes deployed at high-visibility events – even while a more moderate position is advocated in their published contributions. Most significant of all, perhaps, is that, in the perception of corporate management, very few public interest groups openly applaud excellence in corporate responsibility or distance themselves from unfair criticism of those corporations who are on record as striving for leadership, for example, in the implementation of the Global Compact's ten principles.

The reluctance to grant leading companies any reputational kudos for their corporate responsibility efforts may backfire on campaigners, however, by weakening the willingness of corporations to aim higher on the corporate responsibility pyramid and come up with deliverables beyond the *ought to* dimension. Campaign strategies that seek to undermine corporate integrity in the interest of sensationalism not only represent a lack of intellectual integrity but are also likely to lead to 'corporate responsibility fatigue' resulting in companies falling back to a legalistic, compliance-oriented approach.[29]

I do agree with Jeffrey Sachs's observation, that many of the

> … antiglobalisation leaders have the right moral fervor and ethical viewpoint, but the wrong diagnosis of the deeper problems, [and that] anticorporate, antitrade attitudes have also resulted from a knee-jerk antipathy to capitalism that reflects a more profound misunderstanding. Too many protesters do not know that even Adam Smith shared their moral sentiments and practical calls for social improvement, that even proponents of trade and investment can also believe in government-led action to address the unmet needs of the poor and the environment. Too many protesters do not know that it is possible to combine faith in the power of trade and markets with understanding of their limitations as well. The movement is too pessimistic about the possibilities of capitalism with a human face, in which the remarkable power of trade and investment can be harnessed while acknowledging and addressing limitations through compensatory collective action (Sachs 2005: 356–57).

At the risk of appearing patronising to radical NGOs and activists, I see a number of questions that deserve to be asked. Is it unreasonable for stakeholders to:

- Avoid extrapolating from worst-case breaches of corporate responsibility to level sweeping accusations at all (multinational) companies?
- Accept the existence of a fair societal division of responsibility and acknowledge the economic and social benefits resulting from conventional business activities?
- Acknowledge corporate responsibility excellence and award reputation capital to those who deserve it while curbing expectations of what corporations can deliver?[30]
- Be 'solution-driven' and participate constructively in the search for answers, instead of resorting to political rhetoric (such as 'End globalisation!') and moral condemnation of corporate actors?

Tackling these issues is essential to encourage constructive dialogue and to entice corporate management into the public debate on pragmatic solutions for the complex issues arising from 'failing markets' and 'failing states'. Neither companies nor NGOs – and even less the governments of poor countries – will be able to bring today's complex social problems towards a sustainable solution without engaging with each other and developing innovative kinds of symbiosis which do not discredit the legitimate objectives of structurally different institutions.

The significance of positive feedback for deserving companies is underlined by the fact that few are fortunate enough to have such socially sensitive management that will do the right thing simply as a result of its own deep-rooted values. Corporate managers who allocate resources strictly according to return on narrow financial investment criteria are today in a clear majority – and are likely to remain so in the foreseeable future. For them there are currently few incentives to do more than what the law, the market and common decency demand. Hence, they will not invest in programmes arising from a holistic definition of corporate responsibility – and certainly not in poverty-oriented corporate philanthropy. The fact that human nature and markets respond to positive incentives is likely to have positive effects from the perspective of individual senior managers, and motivate allocation of more resources for corporate responsibility deliverables beyond the 'normal business case'.[31]

Greater civil society appreciation for corporate endeavours beyond the 'normal business case' would create reputation capital for 'good' corporations and could change the equation for the business case.[32] This would create a new dimension of competition between companies competing with integrity and lead to more and better corporate responsibility deliverables beyond the conventional business case.

Stakeholders with a genuine interest in solving the plethora of economic, social and ecological problems will acknowledge that business can play a significant role in the solution of major global issues – and, if circumstances are right, is willing to listen, learn, compromise and cooperate. Increasingly, enlightened NGOs are becoming involved in a constructive manner to help cope with major challenges. A new MNC-NGO collaboration paradigm – one combining and pooling skills, experiences and resources beyond those of any individual actor – would undoubtedly lead to improved societal conditions, without calling into question the identity of the involved parties and the particularity of their interests. All participating actors retain 'ownership' of the reciprocal relationship, of the negotiation process and of the results achieved, allowing constructive changes to be implemented or, at the very least, areas of dissent to be reduced. Best practice today, in this respect, is illustrated by WWF and by Transparency International, as well as by the Amnesty International Business Group. Those public interest group and other civil society institutions willing to apply a (reciprocal) fairness principle in relations with the private sector are likely to play an increasingly pivotal role. While maintaining their identity, integrity and independence, NGOs giving positive public feedback to those who deserve it and working together with the private sector create synergies for better solutions in a shorter period of time.

Those sitting on the fence and voicing undifferentiated criticism against globalisation and the multinationals will have to ask themselves whether they do their best to reach one of the most important objectives of the UN Global Compact: to use 'collective action … to advance responsible corporate citizenship so that business can be part of the solution to the challenges of globalisation' (Global Compact Office 2007). The realisation of the UN's vision – a more sustainable and inclusive global economy – as well as sustainable successes in reaching the Millennium Development Goals can only be achieved in cooperation with the business sector, not against it.

Notes

1 For the record: policies to improve income distribution in the context of economic growth will help to 'lift more boats'. For an introduction to this debate, see Chenery 1974.

2 While absolute poverty decreased, disparities of income increased; see Wade 2004.

3 See for example Corporate Crime Reporter's list of 'The Top 100 Corporate Criminals of the 1990s' (www.corporatecrimereporter.com/top100.html) using 'the most narrow and conservative of definitions – corporations that have pled guilty or no contest to crimes and have been criminally fined'. The '100 corporate criminals' fell into 14 categories of crime: environmental (38), antitrust (20), fraud (3), campaign finance (7), food and drug (6), financial crimes (4), false statements (3), illegal exports (3), illegal boycott (1), worker death (1), bribery (1), obstruction of justice (1), public corruption (1) and tax evasion (1). A list highlighting that modern corporate governance is not just about avoiding crimes, but about participating in an open debate about legitimate courses of action, is currently updated by the Business and Human Rights Resource Centre (see www.business-humanrights.org/Documents/Chart-Responses.doc).

4 www.un.org/News/Press/docs/2004/sgsm9387.doc.htm, accessed 21 September 2007.

5 See various annual reports of the World Investment Report of UNCTAD (www.unctad.org/wir, accessed 21 September 2007).

6 See the title of a book that still merits being read (De George 1993): *Competing with Integrity in International Business*.

7 Keeley (1988: 222ff.) argues that this implies that potential harm should be detected and dealt with preventively.

8 Close to this 'theoretical' observer's view come surveys or polls such as GlobeScan 1999 or expert surveys such as GlobeScan 2005.

9 In a slightly different context this was the title of an interview with Michael Porter by Mette Morsig (Porter 2003). For the great variety of concepts behind the term, see Economist Intelligence Unit 2005. Interestingly, the tenor of this *Economist* publication is much more positive towards corporate responsibility than 'The Good Company' (Crook 2005).

10 This was stated 'in the year of the lord 1916' by J. Maurice Clark, and he specifically emphasised that charity should not repair the damage done by irresponsible corporate conduct (Clark 1916: 229). For an updated discourse on corporate philanthropy, see Leisinger 2007.

11 Hsieh is building his arguments on John Rawls's account of the 'Law of the People'; see Rawls 1999.

12 So argued Mark Kramer and John Kania of FSG Social Impact Advisors (www.fsg-impact.org, accessed 21 September 2007) on the occasion of a Corporate Philanthropy Summit in New York, 6–7 June 2006 (www.corporatephilanthropy.org/summit, accessed 21 September 2007).

13 This argument of Milton Friedman's famous article 'The Social Responsibility of Business is to Increase its Profits' – concluding that one could refer to some of these responsibilities as 'social responsibilities' but as those of individuals and with their personal resources, not of business with shareholders' money (Friedman 1970) – still recurs; see for example Crook 2005 in the special section of *The Economist* on 'The Good Company'.

14 www.unglobalcompact.org, accessed 21 September 2007.

15 This has been the title of a report by IBLF on the boundaries of business engagement in global development challenges (to be downloaded on www.iblf.org/resources/general.jsp?id=57, accessed 21 September 2007).

16 For a detailed analysis of the right to health debate in a corporate context, see Leisinger 2005.

17 For an approach distinguishing social norms according to different degrees of obligation, see Dahrendorf 1959: 24ff.; for a similar differentiation of corporate responsibilities, see Carroll 1993: 35.

18 See in this context the old Kantian differentiation between 'legality' and 'morality' (Kant 1785: section 'The Relation of the Faculties of the Human Mind to the Moral Laws').

19 Living wages, even as a dynamic concept, refer to a 'basic needs' basket, which is defined along relatively narrow parameters. Whatever remuneration goes beyond these parameters must be justified by a corporate desire to hire better-than-average employees and not by social idealism. Although critics will argue otherwise, several UN World Investment Reports have established that, as a rule, transnational corporations with their headquarters in Europe or the US pay much higher salaries and wages and offer substantially more benefits. This could also be viewed as a problem, as it attracts the best national talents and hence puts national firms at a competitive disadvantage. Another argument to be taken seriously in this context is the fact that most workplaces in the industrial sector pay substantially higher incomes than those in subsistence agriculture or local handicraft. Hence, caution must be applied when comparing remuneration packages. See, as a company-specific case study, Brokatzky-Geiger *et al.* 2007.

20 Milton Friedman's famous phrase 'the business of business is business' (Friedman 1970) is frequently quoted in this respect; however, often not in the appropriate context. Friedman argues that 'there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud'. With regard to today's corporate responsibility debate one might say that 'the rules of the game' have changed.

21 This argument makes the assumption that consumers and investors have sufficient information about the corporate responsibility policy to make informed purchasing and investment decisions – the validity of which is not clearly established; see Whitehouse 2006: 280.

22 For the methodological difficulties, see also Margolis and Walsh 2001b: 9ff.

23 For example, additional training of employees, management processes and corporate guidelines or improvement of corporate social services, and environmental protection.

24 A representative selection of the most important literature in this respect includes: Freeman 1984, Carroll 1993, Clarkson 1998, Donaldson and Dunfee 1999, Post et *al*. 2002 and Phillips 2003.

25 See, for example, in a special issue of *New Academy Review* on 'Business and Human Rights', 'Business interests … have been antagonistic to human rights' (Swithern 2003:50) or 'MNCs … also undermine the ability of individual states to protect people from human rights abuses' (Kinley *et al*. 2003:92).

26 A telling example is that, of the five chemical companies in Basel (Switzerland), only one, Novartis, has pledged support to the UN Global Compact. The other four companies have not been questioned about why they do not commit to global corporate citizenship guidelines; rather it is Novartis that has faced insinuations of 'bluewashing': that is, abusing the UN logo for public relations purposes.

27 The picture is different in the US where corporate philanthropy enjoys a high degree of appreciation and is accompanied by much goodwill, with the result that substantially more resources are dedicated to corporate philanthropy than in Europe; see www.corphilanthropy.org (accessed 21 September 2007).

28 Of course generalised corporate prejudices about NGOs are equally unhelpful and intellectually shoddy.

29 There are already developments that could be interpreted as signs of corporate responsibility fatigue: A number of companies which for years made special efforts in sustainability reporting are changing their attitude and going back to a legal compliance-based approach (personal communication with members of the Hertie School of Governance research team, Berlin, 29 August 2006).

30 The bar is continually raised until it is eventually knocked down in a vicious circle of self-fulfilling prophecies from the groups most critical of multinationals, through an inversion of proof. An example is the case of Médecins sans Frontières and Novartis's anti-malarial *Coartem* provided at US$1 – below production cost – to the WHO (World Health Organisation) for distribution to poor societies. Médecins sans Frontières attacked the company publicly for not 'walking its talk' when Novartis announced problems with the production of unexpectedly high quantities of *Coartem*, over and above the production capacity based on the forecast of the WHO. One component of the combination product *Coartem* is a plant whose production depends on a long agricultural cycle and problems developed because of issues that were beyond the company's control. When – after substantial additional investments and efforts to overcome the bottlenecks – production targets were eventually surpassed, no public retractions were made by those who had accused the company.

31 This is not meant to insinuate that people act morally only if there are strong incentives to do so. Our argument is based on Amitai Etzioni's thesis that people's behaviour is influenced by two factors: first, by what they perceive to be their moral obligation and, second, by what they perceive to be in their interest. Etzioni (1988) acknowledges significant differences in the extent to which these factors work with different personalities.

32 In addition to reputation capital, other 'rewards' might include price differentials in public tenders, preference given in international/institutional procurement, and so on.

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Questions for Discussion

1. In your opinion, what are some of the most important ethical problems facing multinational corporations operating in developing countries? Do you think the principles offered by De George might help resolve some of these dilemmas?
2. According to Donaldson, business firms should act according to a minimum moral threshold which includes respect for core human values, while at the same time respecting local traditions and context when deciding what is right or wrong. Do you agree with this position, which is both absolute and relative in nature?
3. In your view, exactly what is wrong with bribery? If bribery is a common practice in some countries, why shouldn't companies in other jurisdictions be allowed to practice bribery in those countries? Do you agree with Turow that bribery is fundamentally immoral?
4. Do companies have obligations to use their 'leverage' to protect human rights in the countries in which they do business, as Wood suggests? Do you agree with his conditions for when this obligation arises?

Cases for Part 4

Introduction

The first mini-case in Part 4, "Pat Sheritan," addresses the obligation to disclose over-billing to one's customer or client. The dilemma faced in "John Snyder" involves appropriate international ethical standards, as well as environmental ethics. The articles in Chapters 8 and 9 dealing with international business and the environment can be useful background for discussing this mini-case.

The cases in Part 4 provide an opportunity for greater reflection on ethical issues related to consumers, the environment, and international business. In "The Ethics of Marketing: Nestlé's Infant Formula," the company must address particular marketing issues arising in a Third World environment, as well as its obligations to ensure its product is used properly. How does Brenkert's concern over marketing to the vulnerable relate to this case? The case "TransAuto Corporation Trade-offs" involves critical budgetary decisions faced by the company's CEO. Some of the budget issues regard matters such as closing a plant, gifts to executives, and the use of child labor. Which budgetary items should take priority? In "Sony Online Entertainment: Everquest® or EverCrack?" readers must decide whether Sony Online should release a new version of its popular online game, when many users have become addicted, leading to potential harm including suicide. "Dicing with Death? A Case Study of Guidant Corporation's Implantable Defibrillator Business" raises the question whether the company should disclose the defect to patients in addition to the US government when it is predicted that more patients will die due to replacement surgery. Velasquez's article in Chapter 7 in terms of manufacturer's obligations to the consumer can be helpful in analyzing these cases. In "Chiquita Accused of Funding Columbia Terrorists," readers must decide whether Chiquita should have illegally paid a terrorist group in Columbia in order to protect the lives of its employees. In "Wal-Mart Hushed Up a Vast Mexican Bribery Case," the integrity of the global firm's operations are called into question. Readers can use the case to consider the points raised by Donaldson and Turow in their articles. In "Yahoo! and Google in China," two famous cases are discussed involving firms operating in China. In the Yahoo! case, the firm was required to provide private information about an email user to the Chinese police, who were alleging he had violated Chinese law. Google needed to decide whether it should abide by Chinese law requiring self-censorship of potentially politically sensitive content. The more recent "Google Softens Tone on China" case provides an update to Google's efforts to operate in China. The articles in Chapter 9 by De George, Velasquez, and Donaldson all provide assistance in trying to sort out the ethical issues involved in these cases.

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Mini-Cases

Pat Sheritan

Pat Sheritan, a senior associate in Assurance, has recently worked with Advisory Practice on a very difficult and highly confidential analysis for the chairman of a medium-size manufacturing company. The chairman had been concerned about certain deals with a new subcontractor that were being promoted by one of the vice presidents.

After some intense research, Sheritan was able to substantiate the chairman's concerns about conflict of interest. As a result, the vice president was fired, and the company avoided what could have been a $5-million loss.

Amid the intense pressure to get bills out promptly, Sheritan inadvertently double-billed the client for some of the analysis. Sheritan realized the error two weeks later. However, by then, the grateful client had already paid the bill.

Sheritan is not sure how to proceed. The amount of the overbilling is relatively small vis-à-vis the total bill, and the total bill was within the range stated in the letter of arrangement. In addition, the summary of time and expenses was never charged for a lot of time that was spent working over several weekends. The client did not require detailed time charging records to substantiate the amounts billed.

What should Sheritan do?

Discussion questions

1. How do you decide when to charge and when not to charge time to a client engagement?
2. If Sheritan never had to provide the client with substantiating documentation for what she invoiced, has she actually done anything wrong from the client's perspective? After all, she didn't actually reflect all of her time on her time reports.

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John Snyder

John Snyder is VP of International Manufacturing for GoodChem USA, and has recently signed a deal to build a major new chemical manufacturing plant in Southeast Asia. He is working through the final details of the proposal with Alex, the appointed Director of the new facility, when a letter arrives from Tang Chen, the VP for International Affairs at GuddoKagaku, the joint venture company that helped GoodChem work through the red tape which often hampers foreign investors in Southeast Asia.

Tang's letter reminds John once again that neither he nor Tang was happy with the decision that had been made by the two companies to not install US-style scrubbers in the production process. Tang realizes that there was no legal requirement, and that installation of the scrubbers would cost them time and money, which may be critical in securing the competitive edge over the domestic producers – an edge that would make the venture viable. But he is still concerned over the environmental impact this will have on his country. As a side note, he also mentions that he has heard rumors that a powerful and well-connected environmental activist group is preparing to make the actions of GoodChem their next big PR scandal.

Alex is anxious to secure the Director's position and points out that none of the domestic producers have scrubbers in place, and that should the venture not meet the expectations of senior management, it would be Alex's career, not John's, on the line. Alex also reminds John that if this project is successful, it will most likely secure John's place in the race for CEO.

But John keeps thinking of Tang's closing remarks that ask John to think of his children before he makes a last decision not to install the scrubbers.

Adapted by the Center for Business Ethics at Bentley University from the video *Beyond Borders: Ethics in International Business*, produced by Jacoby-Storm Productions Incorporated for the Ethics Resource Center. Permission by Jacoby-Storm Productions.

Discussion questions

1. Would John want his family to live next to a plant without scrubbers?
2. What is the short-term cost/long-term risk trade-off in not installing scrubbers?
3. In what instances is it acceptable to adhere to host country standards that are less stringent than those of a company's home country?

MBA Student Mini-Dilemmas

Fire Employee with HIV in South America?

You are working in South America.You hear a knock on your office door. "Come in," you holler, and Manuel, a recent hire who had been working for you for two months, enters. "Can I talk to you?" he asks, which was a question that was usually followed by a request for a raise. You are unprepared for what comes next. "I want to tell you something; please don't tell anyone at the head office. I am giving you the option to let me go, and I promise I won't cause any problems for you if you do. I have HIV." This is your third year of running your leather goods business. The employee, an artisan, used communal tools, shared with other artisans on his production team. The products were handmade, and artisans generally suffered some kind of minor cut about once every six months. The law gives employers a three-month probationary period during which they can fire any employee, no questions asked, no severance required. After this period, employers are required to pay substantial severance packages and face a high risk of costly lawsuits initiated by former employees. The law of the country generally permits discrimination, with the explicit exception of discrimination against people who have HIV or AIDS.Your business is new and cash funds are limited. Paying an employee who was frequently sick would not only drain funds but slow down production, which is performed in teams. On any given day, having a team member out sick would significantly reduce the company's production output. Your business partners, an equity firm, have expressed that they want you to fire Manuel and reduce any future liability. Do you let him go, or find another solution?

The Unethical Client?

You are responsible for helping a wealthy entrepreneur client from a Middle Eastern country to manage his assets. The firm established a private holding company and would structure a series of cash transfers from the company to dozens of small holding companies in his home country. There were more than a dozen transfers, each for about US$2–3 million. The transfers were structured as "loans" to avoid international taxation, and interest and payments on the loans were deferred indefinitely, so that the recipient would never need to make a payment for the interest or principal. While the practice would be frowned upon by the IRS, it was technically considered legal. The recipient country was currently under UN sanction for sheltering terrorist organizations. You become suspicious that the money is funding terrorism, and discuss the matter with your boss. You indicate that the amount of money is significant for the country, and ask whether the firm knows who is receiving the money or what the client is getting in return for the money. Your boss says, "These are questions we do not need to ask. We just need to follow the federal rules for reporting wire transfers, and that's what we do." You press further, and ask whether there are still obligations on the firm to report if something looks suspicious. Your boss turns red and slams his fist on the desk. He says, "No, absolutely not. It's up to the regulators to tell us if there is anything suspicious. All we need to do is our jobs. This client is a very private person and we will lose him as a client if we start prying into his business." Do you push your boss harder, notify the appropriate government authorities, or do nothing? What does your decision depend upon?

The Ethics of Marketing
Nestlé's Infant Formula

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Introduction

Among the many different types of dilemmas faced by multinational enterprises are those related to its marketing of consumer products. It has now become apparent that the marketing of First World foods in Third World nations poses a special type of concern to the populations and governments of host nations, and to the would-be marketers themselves. While there are a number of products that one can cite as illustrative of the generic issue, none has so sharply and clearly defined it as the controversy surrounding the marketing and promotion of infant formula in the developing world.

My perspective on the infant formula controversy, industry, and on Nestlé in particular, is derived from more than a decade of research. In addition to field research on infant formula marketing in Latin America, Africa, and Southern Asia. I have served as a consultant to the World Health Organization (WHO) in the development of the international marketing code, and testified at congressional and United States Senate hearings on these issues. Most recently, it has included about 18 months of service on the Nestlé Infant Formula Audit Commission, which was created to monitor the company's compliance with marketing policies that were drafted for the purpose of implementing the WHO Code.

Rest assured, this is no apologia for Nestlé. I know that some of their managers disagree with my interpretation of the evidence. That troubles me little, for I cannot think of an ethical dilemma that does not breed some disagreement among caring participants. Were it otherwise, I doubt it could be called a dilemma. Among the various types of ethical dilemmas confronting the managers of multinational enterprises (MNEs) are those tied to the introduction of products developed and used in one social environment into a significantly different environment. I prefer to term this the introduction of First World Products in Third World Markets.

The infant formula situation involves a product which is not defective in itself. This distinguishes it from such cases as the dumping of products which are unsafe or deemed unacceptable for sale in the United States, but are accepted for sale in another nation (e.g., Tris-treated sleepwear).

Infant formula is also not harmful to the consumer (user) when used properly under appropriate conditions. This distinguishes it from products such as tobacco, which are, in the view of most health professionals, per se dangerous to all users.

Infant formula is the *definitive* example, however, of a First World product which is safe when used properly, but which is *demanding*. That is, when risk conditions are present, it can be – and is – potentially harmful to users.

The fundamental ethical dilemma for MNE managers, then, is whether such a product can be marketed when it cannot be guaranteed, or reasonably expected, that it will be used by people who meet the minimum conditions necessary for safe use.

Evolution of a Public Issue

The criticism of the infant formula manufacturers for their aggressive marketing behavior in developing nations became a serious issue in 1970. Prior to that time, individual physicians and health workers had criticized promotional practices, but there was nothing to suggest an organized campaign of criticism. In 1970, however, the Protein-Calorie Advisory Group

James E. Post, "The Ethics of Marketing: Nestlé's Infant Formula." Excerpted from James E. Post, "Ethical Dilemmas of Multinational Enterprise: An Analysis of Nestlé's Traumatic Experience with the Infant Formula Controversy," in *Ethics and the Multinational Enterprise,* ed. W. Michael Hoffman, Ann E. Lange, and David A. Fedo (Lanham, Md.: University Press of America, 1986). Reprinted with permission of James E. Post.

(PAG) of the United Nations held a meeting in Bogota to discuss the problem of infant malnutrition and disease in developing nations. Participants pointed a finger of blame at the industry, charging that it pushed its products to mothers, many of whom lived in circumstances that made the use of such products a highly risky adventure. First, infant formula must be sold in powdered form in tropical environments, requiring that the mother mix the powder with locally available water. When water supplies are of poor quality, as so often is the case in the developing nations, infants are exposed to disease. Second, since the product must be mixed, preparation instructions are important, and mothers must be able to read. Unfortunately, the rate of illiteracy is very high in many developing nations. Thirdly, since infant formulas are relatively expensive to purchase, there is a temptation to overdilute the powder with water. This effort to "stretch" its uses enables the mother to go a few extra days without buying a new supply. Unfortunately, overdiluted formula preparations provide very poor nutrition to the baby. Thus mothers who came to the health clinics with malnourished babies often reported that a five day supply of formula had been stretched to ten days or more. Having decided to bottlefeed their babies in order to improve their chances for a healthy life, many mothers discovered to their horror that they had actually been starving their little ones. Because corporate advertising by the infant formula companies had promoted the idea that bottlefeeding was better than breastfeeding, a view with which doctors disagreed, there was a sharp condemnation of the industry and its behavior at the Bogota meeting.

Management scholars now understand that public issues often proceed through a predictable series of phases in their evolution. Some refer to this as the "public issue life cycle," modelled after the product life cycle described in marketing research. The public issue life cycle can be thought of as a measure of continuing public concern about an underlying problem.

Phase I of the issue life cycle involved rising awareness and sensitivity to the facts of the issue. In the infant formula controversy, this phase began with the PAG Meeting in 1970 and continued for several years. An important element in the process of rising awareness was the activity of journalist Peter Muller who, with support from the British charity group, War on Want, travelled to Africa in the early 1970s to study allegations of marketing abuses. Muller wrote several articles and a pamphlet which War on Want published in 1974 under the title, *The Baby Killer*. These publications began to draw the attention of a broader public to the problem of sick and dying children, and the connection between commercial practices and this tragedy.

Because Nestlé was, and still is, the industry's largest producer and seller of infant formula products, Muller encountered many examples of Nestlé advertising and promotional practices in Africa. Indeed, Nestlé employees were willing to speak with Muller, while those of other companies were often much less willing. Not surprisingly, then, *The Baby Killer* pamphlet included Nestlé actions as examples of unethical industry behavior. This became very important, because a Swiss public action group, Third World Action Group, reprinted the Muller pamphlet in Switzerland under the new title, *Nestlé Kills Babies!*

Nestlé immediately sued the group for defamation and in 1975 the case came to trial in Switzerland. Because the trial involved several hearings, with experts from developing nations brought in to testify, the media began to show increasing interest in the story. It became quite clear that although the trial involved only Nestlé and the defendants, the entire infant formula industry was being examined and criticized for their actions in the developing nations. Thus, the trial was a turning point in two important ways. First, public interest in the issue expanded greatly as the newspaper stories began to carry the details of what one doctor called "commerciogenic malnutrition" – malnutrition brought about because of corporate commercial practices. Second, the infant formula industry began to respond as an industry, having formed an international association, known as the International Council of Infant Foods Industries (ICIFI). The council, whose existence was announced in Switzerland at the time of the trial, made an immediate effort to develop an international code of marketing which addressed some of the most criticized marketing practices. In this Phase II of the life cycle, both the critics, the media, and the industry recognized that the issue had become an important political matter, as well as a public health concern.

Between 1975 and 1978, the infant formula controversy became increasingly politicized. The media in

Europe and the United States paid increasing attention to the conflict. Each newspaper or magazine story brought about more awareness in the general public. The critics highlighted the terrible tragedy of dying and sick children, while the companies, including Nestlé, tried to respond to the criticism individually and through ICIFI. The political pressure mounted against the industry. In 1977, an official consumer boycott of Nestlé and its products was begun in the United States. Interest in the boycott spread quickly, in part because many member churches of the National Council of Churches had been concerned about the problems of world hunger. The Nestlé boycott gave church leaders an opportunity to educate their congregations about the problem of world hunger and suggest a practical course of action that would pressure companies to act responsibly in dealing with the poor and needy of the Third World. The National Council of Churches had been concerned about many corporate responsibility issues, and had a special research and action unit known as the Interfaith Center on Corporate Responsibility (ICCR). ICCR became actively involved in the boycott campaign, and helped spread the message of consumer action to hundreds of thousands of people in the United States.

The high point of Phase II of the infant formula controversy occurred when boycott sponsors were able to convince the staff of United States Senator Edward Kennedy to hold hearings into the infant formula marketing controversy. These hearings were held in May, 1978 in Washington, DC, and occurred at a time when Senator Kennedy was widely rumored to be considering a campaign for the presidency against incumbent President Jimmy Carter. The media followed Kennedy's every action. On the day of the public hearing, every American television network had cameras in the hearing room, and many famous reporters sat at special tables to hear the testimony of witnesses. The witnesses were heard in three groups. First, people who had worked in developing nations told a tale of human tragedy and marketing abuses by the companies. The second panel consisted of experts in public health (Pan American Health Organization, World Health Organization), medicine, and the author of this paper, who was an expert on the industry. The third panel consisted of the company representatives. Nestlé was represented by the head of its Brazilian Operation, and the three American companies were represented by senior executives from their corporate headquarters.

The Kennedy hearings were a landmark in the history of this controversy. They represented the highest level of media attention and political attention that had been achieved in nearly eight years of conflict. Critics had to be pleased with their success. Moreover, Nestlé behaved in a way that actually strengthened the claims of the boycott supporters and organizers. The company's representative charged that the consumer boycott was a conspiracy of church organizations and an indirect attack on the free enterprise system. Senator Kennedy exploded in anger at the charge that the churchmen and health workers were part of a conspiracy to undermine the free enterprise system. The Nestlé statement was a political disaster. Every television program featured the testimony and the reaction from the political leaders in attendance. Nestlé was denounced for its statement and its foolishness.

Phase III of an evolving public issue occurs when some governmental or other formal action begins to develop. In a single nation, this may take the form of a regulatory standard, a piece of legislation, or a government program. In the infant formula controversy, formal action took the form of an international code of marketing conduct which industry and national governments would support. Following the Kennedy hearings, the Director-General of the World Health Organization agreed to convene a meeting of interested parties to lay the groundwork for international action. An important meeting took place in 1979, with delegates calling upon WHO to draft an international marketing code. The code development process took several years, required extensive negotiation, and eventually produced a document that was adopted by the World Health Assembly (the governing body of WHO) in 1981. Throughout this process, Nestlé and other industry members actively participated in the discussions and lobbied for particular terms and provisions. In advance of the World Health Assembly vote, Nestlé was the only company to publicly state that it would follow the code if it was adopted.

Phase IV of a public issue involves the process of implementing the new policy throughout the organizations involved. This is called "institutionalizing" the policy action. Nestlé considered how to implement the WHO Code's provisions following the World Health Assembly's adoption. But there existed a number of very serious obstacles. Many of the Code's terms were imprecise, leaving unanswered questions about the proper interpretations. WHO was reluctant to provide continuing interpretation and reinterpretation of the Code's terms, as this would require a staff of lawyers and a continuing commitment. In addition, the Nestlé boycott continued in both the United States and Europe. Critics continued to pressure the company, and offered alternative interpretations of various code provisions. WHO had no desire to get further drawn into the dispute between the company and its adversaries. Thus, Nestlé was left to negotiate proper interpretations with members of what was now called the International Nestlé Boycott Committee (INBC).

Since 1981, Nestlé has continued to pursue a process of institutionalizing the provisions of the WHO Code by transforming those requirements into policy instructions for its own sales and marketing personnel. A number of innovations have been created to assist this process. These will be discussed below. In early 1984, the international boycott group suspended the Nestlé boycott, following extensive negotiations about such critical issues as product labelling, marketing in health facilities, gifts to medical personnel, and provisions of free supplies to health institutions. By October 1984, the INBC leaders had concluded that Nestlé's commitment to implement the policies had proceeded well enough to permit them to terminate the boycott. Its conclusion was announced at a joint press conference attended by boycott leaders and senior Nestlé managers. Nearly fifteen years after the first formal complaints began. Nestlé had managed to close the controversy over its marketing activities.

Ethical Issues and Lessons

Throughout this long conflict, Nestlé has faced a variety of difficult ethical issues. Some of the broad issues and lessons are summarized below.

All businesses which sell their products in developing nations must consider two basic questions: (1) Is the product an appropriate one for the people in that country? and (2) Are the proposed tactics for marketing the product proper for selling the products but not misleading consumers for whom the product is not appropriate? As Nestlé discovered, both questions are easily overlooked by managers when they are concerned with sales and profits.

Managers should recognize the following points about the appropriateness of products in developing nation markets.

1. Products which are appropriate and acceptable in one social environment may be inappropriate in the social environment of another nation.

Infant formula products are demanding products. There must be pure water with which to prepare them, refrigeration to safely store unused prepared formula, and customers must be able to read instructions and have the income to purchase adequate quantities of the products. The greater the existence of these *risk factors*, the less appropriate the product becomes for marketing. This phenomenon applies to many other consumer products as well.

2. Good products, made without defects, may still be inappropriate because of the inherent riskiness of the environment in which those products are to be used.

Nestlé and its competitors often stated that the market they sought to reach consisted only of those who could safely use the product, and who had adequate income. However, the evidence from many developing nations continuously showed that vast numbers of the population did not meet the necessary requirements for safe use of the product. By selling formula products to such people, managers could know with virtual certainty that there would be overdilution, improper mixing, or contamination with impure water. As Nestlé discovered, many people would denounce and criticize any company that sought to sell its infant formula products under such conditions. When a large part of the population cannot safely use a product, *and* the company cannot effectively segment the market to ensure that only qualified consumers purchase and use it, there may be no choice for the business but to halt sales in that community.

3. Companies may not close their eyes once a product is sold. There is a continuing responsibility to monitor product use, resale, and consumption to determine who is actually using the product, and how. Post-marketing reviews are a necessary step in this process.

Repeatedly, Nestlé and its industry colleagues claimed that they had no desire or intention to see unqualified consumers use their formula products. In 1978 at the United States Senate hearings, representatives from Nestlé, Abbott Laboratories, American Home Products, and Bristol-Myers were asked whether they conducted any post-marketing research studies to determine who actually used their products. Each company representative answered that his company did no such research and did not know who actually used its products. Naturally, critics attacked the companies for such a careless attitude toward learning the true facts surrounding their products.

4. Products which have been sold to consumers who cannot safely use them must be demarketed. Demarketing may involve withdrawal or recall of products, limitations of the selling of the product, or even a halting of future sales.

The infant formula controversy raised the issue of whether, and when, companies should demarket products which have been commercially successful, but also harmful to innocent consumers. Nestlé and its competitors gradually changed their marketing practices, and recognized that infant formula was not the same "mass market" product that it had once been. The World Health Organization Code specifically indicated that marketing had to be done in ways that guaranteed that the users of formula products had proper information to use the product safely, and to make an intelligent choice about whether or not infant formula was even an appropriate product for them to use. Much of this is to be done by insisting that companies not market directly to mothers, but channel product supplies and advice through health institutions which can ensure that unbiased health information is received by the mother.

5. Marketing strategies must be appropriate to the circumstances of consumers, the social and economic environment in which they live, and to political realities.

Consumer advertising to people for whom product use is highly risky is unacceptable and unethical marketing behavior. Critics of the infant formula industry continued to find evidence of highly aggressive and misleading advertising by companies for many years after the issue became well known. Mass marketing became an unacceptable and inappropriate marketing strategy for infant formula products. The companies, however, had difficulty segmenting their markets and drawing back from the mass market approach. It was only through an industry-wide effort, and then the WHO Code, that managers began to accept that it was more appropriate to focus marketing promotions through the health care system than to consumers directly.

6. Marketing techniques are inappropriate when they exploit a condition of consumer vulnerability.

Many firms in the industry used "milk nurses" during the 1960s and 1970s. These were sales personnel who dressed in nurses' uniforms and visited new mothers in hospitals. They would try to encourage the mother to allow their babies to be fed formula, rather than breastfeed, in order to encourage formula adoptions. Since a mother loses the ability to breastfeed after several days of not doing so, such a decision would then require that the baby continue to be fed from a bottle for the next six months. This would be good for formula sales, if the mother could afford to buy it, but might be bad for the baby if the mother had to find a cheaper substitute product to put in the bottle. In South America, for example, members of my own research team saw mothers feeding a mixture of corn starch and water to babies because they had no money to buy formula. Mothers who have given birth are quite vulnerable, and the use of the milk nurses took advantage of that vulnerability in ways that were unethical and unfair. Actions which exploit consumer vulnerability and result in harm are inappropriate marketing tactics.

7. Marketing strategies should be formulated in such a way as to permit flexibility and adjustment to new circumstances.

In the early 1970s, Nestlé management knew that critics had a legitimate concern for the sales practices of the industry, but were unable to change their marketing activities in response. The company seemed to be "locked in" to a strategy of resistance, denial, and anger at such charges. In retrospect, it seems that Nestlé needed time to change its marketing strategy from a mass-market, consumer-advertising approach, to one which emphasized promotion through the medical and health care system. It took Nestlé much longer to change its marketing strategy than it took many of its competitors. This may have been because of pressures from field managers or from the product marketing staff, which denied the truth of the critics' charges. Whatever the case, the company was injured by its slow response to criticism, and its seeming inability to find an alternative way to continue marketing its products. A company which can only market its products in one way is very vulnerable to public issues and political pressures.

Conclusion

Nestlé's traumatic experience with the infant formula controversy has finally come to an end, but the impact is likely to last for many years. The company suffered a major blow to its reputation and to the morale of its people. It is traumatic and difficult for people to be told they are working for a company which "kills babies." Today, Nestlé's senior management is again working to restore the company's economic and cultural fabric. Its future success will depend upon much more than sales and profits. Nestlé has been a successful institution as well as a successful business. Institutions represent a structure of values, and it is this structure which was most sharply affected by the long controversy over infant formula.

If a historian writes the history of Nestlé one hundred years from now, will he or she include a reference to the infant formula controversy? Very likely yes. The conflict continued for more than ten years, cost the company many millions of dollars of revenue, expenses, and profits, and damaged or destroyed the careers of a number of its promising managers. It is impossible to say how long it will take for the company to regain its good name and for the public to once again think of Nestlé as a good corporate citizen.

Multinational corporations must learn to anticipate conflicts of the sort faced by Nestlé, and be prepared to respond in ways that not only justify what the company is doing but also deal with the legitimate concerns of the critics. Union Carbide cannot forget its experience in Bhopal, India: Unilever cannot ignore its experience with Persil in England: Johnson & Johnson cannot forget its experience with Tylenol in the United States: and Nestlé cannot forget its experience with infant formula. Each of these experiences involved a company with a good reputation, successful business strategies, and a major public credibility problem. The resolution of each dilemma required a careful integration of public affairs strategies with the business strategy for the company. And each situation demanded and required that the company's managers recognize the *common interest* that existed between the corporation and the public. In the long ran, there is no other way to harmonize the legitimate interests of companies with the legitimate interests of the public.

TransAuto Corporation Trade-offs

Rewritten by Mark S. Schwartz

Arthur Hodgson, Chief Executive Officer of the TransAuto Corporation, was reflecting on the presentations by the various divisions of the company of their operating plans and financial budgets for the next three years, which he had heard during the past several days. A number of critical decisions would have to be made at tomorrow's meeting of the nine senior executives who formed TransAuto's Corporate Operating Committee. Although TransAuto's tradition was one of consensus management, Hodgson knew that he was

Mark S. Schwartz, "TransAuto Corporation Trade-offs." Adapted from "Dorrence Corporation Trade-offs" by Hans A. Wolf. An Alling Foundation Ethics Award case. Copyright © 1990 by Columbia University. Printed with permission of the Graduate School of Business, Columbia University.

expected to exercise leadership and would have the final word, as well as the ultimate responsibility for the subsequent performance of the company.

TransAuto, a large U.S.-based automobile company with sales and operations throughout the world, had achieved an outstanding long-term record of growth in sales and profits. The company had not incurred a loss in any year since 1957 and profits had increased in 45 out of the past 51 years. During the past 10 years, sales had grown at an average compound rate of 12% per year and profits had increased at a 15% average annual rate. TransAuto's profit as a percent of sales was considerably higher than that of the average U.S. industrial concern.

This growth had produced a huge increase in the value of TransAuto's stock. There are approximately 30,000 TransAuto shareholders, but as with many large American corporations, about 65% of TransAuto shares are held by a relatively small number of pension funds, mutual funds, university endowments and insurance companies. TransAuto grants stock options to its executives and permits employees in the U.S. and several other countries to purchase TransAuto stock through the company's savings plan. TransAuto executives own about 2% of the company's shares and all other employees about 1%. Thus, directly and indirectly, TransAuto is owned by millions of people who are affected to some degree by the market place of TransAuto shares.

TransAuto's fine record of growth had also brought benefits to the company's customers, employees and the communities in which the company had operations. Because of its profitability, TransAuto was able to pay higher than average salaries to its employees, pay sizeable incentive awards to middle and upper management and bonuses to all employees based on the success of the company. TransAuto's growth also had provided unusual opportunities for career growth to many of its people. The company prided itself on being a good citizen in the communities in which its factories were located. It contributed to local charities and encouraged its employees to work constructively in community organizations.

Hodgson felt that 2008 was, however, a very disappointing year. The company fell short of the goals that management had established at the start of the year.

Growth in sales and profits was far below the rate of recent years and below the levels achieved by several of TransAuto's peers in the automobile industry. Management incentive awards and employee bonuses were, therefore, about 5% smaller than those distributed for 2007. The value of TransAuto stock was about 20% below its high point.

Consequently, Hodgson considered it important that TransAuto achieve at least a 13% profit growth in 2009, and higher rates in the two years beyond that. He recognized that such a goal would not be easy to reach. It would not only require the best efforts of the entire organization, but also force some tough decisions.

The 2009 budget proposed by the divisions added up to a growth rate of only 8% in profit-after-taxes, five percentage points below the 13% profit growth that Hodgson considered a minimum acceptable level. As a rough rule of thumb he calculated that each percentage point increase in the profit growth rate required about $4 million additional profit-before-taxes, thus *Hodgson was looking to improve the budget by $20 million*. The budget could be improved either through generating additional revenues or by reducing expenditures. During the course of the three days of presentations he had identified seven possibilities for such improvements about which decisions would have to be made. In his notes he had summarized them as follows:

1. **Adjusting the balance sheet** The company had a relatively simple means by which to improve its bottom line. Essentially, a percentage of the company's losses for the current year could be shifted from the company's current balance sheet to the balance sheet of a newly established offshore company. Although the company's shareholders would not necessarily have full and complete knowledge about the changes, the shift was legal and within acceptable accounting standards according to the company's auditors and lawyers, and would no doubt help improve shareholder value for the following year. In addition to improving the company's balance sheet, the improved share price of the company would also improve the value of Hodgson's own personal share portfolio in the short term, as well as those of executives and employees owning shares. **Options: (a) shift losses from balance sheet (additional net gain of $8 million); (b) do nothing (no additional net gain)**
2. **Closing TransAuto's plant in South America** TransAuto had purchased a small automobile company in a South American country in the early

1990s when prospects for growth in the local market seemed excellent. Unfortunately, the country has spiraled in terms of human rights abuses. A military coup recently took over the government. The new military government immediately arrested opposition party leaders and executed them. Reports of slave labor of citizens in order to build new roads and bridges were being reported by human rights groups. The new government used revenues from foreign operations (e.g., taxes) to purchase military weapons used in suppressing the general public. The new government has however promised various tax breaks and other incentives to encourage foreign companies such as TransAuto to remain in the country. Although the media had not yet reported on the company's operations in the country, the company had started to receive some e-mails from the public asking whether the company intended to remain. Leaving would not be so easy however. If TransAuto left the country, the company's 500 employees would have to be fired. If it stayed in the country, it could try to influence the actions of the government, however, due to the company's relatively limited investment in the country, it was unlikely to have much effect. **Options: (a) leave country (loss of $2 million); (b) remain in country (net gain of $4 million)**.

3. **Potential whistle-blower** Hodgson was informed by one of his senior managers that a junior employee was threatening to blow the whistle on the company. Apparently, one of TransAuto's automobiles was sold decades ago knowing that it could experience a sudden acceleration problem. Senior management at the time had decided not to disclose information regarding its prior knowledge of the defect to either the U.S. government or to the public. The company's lawyers indicated at the time that there was no legal obligation to report the information. Over the years two individuals have been killed due to the sudden acceleration problem, but the victims' families have been unable to successfully sue the company. This may now change however as a disgruntled employee who secretly kept incriminating company documents is threatening to disclose them to the victims' families. The lawsuits if successful would probably cost the firm $4 million. The employee is seeking a severance payment of $1 million in exchange for signing a non-disclosure agreement whereby he would agree not to say anything to anyone about the documents. If the employee failed to abide by the agreement there would be severe financial repercussions for him. **Options: (a) do not pay employee (no loss but risk of lawsuits if employee discloses to families of victims); (b) pay employee (loss of $1 million but most likely avoid any future lawsuit); (c) pay damages to the families of the victims (loss of $4 million but avoid any future risk of lawsuit)**.
4. **"Gift" to senior executive** In one European country, the senior purchasing manager of a national car rental chain (a public company), has approached Hodgson personally indicating his willingness to "do exclusive business" with TransAuto. He will ensure that his company purchase all of their new car needs from TransAuto for the following year. The profits from such a sales contract would be in the amount of $4 million. He has indicated that all that is necessary to close the deal is an all-expenses-paid trip for him and his family to the United States (including visits to New York City and Florida's Disney World). Your lawyers have indicated that paying for such expenses is not against U.S. law, but remind you that TransAuto has recently amended its code of ethics to prohibit giving expensive gifts where such gifts are really intended as bribes. **Options: (a) provide trip (net gain of $4 million); (b) don't provide trip (no net gain)**.
5. **Supplier and child labor** TransAuto currently uses car mats for its cars produced in factories in the United States. You have an opportunity to switch to a supplier with factories in Asia producing car mats for several automobile companies. You have discovered however that the supplier is currently using children aged 15. This practice is consistent with other factories in the country. You also discover that the majority of children this age do not go to school, and that the income the child receives is used to help support the child's family. The supplier has indicated that hiring only adults is not an option, as this would lead to an increase in wages, and would diminish the

competitive advantage of the supplier in selling to other automobile manufacturers. The quality of the car mats is comparable to car mats produced in the U.S. The savings from using the Asian supplier will be $6 million. **Options: (a) use Asian supplier (net gain of $6 million); (b) don't use supplier (no net gain)**.

6. **Charitable giving** TransAuto has engaged in charitable giving for over 20 years. The amount of giving has increased steadily, and currently stands at $4 million. Although less than other industries, the amount is slightly above the average percentage of pre-tax profits donated by its main competitors. TransAuto donates to many charitable causes, including environmental organizations and to help support educational efforts in US inner cities. Another possible change for next year was to reduce the amount of charitable giving half, or drop it altogether. **Options: (a) continue same amount of charitable giving (no net gain); (b) reduce by half the amount of charitable giving (net gain of $2 million); (c) reduce charitable giving completely (net gain of $4 million)**.
7. **New South African manufacturing plant** The company's projected demand for its vehicles required a new manufacturing plant to be built. After an extensive search for locations, the company identified an opportunity to build a new plant in South Africa on the outskirts of a town. In comparison to other possible sites, which would necessarily be more expensive, this one appeared ideal. The town in South Africa had won the competition for the new plant because of the availability of inexpensive land, relatively low wages, and certain tax concessions. In addition, TransAuto felt it would be fulfilling its social responsibilities by providing jobs in an area of high unemployment. The problem was that to build the plant, an area of rare trees and other plant life would have to be destroyed. This would lead to a depletion of the animal life, which would in turn force a small group of indigenous people (who lived off the land) in a nearby village to relocate. Their native culture and way of life would no doubt be destroyed due to the relocation. According to the laws of South Africa, the company would be in compliance with its laws by building the plant despite the environmental and social damage. According to US environmental law, the company would probably be prevented from building the plant. **Options: (a) build new plant (net gain of $4 million); (b) do not build new plant (no net gain)**.

Despite the difficulties surrounding each of the issues Hodgson had identified, he felt it was critical that the 2009 budget be improved to call for 13% profit growth. He believed that a second year in a row of below-average profit growth would be viewed very negatively by the investment community, be demoralizing to the company's management, and could result in a substantial drop in the value of the company's stock as investors switched to automobile companies with better 2009 results. He also recognized that large institutional investors, such as pension funds, were taking a more active role in demanding better performance from the managements of the companies in which they invested the funds entrusted to them.

Sony Online Entertainment EverQuest®or EverCrack?

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The Incident

At around 6:00 a.m., on Tuesday, November 20, 2001, in Hudson, WI, Shawn Woolley had logged on to his computer and began playing EverQuest®,[1] his favorite

Judith W. Spain and Gina Vega, "Sony Online Entertainment: EverQuest® or EverCrack?" *Journal of Business Ethics*, 58(1/3), 2005, pp. 3–6. Reprinted with permission of Springer.

game. A few hours later he committed suicide. Two days passed and, when he didn't show up for Thanksgiving dinner, his mother, Liz Woolley, found his body in a rocking chair at his computer desk. He had a 0.22 caliber rifle at his side and EverQuest® was still playing on his computer screen.[2]

Mrs. Woolley stated to the news media that she believed the cause of Shawn's suicide was his addiction to EverQuest®.[3] The news media picked up on the suicide story and the potential issues of addiction, obsession, or compulsion of today's consumer for online game-playing at the expense of their daily lives. Although the media contacted Sony Online Entertainment (SOE) for comment, the only response from the company was from Mr. McDaniel, VP of Marketing for SOE, stating "There's a duty on the consumer to use it responsibly."[2]

Shawn Woolley

Shawn Woolley, a 21-year-old shy, slightly overweight young man, had been diagnosed with depression in conjunction with schizoid personality behavior. He also had a history of seizures. Shawn had been living in a group home for a short time, but checked himself out after several months and rented his own apartment. He had held a variety of different jobs over the preceding year, but he quit his last job about a week before the suicide.[4]

Shawn began playing EverQuest® approximately 1 year before his death. When he committed suicide, he left no note. The only clues for what he had been doing prior to his suicide were notes about names and terms related to EverQuest®. His family claimed that the lure of the game for Shawn was the camaraderie with other players. Mrs. Woolley related one incident in which Shawn cried because another player had stolen some of the treasures he had collected playing the game.[2]

EverQuest® – The Game

Emblazoned across the EverQuest® website were the words, "Pause Life. Play Game." EverQuest® was a "real 3D massively multiplayer (MMP) fantasy game role playing game (RPG)." A massively multiplayer online game is a video game where a player connects through the Internet to a persistent virtual world, joining with hundreds of thousands of other gamers in a shared experience. In a role playing game, there is no "winning" in the traditional sense. Players create their own characters which are then "free" to roam the fantasy world.

The scope of EverQuest® differed from player to player, EverQuest® players entered into an enormous virtual entertainment world named Norrath, with its own species, economic systems, alliances, and politics. The players could wander around seeking allies and knowledge, facing epic challenges, meeting new friends, and more.

Each player defined his/her own character's destiny. The character could be a knight, a misshapen elf, a dwarf, a monster, or a damsel in distress. Characters grew in strength and in power based on the total number of hours they were played. EverQuest® players usually attempted to form "guilds" or teams which worked together to earn points, slay monsters, and capture key positions within the world of Norrath. A monetary value was attached to the characters as they became recognized "rulers" in Norrath. One player who reached the highest EverQuest® levels reported selling three characters on e-bay for $4,500.[5]

Pressure for players to continue playing the game and not logging off was tremendous. Logging off could hurt the guild's chances of advancing through the game since strength in numbers was critical for attacking a dragon or another guild, or trying to steal the treasures of another character. In addition, logging off could allow your character to be attacked because, even though a player was not online, their character remained in play and actively involved in the land of Norrath.

Financial Implications

Introduced by Sony Online Entertainment in 1998, EverQuest® retailed for approximately $40. It required either a Sony Playstation game system ($199.00) or could be played on a personal computer. For an additional $12.95 per month, players could sign up to play the game online. Revenues from online subscriptions netted Sony approximately $5 million a month.[6]

The game and its expansions were widely popular. One expansion of the EverQuest®, game, "The Shadow of Luclin", sold 120,000 copies on the day it was released. As of May 2003, there were approximately 430,000 registered players of EverQuest®, with approximately 12,000 more signing up each month.[6] On any given night, approximately 100,000 players roamed the world of Norrath.[7] Since Norrath existed online, the players were from around the world, increasing the likelihood that play would be intense even when most of America was sleeping. Indeed, demand in Europe for this game became so great that in November 2001, Sony had to construct and bring online a new server dedicated to EverQuest®.[8]

More than 1000 computers kept the game running, with 47 Sony staffers continually adding items and quests to the game and approximately 128 "game masters" functioning online wandering around in Norrath answering questions.[6] Because the game became so popular, Norrath was likely to become overpopulated. To combat this, Sony launched 42 versions of the game so that players could relocate their character to different "world" for a $50 fee.[6] The revenue stream was so good that Sony planned to introduce EverQuest II®, a project costing $20 million.[6]

Online Addiction

Numerous mental health organizations are dedicated to dealing with online addiction.[9] Experts believe that online gaming is a significant addiction problem, causing a growing number of people spending huge chunks of time at the computer. Some psychologists believe that this particular game is so addictive in nature that it should be called "EverCrack."[3] The peer pressure to stay online and help your guild, the lure of playing anonymously, and the thrill of the hunt, make EverQuest® very appealing to consumers.

Mrs. Woolley developed her own website in her quest to educate people about the dangers of playing Everquest®.[10] Two additional websites appeared for EverQuest® "widows," dedicated to providing a support group for those individuals dealing with a husband, wife, girlfriend, son, etc. addicted to playing the game. An active website with links to numerous online addiction services, "EQ Widows" listed 3654 members.[11] A similar website provided opportunities for aggrieved family members to vent their anger about the game and receive moral support.[12] One member stated that her fiancé "picked the game over me on Mother's Day. He picks the game over when I have my family from out of town."[13] Other members responded with advice and encouragement, including one member who opined that she should "move on … There is no reason for you to suffer when there are other men out there in the real world that you can date."[13]

In one survey, 45.2% of the 1989 respondents considered themselves addicted to EverQuest®. The typical player logged more than 20 hours per week playing the game,[7] with one survey estimating that 15% of the users played between 40–50 hours per week.[14] Another survey of 3166 players indicated that for the 18–22-year-old age group, 50.7% of the males and 44.7% of the females have lost sleep over their playing habits.[15]

However, some psychologists believe that the online gaming is not addictive. Instead, they say, the personality of the particular player is what puts him or her at risk. Shawn Woolley's diagnosed personality disorders made it easy for him to reinvent himself on line, which is what he appeared to do. This "escape from reality" feature of the game could be very alluring to individuals with low self esteem. The thrill of anonymity may have lured Shawn and other players to continue playing and playing and playing. …

Future of SOE and Online Gaming

SOE planned to introduce EverQuest II® in the fall of 2003. Destined to be as popular as EverQuest®, the new version would be set in a new age – the Age of Destiny. Players' quests would directly affect the structure of the game, thus changing the plot line on a monthly basis. SOE was anticipating high profits and favorable customer response with this new product.

But, SOE had some possible legal issues looming. Mrs. Woolley was contemplating filing a lawsuit against Sony Online Entertainment for its alleged role in her son's suicide. Some time after January 2003, a warning label appeared on EverQuest®'s website: "Photosensitive. Seizure Warning." In addition, in Tampa, FL, the EverQuest® game was implicated in the death of a young child when the father threw the child into a closet after the child's crying had interrupted his game playing.[16]

Scott McDaniel paced his office and thought about the planned release of EverQuest II®. As big a money-maker as it promised to be, was SOE justified in releasing it? Was the game really responsible, even in part, for death, abuse, or other personal emotional damage to players? McDaniel himself had a family. Was there something he should be doing besides preparing the ad campaign?

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Dicing with Death?
A Case Study of Guidant Corporation's Implantable Defibrillator Business

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1. Introduction[1]

Joshua Oukrop, of Grand Rapids, Minnesota, was an active teenager who enjoyed an outdoors lifestyle. When he was seventeen, Joshua began to experience bouts of faintness and sometimes total blackout. His physician, Dr. Barry J. Maron, diagnosed him with hypertrophic cardiomyopathy, a heart condition in which the wall of the heart is unusually thick. The condition put Joshua at a high risk of dying young due to heart failure.

Dr. Maron recommended that Joshua undergo surgery to receive a heart defibrillator, an electronic device designed to deliver an electrical shock in case the heart stops beating. Joshua's father, Lee Oukrop, suffered from the same heart condition and had already had a defibrillator implanted. "I promised my son it would save his life," Lee Oukrop said.

In October 2001, Joshua underwent surgery and received a Prizm 2 DR 1861 defibrillator made by Guidant Corporation. Soon after, he returned to hiking, bicycling and snowboarding back home in Grand Rapids, and was able to carry on his previous active lifestyle. Joshua eventually matriculated into Bemidji State University in Minnesota, hoping one day to become a teacher.

The impact on Joshua's life of having the defibrillator implanted in his chest was minor. Every three months, he would see Dr. Maron to have his device checked and maintained. "Each time, it was normal," Dr. Maron said.

In March of 2005, six weeks after his last checkup, Joshua went to Utah with his girlfriend for spring break. During a mountain bike ride, he started complaining of fatigue. He stopped, got off his bike, collapsed, and died of cardiac arrest.

Later tests by Guidant Corporation showed that his defibrillator, the Prizm 2 DR 1861, had failed to deliver its lifesaving jolt when Joshua needed it. The cause of the malfunction was a short-circuit that would not have been detectable in advance. It could have happened during or before Joshua's cardiac arrest, but because of it, the device was unable to save Joshua's life.

Two months after Joshua's death, Guidant officials met with Joshua's doctors to explain what went wrong. The doctors learned that the company had already been aware of the possibility of a short-circuit in the Prizm 2 DR model 1861, since they had observed it in other, returned, devices (but no other patients were thought to have died due to the malfunction). In fact, Guidant had changed its manufacturing process twice in 2002 to address the problem, which had been eliminated after the changes. In compliance with the law, the company had informed the federal Food and Drug Administration (FDA) of the manufacturing changes, but was not required by law to inform doctors, and had decided not to do so.

Joshua Oukrop's doctors, Dr. Barry J. Maron and Dr. Robert G. Hauser, were outraged. They told the *New York Times* that they would have replaced the unit if they had known of the potential malfunction. In response, Dr. Joseph M. Smith, Senior Vice President and Chief Medical Officer of Guidant's Cardiac Rhythm Management Division, argued that the risks associated with replacing the device, as many patients would be likely to do if the company publicized the problem, were much higher than the risk of malfunction, which remained very small and within product specifications.

Martin E. Sandbu with Jeisun Wen, "Dicing with Death? A Case Study of Guidant Corporation's Implantable Defibrillator Business." © 2008 by Martin Sandbu. Reprinted with kind permission of the author.

2. The Genesis of a Dilemma

Guidant Corporation was originally a spin-off from Eli Lily and Company. In 1994, it adopted the name Guidant. It made its first initial public offering on December 14, 1994, on the New York Stock Exchange (ticker symbol: GDT).[2]

In the following ten years, Guidant experienced strong growth in demand for its medical devices, partly due to the aging population. From 1994 through 2004, sales went from just under $900 million to $3.8 billion – an average growth rate of 16% per annum. Market capitalization grew from $1 billion to $23 billion as of the end of 2004. By the same year, Guidant employed over 12,000 individuals, and more than 2 million patients worldwide were treated by its therapies.

Guidant was the first company in the world to introduce the automatic Implantable Cardioverter Defibrillator (ICD), a device that restores a normal heartbeat for patients with abnormally fast and life-threatening heart rhythms, which can lead to sudden cardiac arrest. Guidant also pioneered the world's first cardiac resynchronization therapy defibrillator (CRT-D) for heart failure (the gradual weakening of the heart muscle that affects more than 20 million people worldwide).

Of its various business groups, Guidant's Cardiac Rhythm Management business in particular consistently grew faster than the market, which increased by a total of 14 percent over the decade to 2004. That year, Guidant's implantable defibrillator sales reached $1.8 billion, an 18 percent year-over-year increase, fueled in large part by cardiac resynchronization therapy defibrillators for heart failure patients. Sales of implantable defibrillator systems made up 47% of total revenues (Exhibit 1).

In December of 2004, Guidant found itself courted by healthcare products giant Johnson & Johnson which sought to acquire the medical devices manufacturer to bolster its portfolio of medical products and enter a growing market in which it had little presence. On June 15, 2004, Johnson & Johnson announced that it would offer Guidant shareholders 25.4 billion dollars in cash and stocks to take over the company, corresponding to $76 per share.[3] After the death of Joshua Oukrop in March, Guidant came under pressure due to media attention to the case. On June 17, 2005, the *New York Times* published its story about Joshua and interviews with both his doctors and Guidant executives. The same day, Guidant issued an advisory to physicians with information about the possible malfunction.[4] In the advisory, Guidant recommended that patients do not replace their ICDs prior to the appearance of normal replacement indicators. Despite the recommendation, Guidant offered a free replacement device to any of its patients deciding to undergo surgery to remove a PRIZM 2 DR 1861 unit produced before the April 2002 manufacturing modification, as well as up to $2,500 of unreimbursed medical expenses incurred by patients associated with replacement surgery. In a follow-up advisory issued on August 8, Guidant reported that no additional clinical failures had been observed with the model.[5]

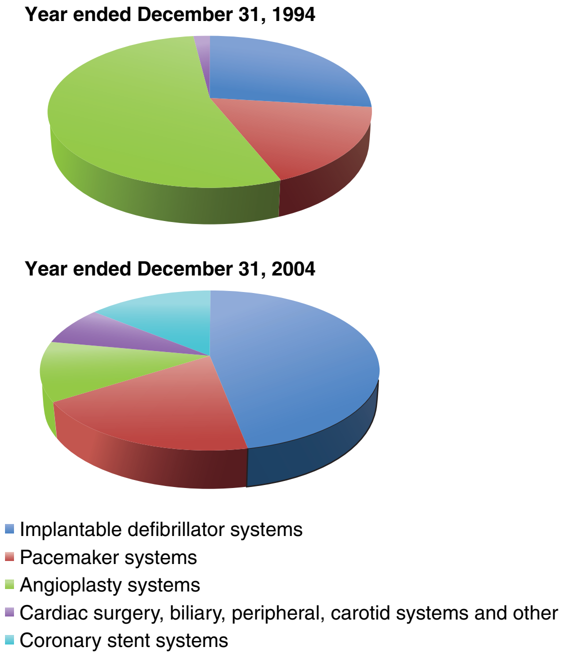

Exhibit 1 Product composition of Guidant's sales. *Source*: Guidant Corporation Annual Report 2004.

By summer 2005, the deal with Johnson & Johnson had still not been closed. With the media fallout from the malfunction in its Prizm 2 model, Guidant's position was deteriorating fast. Negotiating hard, Johnson & Johnson began to call for a lower price than the one originally offered, citing the trouble Guidant was experiencing over its defibrillators, and the possible financial ramifications, as the reason for the revaluation. Unless another company made a competing offer for it, Guidant officials knew that they would have to accept a significantly lower offer from Johnson & Johnson in a renegotiated deal. As expected, on November 15, 2005, Johnson & Johnson revised its offer down to 21.5 billion dollars or $63.08 per share.[6]

3. How ICDs Work

Implantable Cardioverter Defibrillators (ICDs), the type of implanted device that was used by Joshua Oukrop, constituted the mainstay of Guidant's business. These devices help regulate heart rhythm through the use of electrical charges, preventing potentially fatal consequences of an irregular heartbeat. They are surgically placed under the skin and powered by batteries. The devices are often used in patients at risk of sudden cardiac arrest, and can provide doctors with critical, detailed information regarding each episode in which the ICD was activated to deliver therapy.

ICDs have grown increasingly complex since their inception, but generally are made up of a computer microprocessor, a battery, and leads that all work together to detect cardiac activity and deliver the required electric jolt when needed. The computer component has become increasingly sophisticated, often combining diagnostic software, programmable options, and combined pacing, defibrillating, and heart failure therapy.

ICDs require replacement every 5 to 6 years depending on the model being used. Factors that play into the need for replacement may include hardware and software malfunctions, frequency of therapy, and environmental conditions; however, a dominant reason for ICD replacement has been battery depletion. Towards the end of its expected life, the failure rate of ICDs increases, so patients are often advised to replace their units before this happens.

The ability of ICDs to prolong the expected lifespan of its users has been well documented in medical literature. In the Sudden Cardiac Death in Heart Failure Trial (SCD-HeFT) sponsored by the National Heart, Lung and Blood Institute (NHLBI), 2521 patients with heart failure were randomly assigned to receive a placebo treatment, medication with the drug amiodarone, or an ICD.[7] After 5 years, the cumulative mortality rate was 36.1% in the placebo group, 34.0% in the amiodarone group, and 28.9% in the ICD group. While the risk of death in the group receiving drug medication was not statistically different from the placebo group, ICD therapy was associated with a statistically significant reduction in the risk of death of 7.2 percentage points.

According to another study, in 2005 "fewer than 20% of the 1.6 million US patients with recognized indications for ICD implantation as defined by the Center for Medicare and Medicaid Services have a device implanted. Another 600,000 US patients have heart failure but none of the Center's indications for ICDs; they may also be candidates for ICDs according to the SCD-HeFT trial, but almost none of them have received an ICD. Therefore, many thousands of patients are dying without defibrillators."[8]

4. A Faulty Product?

The complexity of ICDs and the intrusive operation required to implant them raise obvious concerns regarding the safety of the devices. As with any mechanical device, failures will occur. Batteries drain over time, decreasing reliability. Leads are exposed to the mechanical forces of a beating heart and their wires and insulation may wear out over time.

On July 1, 2005, the FDA issued a report that identified Guidant's June 17 advisory regarding the Prizm 2 DR device as a Class I recall.[9] Devices carrying this classification are those believed by the FDA to have the potential to cause serious adverse health consequences in the case of malfunction.

In mid-September 2005, Guidant issued a comprehensive Product Performance Report to make quality and performance information publicly available. Details concerning the failures experienced by the Prizm 2 DR were also included in the document.[10] A summary table is reproduced in Exhibit 2.

The product performance report counts the total number of U.S. registered implants for the device at 43,000. From these, 124 failures had been confirmed, or 0.29%. Only 63 of the failures, or 0.15%, were of a nature that compromised the electroshock therapy and could result in the death of the patient. Thus the overall failure rate was very low, in particular in comparison with the reduction in mortality that such devices provide. Furthermore, 26 of the 63 failures that compromised therapy were due to the short-circuit that proved fatal to Joshua Oukrop. Apart from the newly discovered short-circuit, therefore, the rate of confirmed failures in the U.S. population of units was 0.23% (98 out of 43,000), or 0.09% (37 out 43,000) if we exclude the failures that did not compromise therapy.

Exhibit 2 Guidant product performance report for Ventak Prizm 2 DR model 1861.

VENTAK PRIZM 2 DR Model 1861

Total registered U.S. implants:	43000
U.S. confirmed failures:	124
U.S. approval date:	August 2000
Average device age (months):	30.1

	Therapy available	*Therapy compromised*	*Total*
Electrical	**16**	**7**	**23**
Capacitor	13	3	
Integrated circuit	1	2	
Device tones	2		
Integrated circuit		1	
Resistor		1	
Mechanical	**12**	**36**	**48**
Short circuit (PRIZM 2 DR) *(advisory issued)*		26	
Seal plug	9	9	
Header	2	1	
Setscrew	1		
Mechanical	**8**	**0**	**8**
Software download	7		
Impedance measurements	1		
Other	**25**	**20**	**45**
Non-patterned	13	17	
Battery depletion	8	3	
Power on reset	2		
Battery voltage at implant	2		
U.S. confirmed failures	**61**	**63**	**124**

Source: Guidant Corporation Product Performance Report 2005.

The short-circuit had only occurred in units manufactured prior to April 2002, when Guidant changed its manufacturing process to eliminate the problem, and was not thought to be possible in units produced at later dates. No failures had been observed in post-April 2002 products. In addition, Guidant updated its manufacturing process again in November 2002 to provide further safeguards against defects. The manufacturing process changes were reported to the Food and Drug Administration, in compliance with the law; however, Guidant was not required to publicize either the changes or the reason for them. In particular, it was not legally required to divulge the potential malfunction to doctors.

The worldwide number of Prizm 2 DR units produced before the 2002 manufacturing changes was 26,000. Guidant had documented a total of 28 cases of short-circuits from the 26,000 vulnerable implants (the 26 in the United States mentioned above, and two more abroad). This translates to a failure rate of 0.11% among vulnerable units, which would come on top of the 0.23% failure rate for Prizm 2 DR (or 0.09% on the narrower definition) devices from other causes. Naturally, the risk could be higher, since not all failures are necessarily noticed and documented. In returned product testing, Guidant examined 1,005 devices manufactured on or before April 16, 2002. Out of this sample, four failures (0.40%) were provoked. Guidant noted, however, that these devices represent only a non-random sample of the implanted population, and may not be representative of the rest of the active units. The company's own estimate of the risk of a short-circuit in pre-April 2002 units was between 0.10% and 0.24%.

5. The Dangers of Information

In response to criticism from Joshua Oukrop's doctors, Guidant pointed to the risks associated with undergoing surgery to replace an ICD before its normal expiration. The risk of complications under or after such surgery is considerable. A study in the medical journal *Heart*, summarized in Exhibit 3, estimated this risk at 1.9% on average for both first implants and replacement surgery.[11] The different types of complications include wound infection, erosion[12], lead displacement and/or malfunction, and non-healing wounds; and they can in rare cases cause death. The risk of complication from replacement was in fact much higher than for first implants. Of the *Heart* study's 245 patients who underwent replacement surgery there were a total of 16 complications (6.5%) of which one death (0.41%).

The increase in the risk of death attributable to possible short-circuits in the Prizm 2 DR – between 0.10 and 0.24 percentage points, on Guidant's estimates – was therefore comparable to the 0.41% risk of death in early replacement surgery. Both numbers also imply no more than tiny marginal changes to the average risk of death among heart failure sufferers with ICDs – 28.9% over five years, which is the typical lifetime of a device, as against 36.1% for those without one – documented by the SCD-HeFT.

We can put the numbers differently. Of the 14,000 U.S. patients who still had a vulnerable Prizm 2 DR unit implanted, an expected number of 14 to 34 of them might be affected by the short-circuit, on Guidant's risk estimate. If all 14,000 chose to undergo early replacement surgery, those 14 to 34 would be saved, but an expected 57 more people could die in surgery than otherwise would (and many more would suffer non-lethal complications).[13]

Guidant's argument for why they had not publicized the manufacturing defect referred to the consequences of doing so on the health of patients who had the device implanted. The numbers above support the contention that publicizing the problem might have led to worse consequences than Guidant's chosen course of action. Patients, worrying about the short-circuit, might demand replacement surgery before normal schedule, which is as risky as leaving the device in or even riskier when counting non-lethal surgery complications. From a utilitarian point of view, this constitutes a reason not to divulge the information, since more lives might be lost from the ensuing replacement surgeries than from the malfunction itself.

Even in the best of cases, the minute improvement in net risk that replacement surgery might provide raises the question of whether it warrants the cost of a new device and the surgery itself The device alone could cost $22,000 at the time.[14] For Medicare patients, the government would reimburse up to $30,000. But otherwise (and above the reimbursement limit), patients and their insurance providers would be left to pick up the tab. After issuing its advisory, Guidant announced it would bear the cost of replacement units and pay patients up to $2,500 to defray costs of unreimbursed medical care. No matter who foots the bill, however, marginally

Exhibit 3 Number of late complications following ICD implanation or elective unit replacement surgery.

	n	*Infection*	*Erosion*	*Electrode problems*	*Misc.*	*Totals*
First implants						
Single chamber	1985	9 (0.5%)	8 (0.4%)	3 (0.2%)	5 (0.3%)	25 (1.3%)
Dual chamber	391	4 (1.0%)	2 (0.5%)	1 (0.3%)	2 (0.5%)	9 (2.3%)
Elective unit replacement	245	5 (2.0%)	10 (4.1%)	1 (0.4%)	0 (0.0%)	16 (6.5%)
Total	**2621**	**18 (0.7%)**	**20 (0.8%)**	**5 (0.2%)**	**7 (0.3%)**	**50 (1.9%)**

Source: Table 2 in A. A. Harcombe, S. A. Newell, *et al.*, "Late complications following permanent pacemaker implantations or elective unit replacement," *Heart*, Vol. 80 (1998), pp. 240–244.

reducing the risk of death by replacement surgery comes at a high price.

6. Legal and Professional Context

The federal government regulates the manufacturing and use of medical devices under the 1990 Safe Medical Devices Act and the 1992 Medical Device Amendments. Post-sale surveillance of medical devices was strengthened by requiring health care facilities to report device-related serious injuries or deaths, by establishing tracking of certain high-risk devices, and by giving the FDA authority to require tracking for any other device. Manufacturers were required to report to the FDA any device malfunction that could cause significant injury. As a result of this legislation, the FDA receives numerous device-related adverse event reports. The law, however, left it to Guidant's discretion whether to inform doctors of the potential malfunction. Guidant exercised that discretion by not divulging information about the manufacturing defect. They later defended that decision based on the risks of replacement surgery, presented in the previous section.

Joshua's doctor refused to accept Guidant's utilitarian argument. "It is a statistical argument that has little to do with real people," Dr. Maron said. He also said that the numbers reported to Guidant might understate the situation because product problems could go undetected or might not be reported.[15]

The Heart Rhythm Society responded to these events by calling for a task force to examine and develop new guidelines to better protect patients. In a press release, Anne B. Curtis, MD, president of the Heart Rhythm Society said, "Patients need to discuss the variety of treatment options available with the heart rhythm specialist overseeing their care. Each patient is unique and the decision regarding ICD treatment based on recall information from the manufacturer and the FDA will depend on the patient's specific medical condition."[16]

In an article published by the *Journal of the American Medical Association*, Dr. William H. Maisel wrote "Manufacturers are required to report to the FDA any device malfunction that causes or could cause significant injury. The decision for a manufacturer, however, of whether or not to notify physicians, patients, or the public about an observed malfunction is less straightforward. Historically, judgments have been made on a case-by-case basis by considering factors such as rate of malfunction, likelihood of patient injury, cause of device failure, and potential to mitigate the problem with an intervention. Because of the enormous financial consequences of the manufacturer's decision, there is also an inherent conflict of interest."[17]

Conclusion

When Guidant found out about the malfunction, it had to choose whether or not to inform the public about the short-circuits in the Prizm 2 DR. While it complied with its legal obligation to report manufacturing changes to the FDA, it did not go beyond the disclosure demanded by the law, and only released its findings once the *New York Times* was about to reveal them. A utilitarian argument for withholding the information exists: More lives could be lost, and certainly more complications could be caused, if the information was widely publicized than if the findings were kept under wraps.[18] Guidant had the additional concern that media coverage on the problem would upset the takeover negotiations with Johnson & Johnson at a critical stage. Many patients and medical professionals, meanwhile, claimed that they had a right to be informed. Did Guidant do the right thing?

Notes

This case study is derived from an original teaching note developed in 2005–2006 with research assistance from Jeisun Wen, for classroom use at the Wharton School, University of Pennsylvania.

[1] The information in this section is based on Barry Meier, "Maker of Heart Device Kept Flaw From Doctors," *New York Times*, May 24, 2005, and Maura Lerner, "Hunting down dangers to the heart," *Minneapolis Star Tribune*, 24 July 2005.

2 The facts in this and the next three paragraphs are taken from Guidant Corporation's Annual Report 2004, available on http://web.archive.org/web/20060312024230/www.guidant.com/investors/annualreport/Guidant AR2004.pdf (accessed March 2013).

3 Guidant press release 15 December 2004, http://bostonscientific.mediaroom.com/index.php?s=24913&item = 22087 (accessed March 2013).

4 Available on http://web.archive.org/web/20051028093844/www.guidant.com/physiciancommunications/PRIZM2 DR.pdf (accessed March 2013).

5 Available on http://web.archive.org/web/20060312021524/www.guidant.com/physiciancommunications/PRIZM2 Update.pdf (accessed March 2013).

6 Kwan Yuk Pan, "Guidant rises on J&J revised bid," *Financial Times*, 16 November 2005. As it turned out, In December Guidant would receive an acquisition offer from Boston Scientific, a medical technology company.

7 Gust H. Bardy, Kerry L. Lee, *et al.*, "Amiodarone or an Implantable Cardioverter–Defibrillator for Congestive Heart Failure," *The New England Journal of Medicine*, Vol. 352, No. 3 (January 20, 2005), pp. 225–237.

8 J. David Burkhardt and Bruce L. Wilkoff, "Malfunctions in implantable cardiac devices: Putting the risk in perspective," *Cleveland Clinic Journal of Medicine*, Vol. 72, No. 9 (September 2005), pp. 736–744.

9 "FDA Updates Consumers on Guidant Corporation's Implantable Defibrillators," FDA Press Release P0537, 1 July 2005. Available on http://www.fda.gov/NewsEvents/Newsroom/PressAnnouncements/2005/ucm108456.htm (accessed March 2013).

10 Available on http://web.archive.org/web/20051126074952/www.guidant.com/physician/ product performance report.pdf (accessed March 2013).

11 A. A. Harcombe, S. A. Newell, P. F. Ludman et al., "Late complications following permanent pacemaker implantations or elective unit replacement," *Heart*, Vol. 80 (1998), pp. 240–244.

12 Deterioration of tissue membranes due to physical abrasion or inflammation.

13 The numbers are calculated by multiplying 14,000 by the estimated risk probabilities. The expected number of surgery deaths is somewhat misleading, since patients eventually need replacement surgery anyway when the unit wears out. Still, an accelerated pace of replacement surgery implies more replacement surgeries overall over a given lifetime, so many people will end up with one more replacement surgery (with the attendant exposure to risk) than otherwise. If this is half the population, the expected number of surgery deaths is 28.

14 Cinda Becker, "Stuck with the check?," *Modern Healthcare*, Vol. 35, No. 26 (27 June 2005), p. 20–22.

15 Meier, "Maker of Heart Device Kept Flaw From Doctors".

16 Heart Rhythm Society, "Heart Rhythm Society to Develop Guidelines on ICD Recalls: Task Force to Begin Drafting Recommendations on Manufacturer Notification Standards," Press release 22 June 2005, available on http: //www.medscape.com/pages/editorial/pressreleases /pr-crm-hrs14 (accessed March 2013).

17 William H. Maisel, "Safety Issues Involving Medical Devices Implications of Recent Implantable Cardioverter-Defibrillator Malfunctions," *Journal of the American Medical Association*, 24/31 August, 2005.

18 For a fuller presentation of utilitarianism and its application to business ethics, see Martin E. Sandbu, *Just Business: Arguments in Business Ethics*, London: Pearson/Prentice Hall, 2011, especially chapters 5–7.

Chiquita Accused of Funding Colombia Terrorists

Curt Anderson

"Chiquita Accused of Funding Columbia Terrorists," AP story by Curt Anderson, May 30, 2011. Reprinted with permission of The YGS Group. © 2011 The Associated Press. All rights reserved. This material may not be published, broadcast, rewritten, or redistributed.

MIAMI – Each name is next to a number, in black type on a thick legal document. They are the mothers and fathers, spouses, sisters and brothers of thousands of Colombians who were killed or vanished during a bloody civil conflict between leftist guerrillas and right-wing paramilitary groups whose victims have largely been civilians.

The list has at least 4,000 names, each one targeting Chiquita Brands International in U.S. lawsuits, claiming the produce giant's payments and other assistance to the paramilitary groups amounted to supporting terrorists.

Cincinnati-based Chiquita in 2007 pleaded guilty to similar criminal charges brought by the Justice

Department and paid a $25 million fine. But if the lawsuits succeed, plaintiffs' lawyers estimate the damages against Chiquita could reach into the billions. The cases filed around the country are being consolidated before a South Florida federal judge who must decide whether to dismiss them or let them proceed.

"A company that pays a terrorist organization that kills thousands of people should get the capital punishment of civil liability and be put out of business by punitive damages," said attorney Terry Collingsworth, who filed one of the first lawsuits on behalf of Colombians.

Chiquita has long maintained it was essentially blackmailed into paying the paramilitary groups – perpetrators of the majority of civilian deaths in Colombia's dirty war – and insists the lawsuits should be dismissed.

"Chiquita was extorted in Colombia and company officials believed that the payments were necessary to prevent violent retaliation against employees," said company spokesman Ed Loyd.

The lawsuits could be strengthened by the recent release of some 5,500 pages of internal Chiquita documents that were produced during the Justice Department probe. The documents detail how payments were hidden by accounting maneuvers, and shed light on Colombian government and political involvement with the paramilitary group. They also show there was a debate among Chiquita executives about whether the payments were proper.

In a 1997 handwritten note, one Chiquita executive said such payments are the "cost of doing business in Colombia."

"Need to keep this very confidential – people can get killed," he wrote.

Chiquita, with some 21,000 employees on six continents, is best known as the top U.S. banana seller but also markets a variety of other produce and fruit-based snacks.

Chiquita's sprawling banana operations in Colombia date to 1899, mostly in remote areas of Santa Marta and Uraba along the Caribbean coast. By the 1970s, the country's civil conflict threatened the banana farms, mostly fomented by the leftist Revolutionary Armed Forces of Colombia – known by its Spanish acronym, FARC. The guerrillas demanded payment from companies such as Chiquita or they would attack workers and operations. Chiquita paid between $20,000 and $100,000 a month, court documents show.

FARC became so powerful in the banana-growing areas that Colombia's military forces could not defeat them. The group bombed Chiquita operations and kidnapped employees. In 1995, 17 banana workers were gunned down on a muddy soccer field, U.S. prosecutors said. Later that year, FARC forced 26 workers to lie in a ditch and they were shot in the head.

The AUC, a Spanish acronym for the United Self-Defense Forces of Colombia, was founded in 1997 as an umbrella group to unite the far-right militias across the country. Those militias were formed in the 1980s by ranchers and drug traffickers to counter extortion and kidnapping by the FARC and other leftist rebels.

The AUC wasted no time trying to muscle FARC out of the Chiquita money stream.

Paramilitary warlords, backed by top military and political leaders, have admitted to killing more than 50,000 civilians, Colombian prosecutors said.

The Chiquita lawsuit cites a number of AUC massacres, including a July 1997 operation in the town of Mapiripan in which at least 49 people were tortured, dismembered and decapitated. In February 2000, about 300 AUC troops tortured dozens of people and killed 36 people.

The top AUC leader, Carlos Castano, told Chiquita executives in a meeting that the money would be used to drive out the guerrillas and protect the company's interests. For seven years, Chiquita made over 100 payments totaling $1.7 million to the AUC or affiliated organizations, according to court documents.

About half that money was paid after the U.S. government, on September 10, 2001, declared the AUC a foreign terrorist organization, just as FARC had been designated years earlier. That made it a crime for anyone in the U.S. to do business with either paramilitary group.

Chiquita, however, said in court documents it was unaware of the AUC terrorist designation until late February 2003 – some 18 months later – even though the news in 2001 was widely reported by the media, including leading national publications in the U.S.

and Colombia and newspapers in Chiquita's headquarters city of Cincinnati.

The discovery, Chiquita said, was made by a company lawyer researching the AUC on the Internet. That eventually led to Chiquita's guilty plea, and in 2004 the company sold its Colombian banana operations.

The lawsuits contend the AUC was able to continue its violent rampage mainly because of Chiquita's financial support. The cases are brought under the Alien Tort Statute, a 222-year-old law that allows foreigners to sue in American federal courts if their claims involve violations of U.S. treaties or the "law of nations."

The ATS, as the law is known, has been used previously to bring lawsuits over human rights violations in foreign countries, but the cases are often difficult to prove. In 2007, a federal jury in Alabama ruled against Colombians making similar claims involving the AUC and the Alabama-based Drummond coal company, a verdict that was upheld on appeal.

It wasn't just money that Chiquita provided the AUC, according to court documents. In 2001, Chiquita was identified in invoices and other documents as the recipient of a shipment from Nicaragua of 3,000 AK-47 assault rifles and 5 million rounds of ammunition. The shipment was actually intended for the AUC.

The guns and ammo were unloaded by Chiquita employees, stored at Chiquita warehouses, and then delivered by trucks to the AUC, court papers said. They also claim there were at least four similar shipments, prompting AUC leader Castano to boast about the deals in a Colombian newspaper.

To the Colombians' lawyers, all of this adds up to overwhelming evidence that Chiquita should be held liable.

"There is too much evidence over too long a period of time," Collingsworth said. "How do you talk your way out of that?"

Chiquita, however, is seeking to have the claims dismissed and said the cases wrongly seek to make the company liable "for every murder these terrorist groups committed during the several decades in which they held sway in the lawless, remote regions of Colombia where Chiquita's subsidiary operated."

U.S. District Judge Kenneth Marra has refused to dismiss the cases involving murders and other crimes committed against U.S. citizens by FARC. But he has not yet ruled on the AUC cases.

Collingsworth said if the cases proceed he expects serious settlement talks to begin.

"I can't believe a jury wouldn't give each of these people $50 million, easily," he said. "That number is huge. I think both sides have an interest in some kind of structured settlement."

Wal-Mart Hushed Up a Vast Mexican Bribery Case

David Barstow

MEXICO CITY – In September 2005, a senior Wal-Mart lawyer received an alarming e-mail from a former executive at the company's largest foreign subsidiary, Wal-Mart de Mexico. In the e-mail and follow-up conversations, the former executive described how Wal-Mart de Mexico had orchestrated a campaign of bribery to win market dominance. In its rush to build stores, he said, the company had paid bribes to obtain permits in virtually every corner of the country.

The former executive gave names, dates and bribe amounts. He knew so much, he explained, because for years he had been the lawyer in charge of obtaining construction permits for Wal-Mart de Mexico.

Wal-Mart dispatched investigators to Mexico City, and within days they unearthed evidence of widespread bribery. They found a paper trail of hundreds of suspect payments totaling more than $24 million. They also found documents showing that Wal-Mart de Mexico's top executives not only knew about the

David Barstow, "Wal-Mart Hushed Up a Vast Mexican Bribery Case," *The New York Times*, April 21, 2012. Reprinted with permission of Pars International.

payments, but had taken steps to conceal them from Wal-Mart's headquarters in Bentonville, Ark. In a confidential report to his superiors, Wal-Mart's lead investigator, a former F.B.I. special agent, summed up their initial findings this way: "There is reasonable suspicion to believe that Mexican and USA laws have been violated."

The lead investigator recommended that Wal-Mart expand the investigation.

Instead, an examination by *The New York Times* found, Wal-Mart's leaders shut it down.

Neither American nor Mexican law enforcement officials were notified. None of Wal-Mart de Mexico's leaders were disciplined. Indeed, its chief executive, Eduardo Castro-Wright, identified by the former executive as the driving force behind years of bribery, was promoted to vice chairman of Wal-Mart in 2008. Until this article, the allegations and Wal-Mart's investigation had never been publicly disclosed.

But *The Times*'s examination uncovered a prolonged struggle at the highest levels of Wal-Mart, a struggle that pitted the company's much publicized commitment to the highest moral and ethical standards against its relentless pursuit of growth.

Under fire from labor critics, worried about press leaks and facing a sagging stock price, Wal-Mart's leaders recognized that the allegations could have devastating consequences, documents and interviews show. Wal-Mart de Mexico was the company's brightest success story, pitched to investors as a model for future growth. (Today, one in five Wal-Mart stores is in Mexico.) Confronted with evidence of corruption in Mexico, top Wal-Mart executives focused more on damage control than on rooting out wrongdoing.

In one meeting where the bribery case was discussed, H. Lee Scott Jr., then Wal-Mart's chief executive, rebuked internal investigators for being overly aggressive. Days later, records show, Wal-Mart's top lawyer arranged to ship the internal investigators' files on the case to Mexico City. Primary responsibility for the investigation was then given to the general counsel of Wal-Mart de Mexico – a remarkable choice since the same general counsel was alleged to have authorized bribes.

The general counsel promptly exonerated his fellow Wal-Mart de Mexico executives.

When Wal-Mart's director of corporate investigations – a former top F.B.I. official – read the general counsel's report, his appraisal was scathing. "Truly lacking," he wrote in an e-mail to his boss.

The report was nonetheless accepted by Wal-Mart's leaders as the last word on the matter.

In December, after learning of *The Times*'s reporting in Mexico, Wal-Mart informed the Justice Department that it had begun an internal investigation into possible violations of the Foreign Corrupt Practices Act, a federal law that makes it a crime for American corporations and their subsidiaries to bribe foreign officials. Wal-Mart said the company had learned of possible problems with how it obtained permits, but stressed that the issues were limited to "discrete" cases.

"We do not believe that these matters will have a material adverse effect on our business," the company said in a filing with the Securities and Exchange Commission.

But *The Times*'s examination found credible evidence that bribery played a persistent and significant role in Wal-Mart's rapid growth in Mexico, where Wal-Mart now employs 209,000 people, making it the country's largest private employer.

A Wal-Mart spokesman confirmed that the company's Mexico operations – and its handling of the 2005 case – were now a major focus of its inquiry.

"If these allegations are true, it is not a reflection of who we are or what we stand for," the spokesman, David W. Tovar, said. "We are deeply concerned by these allegations and are working aggressively to determine what happened."

In the meantime, Mr. Tovar said, Wal-Mart is taking steps in Mexico to strengthen compliance with the Foreign Corrupt Practices Act. "We do not and will not tolerate noncompliance with F.C.P.A. anywhere or at any level of the company," he said.

The Times laid out this article's findings to Wal-Mart weeks ago. The company said it shared the findings with many of the executives named here, including Mr. Scott, now on Wal-Mart's board, and Mr. Castro-Wright, who is retiring in July. Both men declined to comment, Mr. Tovar said.

The Times obtained hundreds of internal company documents tracing the evolution of Wal-Mart's 2005 Mexico investigation. The documents show Wal-Mart's leadership immediately recognized the seriousness of the allegations. Working in secrecy, a small group of executives, including several current members of Wal-Mart's senior management, kept close tabs on the inquiry.

Michael T. Duke, Wal-Mart's current chief executive, was also kept informed. At the time, Mr. Duke had just been put in charge of Wal-Mart International, making him responsible for all foreign subsidiaries. "You'll want to read this," a top Wal-Mart lawyer wrote in an Oct. 15, 2005, e-mail to Mr. Duke that gave a detailed description of the former executive's allegations.

The Times examination included more than 15 hours of interviews with the former executive, Sergio Cicero Zapata, who resigned from Wal-Mart de Mexico in 2004 after nearly a decade in the company's real estate department.

In the interviews, Mr. Cicero recounted how he had helped organize years of payoffs. He described personally dispatching two trusted outside lawyers to deliver envelopes of cash to government officials. They targeted mayors and city council members, obscure urban planners, low-level bureaucrats who issued permits – anyone with the power to thwart Wal-Mart's growth. The bribes, he said, bought zoning approvals, reductions in environmental impact fees and the allegiance of neighborhood leaders.

He called it working "the dark side of the moon."

The Times also reviewed thousands of government documents related to permit requests for stores across Mexico. The examination found many instances where permits were given within weeks or even days of Wal-Mart de Mexico's payments to the two lawyers. Again and again, *The Times* found, legal and bureaucratic obstacles melted away after payments were made.

The Times conducted extensive interviews with participants in Wal-Mart's investigation. They spoke on the condition that they not be identified discussing matters Wal-Mart has long shielded. These people said the investigation left little doubt Mr. Cicero's allegations were credible. ("Not even a close call," one person said.)

But, they said, the more investigators corroborated his assertions, the more resistance they encountered inside Wal-Mart. Some of it came from powerful executives implicated in the corruption, records and interviews show. Other top executives voiced concern about the possible legal and reputational harm.

In the end, people involved in the investigation said, Wal-Mart's leaders found a bloodlessly bureaucratic way to bury the matter. But in handing the investigation off to one of its main targets, they disregarded the advice of one of Wal-Mart's top lawyers, the same lawyer first contacted by Mr. Cicero.

"The wisdom of assigning any investigative role to management of the business unit being investigated escapes me," Maritza I. Munich, then general counsel of Wal-Mart International, wrote in an e-mail to top Wal-Mart executives.

The investigation, she urged, should be completed using "professional, independent investigative resources."

The Allegations Emerge

On Sept. 21, 2005, Mr. Cicero sent an e-mail to Ms. Munich telling her he had information about "irregularities" authorized "by the highest levels" at Wal-Mart de Mexico. "I hope to meet you soon," he wrote.

Ms. Munich was familiar with the challenges of avoiding corruption in Latin America. Before joining Wal-Mart in 2003, she had spent 12 years in Mexico and elsewhere in Latin America as a lawyer for Procter & Gamble.

At Wal-Mart in 2004, she pushed the board to adopt a strict anticorruption policy that prohibited all employees from "offering anything of value to a government official on behalf of Wal-Mart." It required every employee to report the first sign of corruption, and it bound Wal-Mart's agents to the same exacting standards.

Ms. Munich reacted quickly to Mr. Cicero's e-mail. Within days, she hired Juan Francisco Torres-Landa, a prominent Harvard-trained lawyer in Mexico City, to debrief Mr. Cicero. The two men met three times in October 2005, with Ms. Munich flying in from Bentonville for the third debriefing.

During hours of questioning, Mr. Torres-Landa's notes show, Mr. Cicero described how Wal-Mart de Mexico had perfected the art of bribery, then hidden it all with fraudulent accounting. Mr. Cicero implicated many of Wal-Mart de Mexico's leaders, including its board chairman, its general counsel, its chief auditor and its top real estate executive.

But the person most responsible, he told Mr. Torres-Landa, was the company's ambitious chief executive, Eduardo Castro-Wright, a native of Ecuador who was recruited from Honeywell in 2001 to become Wal-Mart's chief operating officer in Mexico.

Mr. Cicero said that while bribes were occasionally paid before Mr. Castro-Wright's arrival, their use soared after Mr. Castro-Wright ascended to the top job in 2002. Mr. Cicero described how Wal-Mart de Mexico's leaders had set "very aggressive growth goals," which required opening new stores "in record times." Wal-Mart de Mexico executives, he said, were under pressure to do "whatever was necessary" to obtain permits.

In an interview with *The Times*, Mr. Cicero said Mr. Castro-Wright had encouraged the payments for a specific strategic purpose. The idea, he said, was to build hundreds of new stores so fast that competitors would not have time to react. Bribes, he explained, accelerated growth. They got zoning maps changed. They made environmental objections vanish. Permits that typically took months to process magically materialized in days. "What we were buying was time," he said.

Wal-Mart de Mexico's stunning growth made Mr. Castro-Wright a rising star in Bentonville. In early 2005, when he was promoted to a senior position in the United States, Mr. Duke would cite his "outstanding results" in Mexico.

Mr. Cicero's allegations were all the more startling because he implicated himself. He spent hours explaining to Mr. Torres-Landa the mechanics of how he had helped funnel bribes through trusted fixers, known as "gestores."

Gestores (pronounced hes-TORE-ehs) are a fixture in Mexico's byzantine bureaucracies, and some are entirely legitimate. Ordinary citizens routinely pay gestores to stand in line for them at the driver's license office. Companies hire them as quasi-lobbyists to get things done as painlessly as possible.

But often gestores play starring roles in Mexico's endless loop of public corruption scandals. They operate in the shadows, dangling payoffs to officials of every rank. It was this type of gestor that Wal-Mart de Mexico deployed, Mr. Cicero said.

Mr. Cicero told Mr. Torres-Landa it was his job to recruit the gestores. He worked closely with them, sharing strategies on whom to bribe. He also approved Wal-Mart de Mexico's payments to the gestores. Each payment covered the bribe and the gestor's fee, typically 6 percent of the bribe.

It was all carefully monitored through a system of secret codes known only to a handful of Wal-Mart de Mexico executives.

The gestores submitted invoices with brief, vaguely worded descriptions of their services. But the real story, Mr. Cicero said, was told in codes written on the invoices. The codes identified the specific "irregular act" performed, Mr. Cicero explained to Mr. Torres-Landa. One code, for example, indicated a bribe to speed up a permit. Others described bribes to obtain confidential information or eliminate fines.

Each month, Mr. Castro-Wright and other top Wal-Mart de Mexico executives "received a detailed schedule of all of the payments performed," he said, according to the lawyer's notes. Wal-Mart de Mexico then "purified" the bribes in accounting records as simple legal fees.

They also took care to keep Bentonville in the dark. "Dirty clothes are washed at home," Mr. Cicero said.

Mr. Torres-Landa explored Mr. Cicero's motives for coming forward.

Mr. Cicero said he resigned in September 2004 because he felt underappreciated. He described the "pressure and stress" of participating in years of corruption, of contending with "greedy" officials who jacked up bribe demands.

As he told *The Times*, "I thought I deserved a medal at least."

The breaking point came in early 2004, when he was passed over for the job of general counsel of Wal-Mart de Mexico. This snub, Mr. Torres-Landa wrote, "generated significant anger with respect to the lack of recognition for his work." Mr. Cicero said he began to assemble a record of bribes he had helped orchestrate to "protect him in case of any complaint or investigation," Mr. Torres-Landa wrote.

"We did not detect on his part any express statement about wishing to sell the information," the lawyer added.

According to people involved in Wal-Mart's investigation, Mr. Cicero's account of criminality at the top of Wal-Mart's most important foreign subsidiary was impossible to dismiss. He had clearly been in a position to witness the events he described. Nor was this the first indication of corruption at Wal-Mart de Mexico under Mr. Castro-Wright. A confidential investigation, conducted for Wal-Mart in 2003 by Kroll Inc., a leading investigation firm, discovered that Wal-Mart de Mexico had systematically increased its sales by helping favored high-volume customers evade sales taxes.

A draft of Kroll's report, obtained by *The Times*, concluded that top Wal-Mart de Mexico executives had failed to enforce their own anticorruption policies, ignored internal audits that raised red flags and even disregarded local press accounts asserting that Wal-Mart de Mexico was "carrying out a tax fraud." (The company ultimately paid $34.3 million in back taxes.)

Wal-Mart then asked Kroll to evaluate Wal-Mart de Mexico's internal audit and antifraud units. Kroll wrote another report that branded the units "ineffective." Many employees accused of wrongdoing were not even questioned; some "received a promotion shortly after the suspicions of fraudulent activities had surfaced."

None of these findings, though, had slowed Mr. Castro-Wright's rise.

Just days before Mr. Cicero's first debriefing, Mr. Castro-Wright was promoted again. He was put in charge of all Wal-Mart stores in the United States, one of the most prominent jobs in the company. He also joined Wal-Mart's executive committee, the company's inner sanctum of leadership.

The Initial Response

Ms. Munich sent detailed memos describing Mr. Cicero's debriefings to Wal-Mart's senior management. These executives, records show, included Thomas A. Mars, Wal-Mart's general counsel and a former director of the Arkansas State Police; Thomas D. Hyde, Wal-Mart's executive vice president and corporate secretary; Michael Fung, Wal-Mart's top internal auditor; Craig Herkert, the chief executive for Wal-Mart's operations in Latin America; and Lee Stucky, a confidant of Lee Scott's and chief administrative officer of Wal-Mart International.

Wal-Mart typically hired outside law firms to lead internal investigations into allegations of significant wrongdoing. It did so earlier in 2005, for example, when Thomas M. Coughlin, then vice chairman of Wal-Mart, was accused of padding his expense accounts and misappropriating Wal-Mart gift cards.

At first, Wal-Mart took the same approach with Mr. Cicero's allegations. It turned to Willkie Farr & Gallagher, a law firm with extensive experience in Foreign Corrupt Practices Act cases.

The firm's "investigation work plan" called for tracing all payments to anyone who had helped Wal-Mart de Mexico obtain permits for the previous five years. The firm said it would scrutinize "any and all payments" to government officials and interview every person who might know about payoffs, including "implicated members" of Wal-Mart de Mexico's board.

In short, Willkie Farr recommended the kind of independent, spare-no-expense investigation major corporations routinely undertake when confronted with allegations of serious wrongdoing by top executives.

Wal-Mart's leaders rejected this approach. Instead, records show, they decided Wal-Mart's lawyers would supervise a far more limited "preliminary inquiry" by in-house investigators.

The inquiry, a confidential memo explained, would take two weeks, not the four months Willkie Farr proposed. Rather than examining years of permits, the team would look at a few specific stores. Interviews would be done "only when absolutely essential to establishing the bona fides" of Mr. Cicero. However, if the inquiry found a "likelihood" that laws had been violated, the company would then consider conducting a "full investigation."

The decision gave Wal-Mart's senior management direct control over the investigation. It also meant new responsibility for the company's tiny and troubled Corporate Investigations unit.

The unit was ill-equipped to take on a major corruption investigation, let alone one in Mexico. It had fewer than 70 employees, and most were assigned to chasing shoplifting rings and corrupt vendors. Just four people were specifically dedicated to investigating corporate fraud, a number Joseph R. Lewis, Wal-Mart's director of corporate investigations, described in a confidential memo as "wholly inadequate for an organization the size of Wal-Mart."

But Mr. Lewis and his boss, Kenneth H. Senser, vice president for global security, aviation and travel, were working to strengthen the unit. Months before Mr. Cicero surfaced, they won approval to hire four "special investigators" who, according to their job descriptions, would be assigned the "most significant and complex fraud matters." Mr. Scott, the chief executive, also agreed that Corporate Investigations would handle all allegations of misconduct by senior executives.

And yet in the fall of 2005, as Wal-Mart began to grapple with Mr. Cicero's allegations, two cases called into question Corporate Investigations' independence and role.

In October, Wal-Mart's vice chairman, John B. Menzer, intervened in an internal investigation into a senior vice president who reported to him. According to internal records, Mr. Menzer told Mr. Senser he did not want Corporate Investigations to handle the case "due to concerns about the impact such an investigation would have." One of the senior vice president's subordinates, he said, "would be better suited to conduct this inquiry." Soon after, records show, the subordinate cleared his boss.

The other case involved the president of Wal-Mart Puerto Rico. A whistleblower had accused the president and other executives of mistreating employees. Although Corporate Investigations was supposed to investigate all allegations against senior executives, the president had instead assigned an underling to look into the complaints – but to steer clear of those against him.

Ms. Munich objected. In an e-mail to Wal-Mart executives, she complained that the investigation was "at the direction of the same company officer who is the target of several of the allegations."

"We are in need of clear guidelines about how to handle these issues going forward," she warned.

The Inquiry Begins

Ronald Halter, one of Wal-Mart's new "special investigators," was assigned to lead the preliminary inquiry into Mr. Cicero's allegations. Mr. Halter had been with Wal-Mart only a few months, but he was a seasoned criminal investigator. He had spent 21 years in the F.B.I., and he spoke Spanish.

He also had help. Bob Ainley, a senior auditor, was sent to Mexico along with several Spanish-speaking auditors.

On Nov. 12, 2005, Mr. Halter's team got to work at Wal-Mart de Mexico's corporate headquarters in Mexico City. The team gained access to a database of Wal-Mart de Mexico payments and began searching the payment description field for the word "gestoria."

By day's end, they had found 441 gestor payments. Each was a potential bribe, and yet they had searched back only to 2003.

Mr. Cicero had said his main gestores were Pablo Alegria Con Alonso and Jose Manuel Aguirre Juarez, obscure Mexico City lawyers with small practices who were friends of his from law school.

Sure enough, Mr. Halter's team found that nearly half the payments were to Mr. Alegria and Mr. Aguirre. These two lawyers alone, records showed, had received $8.5 million in payments. Records showed Wal-Mart de Mexico routinely paid its gestores tens of thousands of dollars per permit. (In interviews, both lawyers declined to discuss the corruption allegations, citing confidentiality agreements with Wal-Mart.)

"One very interesting postscript," Mr. Halter wrote in an e-mail to his boss, Mr. Lewis. "All payments to these individuals and all large sums of $ paid out of this account stopped abruptly in 2005." Mr. Halter said the "only thing we can find" that changed was that Mr. Castro-Wright left Wal-Mart de Mexico for the United States.

Mr. Halter's team confirmed detail after detail from Mr. Cicero's debriefings. Mr. Cicero had given specifics – names, dates, bribe amounts – for several new stores. In almost every case, investigators found documents confirming major elements of his account. And just as Mr. Cicero had described, investigators found mysterious codes at the bottom of invoices from the gestores.

"The documentation didn't look anything like what you would find in legitimate billing records from a legitimate law firm," a person involved in the investigation said in an interview.

Mr. Lewis sent a terse progress report to his boss, Mr. Senser: "FYI. It is not looking good."

Hours later, Mr. Halter's team found clear confirmation that Mr. Castro-Wright and other top executives at Wal-Mart de Mexico were well aware of the gestor payments.

In March 2004, the team discovered, the executives had been sent an internal Wal-Mart de Mexico audit that raised red flags about the gestor payments. The audit documented how Wal-Mart de Mexico's two primary gestores had been paid millions to make "facilitating payments" for new store permits all over Mexico.

The audit did not delve into how the money had been used to "facilitate" permits. But it showed the payments rising rapidly, roughly in line with Wal-Mart de Mexico's accelerating growth. The audit recommended notifying Bentonville of the payments.

The recommendation, records showed, was removed by Wal-Mart de Mexico's chief auditor, whom Mr. Cicero had identified as one of the executives who knew about the bribes. The author of the gestor audit, meanwhile, "was fired not long after the audit was completed," Mr. Halter wrote.

Mr. Ainley arranged to meet the fired auditor at his hotel. The auditor described other examples of Wal-Mart de Mexico's leaders withholding from Bentonville information about suspect payments to government officials.

The auditor singled out José Luis Rodríguezmacedo Rivera, the general counsel of Wal-Mart de Mexico.

Mr. Rodríguezmacedo, he said, took "significant information out" of an audit of Wal-Mart de Mexico's compliance with the Foreign Corrupt Practices Act. The original audit had described how Wal-Mart de Mexico gave gift cards to government officials in towns where it was building stores. "These were only given out until the construction was complete," Mr. Ainley wrote. "At which time the payments ceased."

These details were scrubbed from the final version sent to Bentonville.

Investigators were struck by Mr. Castro-Wright's response to the gestor audit. It had been shown to him immediately, Wal-Mart de Mexico's chief auditor had told them. Yet rather than expressing alarm, he had appeared worried about becoming too dependent on too few gestores. In an e-mail, Mr. Rodríguezmacedo told Mr. Cicero to write up a plan to "diversify" the gestores used to "facilitate" permits.

"Eduardo Castro wants us to implement this plan as soon as possible," he wrote.

Mr. Cicero did as directed. The plan, which authorized paying gestores up to $280,000 to "facilitate" a single permit, was approved with a minor change. Mr. Rodríguezmacedo did not want the plan to mention "gestores." He wanted them called "external service providers."

Mr. Halter's team made one last discovery – a finding that suggested the corruption might be far more extensive than even Mr. Cicero had described.

In going through Wal-Mart de Mexico's database of payments, investigators noticed the company was making hefty "contributions" and "donations" directly to governments all over Mexico – nearly $16 million in all since 2003.

"Some of the payments descriptions indicate that the donation is being made for the issuance of a license," Mr. Ainley wrote in one report back to Bentonville.

They also found a document in which a Wal-Mart de Mexico real estate executive had openly acknowledged that "these payments were performed to facilitate obtaining the licenses or permits" for new stores. Sometimes, Mr. Cicero told *The Times*, donations were used hand-in-hand with gestor payments to get permits.

Deflecting Blame

When Mr. Halter's team was ready to interview executives at Wal-Mart de Mexico, the first target was Mr. Rodríguezmacedo.

Before joining Wal-Mart de Mexico in January 2004, Mr. Rodríguezmacedo had been a lawyer for Citigroup in Mexico. Urbane and smooth, with impeccable English, he quickly won fans in Bentonville. When Wal-Mart invited executives from its foreign subsidiaries for several days of discussion about the fine points of the Foreign Corrupt Practices Act, Mr. Rodríguezmacedo was asked to lead one of the sessions.

It was called "Overcoming Challenges in Government Dealings."

Yet Mr. Cicero had identified him as a participant in the bribery scheme. In his debriefings, Mr. Cicero described how Mr. Rodríguezmacedo had passed along specific payoff instructions from Mr. Castro-Wright. In an interview with *The Times*, Mr. Cicero said he and Mr. Rodríguezmacedo had discussed the use of gestores shortly after Mr. Rodríguezmacedo was hired. "He said, 'Don't worry. Keep it on its way.' "

Mr. Rodríguezmacedo declined to comment; on Friday Wal-Mart disclosed that he had been reassigned and is no longer Wal-Mart de Mexico's general counsel.

Mr.Halter's team hoped Mr.Rodríguezmacedo would shed light on how two outside lawyers came to be paid $8.5 million to "facilitate" permits. Mr. Rodríguezmacedo responded with evasive hostility, records and interviews show. When investigators asked him for the gestores' billing records, he said he did not have time to track them down. They got similar receptions from other executives.

Only after investigators complained to higher authorities were the executives more forthcoming. Led by Mr. Rodríguezmacedo, they responded with an attack on Mr. Cicero's credibility.

The gestor audit, they told investigators, had raised doubts about Mr. Cicero, since he had approved most of the payments. They began to suspect he was somehow benefiting, so they asked Kroll to investigate. It was then, they asserted, that Kroll discovered Mr. Cicero's wife was a law partner of one of the gestores.

Mr. Cicero was fired, they said, because he had failed to disclose that fact. They produced a copy of a "preliminary" report from Kroll and e-mails showing the undisclosed conflict had been reported to Bentonville.

Based on this behavior, Mr. Rodríguezmacedo argued, the gestor payments were in all likelihood a "ruse" by Mr. Cicero to defraud Wal-Mart de Mexico. Mr. Cicero and the gestores, he contended, probably kept every last peso of the "facilitating payments."

Simply put, bribes could not have been paid if the money was stolen first.

It was an argument that gave Wal-Mart ample justification to end the inquiry. But investigators were skeptical, records and interviews show.

Even if Mr. Rodríguezmacedo's account were true, it did not explain why Wal-Mart de Mexico's executives had authorized gestor payments in the first place, or why they made "donations" to get permits, or why they rewrote audits to keep Bentonville in the dark.

Investigators also wondered why a trained lawyer who had gotten away with stealing a small fortune from Wal-Mart would now deliberately draw the company's full attention by implicating himself in a series of fictional bribes. And if Wal-Mart de Mexico's executives truly believed they had been victimized, why hadn't they taken legal action against Mr. Cicero, much less reported the "theft" to Bentonville?

There was another problem: Documents contradicted most of the executives' assertions about Mr. Cicero.

Records showed Mr. Cicero had not been fired, but had resigned with severance benefits and a $25,000 bonus. In fact, in a 2004 e-mail to Ms. Munich, Mr. Rodríguezmacedo himself described how he had "negotiated" Mr. Cicero's "departure." The same e-mail said Mr. Cicero had not even been confronted about the supposed undisclosed conflict involving his wife. (Mr. Cicero flatly denied that his wife had ever worked with either gestor.) The e-mail also assured Ms. Munich there was no hint of financial wrongdoing. "We see it merely as an undisclosed conflict of interest," Mr. Rodríguezmacedo wrote.

There were other discrepancies.

Mr. Rodríguezmacedo said the company had stopped using gestores after Mr. Cicero's departure. Yet even as Mr. Cicero was being debriefed in October 2005, Wal-Mart de Mexico real estate executives made a request to pay a gestor $14,000 to get a construction permit, records showed.

The persistent questions and document requests from Mr. Halter's team provoked a backlash from Wal-Mart de Mexico's executives. After a week of work, records and interviews show, Mr. Halter and other members of the team were summoned by Eduardo F. Solórzano Morales, then chief executive of Wal-Mart de Mexico.

Mr. Solórzano angrily chastised the investigators for being too secretive and accusatory. He took offense that his executives were being told at the start of interviews that they had the right not to answer questions – as if they were being read their rights.

"It was like, 'You shut up. I'm going to talk,' " a person said of Mr. Solórzano. "It was, 'This is my home, my backyard. You are out of here.' "

Mr. Lewis viewed the complaints as an effort to sidetrack his investigators. "I find this ludicrous and a copout for the larger concerns about what has been going on," he wrote.

Nevertheless, Mr. Herkert, the chief executive for Latin America, was notified about the complaints. Three days later, he and his boss, Mr. Duke, flew to Mexico City. The trip had been long-planned – Mr. Duke toured several stores – but they also reassured Wal-Mart de Mexico's unhappy executives.

They arrived just as the investigators wrapped up their work and left.

A Push to Dig Deeper

Wal-Mart's leaders had agreed to consider a full investigation if the preliminary inquiry found Mr. Cicero's allegations credible.

Back in Bentonville, Mr. Halter and Mr. Ainley wrote confidential reports to Wal-Mart's top executives in December 2005 laying out all the evidence that corroborated Mr. Cicero – the hundreds of gestor payments, the mystery codes, the rewritten audits, the evasive responses from Wal-Mart de Mexico executives, the donations for permits, the evidence gestores were still being used.

"There is reasonable suspicion," Mr. Halter concluded, "to believe that Mexican and USA laws have been violated." There was simply "no defendable explanation" for the millions of dollars in gestor payments, he wrote.

Mr. Halter submitted an "action plan" for a deeper investigation that would plumb the depths of corruption and culpability at Wal-Mart de Mexico.

Among other things, he urged "that all efforts be concentrated on the reconstruction of Cicero's computer history."

Mr. Cicero, meanwhile, was still offering help. In November, when Mr. Halter's team was in Mexico, Mr. Cicero offered his services as a paid consultant. In December, he wrote to Ms. Munich. He volunteered to share specifics on still more stores, and he promised to show her documents. "I hope you visit again," he wrote.

Mr. Halter proposed a thorough investigation of the two main gestores. He had not tried to interview them in Mexico for fear of his safety. ("I do not want to expose myself on what I consider to be an unrealistic attempt to get Mexican lawyers to admit to criminal activity," he had explained to his bosses.) Now Mr. Halter wanted Wal-Mart to hire private investigators to interview and monitor both gestores.

He also envisioned a round of adversarial interviews with Wal-Mart de Mexico's senior executives. He and his investigators argued that it was time to take the politically sensitive step of questioning Mr. Castro-Wright about his role in the gestor payments.

By January 2006, the case had reached a critical juncture. Wal-Mart's leaders were again weighing whether to approve a full investigation that would inevitably focus on a star executive already being publicly discussed as a potential successor to Mr. Scott.

Wal-Mart's ethics policy offered clear direction. "Never cover up or ignore an ethics problem," the policy states. And some who were involved in the investigation argued that it was time to take a stand against signs of rising corruption in Wal-Mart's global operations. Each year the company received hundreds of internal reports of bribery and fraud, records showed. In Asia alone, there had been 90 reports of bribery just in the previous 18 months.

The situation was bad enough that Wal-Mart's top procurement executives were summoned to Bentonville that winter for a dressing down. Mr. Menzer, Wal-Mart's vice chairman, warned them that corruption was creating an unacceptable risk, particularly given the government's stepped-up enforcement of the Foreign Corrupt Practices Act. "Times have changed," he said.

As if to underscore the problem, Wal-Mart's leaders were confronted with new corruption allegations at Wal-Mart de Mexico even as they pondered Mr. Halter's action plan. In January, Mr. Scott, Mr. Duke and Wal-Mart's chairman, S. Robson Walton, received an anonymous e-mail saying Wal-Mart de Mexico's top real estate executives were receiving kickbacks from construction companies. "Please you must do something," the e-mail implored.

Yet at the same time, records and interviews show, there were misgivings about the budding reach and power of Corporate Investigations.

In less than a year, Mr. Lewis's beefed-up team had doubled its caseload, to roughly 400 cases a year.

Some executives grumbled that Mr. Lewis acted as if he still worked for the F.B.I., where he had once supervised major investigations. They accused him and his investigators of being overbearing, disruptive and naïve about the moral ambiguities of doing business abroad. They argued that Corporate Investigations should focus more on quietly "neutralizing" problems than on turning corrupt employees over to law enforcement.

Wal-Mart's leaders had just witnessed the downside of that approach: in early 2005, the company went to the F.B.I. with evidence that the disgraced former vice chairman, Mr. Coughlin, had embezzled hundreds of thousands of dollars. The decision produced months of embarrassing publicity, especially when Mr. Coughlin claimed he had used the money to pay off union spies for Wal-Mart.

Meanwhile, Wal-Mart de Mexico executives were continuing to complain to Bentonville about the investigation. The protests "just never let up," a person involved in the case said.

Another person familiar with the thinking of those overseeing the investigation said Wal-Mart would have reacted "like a chicken on a June bug" had the allegations concerned the United States. But some executives saw Mexico as a country where bribery was embedded in the business culture. It simply did not merit the same response.

"It's a Mexican issue; it's better to let it be a Mexican response," the person said, describing the thinking of Wal-Mart executives.

In the midst of this debate, Ms. Munich submitted her resignation, effective Feb. 1, 2006. In one of her final acts, she drafted a memo that argued for expanding the Mexico investigation and giving equal respect to Mexican and United States laws.

"The bribery of government officials," she noted dryly, "is a criminal offense in Mexico."

She also warned against allowing implicated executives to interfere with the investigation. Wal-Mart de Mexico's executives had already tried to insert themselves in the case. Just before Christmas, records show, Mr. Solórzano, the Wal-Mart de Mexico chief executive, held a video conference with Mr. Mars, Mr. Senser and Mr. Stucky to discuss his team's "hypothesis" that Mr. Cicero had stolen gestor payments.

"Given the serious nature of the allegations, and the need to preserve the integrity of the investigation," Ms. Munich wrote, "it would seem more prudent to develop a follow-up plan of action, independent of Walmex management participation."

The Chief Weighs In

Mr. Scott called a meeting for Feb. 3, 2006, to discuss revamping Wal-Mart's internal investigations and to resolve the question of what to do about Mr. Cicero's allegations.

In the days before the meeting, records show, Mr. Senser ordered his staff to compile data showing the effectiveness of Corporate Investigations. He assembled statistics showing that the unit had referred relatively few cases to law enforcement agencies. He circulated copies of an e-mail in which Mr. Rodríguezmacedo said he had been treated "very respectfully and cordially" by Mr. Senser's investigators.

Along with Mr. Scott, the meeting included Mr. Hyde, Mr. Mars and Mr. Stucky, records show. The meeting brought the grievances against Corporate Investigations into the open. Mr. Senser described the complaints in Mr. Lewis's performance evaluation, completed shortly after the meeting. Wal-Mart's leaders viewed Mr. Lewis's investigators as "overly aggressive," he wrote. They did not care for Mr. Lewis's "law enforcement approach," and the fact that Mr. Scott convened a meeting to express these concerns only underscored "the importance placed on these topics by senior executives."

By meeting's end, Mr. Senser had been ordered to work with Mr. Mars and others to develop a "modified protocol" for internal investigations.

Mr. Scott said he wanted it done fast, and within 24 hours Mr. Senser produced a new protocol, a highly bureaucratic process that gave senior Wal-Mart executives – including executives at the business units being investigated – more control over internal investigations. The policy included multiple "case reviews." It also required senior executives to conduct a "cost-benefit analysis" before signing off on a full-blown investigation.

Under the new protocol, Mr. Lewis and his team would only investigate "significant" allegations, like those involving potential crimes or top executives.

Lesser allegations would be left to the affected business unit to investigate.

"This captures it, I think," Mr. Hyde wrote when Mr. Senser sent him the new protocol.

Four days after Mr. Scott's meeting, with the new protocol drafted, Wal-Mart's leaders began to transfer control of the bribery investigation to one of its earliest targets, Mr. Rodríguezmacedo.

Mr. Mars first sent Mr. Halter's report to Mr. Rodríguezmacedo. Then he arranged to ship Mr. Halter's investigative files to him as well. In an e-mail, he sought Mr. Senser's advice on how to send the files in "a secure manner."

Mr. Senser recommended FedEx. "There is very good control on those shipments, and while governments do compromise them if they are looking for something in particular, there is no reason for them to think that this shipment is out of the ordinary," he wrote.

"The key," he added, "is being careful about how you communicate the details of the shipment to José Luis." He advised Mr. Mars to use encrypted e-mail.

Wal-Mart's spokesman, Mr. Tovar, said the company could not discuss Mr. Scott's meeting or the decision to transfer the case to Mr. Rodríguezmacedo. "At this point," he said, "we don't have a full explanation of what happened. Unfortunately, we realize that until the investigation is concluded, there will be some unanswered questions."

Wal-Mart's leaders, however, had clear guidance about the propriety of letting a target of an investigation run it.

On the same day Mr. Senser was putting the finishing touches on the new investigations protocol, Wal-Mart's ethics office sent him a booklet of "best practices" for internal investigations. It had been put together by lawyers and executives who supervised investigations at Fortune 500 companies.

"Investigations should be conducted by individuals who do not have any vested interest in the potential outcomes of the investigation," it said.

The transfer appeared to violate even the "modified protocol" for investigations. Under the new protocol, Corporate Investigations was still supposed to handle "significant" allegations – including those involving potential crimes and senior executives. When Mr. Senser asked his deputies to list all investigations that met this threshold, they came up with 31 cases.

At the top of the list: Mexico.

After the meeting with Mr. Scott, Mr. Senser had told Mr. Lewis in his performance evaluation that his "highest priority" should be to eliminate "the perceptions that investigators are being too aggressive." He wanted Mr. Lewis to "earn the trust of" his "clients" – Wal-Mart's leaders. He wanted him to head off "adversarial interactions."

Mr. Senser now applied the same advice to himself.

Even as Mr. Halter's files were being shipped to Mr. Rodríguezmacedo, Mr. Stucky made plans to fly to Mexico with other executives involved in the bribery investigation. The trip, he wrote, was "for the purpose of re-establishing activities related to the certain compliance matters we've been discussing." Mr. Stucky invited Mr. Senser along.

"It is better if we do not make this trip to Mexico City," Mr. Senser replied. His investigators, he wrote, would simply be "a resource" if needed.

Ten days after Mr. Stucky flew to Mexico, an article about Wal-Mart appeared in *The Times*. It focused on "the increasingly important role of one man: Eduardo Castro-Wright." The article said Mr. Castro-Wright was a "popular figure" inside Wal-Mart because he made Wal-Mart de Mexico one of the company's "most profitable units."

Wall Street analysts, it said, viewed him as a "very strong candidate" to succeed Mr. Scott.

Case Closed

For those who had investigated Mr. Cicero's allegations, the preliminary inquiry had been just that – preliminary. In memos and meetings, they had argued that their findings clearly justified a full-blown investigation. Mr. Castro-Wright's precise role had yet to be determined. Mr. Halter had never been permitted to question him, nor had Mr. Castro-Wright's computer files been examined, records and interviews show.

At the very least, a complete investigation would take months.

Mr. Rodríguezmacedo, the man now in charge, saw it differently. He wrapped up the case in a few weeks, with little additional investigation.

"There is no evidence or clear indication," his report concluded, "of bribes paid to Mexican government authorities with the purpose of wrongfully securing any licenses or permits."

That conclusion, his report explained, was largely based on the denials of his fellow executives. Not one "mentioned having ordered or given bribes to government authorities," he wrote.

His report, six pages long, neglected to note that he had been implicated in the same criminal conduct.

That was not the only omission. While his report conceded that Wal-Mart de Mexico executives had authorized years of payments to gestores, it never explained what these executives expected the gestores to do with the millions of dollars they received to "facilitate" permits.

He was also silent on the evidence that Wal-Mart de Mexico had doled out donations to get permits. Nor did he address evidence that he and other executives had suppressed or rewritten audits that would have alerted Bentonville to improper payments.

Instead, the bulk of Mr. Rodríguezmacedo's report attacked the integrity of his accuser.

Mr. Cicero, he wrote, made Wal-Mart de Mexico's executives think they would "run the risk of having permits denied if the gestores were not used." But this was merely a ruse: In all likelihood, he argued, Wal-Mart de Mexico paid millions for "services never rendered." The gestores simply pocketed the money, he suggested, and Mr. Cicero "may have benefited," too.

But he offered no direct proof. Indeed, as his report made clear, it was less an allegation than a hypothesis built on two highly circumstantial pillars.

First, he said he had consulted with Jesús Zamora-Pierce, a "prestigious independent counsel" who had written books on fraud. Mr. Zamora, he wrote, "feels the conduct displayed by Sergio Cicero is typical of someone engaging in fraud. It is not uncommon in Mexico for lawyers to recommend the use of gestores to facilitate permit obtainment, when in reality it is nothing more than a means of engaging in fraud."

Second, he said he had done a statistical analysis that found Wal-Mart de Mexico won permits even faster after Mr. Cicero left. The validity of his analysis was impossible to assess; he did not include his statistics in the report.

In building a case against Mr. Cicero, Mr. Rodríguezmacedo's report included several false statements. He described Mr. Cicero's "dismissal" when records showed he had resigned. He also wrote that Kroll's investigation of Mr. Cicero concluded that he "had a considerable increase in his standard of living during the time in which payments were made to the gestores." Kroll's report made no such assertion, people involved in the investigation said.

His report promised a series of corrective steps aimed at putting the entire matter to rest. Wal-Mart de Mexico would no longer use gestores. There would be a renewed commitment to Wal-Mart's anticorruption policy. He did not recommend any disciplinary action against his colleagues.

There was, however, one person he hoped to punish. Wal-Mart de Mexico, he wrote, would scour Mr. Cicero's records and determine "if any legal action may be taken against him."

Mr. Rodríguezmacedo submitted a draft of his report to Bentonville. In an e-mail, Mr. Lewis told his superiors that he found the report "lacking." It was not clear what evidence supported the report's conclusions, he wrote. "More importantly," he wrote, "if one agrees that Sergio defrauded the company and I am one of them, the question becomes, how was he able to get away with almost $10 million and why was nothing done after it was discovered?"

Mr. Rodríguezmacedo responded by adding a paragraph to the end of his report: They had decided not to pursue "criminal actions" against Mr. Cicero because "we did not have strong case."

"At the risk of being cynical," Mr. Lewis wrote in response, "that report is exactly the same as the previous which I indicated was truly lacking."

But it was enough for Wal-Mart. Mr. Rodríguezmacedo was told by executives in Bentonville on May 10, 2006, to put his report "into final form, thus concluding this investigation."

No one told Mr. Cicero. All he knew was that after months of e-mails, phone calls and meetings, Wal-Mart's interest seemed to suddenly fade. His phone calls and e-mails went unanswered.

"I thought nobody cares about this," he said. "So I left it behind."

Note

Alejandra Xanic von Bertrab and James C. McKinley Jr. contributed reporting from Mexico City.

Yahoo! and Google in China

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In line with the UN Declaration's call for "every organ of society" to respect and secure [human] rights, how should international business define and respond to human rights obligations? Perhaps surprisingly, corporations increasingly acknowledge a relationship to human rights issues. The most obvious connections arise from direct economic activities, although resultant impacts occur, both directly and indirectly, on other types of human rights as well.[1]

Historically, international corporations rejected responsibility for civil and political (CP) human rights, usually asserting a stance of political neutrality in the domestic affairs of host nations. This posture initially accorded with the preferences of national governments that demanded foreign corporations not interfere in a nation's internal political affairs. By contrast, business could hardly deny a relationship to economic goals and, consequently, some role in influencing the potential attainment of ESC rights. The central assertion of capitalist market philosophy holds that private corporations, pursuing their self-interest, will (through the guidance of Adam Smith's invisible hand) achieve the greatest economic good for the greatest number of people. Of course, this utilitarian belief does not address distributional consequences for minorities, or in general whose individual rights may be serviced for the benefit of the majority. Still, corporations could claim that their activities generate a larger economic pie and that governments bear any responsibility to redistribute resources to benefit disadvantaged individuals.

In the early 1990s, business made broader assertions, declaring that the economic growth stimulated by international commerce will produce progress on the realization of CP human rights as well. For example, a 1994 *Business Week* editorial argued that expanding foreign trade and investment promotes middle-class growth that, in turn, will lead to greater respect for individual human rights, even under oppressive political regimes.

> The idealists are right to pursue their agenda of supporting individual human rights around the world. But linking that agenda to US trade policy can and has hurt the American economy. Just as surely, rapid economic growth in the Third World is a solvent of the bonds of oppression. Building a strong middle class overseas through foreign investment and trade has led to greater individual rights in South Korea, Taiwan, and elsewhere, even in the face of authoritarian governments ruling in the name of communitarian values. The truth is that delinking trade from human rights policy is the pragmatic way to promote human rights overseas.[2]

This rationale offers a teleological argument that should be testable at some point in time. However, when should projected results be expected, and should the policy be abandoned if anticipated outcomes are not achieved? Such a policy test arose in 2000[3] when the United States established normal trade relations with China, cutting the link between periodic congressional renewal of bilateral trade policy and evaluations of human rights conditions in China. However, subsequent reviews of China's progress, including in the US State Department's annual human rights reports, often found that China's record improved little and sometimes actually worsened even as US–China trade and foreign investment ties increased dramatically.

Does such a record call into question the projected sequential impact of economic growth on respect for human rights? Should international business be held responsible for making a positive impact on respect for CP human rights, or is business responsibility met simply by avoiding any direct involvement m contributing to the violations of such rights? Some international companies specifically endorse human rights principles, such as the UN Declaration, employing various formulations to express the nature of their perceived responsibilities to respect, support and/or promote such standards.[4]

John M. Kline, "Yahoo! and Google in China." Excerpted from *Ethics for International Business: Decision Making in a Political Economy,* 2nd edn (New York: Routledge, 2010), pp. 38–46. Reprinted with permission of Taylor & Francis Books UK.

The phenomenal growth of internet usage in China brought new "best choice" dilemmas for international companies regarding how to respect and promote core human rights values. As a transformational technology, the internet has unparalleled ability to collect and distribute information as well as connect users across the world. Based on principles of freedom and openness, the internet can serve as an instrument of reform and promotion of human rights, even assisting democratic activists to popularize their struggles and recruit supporters. However, national governments are developing sophisticated control mechanisms for restricting internet access to sensitive information and penalizing violators. China is notorious for stringent censorship practices, but other countries such as India, Vietnam, and the United States all impose limitations on the privacy and expression of internet users.

The task facing MNEs in the internet and communication technology (ICT) industry is how to expand business and respect local legal requirements that may entail restrictive censorship, while still honoring obligations to internet users to support freedom of information, expression and the protection of personal privacy. Governments can establish censorship regulations that restrict access to information, whether the subject is pornography or political opinion. National standards vary widely depending on both sociocultural norms and a country's degree of political freedom. Privacy values are at stake when government officials ask ICT enterprises to turn over identifying information on customers. The officials may allege potential legal violations without divulging what offense or law is involved.

These issues gained prominence in 2004 when Shi Tao, a Chinese news reporter, used his private Yahoo! e-mail account to distribute a purportedly secret document urging media to refrain from reporting on an anniversary of the Tiananmen Square massacre. Yahoo! was among the first internet MNEs to establish offices in China in line with improved US–China trade relations. The company followed China's internet regulation policies without fully anticipating the challenges that emerged.In this instance, Chinese police demanded that Yahoo! release private information on a particular e-mail user, alleging he had violated Chinese law. Lacking formal guidelines for disclosing such information, Yahoo! complied with the request. The police used information provided by Yahoo! to trace the e-mail user and arrest Shi Tao, who was eventually convicted and sentenced to 10 years in prison.[5]

The incident sparked international controversy. In 2006 congressional hearings, Yahoo!'s chief executive maintained that the company was obligated to follow the laws of countries in which it operates and under Chinese law was bound to comply with the police request.[6] US lawmakers and human rights organizations asserted that Yahoo! had pursued a politically expedient option abdicating its responsibility to protect the welfare of its users and protest an unjust Chinese policy. Yahoo! later reached out-of-court settlements in US lawsuits filed on behalf of Shi Tao and another activist.[7] Yahoo! also sold its Chinese operations to Alibaba, a local firm that follows Chinese policies, but Yahoo! retained a minority investment in the operation. Should Yahoo! have refused the police demand for information or taken other actions to resist? Does Yahoo! still carry an ethical responsibility for Alibaba's censorship policy and privacy actions, or does the transfer of management control remove Yahoo! from a subsidiarity chain of responsibility?

On censorship, the Chinese government did not provide internet firms operating from China with "black lists" of impermissible words. Instead, the Chinese government required firms to withhold search results or eliminate blog posts that discuss content that " 'damages the honor or interests of the state' or 'disturbs the public order or destroys public stability' or even 'infringes upon national customs and habits.' "[8] Firms must largely interpret these vague prohibitions for themselves. Fearing severe and arbitrary penalties for lax censorship, many firms vigorously censor content while others claim to provide greater openness. Does self-regulation as opposed to adhering to specific restrictions dictated by a government alter the nature of a firm's ethical obligations?

Yahoo! was not the only foreign-owned MNE that encountered difficulty in China. Operating from its California headquarters, Google had captured about one-quarter of Chinese internet search traffic. Since Google staffed no offices in China, the government could not legally require that Google voluntarily censor its search content. However, the Chinese government used the so-called Great Firewall to block many topics for searches from people inside China using google.com, and even temporarily shut down all access to the Google site in September, 2002. The Great Firewall was not wholly effective in blocking sensitive content, but the filtering action significantly slowed search traffic and when Chinese users searched impermissible content, the Firewall could prevent reloading the search engine, creating an impression the Google site had shut down. The slowdowns and shutdowns drove consumers to local competitor Baidu, which efficiently processes content inside China, producing (self-censored) search results more quickly and reliably.[9]

Google's eroding Chinese market share posed a difficult ethical dilemma. The company could continue to operate outside of China, safe from Chinese government demands for self-censorship and user information, but face the prospect of losing more users to Baidu (in which Google also had an investment stake it later sold). Conversely, Google could place its servers within Chinese territory and again yield hits in milliseconds, but confront political and legal pressures to comply with Chinese censorship and information demands. Exhibit 1 discusses Google's response – an announcement in 2006 that it would offer a limited version of its popular search engine to Chinese users.

To avoid being forced to release private information, the dilemma encountered by Yahoo! a few years earlier, Google decided not to offer popular e-mail and blogging services. Blogging attracts 70 million users in China, representing a higher proportion of internet users than in the United States.[10] By forgoing such services, Google offers a less competitive product that reduces its profits. In terms of its search engine, Google announced it would comply with China's self-censorship laws but would seek minimal limitations. Has Google struck an ethical "balance" in terms of its ethical obligations?

When criticized for the decision to launch Google.cn, Google's chief executive responded: "I think it's arrogant for us to walk into a country where we are just beginning operations and tell that country how to run itself."[11] Are appeals to political or cultural relativism valid? Or is such a position "hypocrisy" as Reporters Without Borders might charge? From a deontological perspective, should a company, at a minimum, publically protest Chinese actions as a violation of international human rights, or even refuse to operate under conditions that do not protect freedom of information and personal privacy? From a teleological viewpoint, could foreign company compliance with Chinese restrictions be justified by claims that, over time, increased internet usage will result in changes that improve human rights in China? How should such progress be measured, and when?[12]

In 2009 the Chinese government presented ICT MNEs with another challenge, announcing that by 1 July, all personal computers sold in China must be shipped with a local company's software called Green Dam-Youth Escort. Reportedly aimed mainly at blocking access to pornography, the software would link each computer to a central list of blocked sites, allowing periodic updates. Critics pointed out that the list could be used to block any type of content, might permit the collection of personal data and could expose the computer to cyber attacks or interfere with other software programs. This time, computer hardware manufacturers such as Hewlett-Packard and Dell were caught between defying a Chinese government order or facing charges of aiding information censorship and jeopardizing privacy.[13]

Although Acer, Sony and Chinese-owned Lenovo reportedly agreed to comply, other individual companies commented cautiously on the difficulties of meeting the new requirement, particularly so quickly without thorough tests of the software. Industry and broader business organizations opposed the Chinese order more vocally, calling for its suspension or repeal. Government officials in the United States, the European Union and other countries also protested the Chinese order. One day before the 1 July deadline, China's Ministry of Industry and Information Technology suspended the new requirement, purportedly to provide more time for consultations to perfect the plan.[14]

The earlier ethical dilemmas encountered by ICT MNEs, coupled with public and government scrutiny of their actions, encouraged the development of a voluntary industry code to protect the freedom of expression and privacy of ICT users. Yahoo!, Google and Microsoft, in consultation with groups such as Human Rights First and the Committee to Protect Journalists, engaged in a nearly two-year effort to draft a set of guidelines that could be applied in all

Exhibit 1 Google and Internet rights in China.

Version of Google in China Won't Offer E-mail or Blogs

By David Barboza

SHANGHAI, Jan. 24 – Google is bringing a special version of its powerful search engine to China, leaving behind two of its most popular features in the United States.

In an effort to cope with China's increasingly pervasive Internet controls, Google said on Tuesday that it would introduce a search engine here this week that excludes e-mail messaging and the ability to create blogs.

Google officials said the new search engine. Google.cn, was created partly as a way to avoid potential legal conflicts with the Chinese government, which has become much more sophisticated at policing and monitoring material appearing on the Internet.

Web sites have exploded in popularity in a country eager for freer flow of information. But Web portals and search engines trying to win Chinese users face a significant balancing act they do not want to flout government rules and guidelines that restrict the spread of sensitive contant, but they want to attract users with interesting content.

One result has been that search engines and Web portals have censored their sites and cooperated with Chinese authorities. Indeed, the move to create a new site comes after Google itself, as well as Yahoo and Microsoft, have come under scrutiny over the last few years for cooperating with the Chinese government to censor or block online content.

Currently, people in China use Google by accessing its global engine, Google.com. But industry experts say that the site is often not accessible from inside China, possibly because it is blocked by Chinese authorities culling what is deemed to be sensitive or illegal information.

Google's new Chinese platform, which will not allow users to create personal links with Google e-mail or blog sites, will comply with Chinese law and censor information deemed inappropriate or illegal by the Chinese authorities. This approach might help the company navigate the legal thickets that competitors have encountered in China.

Foreign companies say they must abide by Chinese laws and pass personal information about users on to the Chinese government. In one case two years ago. Yahoo provided information that helped the government convict a Chinese journalist, who was sentenced to 10 years in prison, on charges of leaking state secrets to a foreign Website.

Another challenge, though, is trying to attract Chinese users to a censored engine. Google officials conceded that the company was struggling to balance the need to bolster its presence in the China market with the increasingly stringent regulations that govern Internet use here.

"Google is mindful that governments around the world impose restriction on access to information," a senior executive wrote, responding to questions. "In order to operate from China, we have removed content from the search results available on Google.cn, in response to local law regulation or policy. While removing search results is inconsistent with Google's mission, providing no information (or a heavily degraded user experience that amounts to no information) is more inconsistent with our mission."

The Chinese government has been particularly strict in recent years about filtering antigovernment news and opinion pieces from the Web and blocking Web sites or blogs that question governmental authority.

The government also has employed a variety of techniques to control what appears on the Web – temporarily blocking sites. redirecting viewers to government-controlled sites and even shutting sites, altogether. Government officials have even been able to block references to specific words, like Tibet. Falun Gong and Tiananmen Square.

A year ago, when Google first stared a Chinese language version of its global service, the company filtered out and omitted some news sources that were already being blocked in China. The company said at the time: "There is nothing Google can do about it."

Now, Google officials say they hope they have struck the right compromise. The new site will improve access and speed up regular search engine service in a country where Internet traffic is skyrocketing.even if that service is limited in scope, the company said.

China has more than 100 million Internet users, making it second only to the United States in Web surfers; and blogging, podcasting, playing online games and surfing the Web are wildly popular.

Google says it plans to disclose when information has been blocked or censored from its new site, just as it does in the United States, Germany and other countries.

The regular Google.com site, based outside China, will continue to be available for access from China.

Difficulties using the site have put Google at a disadvantage in China.

Difficulties using the site have put Google at a disadvantage in China, where the Google.com site had lost ground to a Chinese rival, Baidu.com, which went public last year.

Baidu is called the Chinese Google, and Google even has a stake in the company. But officials at Google say that recently they have been losing share in China, partly because of difficulty people had using Google.com.

The Paris-based group Reporters without Borders, which tracks the activities of Western technology companie seeking to do business with repressive regimes, condemned the Google-China deal as "hypocrisy" and called it "a black day for freedom of expression in China" in a statement published on its Web site. "The firm defends the rights of U.S. Internet users" the statement added, "but fails to defend its Chinese users against theirs."

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countries. When announced in October 2008, the Global Network Initiative laid out "a common set of principles for how to do business in nations that restrict free speech and expression." The document acknowledges that companies must obey local laws but pledges to protect personal user information and "narrowly interpret and implement government demands that compromise privacy" while evaluating a country's record on freedom of expression and privacy before launching new business operations.[15]

Proponents endorsed the initiative as meaningful progress in the development of global ICT business practices. Some critics found the Initiative's principles too general and faulted its implementation procedures. Early corporate support for the Initiative was limited, principally to the companies whose dealings with China have been most sharply criticized.[16] As the industry matures and companies look for a decision-marking framework to address new ethical challenges, such voluntary codes may gain greater support.

Arguments for business responsibilities on human right issues can draw on citizenship notions, particularly for those firms that participate and benefit extensively from the global political economy. When a private business enterprise is granted rights as a legal "person," that corporation owes citizenship duties to the nation within which it operates. However, most MNEs hold simultaneous citizenship in literally scores of nations, creating the potential for a clash of loyalties should the interests of its various host nations conflict. Although the concept of global citizenship does not yet correspond to a sanctioned political authority, a growing number of corporations promote increased international integration among national economic and political systems, and pursue global business strategies that supersede the interests of individual nation states. As principal beneficiaries of globalization, these enterprises owe some type of corporate citizenship responsibilities to the global society they serve, even if that society still lacks a correspondingly organized polity.

Human rights concepts and principles can provide emergent guidelines for international corporate citizenship where diverse and sometimes conflicting national legal standards offer insufficient direction for ethical decision making in a global political economy. Nation states are struggling to negotiate a legal framework to manage the impacts of globalization, clearly recognizing the need for agreed standards to govern the rapidly growing range ot political, economic and social interactions.[17] While the drive to devise an international legal framework merits attention and effort, legal standards must be based upon a sufficient societal consensus on underlying values and norms. Comparatively less attention has been paid to the type of ethical analysis that can help identify, clarify and communicate these norms for an emergent global society. The deontological standards suggested by human rights principles may provide a starting point for this analysis as well as a background context for the following chapters that examine topical sets of global ethical dilemmas in an attempt to determine Who should do What, When, Where and, especially, Why?

Notes

[1] See the graphic representation of how international corporation impact human rights contained in exhibit 5.2 in Gladwin and Water, *Multinationals Under Fire*, pp. 144–5.

[2] "To Spur Human Rights, Spur Trade," *Business Week*, editorial, 7 March 1994, p. 138.

[3] M. Vita, "China "Trade Bill Clears Hurdle in Senate," The *Washington Post*, 14 September 2000, p. A2.

[4] J. Kline, "Political Activities by Transnational Corporations: Bright Lines Versus Gray Boundaries," *Transnational Corporations*, vol 12, no. 1, April 2003, pp. 1–25.

[5] P. Goodman. "Yahoo Says it Gave China Internet Data," *The Washington Post* 11 September 2005, p.A30; P. Pan, "U.S. Firms Balance Morality, Commerce," *The Washington Post*, 19 February 2006, p. A17.

[6] D. Milbank, "Searching for an Explanation: No Results Found." *The Washington Post,* 7 November 2007, P.A2.

[7] C. Rampell, "Yahoo Settles with Chinese Families." *The Wall Street Journal*, 14 November 2007, p. D4.

[8] C. Thompson, "Google's China Problem (and China's Google Problem)." *New York Times Magazine*, 23 April 2006, p.64.

9 Ibid.

10 A. Jacobs, "Chinese Learn Limits of Online Freedom as the Filter Tightens," *The New York Times International*, 5 February 2009, p. A8.

11 J. Yardley, "Google Chief Rejects Putting Pressure on China," *The New York Times,* 13 April 2006, p. 7.

12 In January, 2010 Google announced its intention to stop censoring its Chinese search engine, even if it meant leaving China. Although the company had clashed periodically with the government over censorship issues, the immediate impetus for this decision was a cyber attack Google discovered, alleged to originate in China, against several U.S. sites, including attempts to hack into the e-mail accounts of Chinese human rights activists. The controversy will likely spark a new round of developments on this issue. See J. Vascellaro, J. Dean and S. Gorman, "Google Warns of China Exit Over Hacking," *The Wall Street Journal*, 13 January 2010, p.1.

13 L. Chao, "China Squeezes PC Makers," *The Wall Street Journal*, 8 June 2009, p.A1.

14 E. Wong and A. Vance, "China Intent on Requiring Internet Censor Software," *The New York Times*, 19 June 2009, p. A8; L. Chao and J. Dean, "Chinese Delay Plan for Censor Software," *The Wall Street Journal*, 1 July 2009, p.1; M. Wines, " After Outcry, China Delays Requirements for Web-Filtering Software," *The New York Times*, 1 July 2009, p. A6.

15 J. Vascellaro, "Google, Yahoo, Microsoft Set Common Voice Abroad," *The Wall Street Journal*, 28 October 2008, p. B7. For more information on the Global Network Initiative, see the website at http://www.globalnetworkinitiative.org.

16 M. Helft and J. Markoff. "Big Tech Companies Back Global Plan to Shield Online Speech," *The New York Times*, 28 October 2008, p. B8.

17 For an analysis of the legal context for this debate, including the "Draft Norms on the Responsibilities of Transnational Corporation and Other Business Enterprises with Regard to Human Rights" discussed within the UN Commission on Human Rights, see P. Muchlinski, "The Development of Human Rights Responsibilities for Multinational Enterprises," in R. Sullivan (ed.), *Business and Human Rights*, Sheffield: Greenleaf, 2003, pp. 33–51.

Google Softens Tone on China

Amir Efrati and Loretta Chao

Google Inc., which pulled its Web-search engine out of mainland China two years ago after a confrontation with Chinese authorities over censorship, has renewed its push to expand there, in an acknowledgment that it can't afford to miss out on the world's biggest Internet market.

The search giant is hiring more engineers, salespeople and product managers in China and working to introduce new services for Chinese consumers, according to Daniel Alegre, Google's top executive in Asia.

Amir Efrati and Loretta Chao, "Google Softens Tone on China," *The Wall Street Journal*, January 12, 2012. Reprinted with permission.

In particular, Google is aiming to capitalize on its fast-growing Android operating system for mobile devices, online-advertising and product-search services to grow in China, Mr. Alegre said in an interview.

One goal, he said, is to introduce its Android Market, which offers thousands of mobile applications to users of Android-powered smartphones and tablets but isn't available in China.

The company also is trying to win over Chinese consumers with services that don't require official censorship, such as Shihui, which launched in September to help people search among Chinese sites offering discounts at local stores. Google is also working to beef up its product-search service to help consumers find goods from online retailers.

Chinese officials didn't respond to a request for comment.

Google is revving up its new push near the two-year anniversary of its declaration that it would stop censoring its Internet-search results in China, as required by local law, and that it was prepared to leave the country altogether.

The Jan. 12, 2010, announcement represented a stark departure from the policy of compromising with

Chinese authorities that Google and other Western technology companies had long followed. And it was perceived by many Chinese as marking Google's total withdrawal from the country.

The censorship fracas began after Google disclosed it had traced a 2009 cyberattack back to Chinese hackers, who allegedly stole some of the company's proprietary computer code and attempted to spy on Chinese activists' Gmail accounts. Chinese officials denied any connection to the incident.

Google subsequently stopped offering Web search on its main Chinese site, Google.cn, and instead directed people to a search site based in Hong Kong, which isn't subject to the same government censorship requirements.

But for users in mainland China, the Hong Kong search site, along with other Google services such as Gmail, are plagued with frequent service disruptions because of the government's Web-filtering system.

Company co-founder Sergey Brin said at the time of the clash that he pushed for the company to take an anti-censorship stance. He prevailed over then-Chief Executive Eric Schmidt and others, who initially felt Google should stay the course in China, people familiar with those discussions have said.

In an interview with *The Wall Street Journal* back then, Mr. Brin said China's efforts to censor the Web and suppress dissidents reminded him of the "totalitarianism" of the Soviet Union, where he was born. "In some aspects of their policy, particularly with respect to censorship," he added, "I see the same earmarks of totalitarianism, and I find that personally quite troubling."

While Google, which opened its first China office in 2005, shut down many functions there following its decision to stop censoring search results, it says it never abandoned the country. It still has more than 500 employees there, including more than 300 engineers. That's down from about 700 employees in 2009, according to a former Google executive in China.

Now, with Android's growth in China and with more Chinese companies looking to advertise online, Google's decision to reverse course and invest more in China is a "pragmatic" one, said Mr. Alegre.

For Mr. Brin and fellow co-founder and current CEO Larry Page, "there is a very large business opportunity in China, and they recognize it," he said.

Overall, China had more than 500 million Internet users as of September, up from 485 million three months earlier, according to government statistics. By contrast, the U.S. had 220 million Internet users in November, up from 212 million a year earlier, according to research firm comScore Inc.

Google's move comes at a pivotal time for China's Internet industry. Despite the prevalence of government censorship, the Web is increasingly an outlet for Chinese citizens to share information and express discontent, including about the government, amid heightened tensions ahead of the country's once-a-decade leadership transition this year.

Twitter-like microblogging services such as Sina Corp.'s Weibo have become popular platforms for sharing opinions and information about controversial topics, even as Google has sat on the sidelines.

China currently accounts for no more than 2% of Google's total revenue, which is expected to reach more than $40 billion for 2011, according to a Citigroup Inc. analysis.

Google's share of China's Web-search market fell to 17.2% in the third quarter of 2011 from 36% in the fourth quarter of 2009, largely to the benefit of rival Baidu Inc., according to Analysys International, a Beijing-based research firm.

Still, the number of Google Web searches by mainland-Chinese Internet users has risen over the past two years, said Mr. Alegre, who is based in Tokyo and often visits Beijing and Shanghai. Such a gain would theoretically help boost Google's search-ad business, though a company spokesman declined to comment on the matter.

Separately, the company has seen growth in its services that help Chinese advertisers target Internet users – both inside and outside of China – on thousands of non-Google websites and mobile apps.

Overall, Google's revenue in China rose in the last year, compared with 2010, Mr. Alegre said, though he declined to go into specifics. "If you look at what has transpired, we're actually very happy with the way our business is progressing" in China, he said.

Google's share of the Chinese online-ad market stabilized at around 7% during the first half of 2011, according to Analysys, down from 10.9% in the second quarter of 2010.

"People tend to think Google quit China, but China didn't quit Google," said Duncan Clark, chairman of consulting firm BDA China Ltd, referring to Google's advertising services for Chinese companies who want to reach people around the globe.

He added that some Chinese Web users "still put up with the frustration of using Google," including Google Maps and Gmail, despite the disruptions.

If it completes its $12.5 billion acquisition of Motorola Mobility Holdings Inc., as expected, Google will own one of China's largest sellers of mobile devices.

Google also wants to make money from Android, which powers nearly 60% of smartphones in China, according to Analysys. The phones there don't come with official Google services like the company's search engine or the Android Market app store. Mr. Alegre said Google continues to discuss carrying Android Market "with various players in the market" – likely Chinese wireless providers – but that he had nothing to announce.

Introducing Android Market could pose some censorship issues for Google. Non-Google app stores that currently run on China-based Android devices filter out apps that violate Chinese regulations.

Google's relations with some arms of the Chinese government have remained rocky. In effect, it pointed the finger at the government in June 2011, when it announced that China-based parties had been trying to gain access to the Gmail accounts of senior U.S. officials, human-rights activists and others.

Such allegations are "unacceptable," a Chinese Foreign Ministry spokesman said at the time. Several months later, however, China renewed Google's license to operate a website in the country. China has accused Google and the U.S. of using Internet freedom issues to meddle in its internal affairs.

A person familiar with the matter has said Google's systems have been repeatedly targeted by China-based hackers since the successful attack in 2009, though this doesn't necessarily imply government involvement, experts say. Mr. Alegre declined to comment.

Many former Google China employees lament Google's diminished status in the country. "What we hoped to accomplish with Google China is now being realized by Weibo," proving that "engagement is the right approach," said former Google China chief Kai-Fu Lee, who left the company in 2009.

Note

Kersten Zhang contributed to this article.

Part 5

Challenges and Emerging Issues

Introduction

In Part 5 we conclude the text with a discussion on the challenges and future of business ethics.

In earlier parts of the text we explored some of the most important dilemmas faced by American business today. In the final chapter we reflect on some of the issues raised, and look toward to the future of the American corporation. In particular, we wish to ask how the business organization of the future will meet the ethical challenges posed to it by society. Its ability to meet these challenges could prove crucial for business's very survival.

Observers of business sometimes speak as if business had no normative role to play in society, but this view is misleading. The legitimacy of business – the public's acceptance of its right to exist and its belief in the "rightness" of business as an institution – has always rested on business's connection with the highest social values and on its perceived contribution to what we view as the good life or the good society. While business has been essentially a profit-making institution, society has encouraged business to strive for profits in the belief that its doing so would promote the general welfare. Maximizing profits, then, has been the way in which business has discharged its social responsibilities. The "invisible hand" of the market system, it has been assumed, would function automatically to harmonize self-interest and bring about the good of society as a whole. And indeed business has made enormous contributions to American society. It has supported fundamental social values such as freedom of opportunity, productivity, growth, efficiency, and material well-being. It has encouraged enterprise and creativity. No society has a higher standard of living or such an abundance of goods and services.

The legitimacy of business still rests on public confidence in its contribution to a good society. In the past two decades, however, this confidence has eroded, and our conception of a good society has undergone some transformation. Observers of the American scene have concluded that business could be facing a genuine crisis in legitimacy.

Increasingly, people are challenging the belief that economic well-being is identical with social well-being, or that the former leads automatically to the latter. On the contrary, many now feel that some of the same values which contributed to our economic success – growth, productivity, consumption, the profit motive – have led to unacceptably high social costs, such as environmental damage. Many Americans have lost confidence in the ability of the market system automatically to bring about the general welfare. Rather than encouraging business in the single-minded pursuit of profit and waiting for social well-being to follow, the public is demanding that business broaden the scope of its concerns and assume

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a more active role in solving social problems and in working for a good society. The social responsibility of business today, the American public seems to be saying, no longer ends with its economic responsibility.

The view that business should assume social as well as economic responsibilities and take an active role in working toward social goals represents a challenge to the traditional understanding of the nature and functions of business. As we have worked through this text, we have seen the impact of this challenge in nearly every aspect of business activity. Traditionally, business organizations have been understood to be the private property of their shareholders. Managers were viewed as agents of the shareholders, bound by an agreement to serve their interests as the shareholders themselves would serve them – which, presumably, was to make a profit. As we have seen, however, the increasing separation of ownership and control and the decreasing confidence in the market system to contribute to public welfare have undermined the idea that management's sole responsibility is to shareholders.

Business is now expected to exercise responsibility toward a range of "stakeholders," including consumers, employees, and the public at large. For example, society now expects corporations not only to supply goods to consumers, but also to exercise care and foresight to make sure that the product is safe for consumer use. Manufacturers' liability for defective products has been extended to include even situations in which manufacturers could not have foreseen and prevented accidents. Society now demands that business avoid undue pollution and depletion of natural resources, and that it operate as far as possible in harmony with the natural environment. Business has been asked not simply to invest where it is most profitable, but to be sensitive to the social consequences of investment and to use its economic power to alleviate social injustice. It is expected not merely to provide jobs for members of the community, but also to offer a safe, healthy, and fulfilling work environment. Many thinkers have called for restrictions on the corporation's freedom to hire and fire, and on the obedience and loyalty it demands from its employees. Increasingly, business organizations are being asked to adopt hiring policies which help solve problems of racism and sexism. As the duties of business organizations are broadened to include social responsibilities, employees who resist or reveal illegal or unethical acts on the part of their employers may in fact be acting in the best interests of the corporation.

Many of the responsibilities corporations are being asked to assume are duties which, until now, have been associated with government. Traditionally, it has been government's job to promote social welfare. The job of business was to make money. Ironically, the government has also been expected to keep its interference with business at a minimum, passing only those regulations necessary to preserve freedom of competition. As public dissatisfaction with business performance has increased, however, the relationship between business and government has shifted. Business is now subject to a multiplicity of "social regulations," many of which it feels are unfair and unnecessary. The restrictions placed on business by these regulations constitute a powerful argument for complying voluntarily with society's new demands.

How is business to respond effectively to public expectations, however, when institutional attitudes and forces encourage corporate managers to place profits first? Often today's manager is rewarded with success and esteem not for cutting down on the pollution of a local river or for improving employee satisfaction, but for maximizing profits. Indeed, as we have seen in many of the cases included in the text, pressures to sacrifice ethical concerns to profits are often severe. The corporation can create a closed context in which behavior that might be condemned elsewhere is found acceptable.

Chapter 10's first two articles represent more critical reflections on the state of business ethics. In the first article, "What's the Matter with Business Ethics?", Andrew Stark suggests that despite the growth of the business ethics field in academia, it has failed to make any real difference for managers. Part of the problem lies in what Stark calls "the myopia of moral philosophy," whereby business ethics must contend with the issue of whether ethics must take priority over self-interest in order for the action to be considered ethical. The issue over motivation must be addressed. Does it matter whether the firm is acting ethically because it is the 'right' thing to do, or simply because it serves the firm's interests? Stark then discusses the three problematic tendencies of business ethics: (1) it is too general; (2) it is too theoretical; and

(3) it is too impractical. In terms of being too general, the focus for many business ethicists relates to "overhauling the capitalist system" rather than providing ethics strategies for managers who are working within the capitalist system. Business ethicists are also too theoretical. By grounding their work in abstract moral theory and by relying on the language of moral standards such as 'utilitarianism' and 'deontology' or 'Kantian ethics', their field is not sufficiently "user friendly" for managers. Finally, business ethics is also often impractical, by trying to recommend actions which counter the reality of the business world. While this criticism does not necessarily mean that business ethicists should abandon their views of right and wrong, they must at the same time, according to Stark, be more sensitive to the responsibilities of business practitioners to their principals.

In a practical way, however, corporations can take steps to encourage ethical behavior by individuals and enhance an ethical corporate culture. In the next article, "Developing and Sustaining an Ethical Corporate Culture: The Core Elements," Mark Schwartz discusses what he considers the most important steps. Schwartz argues that there are three groups of employees, the 20 percent who will always do the right thing regardless of their work environment, another 20 percent who will always act unethically when the opportunity exists, and the remaining 60 percent who can be influenced to act ethically or unethically depending on their firm's environment. It is this 60 percent, referred to as the "fence sitters," who are the most potentially influenced by an ethical corporate culture.

So what exactly can corporations do to develop and sustain an ethical corporate culture? Schwartz suggests three core elements: (1) a set of core ethical values infused throughout the organization in its policies, processes, and practices; (2) a formal ethical program, including a code of ethics, ethics training, an ethics hotline, and an ethics officer; and (3) the continuous presence of ethical leadership, i.e. an appropriate tone at the top as reflected by the board of directors, senior executives, and managers. While all three elements are distinct, they also overlap, relate to, and reinforce one another. The core universal ethical values for all business firms that Schwartz recommends include: trustworthiness; respect; responsibility; fairness; caring; and citizenship. Schwartz concludes by suggesting that while unethical behavior will never be completely eliminated by business firms, they nonetheless have an ethical obligation to make reasonable attempts to develop and sustain an ethical corporate culture in order to minimize ethical misconduct.

In the next article, "The Ethics Officer as Agent of the Board: Leveraging Ethical Governance Capability in the Post-Enron Corporation," W. Michael Hoffman and Mark Rowe focus on one particular important element in developing and sustaining an ethical corporate culture, the existence of an individual referred to as an ethics officer holding overall responsibility for the compliance and ethics program of the firm. Their primary concern over the role of ethics officer is that the ethics officer should be an agent of the board of directors. To ensure this is the case, the ethics officer would need to be appointed by the board, report directly to and be accountable to the board, and would have his or her compensation set by the board. In addition, only the board, as opposed to the CEO, should be able to fire the ethics officer. Due to the inherent conflict of interest in current ethics officer reporting structures, simply giving the ethics officer 'access' to the board is insufficient, according to Hoffman and Rowe. Unless a change is made, ethics officers will continue to be in a conflict of interest situation and have insufficient power, status, and authority over decision making. Finally, boards also need to enhance their ethical oversight capabilities in terms of being sufficiently well informed and diligent to ensure that no major scandals are brewing among the firm's senior management and within the company as a whole. Having the ethics officer as their agent would assist in this regard.

If a corporation follows the advice of Schwartz as well as Hoffman and Rowe, then it will invest a great deal of time and energy in building an ethical corporate culture. Is it possible for a company to spend too much time and effort on ethics? Can the effort to be ethical have bad consequences? This is one of the questions Andrew Singer investigates in his article "Can a Company be Too Ethical?" Singer notes that there is a narrower and broader sense of "ethics" as it applies to corporations. The narrower sense covers issues such as bribe taking, theft, and sexual harassment – all of which are clearly prohibited by most people's idea of ethics. In a broader sense, ethics includes issues such as affirmative action, empowering workers, and hiring the hardcore unemployed. It is this sense of "ethics," Singer says, that some corporate executives find problematic. The reason, these executives argue, is that such practices are more harmful to business than helpful. Often they have direct or indirect costs that detract from profits. The best place to be, some claim, is in the middle somewhere – neither too unethical nor too ethical.

An example of a company that may have been too ethical, according to Singer, is Control Data Corporation. Some analysts feel that Control Data devoted too many resources to socially responsible projects, and that this was a major factor in the declining fortunes of the company. There is, according to some of the people quoted in Singer's article, an ethical side of business and a profit side, and the two have to be balanced. If this is correct, however, it seems that becoming ethical is a business decision like any other – one is ethical as long as it is to one's benefit. When being ethical ceases to be beneficial, then ethics are discarded.

In "God as a Managerial Stakeholder?" Mark Schwartz presents a unique perspective on stakeholder management. While most accept the standard list of firm stakeholders, including customers, employees, and shareholders, few would suggest that God, or a Supreme Being, could also be included in that list. Schwartz, however, uses stakeholder salience theory to argue that at least for those managers who accept that God exists and has an influence on the world, God can be considered a stakeholder. Schwartz describes the growth of religion or spirituality in the marketplace, including publications, conferences, and religious-based mutual funds. Stakeholder salience theory is then applied by Schwartz to demonstrate that God can be considered a managerial stakeholder. Stakeholder salience theory includes the stakeholder's power to influence the firm, the legitimacy of the stakeholder's relationship to the firm, and the urgency of the stakeholder's claim on the firm. Each of these elements can relate to a manager's perception of God as a potential stakeholder. Schwartz then provides several examples of firms that include God as a stakeholder in their mission statements, as well as corporate leaders who make explicit reference to the impact God has on their business. Arguments are then presented against God as a managerial stakeholder, along with potential managerial implications of accepting God as a managerial stakeholder. At the very least, Schwartz raises the argument that stakeholder management is in many respects in the eye of the beholder.

In the final article of the text, "The Fortune at the Bottom of the Pyramid," C. K. Prahalad and Stuart Hart attempt to challenge the traditional paradigm of business. They argue that it is not only the wealthiest consumers in the world who should be targeted for product sales, but also the poorest 4 billion people who earn less than US$1,500 per year (i.e. the bottom of the 'pyramid' of the world's population). They question and then counter the major assumptions of the business world, including the following: (1) the poor should not be the target consumers because with current cost structures firms cannot profitably compete for that market; (2) the poor cannot afford and have no use for the products and services sold in developed markets; (3) only developed markets appreciate and will pay for new technology; (4) the poor can use the previous generation of technology; (5) the bottom of the pyramid is not important to the long-term viability of business; (6) business can leave Tier 4 to governments and nonprofits; (7) managers are not excited by business challenges that have a humanitarian dimension; (8) intellectual excitement is in developed markets; and (9) it is hard to find talented managers who want to work at the bottom of the pyramid. After debunking the standard assumptions regarding the bottom of the pyramid, Prahalad and Hart then provide their recommendations to help establish the commercial infrastructure for the bottom of the pyramid, including creating buying power, shaping aspirations, improving access, and tailoring local solutions. The article expands notions of international business, corporate social responsibility, and sustainability into new terrain for the business world.

10

Challenges and Emerging Issues

What's the Matter with Business Ethics?

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With the recent boom in business ethics comes a curious irony: the more entrenched the discipline becomes in business schools, the more bewildering – and even off-putting – it appears to actual managers.

Signs of the boom are everywhere, Over 500 business-ethics courses are currently taught on American campuses; fully 90% of the nation's business schools now provide some kind of training in the area. There are more than 25 textbooks in the field and 3 academic journals dedicated to the topic. At least 16 business ethics research centers are now in operation, and endowed chairs in business ethics have been established at Georgetown, Virginia, Minnesota, and a number of other prominent business schools.

And yet, I suspect that the field of business ethics is largely irrelevant for most managers. It's not that they are hostile to the *idea* of business ethics. Recent surveys suggest that over three-quarters of America's major corporations are actively trying to build ethics into their organizations. Managers would welcome concrete assistance with primarily two kinds of ethical challenges: first, identifying ethical courses of action in difficult gray-area situations (the kind that Harvard Business School Lecturer Joseph L. Badaracco, Jr. has described as "not issues of right versus wrong," but "conflicts of right versus right"); and, second, navigating those situations where the right course is clear, but real-world competitive and institutional pressures lead even well intentioned managers astray.

The problem is that the discipline of business ethics has yet to provide much concrete help to managers in either of these areas, and even business ethicists sense it. One can't help but notice how often articles in the field lament a lack of direction or poor fit with the real ethical problems of real managers. "Business Ethics: Where Are We Going?" asks one title. "Is There No Such Thing as Business Ethics?" wonders another. My personal favorite puts it wryly, "Business Ethics: Like Nailing Jello to a Wall."

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What is the matter with business ethics? And more important, what can be done to make it right? The texts reviewed here shed light on both questions. They point to the gulf that exists between academic business ethics and professional management and suggest that business ethicists themselves may be largely responsible for this gap.

Far too many business ethicists have occupied a rarified moral high ground, removed from the real concerns and real-world problems of the vast majority of managers. They have been too preoccupied with absolutist notions of what it means for managers to be ethical, with overly general criticisms of capitalism as an economic system, with dense and abstract theorizing, and with prescriptions that apply only remotely to managerial practice. Such trends are all the more disappointing in contrast to the success that ethicists in other professions – medicine, law and government – have had in providing real and welcome assistance to their practitioners.

Does this mean that managers can safely dismiss the enterprise of business ethics? No. In the past year or two, a number of prominent business ethicists have been taking stock of their field from within. Much like managers trying to reengineer their companies' business processes, they have called for fundamental changes in the way the enterprise of business ethics is conducted. And they are offering some promising new approaches of value to both academic business ethicists and professional managers.

What follows, then, is a guide to business ethics for perplexed managers: why it seems so irrelevant to their problems and how it can be made more useful in the future.

Why Should Managers Be Ethical?

To understand the gap between business ethics and the concerns of most managers, it pays to recall how managers and management academics thought about business ethics before it became a formal discipline. Indeed, much of the research and writing in contemporary business ethics can be understood as a disgruntled reaction to the way ethical issues usually were addressed at business schools – in particular, to the traditional answers to the fundamental question: Why should managers be ethical?

Starting well before World War II and culminating in the 1960s and 1970s, the dominant approach to the moral dimension of business was a perspective that came to be known as *corporate social responsibility*. Largely reacting to neoclassical economics, which holds that the sole responsibility of business is to maximize its immediate bottom line subject to only the most minimal constraints of the law, advocates of corporate social responsibility argued that ethical management requires more than merely following the dictates of the law or signals of the market, the two institutions that otherwise guide business behavior. Rather, ethical management is a process of *anticipating* both the law and the market – and for sound business reasons.

For example, when managers voluntarily undertake socially responsible actions beyond the bare legal minimum required (in environmental protection, say, or antidiscrimination policy), they tend to forestall punitive social regulation. As corporate scholar E. Merrick Dodd, Jr. stated in a 1932 *Harvard Law Review* article, the purpose of ethical management is "to catch any new spirit" and embody it in voluntary standards "without waiting for legal compulsion." Or as Berkeley professor Edwin Epstein more recently and succinctly put it, "being ethical heads off the law."

The social responsibility approach not only took an expansive view of the law but also urged managers to take an expansive view of the market. In the short term, ethical behavior may prove costly to a company's bottom line. But according to the advocates of corporate social responsibility, ultimately the market will reward such behavior. "In general, socially responsible deliberation will not lead management to decisions different from those indicated by long-range profit considerations," the management scholar Wilbur Katz wrote in 1950. Or in the by now famous words of former SEC Chairman John Shad: "Ethics pays."

Most managers were able to assimilate this response to the question "Why be ethical?" fairly easily under the heading *enlightened self-interest*. Indeed, by now the tenets of corporate social responsibility have become conventional wisdom in managerial circles. Organizations like the Business Roundtable publish studies with titles like "Corporate Ethics: A Prime Business Asset." And top corporate executives regularly use the logic of enlightened self-interest, reflected in the statement by former Dow Chairman Robert W. Lundeen: "We found that if we were not running our business in the public interest, the public [would] get back at us with restrictive regulations and laws."

It was one thing, however, for social responsibility advocates to provide a broad and appealing answer to the question: Why should managers be ethical? It was quite another to answer the obvious follow-up: How can managers determine the ethical course in any particular situation and stick to it in the face of competing pressures?

To address this question social responsibility advocates set out in the 1970s to create a brand-new managerial discipline: *business ethics*. One idea was to bring experts in moral philosophy into the business schools. Training in moral philosophy would give business ethicists the analytical frameworks and conceptual tools necessary for making fine-grained ethical distinctions and discerning the appropriate course in difficult ethical situations. Once "retooled" in management, the moral philosophers could apply their sophisticated frameworks to the day-to-day moral problems that managers face.

However things have not worked out quite the way traditional advocates of corporate social responsibility had hoped. Largely because of their background in moral philosophy, a discipline that tends to place a high value on precisely those kinds of experiences and activities where self-interest does *not* rule, many business ethicists found the precepts of corporate social responsibility profoundly dissatisfying. As a result, they have spent a great deal of scholarly time and energy tearing down the social responsibility position in order to erect their own. Indeed, far from taking a step closer to the real-world moral problems of management, several prominent business ethicists have chosen to reopen the fundamental question: Why should managers be ethical?

The Myopia of Moral Philosophy

Business ethicists have two basic problems with the enlightened self-interest answer to the question of why managers should be ethical. First, they disagree that ethical behavior is always in a company's best interest, however enlightened. "There are no vanilla solutions," writes Bentley College ethicist W. Michael Hoffman in his article, "The Cost of a Corporate Conscience." To behave ethically can cost dearly." In other words, ethics and interests can and do conflict.

Second, they object that even when "doing good" is in the company's best interest, acts motivated by such self-interest really can't be ethical. Moral philosophy tends to value *altruism*, the idea that an individual should do good because it is right or will benefit from it. For many business ethicists motivation can be either altruistic or self-interested, but not both. A participant in a symposium called "Do Good Ethics Ensure Good Profits?" (recently sponsored by *Business and Society Review*) put it as follows. "To be ethical as a business because it may increase your profits is to do so for entirely the wrong reason. The ethical business must be ethical." In other words, business for nonbusiness reasons.

Each of these criticisms has its kernel of truth. Clearly, ethics and interests can conflict. Take the example of a racially segregated company in the South during the 1930s. Remaining racially segregated was ethically wrong. Yet active desegregation would have flown in the face of then prevailing public norms and most likely would have been penalized severely by market forces over both the short and long terms.

When ethics and interest do *not* conflict, business ethicists have a point too. Certainly, there is ethical value in doing the right thing because it is right not just because it serves one's interest. And in the real world of business, altruism is one of the many motivations that do shape managers' behavior.

However, the problem is that many business ethicists have pushed both these lines of reasoning to extremes. In the case of the potential conflict between ethics and interests, the fundamental issue for a manager is not whether such conflicts sometimes (or even frequently) occur, but rather how he or she handles them when they occur. Business ethicists have offered too little help with this problem so far. Often they advance a kind of ethical absolutism that avoids many of the difficult (and most interesting) questions.

For example, in *Business Ethics:The State of the Art*, a recent volume of essays by leading business ethicists, edited by R. Edward Freeman, University of Kansas ethicist Richard T. DeGeorge states, "If in some instance it turns out that what is ethical leads to a company's demise," then "so be it." A participant in the *Business and Society Review* symposium echoes this sentiment by arguing that if ethical actions mean that a company's profits are reduced, then "it must accept such a trade-off without regret." Managers would be hard pressed not to view such prescriptions as restatements of the problem, rather than as workable solutions.

In some cases, absolutism leads business ethicists to devalue such traditional business interests as making a profit or succeeding in the marketplace in favor of supposedly more important ethical demands. Take the example of one of the major works in the field, published in 1988: *Corporate Strategy and the Search for Ethics*. by R. Edward Freeman and Daniel R. Gilbert Jr. According to the authors, no corporation is truly ethical unless it has banished all forms of *external motivation* for employees. What do Freeman and Gilbert mean by external motivation? Nothing less than traditional managerial tools such as authority, power, incentives and leadership. Relying on such motivational tools, they argue, is just a sophisticated form of coercion and therefore "morally wrong." In order to be ethical, companies have to make sure that employees' work tasks are compatible with their own personal "projects," thus making external motivation unnecessary. While acknowledging that their view is not "practical," Freeman and Gilbert insist that it is not "optional." If corporations "cannot be run along the lines we propose," they argue, then "we would prefer to give up the idea of the corporation."

Such views may resonate with some moral philosophers but are of little help to managers. Like it or not, corporations do exist, and most managers work in them. These managers still lack solutions for the basic problem of how to balance ethical demands and economic realities when they do in fact conflict.

Surely, business ethicists are not pure moral theorists who needn't worry about the practicality of their prescriptions. Any business ethics worthy of the name should be an ethics of practice. But this means that business ethicists must get their hands dirty and seriously consider the costs that sometimes attend "doing the right thing." They must help managers do the arduous, conceptual balancing required in difficult cases where every alternative has both moral and financial costs.

Similarly, in situations where there is no conflict between ethics and interest, business ethicists must address what Robbin Derry has termed "the paradox of motivation" in her contribution to *Business Ethics*. The fact is most people's motives are a confusing mix of self-interest, altruism, and other influences. Instead of grappling with this complexity, however, many business ethicists have tied themselves in knots over the notion that a managerial act cannot be ethical unless it in no way serves the manager's self interest. This kind of sterile parsing of complex human motivation leads to the untenable position that managers are being genuinely ethical only when it costs them. Put simply, ethics has to hurt.

To grasp how strained such a position can become, consider the following argument made by Norman Bowie, an ethicist at the University of Minnesota's Carlson School of Management, in his article "New Directions in Corporate Social Responsibility." Bowie argues that a company adopting an inner city elementary school is acting ethically only if other companies don't do the same thing. Bowie's curious logic is that when only one company pours resources into a school it's likely that the company won't recoup its investment. Indeed it is other companies that almost certainly will benefit by hiring the school's better educated graduates. The fact that "some firms will ride free" on the expenditures of the sponsoring company guarantees that those "firms who [do] give money to solve social problems are altruistic."

If, of course, enough other companies were to start sponsoring schools, it would be possible for them all to recoup their investment by hiring from a much larger pool of better educated students. But then the spectre of self-interest would raise its head, and the purity of the sponsoring companies' motivation would become muddied. If there were no free riders, there would be no moral companies. An odd argument, to say the least. Some business ethicists used to caution that doing wrong is profitable only when most others are doing right. Now, apparently, they are arguing that doing right is demonstrably moral only when most others are doing wrong.

A few business ethicists have used a similar kind of reasoning to criticize companies that try to create incentives to encourage ethical behavior on the part of their employees. If a manager works in a corporate culture that rewards her for doing good, how can her behavior be considered ethical? In his contribution to *Business Ethics: The State of the Art*, Daniel Gilbert suggests that when ethical behavior is encouraged by "external stimuli," such as senior executives who "model proper behavior" or "provide others with incentives designed to induce proper behavior," then the behavior isn't really ethical. The strong implication is that a manager can be truly *good* only in a *bad* corporation.

If a hint of self-interest is present, in other words, then altruism – and hence ethical motivation – can no longer be assumed. Ironically, neoclassical economists, who believe that all human behavior is essentially self-interested, share this view. There is, of course, an essential difference that underlies this similarity: neoclassical economists hold that self-interested motivation is not immoral, but, for many business ethicists, mixed motives deserve and receive no moral credit.

Mistakes and Missed Opportunities

Of course, many business ethicists have tried to go beyond the question "Why be moral?" to shed light on the hard ethical questions managers face. Even when they do so, their work has tended to suffer from one or more of three typical tendencies. First, it is too general – consumed with offering fundamental proposals for overhauling the capitalist system rather than ethics strategies to assist managers who must work within that system. Second, it is too theoretical – preoccupied with philosophical abstractions and anything but "user-friendly." And third, it is too impractical – concerned with prescriptions that however morally respectable, run so contrary to existing managerial roles and responsibilities that they become untenable. As a result, such work in business ethics simply hasn't "taken" in the world of practice, especially when compared with the work of ethicists in other professions such as government, medicine, or law. These professions are, of course, monopolies and hence can more easily impose ethical strictures on their practitioners. But that's just part of the problem.

Too general. Business, like government, is not just a profession. It is also a system in which everyone, managers and nonmanagers alike, must live. As a result, the classic moral analysts of business and government have tended to be grand philosophers like Karl Marx or Friedrich von Hayek. Rather than focusing on professional norms and behavioral modes, such thinkers have advanced systemic critiques that often question the very premises of economic and political systems such as capitalism or socialism.

Medicine and law provide an instructive contrast. Because these fields are more traditional professions, their greatest moral analysts have tended to be practitioners like Hippocrates or Oliver Wendell Holmes. Such thinkers accepted and worked within the basic premises and norms of their professions. And that context has allowed them and others to come up with ethical precepts of practical value to actual doctors and lawyers.

Although management increasingly has come to be viewed as a profession in this century, a heritage of systemic moral criticism tempts business ethicists to be grand philosophers. In his contribution to *Business Ethics*, for example, Richard DeGeorge calls for the field to address questions such as "Is capitalism ethically justifiable? If so, how? If not, why not? Is socialism ethically preferable?"

These are important questions. But to the considerable extent that business ethicists dwell on them, what they generate is more often high-flow social philosophy than ethics advice useful to professionals. To cite one example, in a recent *Business Horizons* piece entitled "Corporate Social Responsibility: A Critical Approach," R. Edward Freeman and Jeanne Liedtka urge managers to "see corporations…as places in which we can be fully unrestrained human beings, places of 'jouissance' rather than grey flannel, places of liberation and achievement rather than oppression and denial."

Too theoretical. Both medicine and management are referred to as "sciences." Business ethicists share with medical ethicists the challenge of having to bridge a gulf between their own preoccupations with morals and the harder, more "scientific" nature of the professions they study. In contrast, because government and law address the normative values of a particular political community, they are more receptive to the language of values found in moral philosophy. Medical ethicists have gained credibility within their more scientific field by displaying an understanding of the relevant hard medical-science issues. Business ethicists, by contrast, have attempted to gain credibility within their professional field primarily by girding their work with abstract moral theory.

Norman Bowie's contribution to *Business Ethics* addresses this "crisis of legitimacy" that business ethicists face in the "scientific" world of the business school. Many mainstream management scholars, he writes, see ethics as "subjective," "soft," and "normative," while regarding their own fields – finance, say, or marketing or accounting – as "objective," "hard," and "scientific." Bowie defends his field in part by pointing out that business ethics possesses the "complex body of knowledge" that defines a "true discipline." And by way of offering evidence, he notes that business ethics has "at least two major theories, utilitarianism and deontology" as well as a number of "peer-refereed journals."

To peruse recent issues of the *Journal of Business Ethics* is to get a strong sense of the kind of research that has resulted from this need to establish theoretical or scholarly bona fides. The point of one recent article for example, is to argue that "utilitarian and situation ethics, not deontological or Kantian ethics… should be used in a regional code of conduct for multinational companies operating" in sub-Sharan Africa. The point of another is to "defend the view that from a purely rule-utilitarian perspective there is no sound argument favoring the immorality of hostile liquidating takeovers."

Ethical theory can help illuminate the moral problems managers face. But no other field of professional ethics has felt the need to couch its analyses so in the language of pure moral philosophy. In his new book *Ethics and Excellence: Cooperation and Integrity in Business*, University of Texas philosopher Robert C. Solomon writes that "such theorizing is…utterly inaccessible to the people for whom business ethics is not merely a subject of study but is (or will be) a way of life – students, executives, and corporations." Unfortunately, academic insecurity is causing business ethicists to direct their work away from addressing the real needs of managers and toward satisfying the perceived rigors of academic science in their field.

Too impractical. Even when business ethicists try to be practical, however, much of what they recommend is not particularly useful to managers. To understand why, a comparison with law is helpful. In business, as in law, ethicists are increasingly asking individual practitioners to modify their commitments to their traditional principals in order to satisfy the competing interests of nonprincipals. Managers, for example, are urged to weigh the consumer's interest in healthier products against their obligation to provide shareholders with the healthiest possible dividend. And lawyers are now being encouraged to weigh an opposing party's right not to be viciously cross-examined against their own client's right to the most vigorous possible defense.

Such questions are less characteristic of either government or clinical medicine. Rarely do we ask our government officials to put the claims of foreign citizens on a par with our own when they come into fundamental conflict. Nor have we felt comfortable asking a doctor to weigh the claims of another doctor's patient against his or her own; if helping one patient comes at the cost of helping another, we expect policymakers, not individual doctors, to make the necessary trade-offs. At present, the most central ethical issues in clinical medicine and government arise when the diverse interests of the same principals come into conflict – for example, when a patient's interest in being told the truth conflicts with her interest in having peace of mind, or when the interest some citizens have in liberty competes with the interest others have in equality.

In one important respect, then, business ethicists and legal ethicists have an especially difficult row to hoe. Many of their current recommendations simply go against the grain of the traditional professional-principal relationship. This added difficulty doesn't necessarily mean that business ethicists should abandon their views of right and wrong. If they seek to influence the practice of management however, they must advance their proposals with a heightened sensitivity to practitioners' understanding of their professional-principal responsibilities. As Kenneth Goodpaster argues in his thoughtful contribution to the premiere issue of *Business Ethics Quarterly*, "the challenge…is to develop an account of the moral responsibilities of management" that posits a "moral relationship between management and stakeholders" even as it protects "the uniqueness of the principal-agent relationship between management and stockholder."

Few business ethicists have risen to this challenge. In the same issue of *Business Ethics Quarterly*, for example, Norman Bowie uses the uncontroversial proposition that the manager "has obligations to all corporate stakeholders," as a starting point for a radical redefinition of the managerial mission. His conclusion: the "primary obligation" of the manager is "to provide meaningful work for…employees." Even if one believes this assertion to be true, such a claim is so alien to the institutional world inhabited by most managers that it becomes impossible for them to act on it.

Towards a New Business Ethics?

There are signs, however, that at least some business ethicists are beginning to grapple with these shortcomings. They are questioning the direction their field has taken and urging their colleagues to move beyond their current preoccupations. Although a number of their ideas have been simmering for years, the critics' discontent signals the beginning of what might be a more productive direction. Think of it as the *new business ethics*.

While differing in their specific approaches, advocates of the new business ethics can be identified by their acceptance of two fundamental principles. While they agree with their colleagues that ethics and interests can conflict, they take that observation as the starting point, not the ending point, of an ethicist's analytical task. In the fittingly final essay of *Business Ethics*, Joanne B. Ciulla provides a breath of fresh air when she writes, "the really creative part of business ethics is discovering ways to do what is morally right and socially responsible without ruining your career and company."

Second, the new perspective reflects an awareness and acceptance of the messy world of mixed motives. Accordingly, the key task for business ethicists is not to make abstract distinctions between altruism and self-interest but to participate with managers in designing new corporate structures, incentive systems, and decision making processes that are more accommodating of the whole employee, recognizing his or her altruistic and self-interested motivations. Such structures, systems, and processes should not "be construed as the personal yielding to the corporate or the corporate giving in to the personal," suggests Fairfield University business ethicist Lisa Newton in her article "Virtue and Role: Reflections on the Social Nature of Morality." Instead, they should integrate the two roles. And the "name of that integration," writes Newton, "is *ethics*."

Within this broad area of agreement, practitioners of the new business ethics pursue a variety of interesting and useful approaches. In *Ethics and Excellence*, for example, Robert Solomon goes back to Aristotle's conception of "virtue" to devise an ethics of practical value to managers. For Solomon, being virtuous does not "involve radical demands on our behavior." Indeed, such demands are "completely foreign to Aristotle's insistence on moderation." According to Solomon, Aristotle used the word "moral" simply to mean "practical."

In Aristotelian fashion, Solomon proceeds to establish a set of workable virtues for managers: for instance, "toughness." Neither callously self-interested nor purely altruistic, virtuous toughness involves both a "willingness to do what [is] necessary" and an "insistence on doing it as humanely as possible." Throughout his book, Solomon discusses toughness (and other morally complex managerial virtues such as courage, fairness, sensitivity, persistence, honesty, and gracefulness) in the context of real-world situations such as plant closings and contract negotiations.

In an article in *Business Ethics Quarterly* entitled "Shrewd Bargaining on the Moral Frontier: Toward a Theory of Morality in Practice," J. Gregory Dees and Peter C. Cramton develop another useful approach around the idea of "mutual trust." Dees and Cramton rightly emphasize that ethical actions don't take place in splendid isolation, in practice, for example, ethics seems to rest on reciprocity. "It is unfair to require an individual to take a significant risk or incur a significant cost out of respect for the interests or moral rights of others," they write "if that individual has no reasonable grounds for trusting that the relevant others will… take the same risk or make the same sacrifice."

This is an important departure from the absolutist perspective of much contemporary business ethics, particularly from the notion that only when others are *not* making comparable sacrifices can we gain moral luster from doing so. Their "mutual trust" principle allows the authors to find a moral justification for deception in certain kinds of difficult business situations, even as they urge business ethicists to help managers "find strategies for bringing practice closer to moral ideals." And in what could well be a manifesto for the new business ethics, Dees and Cramton argue that "the most important work in business ethics" is not "the construction of arguments to appeal to moral idealists, but the creation of actionable strategies for the pragmatists."

In a similar vein, Thomas Donaldson of Georgetown and Thomas Dunfee of Wharton have emphasized the central role of "social contracts" in devising what Donaldson calls a "minimalist" as opposed to "perfectionist" view of the moral expectations that can be placed legitimately on companies. Social contracts are the implicit moral agreements that, having evolved over time, govern actual business practice. The task of the business ethicist, Dunfee writes in *Business Ethics Quarterly*, is first to identify and make explicit these diverse ethical norms and then to evaluate them against certain universal, but minimalist, moral principles.

Some existing social contracts would fail such a test: racial discrimination in real-estate sales, say. But many would not. For example, the fact that using insider information is considered more acceptable in real estate than in securities transactions does not necessarily mean that real estate agents somehow don't have their moral act together. Absent a fundamental moral principle against using nonpublic information, the ethics of doing so in any given case will depend on the "goals, beliefs, and attitudes" of the relevant business community.

This emphasis on social context finds an intriguing echo in Norman Bowie's work. In "New Directions in Corporate Social Responsibility," Bowie, in effect, turns around the ethical telescope. "If managers and stockholders have a duty to customers, suppliers, employees, and the local community," he argues, then it follows that these social actors also have duties to managers and stockholders. For example, environmentalists who want companies to produce more environmentally friendly products also must work to convince consumers to pay the added cost often necessary for manufacturing such products. In other words, business ethics in not a matter of concern for managers alone. It is everyone's responsibility.

Finally, in *Good Intentions Aside: A Manager's Guide to Resolving Ethical Problems,* Boston University School of Management Professor Laura L. Nash attempts to deliver on Joanne Ciulla's recommendation. Assuming that managers already have good intentions, the task for business ethics is to go beyond "sermonizing" in at least two ways. First, all managers face "hard issues whose solutions are not obvious," where the "reconciliation of profit motives and ethical imperatives is an uncertain and highly tricky matter." It is precisely the need to find those solutions and reconciliations that business ethics should address.

Second, Nash contends that business ethics should concern itself with designing and developing organizations for managers who, like all human beings, display the "normal range of ethical instincts and have a desire to see that these instincts are not compromised at work." *Good Intentions Aside* thus zeros in on what Nash calls "the acute dilemma" – "situations where you do not know what is the right or wrong thing to do" – and the "acute rationalization" – "situations where you know what is right, but fail to do it" because of competitive or organizational pressures.

Nash develops a set of commonsense approaches to help managers deal with these two types of situations. She calls it the "covenantal ethic," defined as "a manager's primary obligation…to see that all parties in a commercial endeavor…prosper on the basis of created value." As an example, Nash cites The Stride Rite Corporation, the $500 million manufacturer of children's shoes. Unlike the products sold by many discount retailers, Stride Rite shoes are designed with a "long-standing, quasi-medical dedication to foot care." The company is also a shrewd marketer, using appealing shoe designs and aesthetically pleasing boutiques. The result: a socially responsible company that is more profitable than traditional "bottom-line" manufacturers. Nash reports that former Stride Rite Chairman Arnold L. Hiatt "refused to be sucked into the ethics versus bottom line" conundrum. "'We're unashamedly out to make a profit,'" she quotes Hiatt, "'*and* we're very concerned about [children's] health....We run the business on both concerns.'"

Moderation, pragmatism, minimalism: these are new words for business ethicists. In each of these new approaches, what is important is not so much the practical analyses offered (as the authors acknowledge, much remains to be worked out) but the commitment to converse with real managers in a language relevant to the world they inhabit and the problems they face. That is an understanding of business ethics worthy of managers' attention.

Developing and Sustaining an Ethical Corporate Culture
The Core Elements

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The Core Elements to Developing and Sustaining an Ethical Corporate Culture

One can argue that of all the issues faced by boards of directors, executives, and managers, corporate unethical activity is one of the most significant in terms of its potential negative impact, while remaining one of the most difficult to properly address. The range of illegal and unethical activity taking place is extensive and includes corruption, bribery, receiving and giving gifts and entertainment, kickbacks, extortion, nepotism, favoritism, money laundering, improper use of insider information, use of intermediaries, conflicts of interest, fraud, aggressive accounting, discrimination, sexual harassment, workplace safety, consumer product safety, or environmental pollution (U.S. Sentencing Commission, 2010). Unfortunately, one doesn't have to look very far over recent years to see significant examples of crime and unethical activity within or on behalf of business organizations and the serious negative impact such scandals have had on investors, employees, customers, competitors, the natural environment, and society (e.g., Enron, WorldCom, Tyco, Parmalat, Siemens, Madoff Investments, BP, etc.). This list does not of course include the more basic legal yet unethical practices by firms and their agents including acts of dishonesty, disloyalty, disrespect, or breaking promises, all of which can also result in unnecessary harm to stakeholders.

But beyond the major scandals that are often the focus of media scrutiny, lawsuits, or government prosecutions, are the more difficult and challenging ethical dilemmas managers face. For example, consider the following firm-level ethical dilemmas faced by managers:

- Should production be moved overseas leading to worker layoffs?
- Should affirmative actions policies be adhered to leading to other qualified candidates being bypassed?
- Should consumer products be sold in third world countries with less stringent consumer protection laws when they would not be legally permitted to be sold in the firm's home country?

Or consider the following individual-level ethical dilemmas managers might face:

- Should I break confidentiality and indicate to a work colleague who is also a good friend that he or she is about to be laid off?
- Should I accept an expensive bottle of wine during the holiday season from a current supplier if the firm does not forbid this?
- Should I join my work colleagues when a potential client is being taken to an adult entertainment club?

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- Should I report my supervisor who is acting in an abusive manner towards other employees and thereby risk losing my own job?

How can firms prevent significant unethical behavior while at the same time provide proper guidance to managers and employees in how to address more challenging day-to-day ethical dilemmas? While a vast array of potential solutions have been presented, many theorists argue that the presence of an "ethical corporate culture" is a necessary, although insufficient, condition if the extent to which illegal or unethical activity is taking place is to be minimized (e.g., Brass et al., 1998). An ethical corporate culture can not only help avoid major illegal or unethical corporate scandals, but lead to more appropriate ethical behavior at all levels of the firm. This theoretical position is in turn at least initially supported by empirical evidence. For example, the "2009 National Business Ethics Survey" of 2,852 U.S. employees conducted by the Ethics Resource Center (2010) found that in "stronger ethical cultures" far fewer employees feel pressure to commit misconduct (4 percent instead of 15 percent), rates of observed misconduct are much lower (39 percent instead of 76 percent), employees who observe misconduct are more likely to report it (43 percent instead of 28 percent), and those who report misconduct are less likely to experience retaliation (4 percent instead of 24 percent). In reviewing the academic literature, Mcdonald (2009, p. 357) states that: "[T]he results highlight the important role that organisational culture plays in ethical decision making…"

There are several difficulties however with an approach that focuses on developing an ethical corporate culture to help combat illegal or unethical activity. The initial challenge is in understanding what exactly 'ethical' corporate culture means, and how it might influence the actions of employees. But before one can define an 'ethical' corporate culture, one must start with a definition of the broader concept of corporate culture found in organizational theory literature. While several definitions exist, for the purposes of this paper corporate culture is considered simply as representing the shared assumptions, values, and beliefs of the organization.

Building on this general definition, Treviño and Nelson (2011, p. 153) suggest that an 'ethical' corporate culture represents a "slice" or "subset" of the organization's broader culture and is "…maintained through a complex interplay [and alignment] of formal [i.e., policies, leadership, authority structures, reward systems, training programs] and informal organizational systems [i.e., peer behavior and ethical norms]." In terms of how an ethical corporate culture can lead to expected ethical behavior, employees can act consistently in accordance with the firm's ethical norms either through a *socialization* process, i.e., employees feel they are expected to behave accordingly, or an *internalization* process, i.e., employees adopt the ethical norms as their own. The goal then is for firms to ensure that within their broader corporate culture of shared values and beliefs that a 'strong' ethical corporate culture also exists, rather than a 'weak' one. Only when this take place will the probability be increased that employees will conform to desired ethical norms.

A second major issue to an approach that focuses on developing an ethical corporate culture is to ask whether its existence, however defined, will actually make a difference with respect to *all* employees and managers. For the purposes of this paper, this position is rejected as being clearly unrealistic, since illegal and unethical activity will always continue despite the existence of even an 'ideal' ethical corporate culture. For example, there are many in the fraud prevention field who accept a '20-60-20' rule; 20 percent of a given workforce will always do the 'right thing', i.e., act legally or ethically, regardless of one's circumstances or work environment. Another 20 percent will always engage in illegal or unethical behavior when the opportunity exists, the rewards are sufficient, and there is a perceived low likelihood of getting caught. The remaining 60 percent of the workforce however, while basically honest, will decide to engage in illegal or unethical behavior, depending on the environment in which they work, based on such factors as managerial pressure, peer pressure, or reward systems, or in the belief that they are acting in the best interests of their firm. Such employees can be referred to as 'fence sitters'. Turning this fact into a potential opportunity, it is this 60 percent that arguably can be most influenced to do the 'right thing' when they work within an ethical corporate culture, and consequently these 'fence sitters' are the target group of this paper. The goal is to identify those measures that can help mitigate or minimize, as oppose to completely eliminate, the extent to which illegal or unethical activity is taking place within or on behalf of business firms.

But even among the 'fence sitters' to be targeted, an additional preliminary hurdle remains. Are employees who can be socialized to act in an ethically appropriate manner even able to initially recognize that they are in the midst of an ethical dilemma in the first place? For example, one study found that two-thirds of average 18–23-year-olds when asked to describe a moral dilemma they had experienced were "…unable to answer the question or described problems that are not moral at all, like whether they could afford to rent a certain apartment or whether they had enough quarters to feed the meter at a parking spot" (Brooks, 2011). When this additional 'ethical awareness' hurdle is added, those who would normally act ethically or those who can be socialized to act ethically will not do so since they cannot even recognize that they are facing an ethical dilemma. The actual distribution of those employees who would always act ethically, might act ethically, or never act ethically when lack of ethical 'awareness' is also taken into account, would actually approximate something closer to '10-50-40' rather than '20-60-20'.

Regardless of the actual distribution, it becomes extremely important for board members, executives, and managers to understand how to best develop and sustain an ethical corporate culture with respect to those employees who can be sensitized to become aware they are facing ethical dilemmas, or for those employees who can be influenced by their work environments. While recognizing that there is no 'one size fits all' solution for all business organizations, one can certainly postulate that certain core elements should be in place at a minimum if one is to have the greatest chance of developing and maintaining an ethical corporate culture.

The key question then becomes: "What are the critical elements that are necessary to develop and sustain an ethical corporate culture?" This paper argues that based on a review of the extant literature, three key elements or fundamental building blocks must necessarily exist if crime, corruption, and other illegal or unethical activity within and on behalf of business firms by their agents is to be minimized through building an ethical corporate culture. The three elements are:

1. the existence of a set of *core ethical values* infused throughout the organization in its policies, processes, and practices;
2. the establishment of a *formal ethics program* including a code of ethics, ethics training, an ethics hotline, and an ethics officer; and
3. the continuous presence of *ethical leadership*, i.e., an appropriate 'tone at the top', as reflected by the board of directors, senior executives, and managers.

While each of these three elements is distinct, they also overlap, relate to, and reinforce each other. As part of an effort to consolidate the extensive theoretical and empirical business ethics research that has been conducted to date, each of the three key elements necessary to develop and maintain an ethical corporate culture will now be discussed.

First Pillar: Core Ethical Values

The existence of a set of core ethical values appears to be critical in establishing an ethical corporate culture. For example, "Corporate values have long been referred to as the central dimension of an organization's culture…" (Hunt et al., 1989, p. 79). An ethical corporate culture has in turn been recognized as important to ethical decision-making. O'Fallon and Butterfield, as part of their extensive literature review on ethical decision-making, state: "The research generally supports the notion that ethical climates and cultures have a positive influence on ethical decision making" (2005, p. 397). Despite the recognized importance of core ethical values however, research suggests that many employees perceive their firms as lacking ethical values. For example, in a survey of 23,000 US employees, only 15 percent felt that they worked in a high-trust environment, only 13 percent had highly cooperative working relationships with other groups or departments, and only 10 percent felt that their organization holds people accountable for results (Covey, 2004).

Although there are a number of potential ethical values for a firm to choose from, it could be argued that one needs to attempt to identify those ethical values which can be considered to be universal in nature. To the greatest extent possible, the selected moral values should retain their significance despite differences in culture, religion, time, and circumstance. The values should be accepted by a large number of diverse individuals and social groups as being of fundamental importance in guiding or evaluating behavior, actions, or policies. Universal moral values are considered as being similar to 'hypernorms', described by Donaldson and Dunfee as "deep moral values" (1999, p. 27) representing "… a convergence of religious, political, and philosophical thought" (1999, p. 44). Hypernorms are considered "…so fundamental that, by definition, they serve to evaluate lower-order norms [while]…reaching to the root of what is ethical for humanity" (1999, p. 44). One list that has been proposed suggests the following set of universal core ethical values for all business firms (Schwartz, 2005):

(i) *trustworthiness*, including honesty, promise-keeping, integrity, transparency, reliability, and loyalty;
(ii) *respect*, including respect for human rights;
(iii) *responsibility*, including accountability, acceptance of fault, and not blaming others;
(iv) *fairness*, including notions of process, impartiality, and equity;
(v) *caring* including avoiding unnecessary harm and sensitivity towards others; and
(vi) *citizenship*, including obeying laws, assisting the community, and protecting the environment.

Can the application of such core ethical values actually assist managers and employees in determining the appropriate course of ethical conduct? To help illustrate their potential, Table 1 below provides a brief analysis of how several of the above core ethical values can be applied to resolve typical ethical dilemmas faced in the workplace.

While in some cases the above core ethical values if applied to business practices constrain the firm's self-interest, in other cases, their consistent application helps to ensure the long-term financial prosperity of the firm. Regardless whether the application of

Table 1 Ethical dilemmas and potential application of ethical values.

Ethical dilemma	*Application of ethical values*
• Should I break confidentiality and indicate to a friend that he or she is about to be laid off?	• While values such as loyalty to one's friend or caring (trying to avoid unnecessary harm) suggest breaching confidentiality and disclosing the information to one's friend, other aspects of *trustworthiness* including *loyalty* to the firm, *honesty*, and *promise-keeping* suggest maintaining confidentiality despite pressure to do otherwise.
• Do I accept an expensive bottle of wine during the holiday season from a current supplier if the firm does not forbid this?	• While one might argue that accepting gifts is the norm and there is no current apparent conflict of interest, the ethical values of *fairness* (e.g., perceived conflict of interest) as well as *loyalty* to the firm and its owners suggests otherwise. At a minimum, if refusing the bottle of wine (or any gift) would be problematic, then the gift should become the property of the firm rather than the property of the individual receiving the gift.
• Do I fully disclose a mistake made to a client or customer when they will not notice and the mistake is insignificant?	• This conflict can place potential negative financial considerations of losing the client into conflict with ethical values. The core values of *trustworthiness* (i.e., *loyalty, honesty, promise-keeping, integrity*) clearly suggests that disclosure must take place. *Respect* for the client suggests that disclosure should take place. *Responsibility* also suggests that accountability for the mistake is taken, while *fairness* would require compensation to be provided if the mistake caused any loss to the client/customer.

ethical values always leads to profit maximization, it can be argued that all business firms should attempt to infuse core ethical values throughout their organizations as the basic starting point to establishing an ethical corporate culture. This infusion should take place within the firm's (a) policies, (b) processes, and (c) practices.

Policies

First, the core ethical values must be made explicit in the firm's policy documents whenever possible. The most important document in which the values should be present is the firm's code of ethics, with the values being stated upfront. The values should also be included in the firm's annual report, public accountability statement or social report, and should be indicated as clearly as possible on the homepage of the firm's website. Although being explicit about ethical values might expose a firm to additional critique from academics, the media, NGOs, customers, or even employees, this should be considered a necessary step towards establishing an ethical corporate culture. Of course, even firms such as Enron, despite being quite explicit in its office banners and training videos about their core ethical values including "integrity," "honesty," and "respect", failed to live up to them. This makes it clear that the values must be incorporated into other processes and practices as well.

Processes

The values only become alive, leading to a more ethical corporate culture, when they are infused and observed throughout the firm's processes. The first process involves hiring, i.e., the right people need to be recruited. There are various methods that can be used to build in ethical values such as honesty and integrity into the hiring process, such as testing and interviews. Questions like "Have you ever faced an ethical dilemma before? If so, how did you handle it?" have the potential to reveal an applicant's general level of awareness of ethical issues and perspective on ethical decision-making. The answer "I don't think I've ever faced an ethical dilemma" suggests a lack of awareness and might represent a red flag during the hiring process. Hiring ethical leaders at the more senior levels can be critical if an ethical 'tone at the top' is to be established (discussed further below).

While concerns have been raised over the use and effectiveness of integrity testing, this tool also remains an important measure for employers to screen out 'executive psychopaths' who despite their 'polish', 'charm', and 'cool decisiveness' are also "cunning, manipulative, untrustworthy, unethical, parasitic, and utterly remorseless" which can make them dangerous to their companies (Morse, 2004, p. 20). Ethical values should be considered as the filter or 'gate' which a potential new employee or manager must get through before financial performance factors should even be considered when hiring. Firms might consider utilizing a group decision-making approach when hiring at the senior levels (as opposed to one-on-one hiring interviews only), as this process better facilitates raising ethical 'red flags' regarding candidates.

The ethical values should also be part of any orientation process, such as ethics training. Performance appraisals should also incorporate consideration of employees' behavior with respect to the ethical values: "An effective performance management system is a key component of the ethical culture. The system plays an essential role in alignment or misalignment of the ethical culture because people pay attention to what is measured, rewarded, and disciplined" (Treviño and Nelson, 2011, p. 172). While it is sometimes more difficult in a performance appraisal to measure behavior that conforms to the ethical values, it is easier to identify employees' actions that fail to reflect the values. Decisions regarding promotion should also be based on the ethical values. Employees who are promoted only on the basis of their financial performance when they have not lived up to the values, only reinforces the perception for other employees that the firm does not consider ethical values to be important; this can have a severe potential impact on the firm's ethical corporate culture. Disciplinary or even dismissal decisions should also be based on whether the values are being lived up to. Most important is that the firm aligns its reward system, including compensation, as far as reasonably possible with the firm's ethical values.

Practices

If the firm has a set of core ethical values, it needs to be perceived to live up to them – that is, it must 'walk the talk'. Without this general perception, the ethical values quickly become meaningless. To prevent this from occurring, there are a variety of practices that should explicitly incorporate the firm's values. All decision-making and behavior at all levels and functions should be based on the firm's ethical values, whenever possible. This would include not only executives, managers, and employees, but at the board of director's level as well. Surveys of employees and customers should also attempt to include feedback on the performance of the firm and its agents with respect to the ethical values. All meetings, additional training efforts, and speeches, especially by senior managers, should make explicit reference to the core ethical values. All of these actions reinforce the core ethical values, helping to sustain an ethical corporate culture.

Another method is to build the ethical values into 'stories' about the actions or decisions of employees, managers, or senior executives which gives greater meaning to the organization's culture. This includes both positive stories, whereby an employee, manager, or even the CEO acted consistently according to the values despite financial pressure to do otherwise. This should also include negative stories, whereby the firm failed to live up to its values but discussion then takes place as to why mistakes were made and how to avoid such mistakes in the future.

Second Pillar: Formal Ethics Program

Most commentators agree that a formal, comprehensive ethics program is necessary to help establish and ensure an ethical corporate culture, particularly for larger organizations. In fact, changing regulations have virtually made it a requirement for large firms or public firms through their boards of directors to ensure that they have such programs in place. For example, the US *Federal Sentencing Guidelines for Organizations* (FSGs), enacted by the US Sentencing Commission (1991), are referred to when judges sentence organizations for violating US federal law. The FSGs permit firms to have their fines reduced if they are able to establish that they possessed an "effective compliance and ethics program" prior to the offence. The *Guidelines*, revised in 2004 and again in 2010, now suggest that an ethical "organizational culture" is necessary before a firm can be considered to have an "effective compliance and ethics program" which is designed to prevent illegal and unethical behavior. The FSGs (Section 8B2.1) state: "To have an effective compliance and ethics program an organization shall promote *an organizational culture that encourages ethical conduct* and a commitment to compliance with the law" (emphasis added). The FSGs go on to identify the minimum requirements for a firm to be considered as possessing an "effective" program, including a code of ethics, ethics training, an individual responsible for the ethics program and a reporting system for improper behavior. In a similar fashion, the US *Sarbanes-Oxley Act* (U.S Senate, 2002) or SOX, also requires firms to ensure the presence of certain elements of an ethics program. Not only are public firms essentially required to possess a code of conduct or ethics, but SOX also suggests certain minimum content for the code, while requiring that firms have established appropriate whistleblowing channels.

Numerous commentators have also now provided more specific recommendations regarding each element of an 'effective' ethics program (see Schwartz, 2004). For example, codes of ethics should be easy to understand, non-legalistic, include relevant examples, avoid negative tone, and include expected behavior and sanctions. The code development process should involve employees, apply to everyone in the organization, and involve a sign-off process whereby employees indicate they have read, understood, and complied with the code. Ethics training should be conducted by managers whenever possible, with relevant examples used. The code should be reinforced regularly at meetings, through emails, newsletters, and managerial and CEO speeches. An administrator, often referred to as an ethics or compliance officer, should be appointed for the ethics program, who has direct access to the board of directors, and who cannot be fired by the CEO. A reporting mechanism should be established which provides for anonymity and confidentiality when possible, with no fear of reprisals. Any enforcement of the code must be fair and consistent. Regular monitoring and auditing of the ethics program's effectiveness should take place, as well as periodic revisions. All of these measures are part of developing a comprehensive and effective ethics program. Ultimately, the program should be based on the core ethical values discussed above. But a firm that possesses core ethical values infused throughout its policies, processes, and practices, even when supported by the establishment of a comprehensive ethics program, is not sufficient. The presence of ethical leadership is also necessary, as will now be discussed.

Third Pillar: Ethical Leadership

Beyond infusing ethical values throughout the organization and developing a comprehensive ethics program, in order to achieve an ethical corporate culture an ethical 'tone at the top' must also exist. In fact, many suggest that an ethical corporate culture is contingent upon ethical leadership: "…the moral tone of an organization is set best by top management… workers generally get their ethical cues by observing what their bosses do" (James, 2000, p. 54). According to Brown et al., "[L]eaders should be the key source of ethical guidance for employees" (2005, p. 117). They define "ethical leadership" as: "[T]he demonstration of normatively appropriate conduct through personal actions and interpersonal relationships, and the promotion of such conduct to followers through two-way communication, reinforcement, and ethical decision-making" (2005, p. 120). Others have even suggested that a relationship exists between ethical leaders and the presence of values within an organization: "Ethics is central to leadership because of the… impact leaders have on establishing the organization's values" (Northouse, 2001, p. 255). Of course, ethical leadership must be demonstrated not just by the CEO and the other senior executives in the C-suite, but at every level including first line supervisors and retail store managers as well.

The relationship between ethical leadership and ethical behavior has also been observed. According to Hitt, "[T]he results of research studies demonstrate that the ethical conduct of individuals in organizations is influenced greatly by their leaders" (1990, p. 3). Perceptions among employees that their managers possess a set of core ethical values and act upon them has been shown to have a significant impact on the ethical corporate culture of the firm. According to a study by Treviño et al. (1999, p. 142), based on a survey of over 10,000 US employees: "When employees perceived that supervisors and executives regularly pay attention to ethics, take ethics seriously, and care about ethics and values as much as the bottom line, all of the outcomes [i.e., less unethical/illegal behavior, greater awareness of ethical/legal issues, employees more likely to look for advice within the firm, willing to deliver bad news to management, report ethical violations, and more committed to the organization] were significantly more positive."

Despite the recognized importance of ethical leadership within business, there appears to be a perception that such leadership is lacking. For example, a 2010 Gallup survey of over 1,000 US adults found that only 15 percent perceived business executives as having "very high" or "high" honesty and ethical standards, even lower than auto mechanics at 28 percent and TV reporters at 23 percent (Gallup, 2010). In a 2009 survey of 1,024 of its readers from around the world, *Harvard Business Review* magazine found that 76 percent of those surveyed had less trust in US senior management than they had the previous year, and 51 percent had less trust in senior management at non-US companies (Podolny, 2009). The research suggests that there is significant room for improvement in society's perception of the ethical values of business leaders.

Why is it the case that the majority of the public, including employees and government regulators, remain so skeptical of the ethical leadership capabilities of corporate executives? One reason is the inherent conflict between the desire of executives to act in a manner that fulfills their fiduciary obligations to shareholders, i.e., maximize the bottom line, versus engaging in what the public considers to be ethical behavior, i.e., putting people before profits. For the general public, which does not possess a fiduciary obligation to stockholders, this perceived conflict of interest and corresponding perceptions of excessive corporate and executive greed is arguably the underlying basis for the anti Wall Street movement. For governments, such perceptions appear to drive continuous calls for enhanced corporate governance regulation to restrain executive conduct. How exactly can managers and executives exemplify ethical leadership and reverse current negative perceptions? Creating perceptions of ethical leadership is no easy task. Since most employees will not have direct contact with their senior managers, the firm's leaders must attempt to develop a *reputation* for ethical leadership. Various studies have examined how an ethical reputation is developed. Treviño et al. (2003) suggest that there are two dimensions to ethical leadership: a 'moral person' dimension and a 'moral manager' dimension. The moral *person* dimension requires the manager to act with integrity, honesty, and trustworthiness. It is based on the manager being observed to treat people with respect and dignity and to live a moral life at the personal level. The moral *manager* dimension is affected not only by visibly role-modeling ethical conduct, but by applying a reward system to hold everyone accountable and through communicating regularly and openly with all employees about the importance of ethical values. If one is perceived as being a strong 'moral manager' but a weak 'moral person', they would be seen as hypocrites, i.e., they talk about the importance of ethics but do not act accordingly. To be an ethical leader, managers must be perceived as being both strong moral *managers* and strong moral *persons*.

Probably the most significant means of demonstrating ethical leadership is to ensure that all decision-making is in accordance with the ethical values as discussed above. This becomes even more apparent when executives are seen to make such decisions even when there is a financial cost to the firm. The ethical values must be seen to take priority over other interests, or they quickly become irrelevant. In one famous example, at the age of twenty-eight, Arthur Andersen, as the founder of his accounting firm, refused to yield to the questionable demands of an important railway client during an audit. He lost the client as a result, but when the client later went bankrupt, Arthur Andersen developed a reputation as someone who could be trusted to act with integrity. This decision set an ethical tone for the firm for many years, leading to Arthur Andersen later acting as a watchdog over the entire accounting industry. Unfortunately, such ethical behavior did not continue long-term at Arthur Andersen, when its culture, especially in relation to its client Enron, began to focus more on the generation of revenues rather than the ethical values originally underlying its auditing business.

In another famous example, former Johnson & Johnson CEO James Burke relied on his firm's credo in order to not only withstand the 1982 Tylenol tampering crisis, but also derive a competitive advantage from it years later. The firm through Burke's leadership did so by relying on its credo's values, which placed safety ahead of financial considerations; it recalled the product nationwide, despite the cost. Similarly, former CEO of Alcoa, Paul O'Neil, developed a reputation for caring about the safety of his employees. He managed this by visiting plants and indicating to employees that there would be no budget for safety matters, and that they should spend money to fix any safety hazard regardless of the cost. He also gave his home phone number for employees to report safety problems, and would personally fly anywhere in the world to visit employees who had been injured. As another example, following a series of scandals at the Canadian bank CIBC related to its dealings with Enron and a $2.4 billion settlement with investors, the new CEO, Gerald McCaughey decided to voluntarily accept a compensation package that delayed the vesting of his share options extensively, and also included a provision that his compensation could be taken away retroactively if a scandal was later discovered that previously took place during his term as CEO of the bank. Such actions could be seen to demonstrate a commitment to ethical values including integrity, caring, and responsibility, leading to a perception of the CEO as an ethical leader.

Unfortunately, however, there are too many examples of companies that failed to establish such an ethical 'tone at the top', leading to significant scandals which sometimes caused their downfall. For example, US firms and their former CEOs such as WorldCom (Bernie Ebbers), Tyco International (Dennis Kozlowski), and Adelphia (John Rigas), Canadian firms such as Hollinger (Conrad Black) and Livent (Garth Drabinsky), and Italian firm Parmalat (Calisto Tanzi) appear to have been lacking an appropriate tone at the top. These examples represent firms with "unethical leadership" leading to behavior that costs firms "…billions of dollars a year due to increased absenteeism, health care costs, lost productivity, and expended costs associated with defending actionable claims" (Brown and Mitchell, 2010, pp. 588–599). In other cases, highly successful CEOs, such as Harry Stoneciper of Boeing and Mark Hurd of HP, were forced to resign following the discovery of inappropriate relationships entered into by the CEOs. Even Enron, despite possessing a comprehensive compliance or ethics program, collapsed at least in part due to an inappropriate tone at the top led by former CEO Jeffrey Skilling, who emphasized bottom-line results as opposed to ethical values. Kenneth Lay, also former CEO and chairman of Enron, demonstrated a lack of ethical leadership when he requested that Enron's managers use his sister's travel agency for all of their overseas flights. The U.S. government bailout of American International Group (AIG), the collapse of Lehman Brothers, and the sale of Merrill Lynch, appear to demonstrate how the self-interested pursuits of these firms' senior leaders led to severe financial repercussions for their investors, clients, employees, and other stakeholders. All of these examples seem to support the claim that: "Leadership which lacks ethical conduct can be dangerous, destructive, and even toxic" (Toor & Afori, 2009, p. 533).

To summarize, an ethical leader is trustworthy, honest, transparent, responsible, caring, respectful, fair, acts with integrity, and puts the interests of the firm and other stakeholders before his or her own personal interests. All of this must be demonstrated through the leader's actions, not just through words. In fact, only greater cynicism among employees will occur if the leader talks about the importance of ethical behavior but does not act accordingly. The failure of senior executives to act accordingly must lead to disciplinary action by their firm's board of directors, regardless of the financial implications, in order to ensure a sense of accountability. Without ethical leadership across the organization, including at the level of the board of directors, there is little chance of establishing and sustaining an ethical corporate culture.

Discussion and Conclusion

Figure 1 summarizes the interaction of all three elements necessary to develop and sustain an ethical corporate culture within a firm.

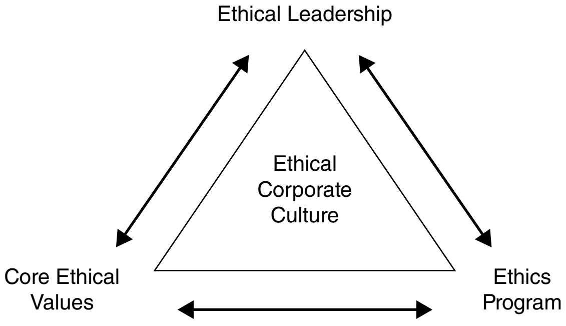

Figure 1 Key elements of an ethical corporate culture.

Once an ethical corporate culture is developed and hopefully sustained, the assumption is that the extent of crime, corruption, and unethical activity within organizations or on their behalf will be minimized. Of course, developing an ethical corporate culture is only the first step, with multiple constant challenges to be overcome. For example, developing and sustaining an ethical corporate culture becomes exceptionally difficult for large multi-national organizations which have tens if not hundreds of thousands of employees around the world, each with their own distinct ethical perspective and culture. A general or overarching 'corporate culture' does not exist or at least would be extremely difficult to ever identify in any large multinational organization. Constant acquisitions or mergers between firms which each possess very distinct ethical corporate cultures makes it even more difficult to establish and maintain consistent ethical norms across an entire organization. A single change in top management can also have a significant negative impact on ethical corporate cultures, as demonstrated with respect to CEO Jeffrey Skilling at Enron. While difficult economic conditions or intense competition that might lead to financial ruin can actually strengthen ethical corporate cultures due to increased scrutiny, such conditions might also intensify the pressure on firms to reject their ethical norms in favor of the bottom line.

Unfortunately, it is often difficult to measure the success of an ethical corporate culture in terms of outcomes, as one cannot always identify the scandal that was avoided as a result of an ethical work

Table 2 Three pillars of an ethical corporate culture: recommendations and examples.

	Recommendations	*Examples*
(l)(a) Core Ethical Values: Policy	• Establish a set of core ethical values for the firm including: trustworthiness; responsibility; caring; citizenship; fairness; and respect. • Emphasize that when in conflict, the ethical values must take priority to the bottom line. • The ethical values should be posted prominently in the firm's code of ethics and on the home page of the firm's website.	• *Good*: Johnson & Johnson's Credo establishes stakeholder priorities by stating that their first responsibility is to the users of their products and services, while their "final responsibility" is to their stockholders. • *Bad*: Toyota's actions leading to the brake pedal recall appeared to equate the value of 'safety' with 'quality', rather than making safety a priority in and of itself.
(l)(b) Core Ethical Values: Process	• An ethical values filter should be applied to decision making including hiring (e.g., testing/interviews), performance appraisals, and firing. • Whether one acts in accordance with the ethical values should be directly tied to the firm's compensation/reward system.	• *Good*: The firm Veritas (Latin for truth) fired their CFO when it was discovered that he had lied years earlier about having an MBA on his resume. • *Bad*: Enron's performance appraisal system ('rank and yank' process of dismissing the bottom 10% performers) appears to have contributed to pressures to cut ethical corners.
(l)(c) Core Ethical Values: Practice	• All firm level and managerial level decision-making should be based on and explicitly refer to the core ethical values whenever possible.	• *Good*: BankBoston's application of the ethical value of respect during layoffs in the 1990s led to the provision of job retraining, educational grants, and support of non-profit employment for laid off employees. • *Bad*: Enron's complete disregard for their explicit values as indicated in their code of ethics including respect and integrity (e.g., honesty).
(2)(a) Formal Ethics Program: Code	• Ensure employee involvement in code creation or revision to help achieve buy-in and ensure realism. • Code should apply to all firm's agents including contractors and suppliers.	• *Good*: Walmart's "Statement of Ethics" applies to all relevant stakeholders including the firm's suppliers, consultants, law firms, public relations firms, contractors, and other service providers. • *Bad*: WorldCom lacked a code of ethics based on the CEO Bernie Ebber's view that having a code was a "colossal waste of time".
(2)(b) Formal Ethics Program: Implementation	• Annual sign-off of the code should take place. • Relevant examples should be used during training. • Manager should conduct training whenever possible.	• *Good*: Johnson & Johnson periodically surveys its employees to evaluate how well the company lives up to its Credo responsibilities. The firm ensures that the Credo remains at the heart of the corporate culture by training its managers in the Credo-based Johnson & Johnson 'Standards of Leadership'. • *Bad*: Enron's training video 'Vision and Values' includes CEO Jeffrey Skilling's statement: "Out there…there's a desire to cut corners, but we can't have that at Enron".
(2)(c) Formal Ethics Program: Administration	• A whistleblowing channel should be established that is well communicated with protections against retaliation provided. • Best to refer to the whistleblowing channel as a 'helpline' and not a 'hotline'. • Annual audit of the ethics program's effectiveness should take place with modifications made if necessary.	• *Good*: Following their bribery scandal, Siemens created an ethics and risk compliance department with 600 employees, developed a training program, and changed the reporting system at the highest levels to try to prevent future misconduct. • *Bad*: BP's alleged failure to protect their employees who raised safety complaints, in part leading to the Gulf oil spill.
(3) Ethical Leadership	• All actions and decisions at all levels throughout the organization should exemplify ethical leadership, up to and including the board of directors. • Managers should ensure that their personal behavior does not conflict with their ethical reputation at work.	• *Good*: J&J's CEO James Burke's decision to recall Tylenol nationwide based on their credo despite the financial cost. • *Bad*: HP CEO Mark Hurd's concealed relationship with a marketing consultant and his submission of inaccurate expense reports.

environment. In any event, while significant and sustained efforts by firms must be undertaken to ensure high ethical standards, they must take place along with the decisions and actions of other stakeholders, including: governments (e.g., through regulation, enforcement, incentives, etc.); employees (e.g., where to work); customers (e.g., which companies' products to buy or services to use); suppliers (e.g., which companies to work with); creditors (e.g., where to lend); shareholders (e.g., where to invest, shareholders resolutions, etc.); NGOs (e.g., through the development of ethical codes and pressure tactics); academics (e.g., through normative research); and the media (e.g., through investigative reporting). As a 'multipronged' approach, all of these stakeholders can collectively place additional pressure or create incentives to encourage firms and their agents to engage in legal and ethical behavior.

With respect to the efforts of the firms themselves, it is argued above that there are three fundamental elements that form the basis of an ethical corporate culture: (1) the existence of a set of *core ethical values;* (2) the establishment of a *formal ethics program;* and (3) the continuous presence of *ethical leadership*. As a summary, Table 2 highlights the key recommendations and provides better known corporate examples of the 'good' and the 'bad' for each of the three pillars of an ethical corporate culture.

With significant corporate scandals taking place in 2010 such as Toyota's recall troubles leading to approximately $50 million in fines and billions of dollars in recall expenses, Goldman Sachs betting against a subprime mortgage product while at the same time recommending the product to its own clients leading to a $550 million settlement, along with BP's massive oil spill in the Gulf of Mexico leading to the establishment of a $20 billion compensation fund, one might question whether these firms had *all* three elements clearly present.

Without all three of these elements firmly in place, each of these firms arguably developed corporate cultures that emphasized financial considerations over the health, safety, or general well-being of other stakeholders. For example, Toyota has been referred to as having a "secretive corporate culture" in Japan which clashed with disclosing safety defects (Linebaugh et al., 2010). Goldman Sachs' corporate culture focus on revenue generation, egos, and bonuses is viewed as contributing to their clients being misled (Morgansen & Story, 2010). BP has been referred to by a U.S. government commission as possessing a "culture of complacency" with profits taking priority to safety leading to the Gulf oil spill (Crooks, 2010). Future research might examine the extent to which firms such as these that suffer ethical scandals were deficient in their ethical values being infused throughout the organization, possessed a weak ethics program, and/or lacked ethical leadership. Research might also examine whether such firms succeed in developing and sustaining an ethical corporate culture following such incidents based on the presence of the three core elements, or if any changes in the ethical culture tend to be merely short-term in nature.

While all three elements are distinct, they also reinforce and support each other. For example, ethical values become the basis for ethics programs, which in turn can enhance ethical leadership. Ethical leadership as discussed above is critical for the successful infusion of ethical values throughout the organization and the potential effectiveness of ethics programs. When all three elements of an ethical corporate culture are in place, employees are not only sensitized to recognize ethical dilemmas they or their firms are facing, but will hopefully have the motivation, ability and confidence to respond in an ethically appropriate manner, with such ethical behavior being supported and rewarded by all managerial levels of the organization. Such ethical sensitivity will hopefully not only take place for macro-level ethical issues, such as whether to open up operations in a country being run by a repressive regime, but also for micro-level issues such as whether to hire a friend who is highly qualified for a job position. Nevertheless, due to human nature, crime, corruption, and other illegal or unethical activity will never be completely eliminated for a certain percentage of the workforce, regardless of whatever efforts are undertaken. However, business firms, including the firm's board of directors, senior executives, and managers, all have an ethical obligation to make reasonable attempts to minimize the presence of crime and unethical activity, for the good of all society.

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The Ethics Officer as Agent of the Board
Leveraging Ethical Governance Capability in the Post-Enron Corporation

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Congressional, regulatory, and judicial investigations into various corporate scandals over the last five years have concluded that inadequate ethical oversight of senior management by the board of directors has been a significant or even dominant cause.[1] The news media may have focused on the wrongdoing of high-powered, Machiavellian executives, driven by greed and hubris, but the fact remains that the ultimate governing authority of any corporation is, and always should be, its board of directors.

To be sure, there have been some egregious failures on the part of boards of major corporations. Boards have, for instance, been found to have: consistently ceded power over the direction of the company to the CEO (WorldCom);[2] knowingly allowed the company to engage in high-risk accounting practices (Enron); [3] witnessed numerous indications of questionable practices by management over several years, but chose to ignore them to the detriment of shareholders, employees, and business associates (Enron);[4] known of violations of law, taken no steps in an effort to prevent or remedy the situation, and failed to act for a long period of time, resulting in corporate losses (Abbott Laboratories);[5] failed to be sufficiently informed and to act independently of the chairman of the board (Fannie Mae);[6] routinely relied on management and the external auditor's representations with little or no effort to verify the information provided (Enron);[7] and failed to function in a way that made it likely that they would notice red flags (WorldCom).[8]

The ingenuity, sophistication, and complexity of some of the frauds perpetrated by company executives do not in any way excuse or mitigate the failure of boards to intervene. On the contrary, such cases tell us that the relevant boards were deficient in significant respects. The various examples we cite have in common a board approach that defaulted to passivity, acquiescence, and sometimes even indifference. All the while, fiduciary responsibilities to shareholders demanded that directors should have acted in a spirit of independent and rigorous inquiry, insisted on full and complete information, challenged management when necessary, and taken decisive action when appropriate. Investigators and commentators have pointed to boards rife with conflicts of interest and lulled by complacency; directors who were inadequately qualified, prepared, or equipped for the rigors of their role; and boards that simply did not exert the requisite authority.

There is an additional reason for these governance failures, which so far appears to have received almost no attention: the ethics and compliance function in corporations has not been working in the way it should, with an all-too-frequent disconnection from the board. More specifically, ethics officers and the programs they oversee have not engaged boards of directors effectively and meaningfully in the ongoing process of rigorous and independent ethical inquiry that is essential to sound corporate governance.There are at least three reasons for this. First, to put it bluntly, ethics officers are in thrall to senior management – the fact that they are typically appointed by, report to, have their compensation set by, and are capable of being fired by senior management creates an inherent conflict of interest. Second, in most cases ethics officers

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do not have the power, status, and authority in their corporations that they need to do their job effectively. Third, the nature of the relationship, as presently structured, between ethics officers and their boards does not engender effective and authoritative collaboration, thereby hampering not only the ethics and compliance program but the governance process as a whole.

The above three issues have not been addressed in spite of an unprecedented focus by Congress, regulators, the judiciary, and companies themselves on ethics, compliance, and corporate governance reform. For the record, this attention resulted in the enactment in 2002 of the Sarbanes-Oxley Act (SOX), generally considered the most significant corporate governance legislation since the securities laws were passed in the 1930s. Its provisions include many reforms intended to protect investors by raising corporate governance standards through improvements in the accuracy and reliability of corporate disclosures. The Securities and Exchange Commission (SEC) then made detailed rules implementing SOX provisions, and in 2003 approved reforms to the corporate governance requirements of the New York Stock Exchange (NYSE), National Association of Securities Dealers (NASD), the American Stock Exchange (AMEX), and NASDAQ. The latter reforms are designed to enhance the accountability, integrity, and transparency of the exchanges' listed companies. Then in 2004, the United States Sentencing Commission amended the Federal Sentencing Guidelines for Organizations (FSGO) for the first time since their inception in 1991. This redefined the criteria of effectiveness for compliance and ethics programs, including a new focus on corporate culture and the role of the board of directors (and other high-level personnel) in promoting "an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[9]

This article will propose that an important step in addressing the above problems effectively is to make the ethics officer an agent of the board of directors. Under this new model, the ethics officer would be appointed by the board, would report directly and be accountable to the board, and would have his or her compensation set by the board. Furthermore, only the board would be capable of firing the ethics officer.

Precisely how the ethics officer's employment contract would be structured and implemented is a matter for employment lawyers, and beyond the scope of this article. We are concerned with the concept of an ethics officer whose tenure is on the terms suggested above, with particular emphasis on reporting *directly* to the board. When we speak in this paper of reporting directly to the board, we mean a relationship of full accountability. This is a relationship that far exceeds the giving of periodic reports to the board about what is going on in the ethics and compliance program. The FSGO now recommends at least one such appearance before the board annually.[10] This may give the ethics officer limited "access" to the board but that is very different from a direct reporting relationship. In addition, as one of the authors of this paper (Hoffman) noted in an earlier co-authored paper, having access to the board does not necessarily enhance an ethics officer's independence from company management.[11]

Unless otherwise indicated, the term "ethics officer" (EO) will be used throughout this article to signify the person with responsibility for overseeing a company's ethics, compliance, and business conduct efforts; in other words, the chief EO, whose brief is to provide strategic and operational leadership to the ethics and compliance program.[12] We recognize that many other terms (e.g., compliance officer, business conduct officer, and business practices officer) are in common usage[13] but use "ethics officer" for convenience. Terminological differences aside, the EO position was created in some companies more than 20 years ago,[14] but it received a strong mandate with the introduction of the FSGO in 1991, which required organizations to appoint a high-level individual to oversee compliance with business conduct standards. The chief EO is usually an appointment at the vice president or senior vice president level, and this person often has other duties to perform, which in some companies may be as general counsel or head of human resources. Indeed, it is rare for the chief EO to be responsible for the day-to-day management of the ethics and compliance program, which will normally be delegated to a person at the director or manager level, who in turn will most likely supervise others. The authority, influence, and effectiveness of the day-to-day EO (and his or her team) are largely derived from that of the chief EO. The latter point is important and will be addressed later in the article.

Let us now consider the three major flaws, mentioned above, in the structure and operation of the ethics and compliance function. To a greater or lesser extent, these shortcomings are limiting the effectiveness of the ethics and compliance function and creating obstacles to good governance in virtually every corporation in the United States.

An Inherent Conflict of Interest in Current EO Reporting Structures

The EO is the person with primary responsibility for ensuring a company's ethical performance. This is now understood as being at least equally important as the company's financial performance because, as we have seen many times in recent years, the latter can be derailed dramatically by ethical missteps. Such is the connection of a company's ethical performance to its financial stability, reputation, and its risk profile generally, that ethics and compliance is as critical a corporate function as marketing, sales, finance, and human resources. In some respects, it is more critical since it touches every aspect of a corporation's business operations like no other corporate function and is inextricably connected to the organization's governance.

When a company seeks to create and sustain an ethical organizational culture, it is critical to promote the universal expectation that no one in the company, no matter how senior, is above the law or the requirement to behave ethically. Everyone from the chairman of the board and the CEO to the most junior mailroom assistant has to be ethically accountable. And given the importance of senior management's performance to the company's success, as well as its significant influence on the corporate ethical culture, one of the EO's most important responsibilities is to monitor and critique senior management's decision making and conduct.

However, when the company's reporting structure is set up so that the EO is appointed by, reports to, and is accountable to management – the situation in almost all companies - this creates a conflict of interest. If the EO's job or career is dependent on the very people whom he or she may need to call to account in respect of their own ethical conduct, there is immediately a possibility that the EO will be influenced by personal interest (consciously or subconsciously) and his or her objectivity or independence will be compromised.[15] Typically, the EO will have been hired by senior management; the EO reports to senior management, to whom he or she is accountable; his or her performance is evaluated by senior management; the EO's compensation is set by senior management; and the EO can be fired by senior management, which could mean not only losing a job but possibly a career.

This conflict of interest can have far-reaching consequences for an organization. Not only can this conflict interfere directly with the EO's judgment and effectiveness in monitoring the decisions and conduct of management, but it might also give rise to a perception among employees generally that management is treated differently. In that event, the EO's credibility and that of the ethics and compliance program is at risk.

As if that were not a huge concern in and of itself, consider the need for corporate ethics and compliance programs to have credibility with regulators, prosecutors, and sometimes, unfortunately, sentencing judges. Self-evidently, such credibility depends significantly upon the way in which EOs are appointed and function. Any question mark over the independence and objectivity of the EO in a particular case is a matter for consideration in assessing program effectiveness within the terms of both the FSGO and the so-called Thompson Memo.[16]

Lest anyone should think these concerns are academic, let us consider two recent and stark illustrations. In 2004 Strong Capital Management (SCM)[17] was subject to administrative and cease-and-desist proceedings by the SEC.[18] The case is notable because a compliance officer, appointed by and reporting to senior management, was indicted for not doing his job; and had he acted as he should have done he might well have been fired by the CEO.

In 2000, Tom Hooker, SCM's director of compliance at the time, noted CEO Richard Strong's frequent personal trading in a compliance review. On hundreds of separate occasions, Strong made redemptions that were inconsistent with limitations in the funds' prospectuses, realizing personal profits of several million dollars. Hooker informed SCM's in-house counsel, who was also the chief compliance officer (and Hooker's supervisor), of Strong's activities. In-house counsel told Strong that his frequent trading to the detriment of the funds and their shareholders should stop immediately. In-house counsel directed Hooker to monitor Strong's trading activity. Although Hooker was directed to monitor Strong's trading, he failed to follow up on this problem to ensure that Strong's trading activity had in fact stopped. There were no compliance measures implemented to monitor or prohibit his delinquent activities.[19]

Thus, even though SCM had a chief compliance officer and a director of compliance, the compliance function was unable and/or unwilling to stop Strong's unethical (and often illegal) activities. It seems safe to assume that both compliance officers were affected by the conflict of interest that arose by reason of their having been hired by SCM's senior management. For the record, the SEC investigation found Hooker to have willfully aided and abetted and caused Strong and SCM's violations, fined him $50,000, and barred him from working in the investment industry.

The Fannie Mae case provides a second example of a systemic conflict of interest preventing the ethics and compliance function from doing its job. Fannie Mae is the largest firm in the U.S. housing finance system. It was the subject of an earnings management scandal that led the SEC in 2004 to direct the firm to restate its financial results for 2002 through mid-2004, on account of a $10.6 billion income and capital overstatement. In the report of its investigation of Fannie Mae, the Office of Federal Housing Enterprise Oversight (OFHEO) noted that Fannie Mae's senior management, through their actions and inactions, committed or tolerated a wide variety of unsafe and unsound practices and conditions between 1998 and 2004.[20] Improper earnings management at Fannie Mae increased the annual bonuses and other compensation linked to earnings per share that senior management received.

Fannie Mae had an Office of Corporate Compliance (OCC) that it established in late 2002 in order to enhance its ethics and compliance program. The OCC was led by the Chief Compliance Officer who reported to the General Counsel. However, the "Report to the Special Review Committee of the Board of Directors of Fannie Mae" (popularly known as the "Rudman Report," after Warren B. Rudman, the former senator who led the independent commission that produced it), found that Fannie Mae's management undermined the perceived independence and impartiality of the company's ethics and compliance functions by housing them within a litigation section of the legal department, headed by a chief compliance officer who also served as the head of the employment practices litigation group responsible for defending the company against employee complaints.[21]

This kind of reporting structure for EOs is not uncommon. At the Conference Board's Ethics and Compliance Conference in May 2006, the results of an informal survey of 51 EOs in the defense industry were presented, showing that 22 percent of them report to the legal department. The author of the survey, Richard Bednar, coordinator of the Defense Industry Initiative on Business Ethics and Conduct (DII), perceives this as a most disturbing trend. He observes that "ethical decisions [are] being transferred into legal decisions … It's the duty of the CEO's lawyer to protect, defend, and deny and *not* engage in the root cause of the problem."[22]

Joe Murphy, a leading commentator on ethics and compliance issues, notes that the acid test of a compliance program is whether it can stand up to powerful managers who are accustomed to having things their own way.[23] We agree with Murphy that this requires the EO (and those working for him or her) to be empowered and protected. But providing the EO with sufficient power and protection will be problematic unless the conflict of interest identified above is effectively removed.

In order to lead, fortify, and oversee the company's efforts to promote and engage in ethical business practices, EOs must operate under conditions that enable them to conduct their responsibilities independently, indiscriminately, and without fear of retribution, whether direct and immediate or insidious and subtle over a period of time. However, it would appear very difficult, if not impossible, to assure EOs these conditions under a system in which they are appointed by, report to, and are accountable to senior management. We must therefore acknowledge the possibility that EOs, in more companies than we would care to imagine, may be subject to pressure – consciously or subconsciously – not to report on the unethical conduct of a company officer who could fire him or her or otherwise negatively affect his or her livelihood or work situation. This leaves us with the choice of accepting this as the best system we can devise, or creating a better one. We prefer the latter option.

The proposal that the EO should be an agent of the board is perhaps somewhat radical – and unlikely to be universally popular[24] – but in our view very necessary. By fundamentally altering the nature of the EO's relationship with the board, the conflict of interest is removed. In this way, the EO can operate independently of management with the direct authority of the board and all the protection that this affords.

Ethics Officers Do Not Have Sufficient Power, Status, and Authority

While there is no doubt that an EO profession has become well established over the last decade,[25] we believe there is a worrying recent trend toward declining EO importance in the corporate hierarchy. Our view is supported by Bednar, who suggests that today's EO is a "position looking for a role" and lists a number of telltale signs that may indicate whether the importance of ethics is cooling in an organization. These include: the EO not being regularly invited to attend the CEO's meetings with direct reports; resourcing of the ethics office is not keeping up with other functional areas; the EO is asked to take on assignments unrelated to his/her core mission; primary ethics functions are becoming outsourced, particularly in the areas of hotline/helpline management and training; and the boss calls the general counsel instead of talking to the EO.[26]

If any of the above signs become apparent in an organization, the EO does not have all the power, status, and influence that he or she should have. Bear in mind that the amended FSGO requires the person with operational responsibility for an organization's ethics and compliance program to be given "adequate resources" and "appropriate authority."[27]

Murphy emphasizes that any company seriously committed to compliance and ethics should ensure that its compliance officer and staff are empowered. He argues that this is indispensable for the compliance program itself to be effective. He notes that one fundamental step in the direction of giving the EO the power and authority he or she needs – and showing full commitment to the success of the ethics and compliance program – is to have a strong board of directors' resolution endorsing the program. A good resolution will commit the company at the highest level and fully empower the EO.[28] We agree with Murphy that it is necessary to empower the EO and his/her program. However, a board resolution is a necessary but insufficient means to achieve this. Our solution goes much further than this.

The proposal that the EO be an agent of the board has the important virtue of elevating the EO in the corporate hierarchy. It would also give the EO the very real authority that comes with any board appointment, and would signal to management and all employees, more than any board resolution, that the ethics and compliance program was endorsed and supported by the highest authority in the corporation.

Boards Need to Enhance Their Ethical Oversight Capabilities

We observed at the beginning of this paper that most, if not all, of the corporate ethical scandals of recent years can be characterized as failures of governance. One of the most significant problems has been that boards of directors have not adequately fulfilled their ethical oversight responsibilities in respect of senior management and the company as a whole. In some cases, boards were not sufficiently engaged or, worse still, they were negligent. In others, they were not well enough informed or equipped to do what was required of them.

To be sure, all boards need to motivate and equip themselves to pursue their responsibilities in a spirit of active, informed, and independent inquiry. They require the knowledge, skills, tools, and support that will allow them to exercise the necessary oversight over senior management and to actively promote an ethical corporate culture.

It is not enough for directors to be diligent and vigilant; they need to assure themselves access on demand to high-quality information about management proposals and activities, and about the company's operations in general. Ideally, the board will acquire such information in the ordinary course of an open and collaborative relationship with senior management. However, we have seen from recent history that boards cannot depend on management disclosure and must take a proactive approach to information gathering and processing.

It is critical that the board receives a continuous and uncorrupted flow of information about matters critical to its oversight of the company. This information must necessarily be accurate, up to date, and unfiltered. Failure in this process was found by the Rudman Report to have been a key factor in what occurred at Fannie Mae. Specifically, the report noted that among the numerous deficiencies afflicting Fannie Mae's ethics and compliance program as of late 2004 was "an unstructured information flow to the board."[29] While information was given to the board from time to time, it does not appear that it was provided in ways that enabled the board to assess the effectiveness of the company's ethics and compliance programs.

We suspect that the Fannie Mae experience is being played out, perhaps in less extreme but nevertheless dangerous ways, in many companies today. Bednar's survey mentioned earlier found that only 20 percent of responding EOs reported to the board of directors, which is an unacceptably low proportion. Moreover, we are concerned – along with Bednar and others – with the quality and frequency of such reports to the board.

Some might say that the board failures we have seen at companies like Enron, WorldCom, Tyco, Fannie Mae, and other companies were isolated, albeit costly, aberrations and that the vast majority of boards would not allow management the same degree of latitude. The same people might argue, especially in a climate of heightened ethical awareness and regulatory fervor, that boards are focused on their oversight responsibilities like never before; and that directors are already doing all they can to maximize their capabilities. The first part of the above contention may be true although we have doubts about the second part. On this matter there is no room for complacency. Every single board of directors in corporate America should assess the potential for improving ethical oversight capabilities.

By changing the nature of the EO's relationship with the board of directors, not only will the EO become more effective but he or she can also significantly assist the board in performing its ethical oversight responsibilities, which will increase ethical corporate governance. The EO can help and advise the board on acquiring, analyzing and acting upon information that is pertinent to the board's ethical oversight responsibilities. In particular, the EO's connection to every part of the organization, and his or her unique perspective and technical expertise, can assure the board of a much higher quality of information than it might otherwise receive.

The EO can help the board in a number of other ways. A closer ongoing relationship with the board will enable the EO to engage the directors in a more comprehensive process of continuous education about ethics and compliance issues in the company, ensuring that they are fully informed about their own responsibilities. This is likely to raise the board's general level of ethical awareness, and can help directors to achieve greater consensus around ethical practices in the company, in its industry, and around ethical issues affecting the board itself. The EO can also provide the board with guidance on finding opportunities to demonstrate ethical leadership and generally to positively influence the corporate culture in the manner contemplated by the FSGO.

As well as providing the directors with an educator and discussion facilitator, an elevated role for the EO could position him or her as "ethics counsel" to the board. Having such guidance could be helpful not only as the board performs its oversight responsibilities in respect of the company, but also in holding itself to required ethical standards. Perhaps Hewlett-Packard's board of directors might have handled its internal investigation of a press leak with greater sensitivity if the company's EO had been an agent of the board. We cannot be sure how an individual in such a position would have brought about a different outcome, though we do know that the chairwoman of the board would not then have been able to resort to her apparent excuse that she relied on management to advise on the ethical appropriateness of the investigative techniques used against members of the board itself and certain journalists.[30] But this situation aside, unless the EO is made an agent of the board of directors in the manner proposed, the board may lack information of sufficient quality and timeliness, and may not have the full complement of tools, advice, and support it requires to perform its governance responsibilities.

Developments Supporting an EO–Board of Directors Reporting Relationship

What we are proposing in this paper may be controversial, but it is not without precedent or analogy.

The United States Sentencing Commission felt sufficiently concerned about board oversight of ethics and compliance to insert a new requirement in the FSGO in November 2004 to the effect that:

> Individual(s) with operational responsibility [for the ethics and compliance program] shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the … program.[31]

Note that the above provision requires reporting to the board as *appropriate*. The FSGO (and application notes thereto) are silent as to what is meant by appropriate, other than to say that if the chief EO does not have day-to-day responsibility for the program, the person who does should report to the board "no less than annually." One can make a case that the chief EO (briefed as necessary) should appear before the board on a much more regular basis. In any event, we suspect that the reporting by EOs to the board is presently not appropriate, nor indeed will it be appropriate until there is a direct reporting relationship of the kind we are proposing.

We find further support for our argument in a (nonbinding) footnote to the SEC final rule applying to Section 406 of SOX, in which the SEC opines on what it means by the "appropriate person" to whom violations of the code of ethics should be reported. The relevant part of the footnote says:

> … we believe the person identified in the code [as the appropriate person] should have sufficient status within the company to engender respect for the code and the authority to adequately deal with the persons subject to the code regardless of their stature in the company. [32]

Almost always, the "appropriate person" will be the EO since he or she typically receives reports of code violations. Clearly, the EO must have adequate authority to deal even with the CEO if necessary. As argued earlier, this is problematic if the EO reports to the CEO or to someone who reports to the CEO. It is logical to extrapolate the SEC's perspective to a requirement that the EO should report directly to the board of directors along the lines we are proposing.[33]

An analogy might also be drawn from Section 301(2) of SOX, which requires the board of directors of a public company (through its audit committee) to be directly responsible for the appointment, compensation, and oversight of the external auditors. We are effectively proposing that the board of directors be directly responsible for the appointment, compensation, and oversight of the EO on the basis that independence and an absence of conflicts of interest are just as essential to the successful performance of the ethics and compliance function as to the external audit function.

Perhaps even more directly applicable is the analogy of compliance officers in the mutual fund industry. The SEC's Rule 38a-l requires each mutual fund to appoint a chief compliance officer (CCO) who must report directly to the fund's board of directors. The rule contains several provisions expressly designed to promote the independence of the CCO from the management of the fund. First, only the fund board can hire or fire the CCO. The fund board (including a majority of independent directors) must approve the designation of the CCO and must approve his/her compensation (or any changes in his/her compensation). The SEC's commentary on the rule contains the following interesting observation that is germane to the issues we are considering:

> We have observed that executives at service providers have overruled their own compliance personnel because of business considerations. For example, some fund advisers have continued to permit investors with whom they had other business relationships to engage in harmful market timing in fund shares after compliance personnel and

> portfolio managers brought the market timing activity to their attention. These compliance personnel may not have had access to fund directors or, having been overruled by their own management, may have felt they were not in a position to approach the board.[34]

Anticipated Objections and Rebuttals

On the basis of interviews with a number of current or retired EOs,[35] and on the basis of informal conversations with EOs, we expect opposition to our proposal that the EO should be an agent of the board. Let us consider a sample of these objections and counter each in turn.

Our CEO/senior management team is highly ethical; so perhaps it is important for some companies to have an EO who is an agent of the board, but it's unnecessary for ours.

This position is optimistic at best, certainly naïve, and betrays a dangerous complacency of the kind that almost certainly foreshadowed the ethical eclipses at the various corporations mentioned earlier. It takes no account of the fact that even managers with a longstanding reputation for integrity can, and sometimes do, buckle under extraordinary pressure, allowing their ethical judgment to be compromised by what they see as overriding business considerations. Furthermore, the management of a company is likely to change at some point. New executives' ethical credibility will remain unproven unless and until (and each time) they are tested by an ethical dilemma.

It is impractical for the EO to report directly to the board of directors (as opposed to management) because the board comprises outsiders who meet infrequently, and who therefore are out of touch with the company's operations.

This argument reflects a limited view of how a board ought to work. For one thing, directors are frequently engaged in company business outside of official meetings and throughout the year, as individuals and in board committees. The argument also ignores the fact that the EO's access to the board, even as presently constituted, is not (and should not be) limited to formal meetings, and many EOs currently develop relationships with individual directors. If, in fact, the board is out of touch with happenings at the company, how could a direct reporting relationship between the EO and the board do anything but help the situation?

Management would view the EO as an outsider and would not take him/her seriously.

There is today no shortage of evidence (anecdotal and reported by the press) of "insider" EOs being excluded or marginalized by management. We actually believe that an EO who is an agent of the board of directors has more, rather than less, chance of being taken seriously by management. Management ought to be looking to build a collaborative relationship with the board, and if they feel threatened or uncomfortable in giving full disclosure to one of its agents, it is a sign that something is wrong in the organization.

Management would not share information with the ethics officer if he or she were not apart of management.

This position assumes that under the current reporting model, management always shares information with the EO. That is certainly not always the case, as we know from anecdotal evidence, from media reports, and deposition evidence in legal cases. As agent of the board, we contend that such information sharing with the EO would increase.

The proposal, if implemented, would damage the EO's relationship with management and would preclude a collaborative relationship between the parties.

If the EO were an agent of the board, this need not alienate the EO from senior management; in fact, when implemented appropriately it would enable the EO to serve as an important conduit between management and the board. Some might say this betrays a naïve impression of human nature and corporate realities. We would simply counter that if management is operating in the right way for the right reasons they have nothing to hide from the board; indeed management should actively cultivate open channels of communication. At the same time it is essential for everyone in the company to understand the importance of the EO's role and be clear that his or her ultimate loyalty and responsibilities are to the board and those whose interests it represents, the shareholders and other stakeholders.

The proposal would cast the EO in the role of the "ethics police," which is an undesirable perception that will hamper the EO's effectiveness.

Our response to this objection is simply to say that it departs from the current reality. If the EO is not in some fashion operating as the "ethics police" we wonder why he or she is in the job at all. Call it oversight or policing or what you will, but this is a critical part of the ethics and compliance function.

Conclusion

Even though the corporate scandals of the last five years have had myriad complex causes and repercussions, to a greater or lesser extent all of them involved fundamental failures of governance. Checks and balances that should have ensured proper oversight of management, triggering corrective action when necessary, were either deficient or absent; systemic conflicts of interest were tolerated, even encouraged; and cultural influences that minimized or eliminated ethical concerns were allowed to fester. In some cases, boards of directors were simply not exhibiting the kind of authority, independence or rigor demanded by their fiduciary responsibilities as the ultimate guardians of the shareholders' interests. In spite of an unprecedented legislative and regulatory response to these events in the United States, resulting in the biggest overhaul of corporate governance for 70 years, we believe that an underlying cause of governance failures in corporations has been overlooked: a systemic disconnectedness of the ethics and compliance function from the board of directors that has prevented both from working as they should. This article has identified three aspects of this malaise. First, there is an inherent conflict of interest in having EOs as a part of management because of the lack of independence and susceptibility to undue pressure that this reporting structure creates. Second, EOs often lack the power and authority to curb misguided or malevolent executive behavior. Third, the current reporting structure precludes the degree of collaboration between the EO and the board that we believe is necessary for fully effective ethical governance.

Having the EO appointed as agent of the board will effectively deal with these problems, providing further leverage for corporate governance reform and society's pursuit of increasingly ethical corporate cultures. This recommendation not only carries the mandates of the FSGO and SOX to their logical conclusions but also is foreshadowed by developments in the accounting and mutual fund industries.

The question arises as to how our proposal might take effect. Boards of directors and shareholders might appreciate its potential for enhancing governance capabilities, but board resolutions to change the EO reporting structure would almost certainly face obstructions in implementation. We have acknowledged that the proposal is unlikely to be popular with companies' senior management or even many EOs – though it seems to us that popularity is rarely the best indicator of merit. While it would be preferable for companies to voluntarily take the steps we are proposing, thereby signaling a strong commitment to truly effective ethical governance, we suspect a legislative or regulatory intervention will be necessary to install EOs as agents of the board.

Notes

[1] See, for example, "The Role of the Board of Directors in Enron's Collapse," Report of the Permanent Subcommittee on Investigations of the Committee of Governmental Affairs, United States Senate, dated, July 8, 2002. (Available online at: http://f11.findlaw.com/news.findlaw.com/cnn/docs/enron/senpsi70802rpt.pdf): see also R. C. Breeden, "Restoring Trust: Report to The Hon. Jed S. Rakoff, The United States District Court for the Southern District of New York, on Corporate Governance for the Future of MCI, Inc.," dated August 2003. (Available online at: http://f11.findlaw.com/news.flndlaw.com/hdocs/docs/worldcom/corpgov82603rpt.pdf .)

[2] "Restoring Trust," l.

[3] "The Role of the Board of Directors in Enron's Collapse," 3.

[4] Ibid.

[5] In re: Abbott Laboratories Derivative Shareholders Litigation 325 F.3d 795 (7th Cir. 2003).

[6] Office of Federal Housing Enterprise Oversight (OFHEO) "Report of the Special Examination of Fannie Mae," May 2006. (Available online: http://www.ofheo.gov/media/pdf/FNMSPECIALEXAM.PDF.)

[7] "The Role of the Board of Directors in Enron's Collapse," 14.

[8] "Report of the Special Investigative Committee of the Board of Directors of WorldCom, Inc.," dated March 31, 2003. (Available online: http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/worldcom/bdspcomm60903rpt.pdf.)

[9] United States Sentencing Commission Guidelines Manual, Chapter 8, Sentencing of Organizations, Washington D.C., November 2005, §8B2.1(a)(2).The Federal Sentencing Guidelines for Organizations, promulgated to guide federal judges in the sentencing of organizational defendants, were significantly amended with effect from November 1, 2004.

[10] The Application Notes for §8B2.1(b)(2) of the Federal Sentencing Guidelines for Organizations states: "If the specific individual(s) assigned overall responsibility for the compliance and ethics program does not have day-to-day operational responsibility for the program, then the individual(s) with day-to-day operational responsibility typically should, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness of the compliance and ethics program."

[11] W. M. Hoffman, J. D. Neill, and O. S. Stovall, "An investigation of ethics offcer independence." Paper presented at the 12th Annual International Conference Promoting Business Ethics on October 26, 2005, in New York. (This paper has been accepted for publication in a forthcoming issue of the *Journal* of *Business Ethics*.)

[12] The Ethics & Compliance Officer Association, the leading membership organization for individuals with ethics, compliance, and business conduct responsibilities, defines an ethics and compliance officer as being "tasked with integrating their organization's ethics and values initiatives, compliance activities, and business conduct practices into the decision-making processes at all levels of the organization." (See http://www.theecoa.org.)

[13] For a detailed review of terms in use, see J. F. Weber and D. Fortun, "Ethics and compliance officer profile: Survey, comparison, and recommendations." *Business and Society Review*, 110 (2005): 97–115.

[14] The defense industry fraud, waste and abuse scandals of the mid-1980s, leading to the Defense Industry Initiative of 1986, were responsible for a flurry of ethics- and compliance-related appointments.

[15] See Hoffman, Neill and Stovall, "An investigation of ethics officer independence."

[16] Memorandum sent on January 2003 by Larry D. Thompson, Deputy Attorney General of the United States, to United States Attorneys, entitled "Principles of Federal Prosecution of Business Organizations." The memo offers guidance to assist prosecutors in determining whether a corporate compliance program is a "paper program" or whether it was designed and implemented in an effective manner. (See http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.)

[17] Strong Capital Management was a registered investment adviser to the Strong funds complex, a family of mutual funds.

[18] In the matter of Strong Capital Management, Inc., Strong Investor Services, Inc., Strong Investments, Inc., Richard S. Strong, Thomas A. Hooker, Jr. and Anthony J. D'Amato. (See http://www.sec.gov/litigation/admin/34–49741.htm.)

[19] Ibid., order, paragraphs 30–32.

[20] Office of Federal Housing Enterprise Oversight (OFHEO), "Report of the Special Examination of Fannie Mae," 1.

[21] Report to the Special Review Committee of the Board of Directors of Fannie Mae (Executive Summary), Februaty 23, 2006, 25.

[22] For a detailed summary of the panel discussion in which Bednar participated, see E. L. Sherwood, "The evolving position of ethics officer," *Ethikos and Corporate Conduct Quarterly*, 20, I (2006): 10–19.

[23] J. Murphy, "Protections for compliance people," *Ethikos and Corporate Conduct Quarterly*, 19, 4 (2006): 1–19.

[24] Hoffman, Neill and Stovall's research included interviews with practicing or retired EOs, the majority of whom felt that reporting to upper management was preferable to reporting directly to the board of directors.

[25] This is evidenced by the growth in membership of the two leading professional associations for ethics and compliance practitioners, the Ethics & Compliance Officers Association (which has 1,150 individual and 650 organizational members) and the Society of Corporate Compliance and Ethics (with over 800 individual members and more than 30 corporate members).

[26] For a fuller consideration of Bednar's ideas, see E. L. Sherwood, "The evolving position of ethics officer," pp.1 0–11.

[27] Federal Sentencing Guidelines for Organizations, §8B2.l(b)(2)(C).

[28] Murphy.

[29] Report to the Special Review Committee of the Board of Directors of Fannie Mae, 499.

[30] See "Intrigue in high places," *Newsweek*, September 6, 2006. (Available online at http://www.msnbc.msn.com/id/14687677/site/newsweek/.) See also "Ex-HP

officer to say she knew of no illegality," *The New York Times*, September 28, 2006.

31 Federal Sentencing Guidelines for Organizations, §8B2.1(b)(2)(C).

32 Federal Register, Volume 68, No. 21 (January 31, 2003), page 5118, footnote 45.

33 For a more detailed analysis of this point see ,J. M. Brennan, "The future: More ethics officers reporting to the board?" *Ethikos and Corporate Conduct Quarterly*, 17, 3 (2003): 6–8.

34 Final Rule: Compliance Programs of Investment Companies and Investment Advisers, Securities and Exchange Commission, 17 CFR Parts 270 and 275 [Release Nos. IA-2204; IC-26299; File No. S57–03–03].

35 See endnote 24.

Can a Company be Too Ethical?

Andrew W. Singer

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"A couple of years ago, we were competing on a government contract," recalls Norman Augustine, chairman and CEO of Martin Marietta Corp. "The low bid would win. Two days before we were to submit the bid, we got a brown paper bag with our competitor's bid in it."

Martin Marietta didn't "spend 10 minutes" debating what to do with this information. Augustine remembers. The company turned the price sheet over to the U.S. government. Martin Marietta also told its competitor what it had received.

"And we did not change our bid."

What happened? "We lost the contract," recalls Augustine. "As a result, some of our employees lost jobs. And our shareholders lost money."

Is this a case of a company being too ethical?

No, answers Augustine. The outcome was only unfavorable in the short term. "We helped establish a reputation that, in the long run, will draw us business." This he accepts as a matter of faith.

"To me, the subject of ethics deals with principles," explains Augustine, "what you believe to be right or wrong." And insofar as ethics deals with principles, it is not possible to be too ethical. "You can't have too much principle."

But not all agree.

"You can spend too much time, too much effort, on almost anything," says Edward Bowman, Reginald Jones Professor of Corporate Management at The Wharton School at the University of Pennsylvania. "It doesn't mean you shouldn't be ethical." But it does suggest that there are limits.

What happens to a company in a highly competitive industry where "sharp" practices are the norm? If it behaves too nobly, might not other corporations succeed in cutting it off at the knees? Or what about companies that pour heaps of money into safety or environmental compliance – above and beyond what is mandated by law? Won't that hurt the bottom line?

A company, too, can pay so much attention to "doing good" that its traditional business suffers. This was a criticism made against Control Data Corp. (now Ceridian Corp.) under William C. Norris in the 1980s. The company ignored its core business at the expense of so-called humanitarian projects, said critics (more on this shortly).

The question – Can a company be too ethical? – admits of no quick or simple answers. In fact. it is difficult even to arrive at a common definition of what one means by ethical. Strictly speaking, ethics is a discipline for dealing with questions of good or bad, right and wrong – but there is also a broader definition, at least in the minds of many executives and ethicists, that embraces issues of so-called social responsibility. (Supererogatory duties, philosophers might call these.) Issues of bribe-taking, the stealing of

Andrew W. Singer, "Can a Company Be Too Ethical?" *Across the Board*, April 1993. © 1993 by Andrew W. Singer. Reprinted with kind permission of the author.

competitive information, and sexual harassment clearly accord with most people's notion of ethics, but others, such as affirmative action, investing in South Africa, empowering workers, and hiring the hard-core unemployed can be addressed only if one accepts an expanded concept.

Nonetheless, asking the question sheds some light on how business leaders view ethics and the business enterprise. (For the purposes of this inquiry, we examine business ethics in both the strict and expanded senses of the word.)

Thomas Donaldson, John F. Connelly Professor of Business Ethics at Georgetown University, observes that what is understood as business ethics among executives has undergone a sea change in recent decades. In the '60s, for instance, "business executives tended to identify corporate ethics with philanthropy and social-oriented programs, like hiring the hard-core unemployed.

"Now it has to do more with *how one approaches business objectives*." Is one being attentive to all one's constituencies, or "stakeholders," including employees, customers, suppliers, and the community in which one operates?

Some people say a company can be too ethical if "it pays its employees like kings," notes Donaldson. They reason that it costs money to pay employees so handsomely, and a company's profit margin may deteriorate, which ultimately hurts shareholders and overall business health. In that case, a serious question arises if the company is behaving toward its shareholders, and others, in a less-than-ethical manner.

The Price of Ethics

Most will agree that ethics sometimes exacts a price in the short run. "You know that old definition of a pioneer: He's the one with the arrows in his butt," says Tom Stephens, chairman, president, and CEO of the Manville Corp. (formerly Johns-Manville, of asbestos notoriety).

Manville emerged from bankruptcy in 1988. Today, Stephens feels an obligation for his company to be more ethical than average – given its past and the fact that it was offered a second chance by the courts. (The company, once one of the world's largest manufacturers of asbestos, was subject to 150,000 lawsuits on behalf of individuals whose health was allegedly ruined from asbestos exposure.) Yet this stance has its perils from a short-term profit standpoint.

Take the issue of product labeling. In the late '80s and early '90s, Manville went beyond what the law required in terms of warning labels on its fiberglass products. After the International Agency for Research on Cancer suggested in 1987 that fiberglass was a "possible carcinogen," the company promptly affixed prominent cancer-warning labels to all its fiberglass products. (The company disputes the claim that fiberglass may be a carcinogen, however.)

This in itself is not so unusual: U.S. companies are expected to respond this way in accordance with the Occupational Safety and Health Administration's (OSHA) Hazard Communication Standard. But Manville went further: It put the warning labels on fiberglass products that it shipped to Japan, and translated those warnings into Japanese. Not only was this not required by law, but the Japanese government advised against it.

Government officials there warned "against using the 'C' word," recalls Stephens. (The Japanese have a particular dread of cancer – a legacy of Hiroshima.) They were afraid of frightening the public. Manville's business customers, in turn, were fearful of scaring their workers. Architects worried about alarming lawyers by specifying a possibly carcinogenic building material.

The Japanese said, "We'll tell them what the risks are," according to Stephens. No need to alarm people by affixing such a label.

"But a human being in Japan is no different from a human being in the U.S.," Stephens says. "We told them we had a policy. We had to have a label."

The Japanese response? "The Japanese trade minister said, 'You are very brave.' "

And it *did* have an impact on the company's Japanese sales. (Twenty-five percent of Manville's revenues are derived from outside the United States.) The company lost 40 percent of sales to Japan in one year.

Stephens, Augustine, and others who recount such stories usually add that their business losses are only in the short term. Manville, for instance, was later able to rebuild all of its Japanese business. But do some managers believe that a business can be too ethical – period – and not just in the short term?

Few are likely to say so publicly. "If you ask people directly, they're likely to give you the most socially responsible answer," observes John Delaney, professor of management at the University of Iowa. But Delaney, who has collected dozens of ethical dilemmas submitted by business executives (including those from a study he conducted of Columbia University business-school graduates), suspects that some executives privately believe a company can, in fact, be too ethical.

He offers this case, which was reported by a corporate auditor at a large, well-known pharmaceutical company:

"The FDA was reviewing our application to place a new drug on the market," the auditor told Delaney. The persistent questioning of the FDA reviewer regarding the application, however, made the auditor uneasy, so he asked to review his company's research-and-development records.

Photocopies of the data provided evidence of "double books". "One set of raw data, completely fabricated, had been provided to me to present to the FDA, while another set of raw data, showing failing results, were the true data," the auditor recalled to Delaney.

The auditor reported his findings, in accordance with corporate procedure, to the international legal department. Eventually, he was asked to testify before the company's board of directors.

"The corporation, as a consequence of the hearing, made me a 'deal.' They would give me all the resources possible to get the drug approval by the FDA. But they promised they would never market the drug. They did not want the embarrassment of the fraud uncovered. . . . I cooperated in the deal, and the company cooperated in its part. Ten years later, the drug is still not on the market."

Subsequent to this "deal," however, the company rewrote the auditor's job description. Its aim seemed to be to make it more unlikely that improprieties of this sort would be uncovered in the future. The new corporate policy prohibited "surprise" audits, for instance. And corporate audit policy was placed directly in the hands of the CEO.

According to Delaney, this suggests that the pharmaceutical concern saw real "costs" in being too ethical. It didn't want to be blatantly unethical – foisting a flawed drug on the public (nor did it fire or demote the whistle-blowing auditor) – but by the same token, it wasn't too keen about uncovering any more episodes or this sort. Hence, it curtailed the audit function. The company seemed to be saying, "Whoa, we don't want to be too ethical. That could lead to real trouble!"

Nor is this stance entirely without financial justification. Back in 1975, the Wharton School's Bowman co-authored "A Strategic Posture Toward Corporate Social Responsibility," a study of 100 companies in the food-processing industry that sought to establish if there was a connection between corporate social responsibility and profits. (Bowman acknowledges that social responsibility is not the same thing as ethics but suggests that the two are related.)

Did the link exist? "If you plot the relationship, the association is curvilinear," says Bowman. That is, as one moves from companies that exhibit little or no social responsibility to those that demonstrate a modest degree, profitability rises. It peaks somewhere in the middle.

(What constituted a socially responsible company? Such factors as concern for the environment and eagerness to hire minorities. An unusually responsible corporation might be one that granted employees paid leaves of absence to work in the local community, for instance.)

"But over on the far right [i.e., among the *most* socially responsible firms], profitability drops off." It is a matter of diminishing marginal returns.

"You can spend too much money on advertising, on computers, on research and development," says Bowman. "Can a company concerned with its overall health spend too much on social responsibility? The answer is yes."

Nonetheless, as a matter of record, "The number of firms that have gotten in trouble for being too ethical is very small," observes David Vogel, professor of business and public policy at the Haas School of Business at the University of California at Berkeley.

While acknowledging that ethics and profits are not always compatible, and a company facing constraints could in theory be too ethical for its own good – such as failing to lay off workers when its sales plummet – in point of fact, "few firms, when faced with that tension, don't give in to the economic constraints," says Vogel.

The Legacy of Control Data

One of the few examples in which a company might have been harmed by being too good, Vogel acknowledges, is Control Data, which may have sapped its resources with humanitarian programs in the early and mid-'80s.

Indeed, the name of Control Data comes up again and again when one asks if a company can be too ethical. (Rightly or wrongly, people seem to accept a broader definition of ethics here: one that goes beyond questions of right and wrong, and encompasses social responsibility.) The computer company has become a paradigm in the minds of some of a company that faltered for being too good.

Under Norris, its visionary founder, Control Data built factories in riot-torn inner cities in the late 1960s and 1970s. It saw this as doing its part to ameliorate the social situation. "You can't do business in a society that is burning," Norris said at the time. The company had an exemplary record of hiring minority men and women with little formal education and few qualifications, and allowing them to rise through the ranks and become foremen and plant managers.

The company also spent $900 million between 1963 and 1980 trying to develop computer-based education programs for schools. The basic idea was that through computer-based instruction, students could learn at their own rate – unlike a class-room, where everyone must adapt to the teacher's pace. Control Data developed programs for everything from third-grade arithmetic to Farsi and Japanese.

While the company remained profitable, it garnered accolades. In 1983, a poll of Wall Street analysts and corporate directors rated Control Data one of the most admired corporations in the United States.

But then the company's core business began to flounder under the onslaught of intense Japanese competition, particularly in the computer-peripherals business. The corporation lost $568 million in 1985. That year, a new Wall Street poll showed Control Data to be among the country's *least* admired companies.

Norris, who resigned as chairman in 1986, has long disputed the view that he was too attached to socially responsible programs. Control Data was not engaged in sundry humanitarian projects, he insists, but rather in "addressing unmet social needs as business opportunities." Although the computer-based education program proved economically untenable, for example, there is no denying that the market for education and training was – and is – potentially enormous.

"I never felt that criticism was appropriate," Norris tells *Across the Board*. The company devoted no more than 5 percent of its resources to these nontraditional projects, he says. But they were in high-profile areas and were dependent on the cooperation of the public sector, such as local and state governments.

Might he have dedicated too much of his own time and energy, if not the company's resources, to such projects, to the detriment of the company's core business?

"The problem that plagued Control Data was a problem that plagued a lot of companies, but it hit us first," says Norris. "We were moving to a world economy. We didn't recognize it as fast as I would have hoped."

Max DePree, chairman of Herman Miller Inc., the furniture manufacturer, knew Norris "a little bit, and admired him greatly." DePree confirms in an interview that he, too, gained an impression that Norris may have devoted too many resources to socially responsible projects. But that isn't the same thing as saying the company was too ethical, even if that is the idea that has taken hold in the public mind.

"If Control Data had problems [in the mid-1980s], it was probably for the same reasons we all did: We underestimated the competition and we didn't stay focused on what we do," DePree says.

Control Data's socially responsible projects may have diminished Norris' focus, DePree acknowledges – but then the answer would have been to appoint a CEO to handle the core business, something that Norris may have resisted doing.

In any event, "I can't accept that Control Data failed because it was too ethical," DePree says.

Interestingly, Norris himself believes that "there are instances where a company can be too ethical." (And here we are back to a strict definition of ethics.) "But it's often a matter of failing to use common sense.

"One example when I was at Control Data occurred in Mexico. Bribes were commonplace at that time. In fact, government officials were expected to make part of their income through bribes. We had a situation where we shipped an expensive computer there. It was sitting on the dock, and the local official said we had to pay $500 if we wanted to move it out.

"Well, common sense says that you better pay that $500" even if the company has a policy against such payments. "The computer could get stolen; it could rain." Control Data made the payment.

The Morality of Management

Many view the way a corporation treats its employees as an ethical issue. Does the company treat its workers with dignity, as "ends" in themselves? Or are employees simply a "means" toward greater corporate profits? Companies that have sought to "empower" their workers by giving them a greater say in design and production matters, for instance, often view these actions as having an ethical – as well as a business – component. One is reaffirming employees as "ends" in themselves. But can a company take this notion too far?

Consultant Verne E. Henderson, while supporting worker empowerment generally, believes such a danger exists. In his book *What's Ethical in Business?* (McGraw-Hill, 1992), Henderson looks at People Express Airlines, the discount-fare carrier of the early 1980s.

The company's founder, Donald Burr, "was considered a motivational genius," writes Henderson. "His management style was unique. Employees were called managers, no matter how insignificant their assignment. Productivity, job satisfaction, and initial customer enthusiasm reached new heights for an airline company. Every employee became a shareholder with stock value that grew in most cases to equal one's annual salary in less than four years. His achievement was remarkable, considering the kind of change he introduced. Employees didn't own the company, but they owned the work."

People Express faltered, however, and it was eventually taken over by Frank Lorenzo's, Texas Air. The company may have been a victim, at least in some part, of its own good intentions, suggests Henderson in an interview. "The company tried so hard to impart dignity to individual workers and managers that it led to attitudes that were not viable over the long term."

People Express told its employees to do what's right – "even when no one is there to help you. They invited people to be entrepreneurs in an industry where it didn't really work. If the captain has a problem with the airplane, he doesn't call a meeting of the passengers to discuss it." Something of the sort occurred at the company, he suggests.

But a case such as People Express may be the exception, not the rule. "If you listed all the companies that failed, you won't find too many like People Express that failed for doing the right thing," DePree tells *Across the Board*. There are many popular misconceptions about what is meant by a "participative environment," adds DePree, who as chairman of Herman Miller has been credited with forging strong bonds between employees and managers.

"We never talk about everyone voting," he continues. Rather, the company seeks decision-making at its most competent level, "and you can't limit that to the talents of the people at the top." In other words, empowerment doesn't mean that everyone votes on every issue. But it does require more input from a wider range of people than is found at most traditional, command-and-control-type companies.

Asking whether a company can be too ethical "is a bit of a conundrum," says DePree. "I can't imagine where we could be too ethical."

According to Martin Marietta CEO Augustine, it is naive to equate good ethics with profits, at least in the short run.

Martin Marietta is a large NASA contractor. It launches spacecraft for the government, and it earns a substantial incentive bonus when those vehicles are launched successfully.

As an illustration of how a company can lose money in the short term by hewing to its principles, Augustine offers this example:

"One day, our insurance department heard about an insurance policy that would insure our launch bonus, for a low premium. For one nickel on the dollar, we could guarantee the dollar."

On the face of it, such an insurance policy looked like a win-win situation. If the company launched the

Philosophy Meets Fiscal Reality

The notion that a company or individual cannot be too ethical reflects a view of ethics and the world that ultimately can be traced back to Aristotle.

Aristotle, it may be recalled, defined virtue as the mean between two blameworthy extremes. Courage, a virtue, represents the mean between cowardice and recklessness. Friendliness, a virtue, is the mean between the extremes of obsequiousness (the desire to please too much) and irascibility (the desire to please too little).

In business, an Aristotelian might see ethics as a sort of balancing act. One has to take into account the demands and needs of various constituencies, or "stakeholders": shareholders, employees, customers, suppliers, and the larger community. No single group can dominate at the expense of any other.

"If one deals with one stakeholder group in an imbalanced way, you do that at the expense of other stakeholders," Guiseppe Bassani, NCR Corp.'s vice president of stakeholder relations, told *ethikos* in September 1991. "In the short term, you can do that. But in the long term, it will kill the company.

"Many times, expectations are not reasonable," he said. A customer may want the company's products for little or nothing. The customer has to be told, "We can't do this. If we do, we'll go out business.

"For me, business ethics is telling people what we can do and what we can't do," Bassani added.

The ethical challenge for Aristotelians is finding that balance, that virtuous mean. A company that refuses to close a failing plant or lay off redundant workers – and subsequently goes bankrupt – is not too ethical, according to this view, but insufficiently ethical. It has slighted one of its key constituencies (shareholders) and probably a second (the remaining workers) at the expense of a third constituency (redundant workers). By failing to achieve that proper balance, management is found lacking in ethical skill.

"Aristotle tells us that ethics is more like building a house than it is like physics," says Georgetown University's Thomas Donaldson. "You learn to build a house by building houses. You learn to be an ethical manager by managing," not by reading textbooks on philosophy.

Professional philosophers sometimes view the practice of business ethics as a theoretical pursuit, continues Donaldson. "It's not. It is an art. It can't be reduced to a science."

For an Aristotelian, it's impossible for a company to be too ethical.

"It is like the question, 'Can a person be too rich, or too thin?'" says Donaldson. In the broadest sense, "a company cannot be too ethical."

But Aristotle's isn't the only perspective on the question. There is another position, one that might be referred to as the Kantian view.

Immanuel Kant, perhaps the most influential moral philosopher of the modern era, viewed moral conduct as something of a struggle. One performs one's moral duty often *in spite* of one's inclinations, or even one's interest. And things don't always work out so well in the end. (Kant's famous example of the individual who refuses to lie, even to save another person's life, is perhaps an extreme illustration of this.)

Many of us would clearly recognize situations in which a person acts ethically and suffers, and not just in the short term. A small-businessman refuses to pay "protection" money, and the mob puts him out of business. Can we really say he was insufficiently ethical for not taking into account stakeholders' interests? Or is it more the case that he was really too ethical – too high-minded – for an imperfect world?

Or consider the struggling entrepreneur who insists on paying his creditors 100 cents on the dollar – even though he could probably force them to accept less – because "a debt is an implied promise, and promises are meant to be kept." He depletes precious working capital and the business fails Might he not have been more successful if he had fewer scruples?

Can a company be too ethical? "I think if you just take the question at face value, the answer is yes, you can be too ethical," says The Wharton School's Edward Bowman. "But you have to be awfully careful by what you mean by ethical." – **A.S**.

spacecraft successfully, it would get the bonus from the government. If the launch failed, the insurance company would pay the bonus.

But the deal raised some troubling questions. Why was the customer – the U.S. government, in this instance – providing the company with the incentive? Obviously, it was to make sure that the company did everything in its power, to ensure a successful launch. Wouldn't an insurance policy of the sort described undermine the government's *intent* in offering the launch bonus?

"Our engineers said: 'It would not make a difference,'" recalls Augustine. They would put forth the same 100 percent effort in any case. "And I believed them," he adds. The company's lawyers raised questions of fiduciary responsibility: Didn't the corporation have an obligation to its shareholders to take the insurance policy? There was, notes Augustine, "big money" at stake.

What to do? Augustine's answer was to call the customer – in this case, a general in the U.S. Air Force.

After explaining the insurance matter, "I said: 'Would you care?'" Augustine explained that it was still *his* decision to make, and not the general's, but he would weigh seriously what the general said in making that decision.

"He said he hadn't heard of such a thing, and wondered if others might already be doing it," recalls Augustine. "But he also said he wanted a couple of days to think it over."

Several days later, he called back. The general, upon reflection, reported that "they 'cared' a lot."

"We finally decided not to buy the insurance. And we subsequently had a loss."

In the final analysis, Augustine believes, matters of principle are not for compromise. One behaves as one does because it is right, he suggests (even if determining what is right sometimes takes some doing, such as consulting with the Air Force general). The so-called bad outcomes are only in the short term. "It always pays off in the long term."

But that is unlikely to convince realpolitikers like Henderson. "If a company is too ethical, it can go out of business," he observes. "There's an ethical side and a profit side of the enterprise, and they have to be balanced."

God as a Managerial Stakeholder?

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Introduction

Can or should God be considered a managerial stakeholder? While at first glance such a proposition might seem beyond the norms of stakeholder management theory or traditional management practice, further investigation and reference to stakeholder theory as well as business reality suggests that there might be both theoretical and practical support for such a notion. This paper will attempt to make the case for God as a managerial stakeholder.

The idea that God can or even should be considered a managerial stakeholder is not completely novel. For example, it has been suggested that: "…as early as the middle ages, 'God' was considered a stakeholder, that is a corporate partner whose profits could be distributed to the poor at the end of each year" (Key, 1999, p. 319). The father of capitalism, Adam Smith, in his *Theory of Moral Sentiments* "…refers often to the Deity, the Author of Nature" (Calkins, 2000, p. 344). Adam Smith conceived religion to be "…that which gives sanctions to the rules of morality before the age of reason and philosophy and God simply to be a 'great Judge' who wields an exact justice in the world to come" (Calkins, 2000, p. 344). Adam Smith held that "…the 'will of the Deity ought to be the supreme rule of our conduct' if for no other reason than out of self-interest" (Calkins, 2000, p. 344).

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Adam Smith's view of God was later to become firmly embedded in the U.S. economy. In 1861, the U.S. Secretary of the Treasury stated that: "…No nation can be strong except in the strength of God, or safe except in His defense. The trust of our people in God should be declared on our national coins" (U.S. Department of Treasury, 2004). As a result, U.S. notes and currency state "In God We Trust" to this day.

John D. Rockefeller Sr., one of America's great industrial magnates during the late 1800s, appears to have accepted God as the critical stakeholder providing for his financial success. Chernow (1999) in his biography states that Rockefeller:

> …never wavered in his belief that his career was divinely favored and asserted bluntly, 'God gave me my money'… Rockefeller always adverted to his own adherence to the doctrine of stewardship the notion of – the wealthy man as a mere instrument of God, a temporary trustee of his money, who devoted it to good causes. 'It has seemed as if I was favored and got increase because the Lord knew that I was going to turn around and give it back' (1999, pp. 54–55).

The concept of God as a stakeholder did not only apply to individuals over the years. The original corporate credo of Johnson & Johnson (i.e., "Our Credo") was written by firm founder Robert W. Johnson in 1943, a year before the company became public. The Credo listed the company's obligations to its various stakeholder groups, including the users of its products, employees, managers, communities, and finally to its stockholders. The last sentence of the Credo stated: "We are determined *with the help of God's grace* to fulfill these obligations to the best of our ability" [emphasis added]. This version of the Credo remained in place until 1979, when the Credo's reference to God was deleted (Johnson and Johnson, 2004).

The perception of God as a managerial stakeholder continues to this day. Mitroff and Denton (1999, p. 69), based on their empirical study of 215 managers, claim that: "…the principal stakeholder [of a Religion-Based Organization] is God, who is equivalent to the 'Big Boss' or CEO and also owner and at the top of the hierarchy." Popular business books have reflected this notion by referring to God as a stakeholder in their titles such as *God is My CEO* (Julian, 2001). U.S. President George Bush, who made it clear during the 2004 U.S. Presidential Debates that he takes God into account with respect to determining U.S. foreign policy (CNN, 2004), also appears to suggest that God is a stakeholder that managers should take into account. In response to several corporate scandals (e.g., Enron and WorldCom), President Bush stated that: "…corporate America has got to understand there is a *higher calling* than trying to fudge the numbers, trying to slip a billion here and a billion there and…hope nobody notices" (BBC, 2002) [emphasis added].

The above suggests that several individuals and firms have for years believed or suggested that God is a managerial stakeholder representing the ultimate CEO, Chairman of the Board, owner, or partner of the firm. Similar to those mentioned above, this paper argues that God both is (i.e., descriptive) and should be (i.e., normative) considered a managerial stakeholder for those businesspeople and business firms that accept that God exists and can affect the world. In other words, for certain individuals, God should not be 'checked at the office door'. Instead, God should be taken into account as a managerial stakeholder when business decisions are made.

In exploring the notion of God as a managerial stakeholder, part one of the paper will first discuss the growth of religion and spirituality within the academic and business communities. Part two will raise arguments supporting God as a managerial stakeholder. Part three will discuss and attempt to address the arguments against considering God as a managerial stakeholder. Part four will discuss the managerial implications of viewing God as a stakeholder. The paper concludes with its limitations.

Part One – Rise of Religion and Spirituality in the Workplace

God is defined by Webster's Dictionary as: "The supreme being, seen as the omnipotent creator and ruler of the universe" (Webster's, 1987, p. 409). The notion of God has been considered an important if not crucial component of the recent 'spirituality in the workplace' movement. For example, Mitroff (2003, pp. 379–380) states that:

> Spirituality is the basic belief that there is a *Supreme Power, a Being, a Force*, whatever you call it, that governs the entire universe - there is a purpose for everything and everyone…It asserts that there is a *transcendent Power* which is responsible for the creation and the care of the universe…Thus, *God, or a Higher Power*, is also imminent in the world. In other words, *God* is not only transcendent but everywhere present as well [emphasis added].

Over the past decade, the appearance of religion, spirituality, and God in the workplace has grown significantly. Several have commented on this growth. Jurkiewicz and Giacalone (2004, p. 129) state that: "Interest in workplace spirituality has increased steadily over the last decade of the twentieth century and into the new millennium…" Conlin (1999, p. 152) states that: "…today, a spiritual revival is sweeping across Corporate America…Gone is the old taboo against talking about God at work." She suggests that: "Once words like 'virtue,' 'spirit,' and 'ethics' got through the corporate door, God wasn't far behind" (Conlin, 1999, p. 158).

There are numerous examples of the growth. In terms of academia, there are now numerous journal articles, books, and conferences on the topic. Several journals have appeared such as the *Journal of Management, Spirituality & Religion* and the *Business Spirit Journal*. Newsletters such as *Spirit at Work* now exist (Broadway, 2001). Other journals have devoted special sections or issues to the subject of spirituality in the workplace including: the *Journal of Management Education* (Dehler and Neal, 2000), the *Journal of Management Inquiry* (Boal and Hirsch, 2000; Glynn, 2005), and the *Journal of Organizational Change Management* (Biberman and Whitty, 1999; Neal and Biberman, 2003, 2004). Business magazines such as *Business Week* (Conlin, 1999) and *Fortune* (Gunther, 2001) have had cover page stories on the subject. Over the years there have been a number of best selling books on workplace spirituality (e.g., Autry, 1991; Block, 1993; Bolman and Deal, 1995; Chappell, 1993; Covey, 1989; Greenleaf, 1977; Nash, 1994; Palmer, 1999; Williams and Houck, 1992).

Over the last decade, there has been "…a sudden increase in conferences and workshops on spirituality in the workplace…" (Neal and Biberman, 2003, p. 363). In 1999, The Academy of Management approved a new interest group on "management, spirituality, and religion" (Neal and Biberman, 2003, p. 363). Babson College holds an annual symposium on business and spirituality with meetings held all over the world (Broadway, 2001). A number of business schools now offer graduate courses in business and spirituality (Epstein, 2002, p. 93).

Activity has also increased in the business world. For example, "10,000 Bible and prayer groups in workplaces…meet regularly…" (Conlin, 1999, p. 152). CEOs and Chairmen of such companies as Medtronic Inc., Cirrus Logic, Cascade Communications, BioGenex, Raytheon, and Aetna International "…are meeting for prayer breakfasts and spiritual conferences" (Conlin, 1999, p. 152). There are now management consultant practices related to spirituality (Calas and Smircich, 2003, p. 328).

In terms of the investment community, religious based mutual funds or indexes have appeared to experience rapid growth over the past decade. According to a study commissioned by MMA Praxis Mutual Funds (MMA, 2002), the number of religious-based mutual funds grew to 75 by 2002. The amount of money of religious-based investment under management grew to $4.42 billion by 2002. From 1999 to 2002 the number of religious mutual funds grew almost eight times faster (121%) than all other types of mutual funds (16%). A number of religious-based indexes have also appeared, including the Carlisle Social Investments Index (Catholic), MMA Praxis Value Index (Anabaptist), and the Dow Jones Islamic Market Index (Islamic).

The rise of spirituality in the workplace does not in and of itself necessarily imply that God is or should be considered a managerial stakeholder, but does set the context in which such an argument might be raised. Based on the growing level of academic and business activity, the concepts of God and business are no longer mutually exclusive, but appear to be more and more inter-connected.

Part Two – Arguments Supporting God as Managerial Stakeholder

Can (or should) an entity such as God be considered to be a stakeholder? In this part, two related arguments are made supporting God as a managerial stakeholder: (1) stakeholder management theory which appears to support the notion of God as a managerial stakeholder for those managers who believe that God exists; and (2) numerous corporate leaders and firms that currently perceive God as a managerial stakeholder.

Stakeholder identification and salience and God as a managerial stakeholder

For the purposes of the paper, God is defined as a: "…transcendent power that is responsible for the creation and care of the universe" (Mitroff and Denton, 1999, p. 24), or "one's higher power" (Mitroff and Denton, 1999, p. 108). The definition is intended to be both broad and all encompassing: "God is non-denominational; everyone is free to conceive of God or their higher power, as they see fit" (Mitroff and Denton, 1999, p. 107).

Alongside the growth of spirituality in business has been the significant development of stakeholder management theory. Over the past two decades, stakeholder management has become an important framework for managers. Based on the influential work by Freeman (1984), other scholars have continued developing stakeholder theory (e.g., Brenner and Cochran, 1991; Donaldson and Preston, 1995; Hill and Jones; 1992; Jones, 1995). Corporations and corporate managers now commonly make reference to their stakeholders.

Despite the growth and development of stakeholder theory however, one important issue continues to focus on the appropriate definition of who or what is a "stakeholder," and on what basis. In a seminal paper on stakeholder identification, Mitchell et al. (1997) indicate that just about any type of entity can be considered a stakeholder: "There is not much disagreement on what kind of entity can be a stakeholder. Persons, groups, neighborhoods, organizations, institutions, societies, and even the natural environment are generally thought to qualify as actual or potential stakeholders" (1997, p. 855). Over time, entities such as the fetus (Mitroff and Denton, 1999, p. 11) or future generations (Wheeler and Sillanpää, 1997, p. 5), as well as the planet or natural environment (Starik, 1995, p. 216) have been proposed as being stakeholders. Philosopher Peter Singer has written of his desire for a regime in which "…the interests of the dog get the same consideration as those of the human, and the loss to the dog is not discounted because the dog is not a member of our species" (Jennings, 1997, p. 1). According to Jennings (1997, p.1): "In the academic literature, the definition of stakeholders has expanded to include all of God's creatures." Expanding on the definition of stakeholder even further, Mitroff and Denton (1999, p. 69) claim that: "…the principal stakeholder [of a Religion-Based Organization] is God." Could (or should) an entity such as God also be considered to be a stakeholder?

Building on Freeman's descriptive definition of a stakeholder as "any group or individual who can affect or is affected by the achievement of the organization's objectives" (1984, p. 46) and his normative principle of "who or what really counts" (1994), Mitchell et al. (1997) propose a set of criteria to identify and separate stakeholders from non-stakeholders (i.e., 'stakeholder identification'), as well as to determine the degree to which managers give priority to competing stakeholder claims (i.e., 'stakeholder salience'). Mitchell et al. argue that (1997, p. 854): "…classes of stakeholders can be identified by their possession or attributed possession of one, two, or all three of the following attributes: (1) the stakeholder's *power* to influence the firm, (2) the *legitimacy* of the stakeholder's relationship with the firm, and (3) the *urgency* of the stakeholder's claim on the firm…these variables define the field of stakeholders: those entities to whom managers should pay attention" [emphasis added].

Prior to examining whether the three attributes (i.e., power, legitimacy, and urgency) exist in the case of God, there are four key assumptions proposed by Mitchell et al. (1997) that must necessarily be accepted if God can be considered to be a managerial stakeholder. These assumptions include: (a) that a mere unidirectional (and not reciprocal) effect is sufficient; (b) the perception of an effect is based on the manager's (and not the firm's) perspective; (c) the perception is of subjective (and not objective) reality; and (d) that the relationship can be a potential (and not necessarily actual) one.

Unidirectional effect

Although others might disagree, based on Freeman's (1984) definition of stakeholder, Mitchell et al. (1997, p. 856) make it clear that "…the stake can be unidirectional or bidirectional – 'can affect or is affected by' – and there is no implication or necessity of reciprocal impact, as definitions involving relationships, transactions, or contracts require." In other words, it is sufficient if God can affect the organization; there is no need for the organization to have an effect on God.

Managers' perspective

Mitchell et al. (1997, p. 871) also make it clear that the identity of stakeholders is established from the perspective of individual managers, as opposed to the firm: "…the perspective of managers might be vital. We propose that, although groups can be identified reliably as stakeholders based on their possession of power, legitimacy, and urgency in relationship to the firm, *it is the firm's managers who determine which stakeholders are salient* and therefore will receive management attention" [emphasis added].

Subjective reality

Mitchell et al.'s (1997, p. 868) theoretical definition of a stakeholder states that: "Stakeholder attributes are socially constructed, not objective, reality." This clarification creates the possibility that all of the attributes that an entity such as God is argued below as possessing (i.e., power, legitimacy, and urgency), can be a socially constructed (i.e., perceived) reality as opposed to an objective (i.e., provable) reality. This clarification is essential as most would accept that God's existence cannot be proven in the same way that the existence of employees, consumers, or suppliers can be established (see Mitroff and Denton, 1999, p. 121). This means that the real issue when applying Mitchell et al.'s (1997) criteria for identifying stakeholders is to determine whether there is a 'perception' that God exists (or any other potential stakeholder), rather than whether God actually exists.

Potential effect

Mitchell et al. (1997) do not argue that stakeholders need to be in an actual relationship with the firm. Instead, they argue that: "…the *potential relationship* can be as relevant as the actual one" (1997, p. 859) [emphasis added]. This view allows for the possibility that while an entity such as God might not currently be affecting the firm, as a 'latent' stakeholder, this could always change in the future depending on the actions taken by the firm's managers or employees.

Presuming that the assumptions indicated above are considered acceptable, one can proceed to the critical question: Do any corporate managers perceive according to their own socially constructed reality that God is a potential stakeholder? According to Mitchell et al.'s (1997) proposed criteria consisting of (i) power, (ii) legitimacy, and (iii) urgency, the answer appears to be in the affirmative.

Power. Mitchell et al. (1997, p. 869) define power as: "A relationship among social actors in which one social actor, A, can get another social actor, B, to do something that B would not otherwise have done." Is God perceived by corporate managers (who believe in the existence of God) as possessing power that could change their otherwise intended actions? The answer appears to be yes. In fact, those managers who believe God to be omnipotent and omnipresent would necessarily accept God as the ultimate power or supreme entity. Conroy and Emerson (2004, p. 384) suggest the possible link between one's belief in an all powerful God and changes to one's behavior: "…perhaps believers in God are less willing to act unethically because they believe that an omniscient God will 'catch' them in the act – or by extension, know their unethical thoughts or attitudes."

Legitimacy. Mitchell et al. (1997, p. 869) define legitimacy as: "A generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system, of norms, values, beliefs, definitions." Those who believe in a God that is merciful and benevolent, would presumably perceive or assume that all of God's actions, in whatever form, were "desirable, proper, or appropriate" according to their own "socially constructed system of norms, values, beliefs, definitions."

Urgency. Mitchell et al. (1997, p. 869) define urgency as: "The degree to which stakeholder claims call for immediate attention." They remind the reader that: "As is true of power and legitimacy, urgency is a socially constructed perceptual phenomenon and may be perceived correctly or falsely by…managers…" (1997, p. 870). A belief or perception that God is always watching, and that there can be immediate (or delayed) consequences for inappropriate behavior (e.g., upon one's day of judgment before the Heavenly Court, etc.), suggests that managers may have a sense of urgency when it comes to God's claims.

The concept of 'stewardship' lends itself to considering God as a managerial stakeholder based on power, legitimacy, and urgency. Managers who believe in an all-powerful God may view themselves as stewards acting on behalf of God's appropriate desires: "[Stewardship]…implies that the world is owned…by God, and that stewards manage it essentially on behalf of this owner" (Worrell and Appleby, 2000, p. 271). This view would then lead to obligations with respect to other stakeholders: "Stewards have responsibilities towards other species/ the natural world, based on their intrinsic value or value to God; Stewards accept a degree of answerability to a higher authority or authorities such as society or God" (Worrell and Appleby, 2000, p. 268). According to Newton (1997, p. 607):

> The obligations of corporate officers are clearly duties of stewardship…They are accountable to the shareholders for that stewardship, just as any property manager is accountable to the owner…But the notion of stewardship goes well beyond clearly defined employer-employee or owner-manager relationships. In certain understandings of property, especially those *based on a transcendent religion*, the duty of stewarding applies indifferently to all property [emphasis added].

This sense of stewardship would arguably lead to a sense of 'urgency', in that God's 'claims' continuously call 'for immediate attention'. The duty of stewardship on behalf of God in a corporate context would "…require every employee up to the CEO to be careful to waste no resources: to conserve money… materials…and the natural environment in the surrounding community (curtailing emissions of all kinds, working diligently to prevent spills and accidents)" (Newton, 1997, p. 607).

Based on the above analysis, God as an entity would appear to meet all three of the specific criteria or attributes (i.e., power, legitimacy, and urgency) set out by Mitchell et al. (1997) for claiming stakeholder status. But according to Mitchell et al. (1997), even if God met only *one* of the three attributes, God could still be considered a stakeholder (1997, p. 854): "…classes of stakeholders can be identified by their possession or attributed possession of *one, two, or all three* of the following attributes…" [emphasis added]. If God is perceived by managers as possessing all three variables, then God is according to Mitchell et al. (1997, p. 878) a 'definitive stakeholder' in which case "…managers have a clear and immediate mandate to attend to and give priority to that stakeholder's claim."

Corporate leaders and firms that perceive God as a managerial stakeholder

Stakeholder management theory, and particularly the notion of stakeholder identification and salience as advocated by Mitchell et al. (1997), suggests that God could be considered a managerial stakeholder. This section moves beyond stakeholder theory to provide several examples of corporate managers and leaders as well as business firms that explicitly recognize God as a managerial stakeholder.

The recognition of God as a stakeholder really should not be that surprising, given that studies show that the vast majority of Americans, including investors, managers, and employees, believe in the existence of God. A Gallup study found that 95% of Americans say they "believe in God or a universal spirit", while 48% say they "talked about their religious faith at work that day" (Conlin, 1999, p. 152). In terms of investors, "…80 percent of [U.S.] investors consider themselves to be religious or spiritual", while "Over 60 percent of those who describe themselves as religious say they either try now or would like to try to incorporate their faith values into their decisions about money" (MMA, 2003). A study consisting of in-depth interviews with over 90 US managers found that "Almost everyone who was interviewed believed in a higher power of god" (Mitroff and Denton, 1999, p. 42). A number of the interviewees "…reported having strongly experienced the presence of a higher power in the workplace" (Mitroff and Denton, 1999, p. 43).

Several individual corporate leaders appear to accept that God is a critical entity to be taken into account when making business decisions, and in this respect represents their most important stakeholder. Some of the better known examples include: Jeffrey Swartz of Timberland, Aaron Feuerstein of Malden Mills, John Tyson of Tyson Foods, Truett Cathy of Chick-fil-A, and Marion Wade of ServiceMaster.

Jeffrey Swartz, Timberland's President and CEO, has spoken openly of how his religious background as an Orthodox Jew gave him an ethical foundation in making business decisions: "We can be *partners with God* in the act of creating something from nothing…" (Broadway, 2001, p. A01) [emphasis added]. Swartz "… uses his religious beliefs to guide business decisions and, in some instances, company policy, often bouncing work problems off his rabbi" (Conlin, 1999, p. 154).

Aaron Feuerstein, the CEO who rebuilt the Malden Mills textile factories in Lawrence, Massachusetts after a devastating fire, is another individual who has discussed how God influences his business decisions. Feuerstein states: "God is one. There is no god of the family, god of the marketplace, god of the temple. *God is one and is present everywhere*" (Koehn, 1999, p. 75) [emphasis added]. According to Treviño and Nelson (2004, p. 39): "Feuerstein is an accomplished businessman. But he is also driven by deeply held moral beliefs. In [a] talk to business professors, he quoted the Bible (in Hebrew!) on the responsibility of a rich man not to praise himself for his riches, and to do kindness, justice, and charity in the community. Given his moral beliefs, he believed that he had no choice but to rebuild his factories."

John Tyson, the CEO of the public company Tyson Foods, Inc., one of the largest providers of chicken, beef, and pork products, also incorporates God into his business:

> In a move viewed warily by some insiders, John Tyson's own religious bent is now reflected in changes made to the corporate code of conduct. Among the core values Tyson Foods now lists: "We strive to be a faith-friendly company," and "*We strive to honor God* and be respectful of each other, our customers and other stakeholders." Tyson has also hired 87 chaplains covering 58 plants to help employees cope with family problems, stress, and other issues. A spokesman says John is not trying to impose his faith on the company, and "we make every attempt to be inclusive of all our team members regardless of their religious persuasion" (Zellner, 2004, p. 90) [emphasis added].

Truett Cathy, the founder of Chick-fil-A, one of the largest privately owned restaurant chains in the United States, appears to accept his firm's role as a steward of God. The following is indicated on Chick-fil-A's corporate website:

> …from the beginning, the first priority for Truett and Chick-fil-A has never been just to serve chicken. It's to serve a higher calling. Our official statement of corporate purpose says that we exist "*to glorify God by being a faithful steward of all that is entrusted to us* and to have a positive influence on all who come in contact with Chick-fil-A." That's why we invest in scholarships, character-building programs for kids, foster homes and other community services. Come to think of it, it's also not a bad motive for striving to serve a really, really good sandwich (Chick-fil-A, 2004) [emphasis added].

Marion Wade of ServiceMaster, a public company, and his successors have incorporated God into the firm's mission by accepting that they act as God's stewards. The following is indicated on ServiceMaster's corporate website:

> Founded as a moth-proofing company in 1929 by Marion E. Wade, a former minor league baseball player, ServiceMaster had its beginnings in Chicago where Wade worked out of his home. Wade had a strong personal faith and a desire to honor God in all he did. Translating this into the marketplace, he viewed each individual employee and customer as being made in God's image – worthy of dignity and respect. His successors, Ken Hansen and Ken Wessner, also shared this view. These three leaders shaped what became our Company objectives: *To honor God in all we do;* To help people develop; To pursue excellence; and To grow profitably (ServiceMaster, 2004) [emphasis added].

Several other U.S. firms acknowledge God on their corporate websites. McKee Foods Corporation, maker of Swiss Cake Rolls among other products, states as part of their company's values that: "The McKee family acknowledges the providence of God in our continued success" (McKee Foods, 2004). Hebrew National, manufacturer of hotdogs and deli meats, states on its corporate logo: "We Answer to a Higher Authority" (Hebrew National, 2004). The firm Love Box, one of the largest independently owned corrugated box manufacturing companies, states in its corporate mission statement: "Vision comes *from God* through Inspiration. Mission is His Vision grasped by the mind. When Mission descends into the heart, it becomes Values. When we practice these Values, it becomes Culture" (Love Box, 2004) [emphasis added].

These examples suggest that for many individuals, as well as several firms, God is considered to be an important (if not the most important) managerial stakeholder. These firms have explicitly acknowledged God on their corporate websites as part of their corporate purpose (e.g., Chick-fil-A), core values (e.g., Tyson Foods), company values (e.g., McKee Foods Corporation), company objectives (e.g., ServiceMaster), corporate logo (e.g., Hebrew National), or mission statement (e.g., Love Box). By explicitly recognizing God in such a manner, these firms appear to satisfy Freeman's definition of a stakeholder as an entity that: "...can affect...the achievement of the organization's objectives" (1984, p. 46).

What is not clear however is how many other corporate leaders or managers believe and/or act as if God is a managerial stakeholder, but for various reasons (e.g., fear of repercussions to their position or status within the firm) do not explicitly acknowledge God in the workplace environment: "The reluctance [to integrate spirituality into their workplaces] is understandable given that the word...frequently invoke[s] curiosity, fear, and ridicule, usually simultaneously" (Jurkiewicz and Giacalone, 2004, p. 130).

To summarize, the argument supporting God as a managerial stakeholder is as follows:

1. Stakeholder identification and salience theory focuses on the "socially constructed reality" (i.e., perceptions) of managers when identifying stakeholders;
2. Stakeholder identification and salience theory suggests three criteria for identifying stakeholders; (i) power, (ii) legitimacy, and (iii) urgency; and
3. God, although a non-human entity, is perceived by many corporate managers (e.g., Swartz, Feuerstein, Tyson, Cathy, Wade, etc.) as well as recognized by several business firms as having power, legitimacy, and urgency according to the definitions of the constructs.

If the argument above is accepted, then God can and should be considered as a stakeholder (i.e., "what counts") for those managers who believe in the existence of God. For many managers, God will be considered the ultimate CEO, Chairman of the Board, owner, or partner of the firm.

Part Three – Arguments Against God as a Managerial Stakeholder

A number of compelling arguments can be raised in opposition to the proposition of God as a managerial stakeholder. Two of the central arguments include: (1) only human beings should be considered potential stakeholders; and (2) God has no place in the business world. Each of these arguments will now be discussed.

God is not a human being

Many have asserted that only human beings (i.e., within a group, organization, or institution), or possibly future human beings (e.g., fetus or future generations), can be considered to be a stakeholder. For example, Freeman "...does insist that 'the human person' (rather than the canine person, one supposes) should be the 'centerpiece of thinking about business" (Jennings, 1997, p. 1). Starik (1995, p. 208) describes the position:

> Typically, listings of stakeholders of organizations have included only human individuals as organizations, such as consumers, stockholders, creditors, suppliers, employees, government officials, legislators, local communities, competitors, interest groups, and the media. These human stakeholders are increasingly thought to be critical to an organization's long-term success, as they can directly and indirectly affect both financial and

> non-financial organizational outcomes (Cornell and Shapiro, 1987). This focus on exclusively human entities pervades both the academic and practitioner management literature (e.g. Baron, 1993; Wood, 1990; Porter, 1980; Weiner and Brown, 1986; Starik, 1990).

Starik suggests the reason why only humans have been considered stakeholders (1995, p. 209):

> Since only humans have been perceived to possess and exercise political economic power and legitimacy, that is, to organize boycotts, negotiate contracts, impose fines, or file lawsuits, only humans have been considered stakeholders, either as individuals or as groups. Non-human nature itself, without the assistance of other human stakeholders, has generally been excluded from stakeholder designation. In this view, non-human entities have not possessed political-economic voice, and, therefore, have not been able to identify nor assert their "stakes," whatever these may have been.

If this view is accepted, then non-human or non-tangible entities or concepts (e.g., the natural environment or God) should not be considered stakeholders. To include God as a corporate stakeholder would in effect open the floodgates of determining who or what might be a stakeholder, and would render stakeholder theory futile: "Stakeholder theory, divorced of all particular meaning, risks…intellectual perforation" (Phillips and Reichart, 2000, pp. 189–190).

Some have suggested however that non-humans should also be considered managerial stakeholders. For example, Starik (1995, p. 211) argues that the natural environment should be considered to be a stakeholder:

> …two leading stakeholder management proponents have argued that the deeper concept of "stakeholder" includes a socio-emotional component, in which stakeholders are not "the other" or are not simply "outside" the organization, but, rather, are partners whose futures and stakes are intertwined (Freeman and Gilbert, 1988).

As a result, Starik (1995, p. 216) would expand the current anthropocentric definition of the concept "stakeholder" to: "any naturally occurring entity which affects or is affected by organizational performance." Starik's position has been accepted by other theorists (Post, 1991; Stead and Stead, 1996). According to Stead and Stead (2000, p. 321): "The planet is the 'ultimate organizational stakeholder'." Even Freeman (1994, p. 426) suggests that Starik's position on the environment as a stakeholder represents "…a fruitful line of work."

Phillips and Reichart (2000, p. 191) reject Starik's position, arguing that only humans should be considered potential stakeholders:

> …on a fairness-based approach to stakeholder theory, only humans can be organizational stakeholders. This is because only humans are capable of generating the necessary obligations for establishing stakeholder status. Only humans are capable of the necessary volition in the acceptance of benefits of a mutually beneficial cooperative scheme.

If it is accepted that only human beings should be considered potential stakeholders, then other entities such as the natural environment or God would be ruled out despite the fact that many might perceive such entities to possess stakeholder status.

God and business should not mix

In order for one to accept that God can and should be considered a stakeholder, the opposition to God or religion in business must be overcome. According to Fort (1996, p. 451): "Many people believe that religious convictions have no appropriate role in business decision making."

There are a number of reasons for the apparent hostility toward religion, spirituality, or God in business. For example, several have commented on the potential negative aspects of workplace spirituality such as "the potential for proselytizing a set of spirituality values as 'the only path' which can breed intolerance" (Milliman et al., 2003, p. 442) or that "… organizations may attempt to manipulate and use the concept of spirituality at work as a tool to increase productivity" (Milliman et al., 2003, p. 443). As one example, when John Tyson, the CEO of Tyson Foods, Inc. decided to put 'God' into the company's code of conduct, concerns were raised that "…the code could alienate employees. It could also make Tyson, with its scandal-tarred past, an easy target for charges of hypocrisy" (Zellner, 2004, p. 90).

Religion and God in business also face many critics: "One of the severest marks against formal religion, especially in the workplace, is that it does impose distinctions. To worship a particular form of God and in a particular way is, consciously or not, to reject others. It is for precisely this reason that the vast majority of those with whom I spoke strongly rejected any form of religion in the workplace" (Mitroff, 2003, p. 378).

Others suggest that business is predominantly secular due to a lack of understanding, rather than due to any hostility toward religion in business:

> The practice of business is generally carried out with little or no reference to explicit religious concerns. This is due less to any outright hostility toward religion than to the fact that in most people's minds religious faith and the operation of a business have little or nothing to do with each other. But even for those who sense that there really is or ought to be a connection between religious faith and the world of business, often find it difficult to articulate effectively just what the connection is (Stebbins, 1997, p. 5).

Fort argues however that business leaders should be able to integrate religion with business. He states that (1996, pp. 469–470): "…business leaders should not censor their religious motivations… [they] ought to be able to rely upon religious justifications for their moral positions." Jon Huntsman, the founder and Chairman of Huntsman Chemical Corp., appears to agree: "I find it impossible to separate life and corporate involvement from my religious convictions" (Mitroff and Denton, 1999, p. 58).

The concern over mixing religion and business also extends to the academic sector. For example, Smith (2004, p. 4) suggests that: "…in the academic world there is a persistent hostility to integrating management and spiritual belief and practice." According to Krahnke et al. (2003, p. 397): "Workplace spirituality, at the assumptive level, is frequently equated with the dogmatic, proselytizing and ethereal machinations most of us abhor, rather than the serious study of a set of policies and practices that can advance both organizations and individuals."

Smith fundamentally rejects such a view: "It betrays hypocrisy on the part of critics who allow it as an aspect of personal life, but insist it is intellectually invalid for that aspect of life humans call 'work'" (Smith, 2004, p. 4). Epstein (2002, p. 94) also discusses the concern over allowing religion to 'creep' into academia:

> I recognize that in the United States where separation of Church and State is an underlying principle of American democracy, inclusion of religiously based consideration in the educational realm is considered by some academics to be somewhat suspect. The fear exists, not without cause, that exposing students to religiously based ethical teachings can turn into heavy-handed sectarian proselytization, inimitable to academic freedom. This situation prevails in some countries today where religious authorities have dominated the educational scene.

Epstein (2002, p, 94) argues similar to Smith (2004) that such concerns should be rejected:

> I submit, however, the risk in the United States and other democratic societies is no greater than is the risk associated with such ideologies such as Marxism, Free Enterprise Capitalism, and the like where, at different times and places, indoctrination in rather than exploration of these 'secular religions' has occurred.

Mitroff and Denton (1999, p. xiv) also believe that academic research in business and the subject of spirituality should not be mutually exclusive: "…organizational science can no longer avoid analyzing, understanding, and treating organizations as spiritual entities." The apprehension over religion, spirituality, and God entering the workplace and academia continues to exist however. Even a generic definition of God, as a supreme entity, might exclude others or create such a perception. Such concerns would have to be overcome before a businessperson or academic could be persuaded that God should be considered a managerial stakeholder.

Part Four – Potential Implications of God as a Managerial Stakeholder

If God were to be viewed as a managerial stakeholder, what are the practical consequences in terms of managerial decision-making? The more significant *potential* implications include: (1) greater meaning for those involved in business; (2) more 'socially responsible' decisions; (3) enhanced ethical decision-making; and (4) a healthier bottom line for the organization.

Greater meaning for employees and managers

The first potential implication is that an acceptance and acknowledgment of God as a managerial stakeholder may in fact give greater meaning and purpose to all those involved in business (e.g., directors, managers, employees, investors). Mitroff (2003, p. 376) concludes that: "…people seriously want the opportunity to realize their full potential as whole human beings both on and off the job…people want to bring their…whole selves to work, the 'complete package' so to speak. They are extremely frustrated with and tired of having to leave significant parts of themselves at home…" Employees and managers who do not believe that God exists might feel however that religion is being imposed upon them (and not derive greater meaning from work) if their firm explicitly acknowledges God as a managerial stakeholder.

Broader 'social responsibility'

Those individuals and firms that accept God as a managerial stakeholder would potentially act in a more 'socially responsible' manner, i.e., by placing less emphasis on short term profit-making, while giving greater consideration to the impacts of decisions on other stakeholders. First, the decision-making process might take more of a long-term perspective:

> …because God's Word is considered eternal, the time line by which a Religion-Based Organization evaluates itself and conducts its affairs is completely shifted from that of the non-religious organization. The time frame is literally extended to eternity - needless to say, the longest span imaginable. Thus the Religion-Based Organization does not manage for only the next quarter or for short-term profits (Mitroff and Denton, 1999, p. 63).

Second, profits would be put into a broader societal perspective by giving it a lower priority while, creating a greater purpose for the bottom line. 'Socially responsible' activities such as corporate charitable giving (e.g., 'tithing'), or community involvement, might be more likely to take place. Third, there might be an enhanced view of the interconnectedness of all stakeholders, resulting in stakeholders being given greater ethical consideration. For example, managers who accept God as a legitimate managerial stakeholder might "…become sensitized to the moral implications of their actions with respect to each stakeholder…and initiate normative thought in a managerial context" (Mitchell et al., 1997, p. 880). As one example of this:

> …Dan Chamberlain, who worked for almost 25 years in senior management at Procter & Gamble and Cadbury Schweppes, says that he became a better boss after he 'committed [his] life to Christ in 1975.' Whereas he used to think of secretaries and janitors as 'the people you sort of trod over, or just order to get you a cup of coffee,' he began to show them the respect they deserved once he began to attend prayer meetings with them before work. '*God took me down a few notches there*' (Schaefer, 2002, p. 21) [emphasis added].

An acceptance of God as a managerial stakeholder could translate into the notion of 'servant leadership', whereby corporate leaders see themselves as stewards who are more willing to put first the needs, aspirations, and interests of others (e.g., employees, customers) before their own interests (Greenleaf, 1977; Sendjaya and Sarros, 2002). Managers who accept God as a managerial stakeholder might also automatically take into account the interests and protection of the natural environment as part of God's creation. This 'sustainability' perspective might alleviate the need to consider the natural environment as a distinct stakeholder or to only act in response to demands put forward by environmental special interest groups.

Improved ethical behavior

Another potential implication of accepting God as a managerial stakeholder is that ethical behavior might be improved. For example, 'religiosity' has been identified as a variable that might influence ethical decision-making. Weaver and Agle (2002, p. 81) refer to Glock and Stark's (1965) definition of religious role expectations (i.e., dimensions of religiosity) as including "…a belief dimension, involving expectations that one will hold to particular religious beliefs (e.g., belief in God as the creator of the world)." Weaver and Agle argue that such a variable can influence ethical behavior: "Our analysis indicates that religious role expectations, internalized as a religious self-identity, can influence ethical behavior" (2002, p. 77).

A number of empirical studies have investigated and suggested that one's degree of 'religiosity' is associated with higher ethical attitudes (Miesing and Preble, 1985; Siu et al., 2000; Smith and Oakley, 1996), or in, more specific areas (see Conroy and Emerson, 2004) such as: student cheating (Allmon et al., 2000; Barnett et al., 1996), insider trading (Terpstra et al., 1993), and environmentalism (Wolkomir et al., 1997). Following their review of the research literature, O'Fallon and Butterfield conclude that "…religion has a positive relationship with ethical decision-making" (2005, p. 392).

Several reasons have been postulated why religiosity (i.e., belief in God) leads to more appropriate behavior. Mitroff (2003, p. 377) reports on his study of corporate managers:

> Everyone felt strongly that, if people and organizations were spiritual, and hence followed a 'higher set of ethical principles', then they could not disown the negative impacts of their actions, particularly those that resulted in harm to the physical and social environment. One could not be spiritual if one produced dangerous or shoddy products, abused employees, disowned the bad consequences of one's products and services for the larger society, and so forth.

Not all implications might be positive however. Acceptance of God as a managerial stakeholder, if tied into certain religious prescriptions, could potentially lead to unethical behavior (e.g., discrimination toward certain stakeholder groups represented by women or homosexuals, etc.). This type of unethical behavior might be considered extremely problematic when it is believed to be prescribed by God. The reason is that those involved would believe that their actions are morally justified, unlike those who know that they are acting inappropriately but do so nonetheless.

Additional research is necessary to explore how different views of God might relate if at all to ethical behavior. One might suppose however that a manager's belief in God could represent the 'last resort' in deterring ethical misconduct for those situations in which there is no perceived threat of getting caught and disciplined for the conduct in question.

Healthier bottom line

It could be the case that explicitly acknowledging God could ultimately lead to an improved bottom line. Several studies have focused on spirituality's effect on the bottom line. Krahnke et al. (2003, p. 397) state:

> …research has revealed that organizations high in workplace spirituality outperform those without it by 86 percent (Lloyd, 1990) and that such organizations grow faster, increase efficiencies, and produce higher returns on investments (Jurkiewicz and Giacalone n.d.). Generalized benefits of a spiritual culture are believed to include increased physical and mental health of employees, advanced personal growth, and an enhanced sense of self worth.

Mitroff also suggests a link between spirituality and profitability (2003, p. 377):

> Perhaps the most significant finding of all was that those organizations that were perceived as 'more spiritual' or 'had a greater spiritual orientation' were also perceived as being significantly more profitable. Not only did such organizations allow their employees to bring more of their total selves to work, but, as a result, both the employees and their organizations were able to 'develop ethically' to a much greater degree. In short, spirituality was perceived as the only true and lasting competitive advantage. The vast majority of those I interviewed felt strongly that, if organizations wanted to be successful, then they had no choice but to become spiritual.

Not everyone agrees however: "While approbations abound, conclusive evidence connecting workplace spirituality with bottom line performance is lacking" (Jurkiewicz and Giacalone, 2004, p. 130).

Limitations and Conclusion

The arguments presented in this paper are contingent on one very important assumption. The suggestion that God *should* be considered a managerial stakeholder may only be relevant to those who believe in a supreme entity. Of course, one cannot prove that God exists or does not exist. For those who do not believe in God's existence, the argument that God *should* be considered a managerial stakeholder would be rejected outright.The reality is however that for many corporate managers, God is in fact a managerial stakeholder. For this reason, God *can* be considered to be a managerial stakeholder, regardless of whether or not God should be considered a stakeholder.

The theoretical work of Mitchell et al. (1997) supports this view based on their criteria: (i) *power* (i.e., God is viewed or attributed by the firm, i.e., its directors, managers, employees, or shareholders, as possessing the ultimate coercive threat in terms of one's judgment, afterlife, or place in heaven); (ii) *legitimacy* (i.e., God's actions are legitimate as they are "desirable, proper, and appropriate"); and (iii) *urgency* (i.e., the relationship with God is considered as being "imperative" and "requiring immediate attention").

Several important issues remain however that must continue to be examined:

1. How can belief in God become actualized into ethical behavior without causing offence to anyone?
2. How are different perceptions of God to be resolved? Do different perceptions of God (i.e., based on different 'words' of God) lead to different behavioral prescriptions or prohibitions?
3. Does belief in God ever lead to a rationalization of unethical or even illegal business practices? If so, how might this be addressed?
4. To what extent is God considered a stakeholder in the personal lives of managers, yet neglected in their business lives? If there is a separation, why does this take place?
5. Can God be a stakeholder for an entire firm, or should God only be considered a stakeholder for individual managers? Should God be explicitly mentioned on a company's website, in its annual report, or in its code of ethics?
6. Can God ever be considered a stakeholder for a public company? Or is this only appropriate for private companies where the founders, CEO, and/or majority shareholders accept the existence and importance of God in their decision-making?
7. To what extent are perceptions of God as a stakeholder different around the world? If there are differences, why might this be the case? Do any non-U.S. firms explicitly recognize God as a stakeholder?
8. Has religion and worship of a supreme entity been replaced by the worship of the almighty dollar bill? Have some corporations achieved God-like status in terms of their influence and power over society?

While many might consider the notion of mixing God and business to be problematic and beyond rational management thought, stakeholder theory and business reality appear to suggest otherwise. It may therefore be that God should be thought of as a stakeholder partner, just as many other stakeholder groups are considered partners (e.g., employees, suppliers, community, etc.). Even if God should not be considered a stakeholder, it may be that God still deserves consideration as part of the decision-making process similar to the natural environment (see Phillips, 2003, p. 143). In any event, the relationship between God and business may be here to stay. Epstein (2002, p. 93) refers to McClay (2000) who:

> …debunks a narrow notion of secularization cum modernization 'which dismisses the possibility of a transcendent realm of being' and notes "Yet the world at the dawn of the 21st century remains energetically, even manically, religious, in ways large and small. And if the 'secularization theory' long promoted by social-scientific students of religion has in fact been discredited, the unanticipated resiliency of religious faith in 20th century America may well be the single most arresting demonstration of the theory's inadequacy.

Considering God as a managerial stakeholder may provide a more feasible means for those theorists and practitioners who wish to better integrate or synthesize God into managerial decision-making. Stakeholder theorists who choose to reject the notion of God as a managerial stakeholder, would appear to be ignoring business reality by disregarding the socially constructed reality of many corporate managers, as well as several business firms.

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The Fortune at the Bottom of the Pyramid

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With the end of the Cold war, the former Soviet Union and its allies, as well as China, India, and Latin America, opened their closed markets to foreign investment in a cascading fashion. Although this significant economic and social transformation has offered vast new growth opportunities for multinational corporations (MNCs), its promise has yet to be realized.

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First, the prospect of millions of "middle-class" consumers in developing countries, clamoring for products from MNCs, was wildly oversold. To make matters worse, the Asian and Latin American financial crises have greatly diminished the attractiveness of emerging markets. As a consequence, many MNCs worldwide slowed investments and began to rethink risk–reward structures for these markets. This retreat could become even more pronounced in the wake of the terrorist attacks in the United States last September.

The lackluster nature of most MNCs' emerging-market strategies over the past decade does not change the magnitude of the opportunity, which is in reality much larger than previously thought. The real source of market promise is not the wealthy few in the developing world, or even the emerging middle-income consumers: It is the billions of *aspiring poor* who are joining the market economy for the first time.

This is a time for MNCs to look at globalization strategies through a new lens of inclusive capitalism. For companies with the resources and persistence to compete at the bottom of the world economic pyramid, the prospective rewards include growth, profits, and incalculable contributions to humankind. Countries that still don't have the modern infrastructure or products to meet basic human needs are an ideal testing ground for developing environmentally sustainable technologies and products for the entire world.

Furthermore, MNC investment at "the bottom of the pyramid" means lifting billions of people out of poverty and desperation, averting the social decay, political chaos, terrorism, and environmental meltdown that is certain to continue if the gap between rich and poor countries continues to widen.

Doing business with the world's 4 billion poorest people – two-thirds of the world's population – will require radical innovations in technology and business models. It will require MNCs to reevaluate price-performance relationships for products and services. It will demand a new level of capital efficiency and new ways of measuring financial success. Companies will be forced to transform their understanding of scale, from a "bigger is better" ideal to an ideal of highly distributed small-scale operations married to world-scale capabilities.

In short, the poorest populations raise a prodigious new managerial challenge for the world's wealthiest companies: selling to the poor and helping them improve their lives by producing and distributing products and services in culturally sensitive, environmentally sustainable, and economically profitable ways.

Four Consumer Tiers

At the very top of the world economic pyramid are 75 to 100 million affluent Tier 1 consumers from around the world. (See Exhibit 1.) This is a cosmopolitan group composed of middle- and upper-income people in developed countries and the few rich elites from the developing world. In the middle of the pyramid, in Tiers 2 and 3, are poor customers in developed nations and the rising middle classes in developing countries, the targets of MNCs' past emerging-market strategies.

Now consider the 4 billion people in Tier 4, at the bottom of the pyramid. Their annual per capita income – based on purchasing power parity in U.S. dollars – is less than $1,500, the minimum considered necessary to sustain a decent life. For well over a billion people – roughly one-sixth of humanity – per capita income is less than $1 per day.

Even more significant, the income gap between rich and poor is growing. According to the United Nations, the richest 20 percent in the world accounted for about 70 percent of total income in 1960. In 2000, that figure reached 85 percent. Over the same period, the fraction of income accruing to the poorest 20 percent in the world fell from 2.3 percent to 1.1 percent.

Exhibit 1 The world economic pyramid.

Annual per capita income[1]	*Tiers*	*Population in millions*
More than $20,000	1	75–100
$1,500–$20,000	2 & 3	1,500–1,750
Less than $1,500	4	4,000

[1] Based on purchasing power parity in U.S.$.
Source: U.N. World Development Reports.

This extreme inequity of wealth distribution reinforces the view that the poor cannot participate in the global, market economy, even though they constitute the majority of the population. In fact, given its vast size, Tier 4 represents a multitrillion-dollar market. According to World Bank projections, the population at the bottom of the pyramid could swell to more than 6 billion people over the next 40 years, because the bulk, of the world's population growth occurs there.

The perception that the bottom of the pyramid is not a viable market also fails to take into account the growing importance of the informal economy among the poorest of the poor, which by some estimates accounts for 40 to 60 percent of all economic activity in developing countries. Most Tier 4 people live in rural villages, or urban slums and shantytowns, and they usually do not hold legal title or deed to their assets (e.g., dwellings, farms, businesses). They have little or no formal education and are hard to reach via conventional distribution, credit, and communications. The quality and quantity of products and services available in Tier 4 is generally low. Therefore, much like an iceberg with only its tip in plain view, this massive segment of the global population – along with its massive market opportunities – has remained largely invisible to the corporate sector.

Fortunately, the Tier 4 market is wide open for technological innovation. Among the many possibilities for innovation, MNCs can be leaders in leapfrogging to products that don't repeat the environmental mistakes of developed countries over the last 50 years. Today's MNCs evolved in an era of abundant natural resources and thus tended to make products and services that were resource-intensive and excessively polluting. The United States' 270 million people – only about 4 percent of the world's population – consume more than 25 percent of the planet's energy resources. To re-create those types of consumption patterns in developing countries would be disastrous.

We have seen how the disenfranchised in Tier 4 can disrupt the way of life and safety of the rich in Tier 1 – poverty breeds discontent and extremism. Although complete income equality is an ideological pipe dream, the use of commercial development to bring people out of poverty and give them the chance for a better life is critical to the stability and health of the global economy and the continued success of Western MNCs.

The Invisible Opportunity

Among the top 200 MNCs in the world, the overwhelming majority are based in developed countries. U.S. corporations dominate, with 82; Japanese firms, with 41, are second, according to a list compiled, in December 2000 by the Washington, D.C.-based Institute for Policy Studies. So it is not surprising that MNCs' views of business are conditioned by their knowledge of and familiarity with Tier 1 consumers. Perception of market opportunity is a function of the way many managers are socialized to think and the analytical tools they use. Most MNCs automatically dismiss the bottom of the pyramid because they judge the market based on income or selections of products and services appropriate for developed countries.

To appreciate the market potential of Tier 4, MNCs must come to terms with a set of core assumptions and practices that influence their view of developing countries. We have identified the following as widely shared orthodoxies that must be reexamined:

- **Assumption #1** The poor are not our target consumers because with our current cost structures, we cannot profitably compete for that market.
- **Assumption #2** The poor cannot afford and have no use for the products and services sold in developed markets.
- **Assumption #3** Only developed markets appreciate and will pay for new technology. The poor can use the previous generation of technology.
- **Assumption #4** The bottom of the pyramid is not important to the long-term viability of our business. We can leave Tier 4 to governments and nonprofits.
- **Assumption #5** Managers are not excited by business challenges that have a humanitarian dimension.
- **Assumption #6** Intellectual excitement is in developed markets. It is hard to find talented managers who want to work at the bottom of the pyramid.

Each of these key assumptions obscures the value at the bottom of the pyramid. It is like the story of the person who finds a $20 bill on the sidewalk. Conventional economic wisdom suggests if the bill really existed, someone would already have picked it up! Like the $20 bill, the bottom of the pyramid defies conventional managerial logic, but that doesn't mean it isn't a large and unexplored territory for profitable growth. Consider the drivers of innovation and opportunities for companies in Tier 4. (See Exhibit 2.) MNCs must recognize that this market poses a major new challenge: how to combine low cost, good quality, sustainability, and profitability.

Furthermore, MNCs cannot exploit these new opportunities without radically rethinking how they go to market. Exhibit 3 suggests some (but by no means all) areas where an entirely new perspective is required to create profitable markets in Tier 4.

Tier 4 Pioneers

Hindustan Lever Ltd. (HLL), a subsidiary of Great Britain's Unilever PLC and widely considered the best-managed company in India, has been a pioneer among MNCs exploring markets at the bottom of the pyramid. For more than 50 years, HLL has served India's small elite who could afford to buy MNC products. In the 1990s, a local firm, Nirma Ltd., began offering detergent products for poor consumers, mostly in rural areas. In fact, Nirma created a new business system that included a new product formulation, low-cost manufacturing process, wide distribution network, special packaging for daily purchasing, and value pricing.

HLL, in typical MNC fashion, initially dismissed Nirma's strategy. However, as Nirma grew rapidly,

Exhibit 2 Innovation and MNC implications in Tier 4.

Drivers of innovation	*Implications for MNCs*
Increased access among the poor to TV and information	Tier 4 is becoming aware of many products and services and i*s* aspiring to share the benefits
Deregulation and the diminishing role of governments and international aid	More hospitable investment climate for MNCs entering developing countries and more cooperation from nongovernmental organizations
Global overcapacity combined with intense competition in Tiers 1, 2, and 3	Tier 4 represents a huge untapped market for profitable growth
The need to discourage migration to overcrowded urban centers	MNCs must create products and services for rural populations

Exhibit 3 New strategies for the bottom of the pyramid.

Price performance	*Views of quality*
• Product development • Manufacturing • Distribution	• New delivery formats • Creation of robust products for harsh conditions [heat, dust, etc.]
Sustainability	*Profitability*
• Reduction in resource intensity • Recyclability • Renewable energy	• Investment intensity • Margins • Volume

HLL could see its local competitor was winning in a market it had disregarded. Ultimately, HLL saw its vulnerability and its opportunity: In 1995, the company responded with its own offering for this market, drastically altering its traditional business model.

HLL's new detergent, called Wheel, was formulated to substantially reduce the ratio of oil to water in the product, responding to the fact that the poor often wash their clothes in rivers and other public water systems. HLL decentralized the production, marketing, and distribution of the product to leverage the abundant labor pool in rural India, quickly creating sales channels through the thousands of small outlets where people at the bottom of the pyramid shop. HLL also changed the cost structure of its detergent business so it could introduce Wheel at a low price point.

Today, Nirma and HLL are close competitors in the detergent market, with 38 percent market share each, according to Indialnfoline.com, a business intelligence and market research service. Unilever's own analysis of Nirma and HLL's competition in the detergent business reveals even more about the profit potential of the marketplace at the bottom of the pyramid. (See Exhibit 4.)

Contrary to popular assumptions, the poor can be a very profitable market – especially if MNCs change their business models. Specifically, Tier 4 is not a market that allows for the traditional pursuit of high margins; instead, profits are driven by volume and capital efficiency. Margins are likely to be low (by current norms), but unit sales can be extremely high. Managers who focus on gross margins will miss the opportunity at the bottom of the pyramid; managers who innovate and focus on economic profit will be rewarded.

Nirma has become one of the largest branded detergent makers in the world. Meanwhile, HLL, stimulated by its emergent rival and its changed business model, registered a 20 percent growth in revenues per year and a 25 percent: growth in profits per year between 1995 and 2000. Over the same period, HLL's market capitalization grew to $12 billion – a growth rate of 40 percent per year. HLL's parent company, Unilever, also has benefited from its subsidiary's experience in India. Unilever transported HLL's business principles (not the product or the brand) to create a new detergent market among the poor in Brazil, where the Ala brand has been a big success. More important, Unilever has adopted the bottom of the pyramid as a corporate strategic priority.

As the Unilever example makes clear, the starting-assumption must be that serving Tier 4 involves

Exhibit 4 Nirma vs. HLL in India's detergent market (1999).

	Nirma	*HLL (wheel)*	*HLL (high-end products)*
Total sales ($ million)	150	100	180
Gross margin (%*)*	18	18	25
ROCE (%)	121	93	22

Source: Presentation by John Ripley, senior vice president, Unilever, at the Academy of Management Meeting, August 10, 1999.

bringing together the best of technology and a global resource base to address local market conditions. Cheap and low-quality products are not the goal. The potential of Tier 4 cannot be realized without an entrepreneurial orientation: The real strategic challenge for managers is to visualize an active market where only abject poverty exists today. It takes tremendous imagination and creativity to engineer a market infrastructure out of a completely unorganized sector.

Serving Tier 4 markets is not the same as serving existing markets better or more efficiently. Managers first must develop a commercial infrastructure tailored to the needs and challenges of Tier 4. Creating such an infrastructure must be seen as an investment, much like the more familiar investments in plants, processes, products, and R&D.

Further, contrary to more conventional investment strategies, no firm can do this alone. Multiple players must be involved, including local governmental authorities, nongovernmental organizations (NGOs), communities, financial institutions, and other companies. Four elements – creating buying power, shaping aspirations, improving access, and tailoring local solutions – are the keys to a thriving Tier 4 market. (See Exhibit 5.)

Each of these four elements demands innovation in technology, business models, and management processes. And business leaders must be willing to experiment, collaborate, empower locals, and create new sources of competitive advantage and wealth.

Creating Buying Power

According to the International Labor Organization's *World Employment Report 2001*, nearly a billion people – roughly one-third of the world's work force – are either underemployed or have such low-paying jobs that they cannot support themselves or their families. Helping the world's poor elevate themselves above this desperation line is a business opportunity to do well and do good. To do so effectively, two interventions are crucial – providing access to credit, and increasing the earning potential of the poor. A few farsighted companies have already begun to blaze this trail with startlingly positive results.

Commercial credit historically has been unavailable to the very poor. Even if those living in poverty had access to a bank, without collateral it is hard to get credit from the traditional banking system. As Peruvian economist Hernando de Soto demonstrates in his path-breaking work, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, commercial credit is central to building a market economy. Access to credit in the U.S. has allowed people of modest means to systematically build their equity and make major purchases, such as houses, cars, and education.

The vast: majority of the poor in developing countries operate in the "informal" or extralegal economy, since the time and cost involved in securing legal title for their assets or incorporation of their microenterprises is prohibitive. Developing countries have tried governmental subsidies to free the poor from the cycle of poverty, with little success. Even if the poor were able to benefit from government support to start small businesses, their dependence on credit from local moneylenders charging usurious rates makes it impossible to succeed. Local moneylenders in Mumbai, India, charge interest rates of up to 20 percent per day. This means that a vegetable vendor who borrows Rs.100 ($2.08) in the morning must return Rs. 120 ($2.50) in the evening.

Extending credit to the poor so they can elevate themselves economically is not a new idea. Consider

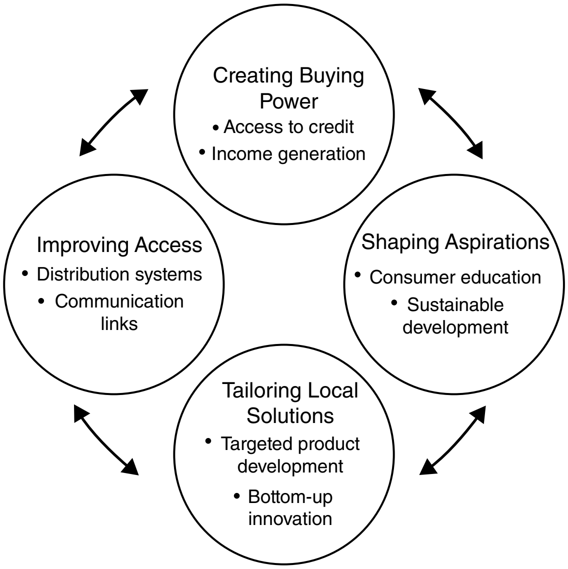

Exhibit 5 The commercial infrastructure at the bottom of the pyramid.

how I.M. Singer & Company, founded in 1851, provided credit as a way for millions of women to purchase sewing machines. Very few of those women could have afforded the steep $100 price tag, but most could afford a payment of $5 per month.

The same logic applies on a much larger scale in Tier 4. Consider the experience of the Grameen Bank Ltd. in Bangladesh, one of the first in the world to apply a microlending model in commercial banking. Started just over 20 years ago by Muhammad Yunus, then a professor in the Economics Department at Chittagong University, Bangladesh, Grameen Bank pioneered a lending service for the poor that has inspired thousands of microlenders, serving 25 million clients worldwide, in developing countries and wealthy nations, including the United States and Great Britain.

Grameen Bank's program is designed to addresses the problems of extending credit to lowest-income customers – lack of collateral, high credit risk, and contractual enforcement. Ninety-five percent of its 2.3 million customers are women, who, as the traditional breadwinners and entrepreneurs in rural communities, are better credit risks than men. Candidates for loans must have their proposals thoroughly evaluated and supported by five nonfamily members of the community. The bank's sales and service people visit the villages frequently, getting to know the women who have loans and the projects in which they are supposed to invest. In this way, lending due diligence is accomplished without the mountain of paperwork and arcane language common in the West.

With 1,170 branches, Grameen Bank today provides microcredit services in more than 40,000 villages, more than half the total number in Bangladesh. As of 1996, Grameen Bank had achieved a 95 percent repayment rate, higher than any other bank in the Indian subcontinent. However, the popularity of its services has also spawned more local competitors, which has cut into its portfolio and shrunk its profits over the past few years.

In addition, Grameen Bank's rate of return is not easy to assess. Historically, the bank was an entirely manual, field-based operation, a structure that undercut its efficiency. Today, spin-offs such as Grameen Telecom (a provider of village phone service) and Grameen Shakti (a developer of renewable energy sources) are helping Grameen Bank build a technology infrastructure to automate its processes. As the bank develops its online business model, profitability should increase dramatically, highlighting the importance of information technology in the acceleration of the microcredit revolution.

Perhaps the most pertinent measure of Grameen Bank's success is the global explosion of institutional interest in microlending it has stimulated around the world. In South Africa, where 73 percent of the population earns less than R5,000 ($460) per month, according to a 2001 World Bank study, retail banking services for low-income customers are becoming one of the most competitive and fast-growing mass markets. In 1994, Standard Bank of South Africa Ltd., Africa's leading consumer bank, launched a low-cost, volume-driven e-banking business, called AutoBank E, to grow revenue by providing banking services to the poor. Through the use of 2,500 automated teller machines (ATMs) and 98 AutoBank E-centres, Standard now has the largest presence in South Africa's townships and other under-serviced areas of any domestic bank. As of April 2001, Standard served nearly 3 million low-income customers and is adding roughly 60,000 customers per month, according to South Africa's *Sunday Times*.

Standard Bank does not require a minimum income of customers opening an AutoBank E account, although they must have some regular income. People who have never used a bank can open an account with a deposit of as little as $8. Customers are issued an ATM card and shown how to use it by staff who speak a variety of African dialects. A small flat fee is charged for each ATM transaction. An interest-bearing "savings purse" is attached to every account to encourage poor customers to save. Interest rates on deposits are low, but superior to keeping cash in a jar. The *Sunday Times* also reported that Standard Bank is considering a loan program for low-income clients.

Computerization of microlending services not only makes the overall operation more efficient, but also makes it possible to reach many more people – lending money to individuals with no collateral and no formal address. Since there is lower overhead and little paperwork, AutoBank's costs are 30 to 40 percent lower than those at traditional branches.

At the 1999 Microcredit Summit, the United Nations, in conjunction with several major MNCs, such as Citigroup Inc. and Monsanto Company, set a goal of making basic credit available to the 100 million poorest families in the world by the year 2005. Unfortunately, the success of this undertaking has been slowed by high transaction costs, a lack of automation, and poor information and communications infrastructures in rural areas.

To address these issues and accelerate the development of microlending, French banker Jacques Attali, the founding president of the European Bank for Reconstruction and Development and a former chief aide of French President François Mitterand during the 1980s, has created PlaNet Finance. Its Web site, www.planetfinance.org, links thousands of microcredit groups worldwide into a network to help microbanks share solutions and lower costs.

Ultimately, the development of an automated solution for tracking and processing the millions of small loans associated with microlending should be possible. If processing and transaction costs can be reduced enough, they can then be bundled together and sold in the secondary market to multinational financial institutions like Citigroup. This would greatly expand the capital available for microlending beyond the current pool from donors and governments.

In the United States, microlending has also taken root over the past decade in poor urban neighborhoods. For example, the ShoreBank Corporation, formerly South Shore Bank, has demonstrated the profitability of banking for the poor in Chicago's troubled South Side. Project Enterprise, a Grameen-like program based in New York City, is aimed at minority entrepreneurs.

Several multinational banks are beginning to offer microbanking services in developing countries. Citigroup, for instance, is experimenting in Bangalore, India, with 24/7 services for customers with as little as a $25 on deposit. Initial results are very positive.

Shaping Aspirations

Sustainable product innovations initiated in Tier 4, and promoted through consumer education, will not only positively influence the choices of people at the bottom of the pyramid, but may ultimately reshape the way Americans and others in Tier 1 live. Indeed, in 20 years, we may look back to see that Tier 4 provided the early market pull for disruptive technologies that replaced unsustainable technologies in developed countries and advanced the fortunes of MNCs with foresight.

For example, Unilever's HLL subsidiary has tackled the lack of practical, inexpensive, low-energy-consuming refrigeration in India. HLL's laboratories developed a radically different approach to refrigeration that allows ice cream to be transported across the country in standard nonrefrigerated trucks. The system allows quantum reductions in electricity use and makes dangerous and polluting refrigerants unnecessary. As a bonus, the new system is cheaper to build and use.

Electricity, water, refrigeration, and many other essential services are all opportunities in developing countries. A U.S.-based NGO, the Solar Electric Light Fund (SELF), has creatively adapted technology and applied microcredit financing to bring electrical service to people in remote villages in Africa and Asia who otherwise would spend money to burn hazardous kerosene, candles, wood, or dung for their light and cooking. SELF's rural electrification system is based on small-scale on-site power generation using renewable resources. A revolving loan fund gives villagers the financial means to operate these electrical systems themselves, also creating jobs. Since its founding in 1990, SELF has launched projects in China, India, Sri Lanka, Nepal, Vietnam, Indonesia, Brazil, Uganda, Tanzania, South Africa, and the Solomon Islands.

The success of SELF and other NGOs focused on small-scale distributed energy solutions has begun to attract the attention of Western companies such as the U.S.'s Plug Power Inc. (fuel cells) and Honeywell Inc. (microturbines). They see the logic in moving into a wide-open market in Tier 4 rather than trying to force their technology prematurely into applications for the developed markets, where incumbents and institutions stand in their way. With several billion potential customers around the world, investments in such innovations should be well worth it.

Improving Access

Because Tier 4 communities are often physically and economically isolated, better distribution systems and communication links are essential to development of the bottom of the pyramid. Few of the large emerging-market countries have distribution systems that reach more than half of the population. (Hence the continued dependence of the poorest consumers on local products and services and moneylenders.) As a consequence, few MNCs have designed their distribution systems to cater to the needs of poor rural customers.

Creative local companies, however, lead the way in effective rural distribution. In India, for instance, Arvind Mills has introduced an entirely new delivery system for blue jeans. Arvind, the world's fifth-largest denim manufacturer, found Indian domestic denim sales limited. At $40 to $60 a pair, the jeans were not affordable to the masses, and the existing distribution system reached only a few towns and villages. So Arvind introduced "Ruf & Tuf" jeans – a ready-to-make kit of jeans components (denim, zipper, rivets, and a patch) priced at about $6. Kits were distributed, through a network of thousands of local tailors, many in small rural towns and villages, whose self-interest motivated them to market the kits extensively. Ruf & Tuf jeans are now the largest-selling jeans in India, easily surpassing Levi's and other brands from the U.S. and Europe.

MNCs can also play a role in distributing the products of Tier 4 enterprises in Tier 1 markets, giving bottom-of-the-pyramid enterprises their first links to international markets. Indeed, it is possible through partnerships to leverage traditional knowledge bases to produce more sustainable, and in some cases superior, products for consumption by Tier 1 customers.

Anita Roddick, CEO of The Body Shop International PLC, demonstrated the power of this strategy in the early 1990s through her company's "trade not aid" program of sourcing local raw material and products from indigenous people.

More recently the Starbucks Corporation, in cooperation with Conservation International, has pioneered a program to source coffee directly from farmers in the Chiapas region of Mexico. These farms grow coffee beans organically using shade, which preserves songbird habitat. Starbucks markets the product to U.S. consumers as a high-quality, premium coffee; the Mexican farmers benefit economically from the sourcing arrangement, which eliminates intermediaries from the business model. This direct relationship also improves the local farmers' understanding and knowledge of the Tier 1 market and its customer expectations.

Information poverty may be the single biggest roadblock to sustainable development. More than half of humanity has yet to make a single phone call. However, where telephones and Internet connections do exist, for the first time in history, it is possible to imagine a single, interconnected market uniting the world's rich and poor in the quest for truly sustainable economic development. The process could transform the "digital divide" into a "digital dividend."

Ten years ago, Sam Pitroda, currently chairman and CEO of London-based Worldtel Ltd., a company created by a telecommunications union to fund telecom development in emerging markets, came to India with the idea of "rural telephones." His original concept was to have a community telephone, operated by an entrepreneur (usually a woman) who charged a fee for the use of the telephone and kept a percentage as wages for maintaining the telephone. Today, from most parts of India, it is possible to call anyone in the world.

Other entrepreneurs have introduced fax services, and some are experimenting with low-cost e-mail and Internet access. These communication links have dramatically altered the way villages function and how they are connected to the rest of the country and the world. With the emergence of global broadband connections, opportunities for information-based business in Tier 4 will expand significantly.

New ventures such as CorDECT in India and Celnicos Communications in Latin America are developing information technology and business models suited to the particular requirements of the bottom of the pyramid. Through shared-access models (e.g., Internet kiosks), wireless infrastructure, and focused technology development, companies are dramatically reducing the cost of being connected. For example, voice and data connectivity typically costs companies $850 to $2,800 per line in the developed world; CorDECT has reduced this cost to less than $400 per line, with a goal of $100 per line, which would bring telecommunications within reach of virtually everyone in the developing world.

Recognizing an enormous business and development opportunity, Hewlett-Packard Company has articulated a vision of "world e-inclusion," with a focus on providing technology, products, and services appropriate to the needs of the world's poor. As part of this strategy, HP has entered into a venture with the MIT Media Lab and the Foundation for Sustainable Development of Costa Rica – led by former President Jose Maria Figueres Olsen – to develop and implement "telecenters" for villages in remote areas. These digital town centers provide modern information technology equipment with a high-speed Internet connection at a price that is affordable, through credit vehicles, at the village level.

Bringing such technology to villages in Tier 4 makes possible a number of applications, including tele-education, telemedicine, microbanking, agricultural extension services, and environmental monitoring, all of which help to spur microenterprise, economic development, and access to world markets. This project, named Lincos, is expected to spread from today's pilot sites in Central America and the Caribbean to Asia, Africa, and Central Europe.

Tailoring Local Solutions

As we enter the new century, the combined sales of the world's top 200 MNCs equal nearly 30 percent of total world gross domestic product. Yet these same corporations employ less than 1 percent of the world's labor force. Of the worlds 100 largest economies, 51 are economies internal to corporations. Yet scores of Third World countries have suffered absolute economic stagnation or decline.

If MNCs are to thrive in the 21st century, they must broaden their economic base and share it more widely. They must play a more active role in narrowing the gap between rich and poor. This cannot be achieved if these companies produce only so-called global products for consumption primarily by Tier 1 consumers. They must nurture local markets and cultures, leverage local solutions, and generate wealth at the lowest levels on the pyramid. Producing in, rather than extracting wealth from, these countries will be the guiding principle.

To do this, MNCs must combine their advanced technology with deep local insights. Consider packaging. Consumers in Tier 1 countries have the disposable income and the space to buy in bulk (e.g., 10-pound boxes of detergent from superstores like Sam's Club) and shop less frequently. They use their spending money to "inventory convenience." Tier 4 consumers, strapped for cash and with limited living space, shop every day but not for much. They can't afford to stock up on household items or be highly selective about what they buy; they look for single-serve packaging. But consumers with small means also have the benefit of experimentation. Unburdened by large quantities of product, they can switch brands every time they buy.

Already in India, 30 percent of personal care products and other consumables, such as shampoo, tea, and cold medicines, are sold in single-serve packages. Most are priced at Rs. 1 (about 1¢). Without innovation in packaging, however, this tread could result in a mountain of solid waste. Dow Chemical Company and Cargill Inc. are experimenting with an organic plastic that would be totally biodegradable. Such packaging clearly has advantages in Tier 4, but it could also revolutionize markets at all four tiers of the world pyramid.

For MNCs, the best approach is to marry local capabilities and market knowledge with global best practices. But whether an initiative involves an MNC entering Tier 4 or an entrepreneur from Tier 4, the development-principles remain the same: New business models must not disrupt the cultures and lifestyles of local people. An effective combination of local and global knowledge is needed, not a replication of the Western system.

The development of India's milk industry has many lessons for MNCs. The transformation began around 1946, when the Khira District Milk Cooperative, located in the state of Gujarat, set up its own processing plant under the leadership of Verghese Kurien and created the brand Amul, today one of the most recognized in the country.

Unlike the large industrial dairy farms of the West, in India, milk originates in many small villages. Villagers may own only two to three buffaloes or cows each and bring their milk twice a day to the village collection center. They are paid every day for the milk they deliver, based on fat content and volume. Refrigerated vans transport the milk to central processing plants, where it is pasteurized. Railroad cars then transport the milk to major urban centers.

The entire value chain is carefully managed, from the village-based milk production to the world-scale processing facilities. The Khira District cooperative provides such services to the farmers as veterinary care and cattle feed. The cooperative also manages the distribution of pasteurized milk, milk powder, butter, cheese, baby food, and other products. The uniqueness of the Amul cooperative is its blending of decentralized origination with the efficiencies of a modern processing and distribution infrastructure. As a result, previously marginal village farmers are earning steady incomes and being transformed into active market participants.

Twenty years ago, milk was in short supply in India. Today, India is the world's largest producer of milk. According to India's National Dairy Development Board, the country's dairy cooperative network now claims 10.7 million individual farmer member-owners, covers 96,000 village-level societies, includes 170 milk-producer unions, and operates in more than 285 districts. Milk production has increased 4.7 percent per year since 1974. The per capita availability of milk in India has grown from 107 grams to 213 grams per day in 20 years.

Putting It All Together

Creating buying power, shaping aspirations, improving access, and tailoring local solutions – the four elements of the commercial infrastructure for the bottom of the pyramid are intertwined. Innovation in one leverages innovation in the others. Corporations are only one of the actors; MNCs must work together with NGOs, local and state governments, and communities.

Yet someone must take the lead to make this revolution happen. The question is, Why should it be MNCs?

Even if multinational managers are emotionally persuaded, it is not obvious that large corporations have real advantages over small, local organizations. MNCs may never be able to beat the cost or responsiveness of village entrepreneurs. Indeed, empowering local entrepreneurs and enterprises is key to developing Tier 4 markets. Still, there are several compelling reasons for MNCs to embark on this course:

- **Resources** Building a complex commercial infrastructure for the bottom of the pyramid is a resource- and management-intensive task. Developing environmentally sustainable products and services requires significant research. Distribution channels and communication networks are expensive to develop and sustain. *Few local entrepreneurs have the managerial or technological resources to create this infrastructure.*
- **Leverage** MNCs can transfer knowledge from one market to another – from China to Brazil or India – as Avon, Unilever, Citigroup, and others have demonstrated. Although practices and products have to be customized to serve local needs, *MNCs, with their unique global knowledge base, have an advantage that is not easily accessible to local entrepreneurs.*
- **Bridging** MNCs can be nodes for building the commercial infrastructure, providing access to knowledge, managerial imagination, and financial resources. Without MNCs as catalysts, well-intentioned NGOs, communities, local

governments, entrepreneurs, and even multilateral development agencies will continue to flounder in their attempts to bring development to the bottom. *MNCs are best positioned to unite the range of actors required, to develop the Tier 4 market.*

- **Transfer** Not only can MNCs leverage learning from the bottom of the pyramid, but they also have the capacity to transfer innovations upmarket all the way to Tier 1. As we have seen, Tier 4 is a testing ground for sustainable living. *Many of the innovations for the bottom can be adapted for use in the resource- and energy-intensive markets of the developed world.*

It is imperative, however, that managers recognize the nature of business leadership required in the Tier 4 arena. Creativity, imagination, tolerance for ambiguity, stamina, passion, empathy, and courage may be as important as analytical skill, intelligence, and knowledge. Leaders need a deep understanding of the complexities and subtleties of sustainable development in the context of Tier 4. Finally, managers must have the interpersonal and intercultural skills to work with a wide range of organizations and people.

MNCs must build an organizational infrastructure to address opportunity at the bottom of the pyramid. This means building a local base of support, reorienting R&D to focus on the needs of the poor, forming new alliances, increasing employment intensity and reinventing cost structures. These five organizational elements are clearly interrelated and mutually reinforcing.

- **Build a local base of support** Empowering the poor threatens the existing power structure. Local opposition can emerge very quickly, as Cargill Inc. found in its sunflower-seed business in India. Cargill's offices were twice burned, and the local politicians accused the firm of destroying locally based seed businesses. But Cargill persisted. Through Cargill's investments in farmer education, training, and supply of farm inputs, farmers have significantly improved their productivity per acre of land. Today, Cargill is seen as the friend of the farmer. Political opposition has vanished.

To overcome comparable problems, MNCs must build a local base of political support. As Monsanto and General Electric Company can attest, the establishment of a coalition of NGOs, community leaders, and local authorities that can counter entrenched interests is essential. Forming such a coalition can be a very slow process. Each player has a different agenda; MNCs have to understand these agendas and create shared aspirations. In China, this problem is less onerous: The local bureaucrats are also the local entrepreneurs, so they can easily see the benefits to their enterprise and their village, town, or province. In countries such as India and Brazil, such alignment does not exist. Significant discussion, information sharing, the delineation of benefits to each constituency, and sensitivity to local debates is necessary.

- **Conduct R&D focused on the poor** It is necessary to conduct R&D and market research focused on the unique requirements of the poor, by region and by country. In India, China, and North Africa, for example, research on ways to provide safe water for drinking, cooking, washing, and cleaning is a high priority. Research must also seek to adapt foreign solutions to local needs. For example, a daily dosage of vitamins can be added to a wide variety of food and beverage products. For corporations that have distribution and brand presence throughout the developing world, such as Coca-Cola Company, the bottom of the pyramid offers a vast untapped market for such products as water and nutritionals.

Finally, research must identify useful principles and potential applications from local practices. In Tier 4, significant knowledge is transmitted orally from one generation to the next. Being respectful of traditions but willing to analyze them scientifically can lead to new knowledge. The Body Shop's creative CEO, Ms. Roddick, built a business predicated on understanding the basis for local rituals and practices. For example, she observed that some African women use slices of pineapple to cleanse their skin. On the surface, this practice appears to be a meaningless ritual. However, research showed active ingredients in pineapple that cleared away dead skin cells better than chemical formulations.

MNCs must develop research facilities in emerging markets such as China, India, Brazil, Mexico, and

Africa, although few have made a big effort so far. Unilever is an exception; it operates highly regarded research centers in India, employing more than 400 researchers dedicated to the problems of "India-like markets."

- **Form new alliances** MNCs have conventionally formed alliances solely to break into new markets; now they need to broaden their alliance strategies. By entering into alliances to expand in Tier 4 markets, MNCs gain insight into developing countries' culture and local knowledge. At the same time, MNCs improve their own credibility. They may also secure preferred or exclusive access to a market or raw material. We foresee three kinds of important relationships: Alliances with local firms and cooperatives (such as the Khira District Milk-Cooperative); alliances with local and international NGOs (like Starbucks's alliance with Conservation International in coffee); and alliances with governments (e.g., Merck & Company's recent alliance in Costa Rica to foster rain forest preservation in exchange for bio-prospecting rights).

Given the difficulty and complexity of constructing business models dependent on relationships with national or central governments (e.g., large infrastructure development), we envision more alliances at the local and regional level. To succeed in such alliances, MNC managers must learn to work with people who may not have the same agenda or the same educational and economic background as they do. The challenge and payoff is how to manage and learn from diversity – economic, intellectual, racial, and linguistic.

- **Increase employment intensity** MNCs accustomed to Tier 1 markets think in terms of capital intensity and labor productivity. Exactly the opposite logic applies in Tier 4. Given the vast number of people at the bottom of the pyramid, the production and distribution approach must provide jobs for many, as in the case of Ruf & Tuf jeans from Arvind Mills: It employed an army of local tailors as stockers, promoters, distributors, and. service providers, even though the cost of the jeans was 80 percent below that of Levi's. As Arvind demonstrated, MNCs need not employ large numbers of people directly on their payroll, but the organizational model in Tier 4 must increase employment intensity (and incomes) among the poor and groom them to become new customers.
- **Reinvent cost structures** Managers must dramatically reduce cost levels relative to those in Tier 1. To create products and services the poor can afford, MNCs must reduce their costs significantly – to, say, 10 percent of what they are today. But this cannot be achieved by fine-tuning the current approaches to product development, production, and logistics. The entire business process must be rethought with a focus on functionality, not on the product itself. For example, financial services need not be distributed only through branch offices open from 9 A.M. to 5 P.M. Such services can be provided at a time and place convenient to the poor consumer – after 8 P.M. and at their homes. Cash-dispensing machines can be placed in safe areas – police stations and post offices. Iris recognition used as a security device could substitute for the tedious personal-identification number and card for identification.

Lowering cost structures also forces a debate on ways to reduce investment costs. This will inevitably lead to greater use of information technology to develop production and distribution systems. As noted, village-based phones are already transforming the pattern of communications throughout the developing world. Add the Internet, and we have a whole new way of communicating and creating economic development in poor, rural areas. Creative use of IT will emerge in these markets as a means to dramatically lower the costs associated with access to products and services, distribution, and credit management.

A Common Cause

The emergence of the 4 billion people who make up the Tier 4 market is a great opportunity for MNCs. It also represents a chance for business, government, and civil society to join together in a common cause. Indeed, we believe that pursuing strategies for the bottom of the pyramid dissolves the conflict between proponents of free trade and global capitalism on one hand, and environmental and social sustainability on the other.

Yet the products and services currently offered to Tier 1 consumers are not appropriate for Tier 4, and accessing this latter market will require approaches fundamentally different from those even in Tiers 2 and 3. Changes in technology, credit, cost, and distribution are critical prerequisites. Only large firms with global reach have the technological, managerial, and financial resources to dip into the well of innovations needed to profit from this opportunity.

New commerce in Tier 4 will not be restricted to businesses filling such basic needs as food, textiles, and housing. The bottom of the pyramid is waiting for high-tech businesses such as financial services, cellular telecommunications, and low-end computers. In fact, for many emerging disruptive technologies (e.g., fuel cells, photovoltaics, satellite-based telecommunications, biotechnology, thin-film microelectronics, and nanotechnology), the bottom of the pyramid may prove to be the most attractive early market.

So far, three kinds of organizations have led the way: local firms such as Amul and Grameen Bank; NGOs such as the World Resources Institute, SELF, The Rainforest Alliance, The Environmental Defense Fund, and Conservation International, among others; and a few MNCs such as Starbucks, Dow, Hewlett-Packard, Unilever, Citigroup, DuPont, Johnson & Johnson, Novartis, and ABB, and global business partnerships such as the World Business Council for Sustainable Business Development. But to date, NGOs and local businesses with far fewer resources than the MNCs have been more innovative and have made more progress in developing these markets.

It is tragic that as Western capitalists we have implicitly assumed that the rich will be served by the corporate sector, while governments and NGOs will protect the poor and the environment. This implicit divide is stronger than most realize. Managers in MNCs, public policymakers, and NGO activists all suffer from this historical division of roles. A huge opportunity lies in breaking this code – linking the poor and the rich across the world in a seamless market organized around the concept of sustainable growth and development.

Collectively, we have only begun to scratch the surface of what is the biggest potential market opportunity in the history of commerce. Those in the private sector who commit their companies to a more inclusive capitalism have the opportunity to prosper and share their prosperity with those who are less fortunate. In a very real sense, the fortune at the bottom of the pyramid represents the loftiest of our global goals.

Resources

The concepts in this article were first articulated, in 1998, and have been made available for discussion in a working paper. For more information, contact the authors.

Stuart Hart, "Beyond Greening: Strategies for a Sustainable World," *Harvard Business Review*, January-February 1997; wvvw.hbsp.harvard.edu/hbr/index.html

C.K. Prabalad and Kenneth Lieberthal, "The End of Corporate Imperialism," *Harvard Business Review*, July-August 1998; www.hbsp.harvard.edu/hbr/index.html

"Is the Digital Divide a Problem or an Opportunity?" *Business Week* Supplement, December 18, 2000.

Robert Chambers, *Whose Reality Counts? Putting First Last* (ITDG Publishing, 1997).

Thomas L. Friedman, *The Lexus and the Olive Tree: Understanding Globalization* (Farrar, Straus and Giroux, 1999).

Amartya Sen, *Development as freedom* (Alfred A. Knopf, 1999)

Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (Basic Books, 2000).

Questions for Discussion

1. Do you agree that a company can be too ethical, as suggested by Singer?
2. Schwartz suggests the core elements in order for a firm to develop and sustain an ethical corporate culture. Can you think of any additional steps that might be needed?
3. Do ethics officers need to be hired and fired by the board of directors, as recommended by Hoffman and Rowe, instead of by the CEO?
4. Do you accept the arguments that God can be considered a managerial stakeholder for certain managers? Can this have implications for business, as Schwartz suggests?
5. Do you believe there is a potential fortune at the bottom of the pyramid, as Prahalad and Hart suggest?

Business Ethics in Hollywood Movies

Mark S. Schwartz

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The following list is a selection of what might be considered some of the more significant Hollywood movies and documentaries that have focused on business ethics issues over the years. Each raises multiple key ethical dilemmas for the individuals and business firms involved. Several of the movies are based on or inspired by real events.

- *Antitrust* (2001). A young computer programmer discovers the inappropriate conduct of his boss, who is creating anti-trust problems. Who can he trust?: www.imdb.com/title/tt0218817/.
- *Avatar* (2009). Humankind attempts to exploit the resources of the planet Pandora but must displace its indigenous population in doing so: www.avatarmovie.com/.
- *Blood Diamond* (2006). Based on true events, the movie deals with how rebel groups in Sierra Leone sold diamonds to fund their wars against the government: www.imdb.com/title/tt0450259/.
- *Boiler Room* (2000). An ambitious trainee joins a high-pressure penny stock firm, and begins to question whether making as much money as possible should be the ultimate goal in life: www.imdb.com/title/tt0181984/.
- *Capitalism: A Love Story* (2009). A documentary by Michael Moore that looks at corporate dominance over ordinary Americans: www.capitalismalovestory.com/.
- *China Syndrome* (1979). A nuclear plant almost meltdowns as a reporter and whistleblower work together to bring out the truth of the cover-up: www.imdb.com/title/tt0078966/.
- *A Civil Action* (1998). A firm that dumped toxic waste is sued by the families of two dead children: www.imdb.com/title/tt0120633/.
- *Class Action* (1991). An auto company is sued over a safety problem. Loosely based on the Ford Pinto case: www.imdb.com/title/tt0101590/.
- *The Corporation* (2003). A documentary that shows the inherent problems underlying the corporate entity: www.thecorporation.com/.
- *Erin Brockovich* (2000). Based on the true story of a legal assistant who takes on a class action lawsuit against energy giant Pacific Gas Company: www.imdb.com/title/tt0195685/.
- *Food, Inc.* (2008). A documentary discussing the dominance over the food industry by a few corporations and the possible negative consequences as a result: www.foodincmovie.com/.
- *Glengarry Glen Ross* (1992). Focuses on the efforts and tactics used by a group of desperate real estate

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agents in making the sale: www.imdb.com/title/tt0104348/.

- *The Insider* (1999). Based on the true story of Jeffrey Wigand, a tobacco executive who must decide whether to blow the whistle on his firm and put his family at risk: www.imdb.com/title/tt0140352/.
- *Jerry Maguire* (1997). Following a moral epiphany, a sports agent is fired and comes to terms with properly serving the needs of one's clients: www.imdb.com/title/tt0116695/.
- *Margin Call* (2011). An analyst discovers his investment bank is on the verge of collapse, and the senior management of the bank must decide what to do with its toxic assets. Inspired by the true events of the US 2007 financial crisis: www.imdb.com/title/tt1615147/.
- *Monsters, Inc.* (2001). The company must scare children in order to produce energy for its city. What is Monsters, Inc. willing to do to avoid an energy crisis?: www.imdb.com/title/tt0198781/.
- *Supersize Me* (2004). A man in average health explores the health consequences of eating only McDonald's food for one month: www.imdb.com/title/tt0390521/.
- *Thank You for Not Smoking* (2005). The chief spokesperson for big tobacco speaks on behalf of cigarettes while trying to remain a role model for his 12-year-old son: www.imdb.com/title/tt0427944/.
- *The Truman Show* (1998). An insurance agent discovers that his entire life is the focus of a reality television show: www.imdb.com/title/tt0120382/.
- *Wall Street* (1987). During the high-flying 1980s on Wall Street, a young stockbroker engages in insider trading under the mentorship of a ruthless and greedy corporate raider: www.imdb.com/title/tt0094291/.

Cases for Part 5

Introduction

The first mini-case in Part 5, "Andrew Ames," involves the dilemma of John, who has received a sexually explicit joke via email from Andrew. The last mini-case, "Bert Tanui," involves the dilemma of what to do when handed a competitor's proposal.

The cases in Part 5 attempt to draw together many of the articles in previous chapters, as well as those in Chapter 10. In "Global Corporation: Running a Global Ethics and Compliance Program" the VP of Business Practices for Global Corporation faces the challenge of integrating tens of thousands of employees of a firm they have just acquired. The problem is that the acquired firm's ethical practices and standards are much weaker than Global Corporation's. The core elements of an ethical corporate culture described by Schwartz can be helpful in analyzing this case. In "Barrick's Tanzanian Project Tests Ethical Mining Policies," a gold-mining firm faces the ethical challenge of extracting resources in a developing nation. The case integrates many of the articles throughout the textbook, including those on international business and the natural environment. In the case "An Ethical Approach to Crisis Management," the decision-making process of BP is ethically examined. Did BP act appropriately? The final case, "Why I Am Leaving Goldman Sachs," is the op-ed piece written by former VP Greg Smith upon quitting his firm, Goldman Sachs. Smith is quite critical of the corporate culture at Goldman, and can't tolerate the exploitation by the firm of its clients.

Mini-Cases

Andrew Ames

Andrew has worked for the company for 23 years and has made lots of friends in that time. There are several guys that he is particularly close with and, outside of work, they go to ball games and golf together regularly in the same league. Over the years they have spent a good deal of time together, and have gotten to know each other very well.

Andrew's brother sent him a sexually explicit joke that was in the form of a cartoon and told him the address on the Internet where it could be found. Andrew went to the site and found a number of very graphic pictures and jokes. On his lunch hour, Andrew downloaded them to his PC and then attached them to an email to his buddies. Since he knew the guys so well, he knew for sure they would not be offended if his humor was not "politically correct."

The next day John opened up his email and saw the one from Andrew. He got a good laugh and wanted to send it to another friend in his department. What should John do?

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Discussion questions

1. Should John wait until break time or lunchtime to send the email to his friend?
2. Is this email OK since it was between friends? Why?
3. Would the answer be different if the joke was not of a sexual nature? If there were not pictures/cartoons?
4. Is the email Andrew sent to John private?

Bert Tanui

Bert Tanui is a consultant in Advisory. After a difficult price negotiation, he has finally landed a contract with a large electronics firm for the development of a complex inventory management system. Since he knows that there were two other finalists, he is particularly pleased.

This is Tanui's first meeting with the client since the contract award. His objective is to clarify the parameters of the research phase and to identify the people he will be working with during the engagement.

In response to Tanui's opening comments about the scope of the effort, the client reaches into a file and hands him a competitor's proposal.

"Take a look at this. It does a good job of spelling out the requirements."

What should Tanui do?

Discussion question

1. When is it acceptable to look at competitor information (if ever)?

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Global Corporation
Running a Global Ethics and Compliance Program

Lisa A. Stewart

Program Manager for the Business Roundtable Institute for Corporate Ethics

In July 2003, Gil Pazzo, vice president of Business Practices for Global Corporation (GC), sat at his desk in the company's Hartford, Connecticut, headquarters considering the challenge of integrating 46,000 new employees into GC's global ethics and compliance program from the recently acquired Exen plc, a United Kingdom-based leader in security and fire protection services. Although Pazzo had faced many difficult issues since he had taken over business practices programs for GC in 1995, this challenge was unique. Simultaneously integrating this volume of employees – who were situated in a variety of different cultures across the globe – would be a monumental task, especially since Exen's ethics and compliance priorities were not on the level of GC's. Pazzo wondered where he should start.

History of GC and Business Units

Global Corporation was a $31 billion global corporation made up of seven business units and a stand-alone

Based on an original case by Lisa A. Stewart, Case BRI-1001, "United Technologies Corporation: Running a Global Ethics and Compliance Program." http://www.darden.virginia.edu/corporate-ethics/pdf/bri-1001.pdf. Original case prepared by Lisa A. Stewart, Program Manager for the Business Roundtable Institute for Corporate Ethics under the supervision of R. Edward Freeman, Elis and Signe Olsson Professor of Business Administration, Director of the Olsson Center, Academic Advisor of the Business Roundtable Institute for Corporate Ethics, and Jeanne Liedtka, Johnson & Higgins Associate Professor of Business Administration, Executive Director of the Batten Institute. Copyright © 2005 by the Business Roundtable Institute for Corporate Ethics (www.corporateethics.org). Reproduction and use for direct educational purposes permitted. All other rights reserved. Reprinted with permission.

research center, which supported research for all divisions. The business unit divisions were Carrier Corporation (climate control systems), Hamilton Sundstrand (airplane systems), Otis Elevator, Pratt & Whitney (airplane engines), Sikorsky (helicopters), GC Power (hydrogen fuel cells), and the recently acquired Exen (security and fire protection services). A global conglomerate with a total of 205,700 employees after the Exen acquisition (138,000 based outside of the United States), GC had over 4,000 locations in approximately 62 countries and did business in more than 180 countries. In 2002, 55 percent of GC's total revenues came from outside the United States, and its net income was $2.2 billion with assets totaling $29.1 billion. In March 2003, GC ranked 49th on the Fortune 500 list of companies.

Many of GC's long-standing business units were originally formed by business pioneers, whose names were still associated with the products. According to George David, chief executive officer of GC, "We invented every business we are in – and in a bunch of cases the name of the [business] is the name of the person who did the invention." Elisha Otis founded Otis Elevator in 1853; Willis H. Carrier invented air conditioning in 1902 and started Carrier Engineering in 1915; in 1920, Hamilton Aero Manufacturing was founded by Thomas Hamilton; Sundstrand Machine Tool Company by David Sundstrand in 1929; Igor Sikorsky founded Sikorsky Aero Engineering in 1923; and Pratt & Whitney Aircraft was incorporated in 1925. Exen, a leader in security and fire protection services and GC's newly acquired company, originated in 1818 in the United Kingdom when Charles and Jeremiah Exen patented their prize-winning detector lock.

GC had a long and complex history. United Aircraft and Transport was formed in 1929, when Boeing Airline & Transport joined forces with Hamilton, Sikorsky, Pratt & Whitney, Chance Vought, and Standard Steel Propeller. That same year, the Research Center, the corporation's central research laboratory, was established in Connecticut. Objections raised by the U.S. government in 1934 dissolved United Aircraft and Transport into three distinct units: Boeing Airplane Company, United Air Lines Transport, and United Aircraft Corporation. In 1975, United Aircraft Corporation changed its name to Global Corporation, to more accurately reflect the broad nature of its business.

Defense Acquisition Scandals of the 1980s

GC was and remains a major contractor to the U.S. government, including the Department of Defense. In the mid-1980s, the defense industry in the United States was embroiled in allegations of fraud, waste, and abuse. Reports of military spending on wildly overpriced spare parts were prevalent in the media, including the memorable $640 toilet seats, $437 hammers, and $748 for two pairs of pliers. In June 1984, a Pentagon audit of the Defense Department's spare parts purchases from October 1981 to September 1983 revealed that 36 percent of the 2,300 audited spare-parts purchases were either "unreasonably priced" or "potentially unreasonably priced." In April 1985, the Pentagon's inspector general announced that 45 of the 100-biggest defense contractors were under investigation by the U.S. Department of Defense.

One of GC's divisions, Pratt & Whitney, faced allegations related to these acquisition scandals. In March 1985, Air Force Secretary Verne Orr wrote a letter asking Harry Gray, the chairman of GC, to voluntarily repay $40 million in excess profits that Pratt & Whitney made on contracts over a six-year period. Responding to the request, a Pratt & Whitney spokesperson asserted that the average earned profit on the contracts was 1.6 percent above the level "anticipated by the government at the outset." He contended that Pratt & Whitney's profits were not only reasonable, but they were also "consistent with the Department of Defense's own guidelines for profit objectives." Pratt & Whitney had "negotiated in good faith to deliver products at fixed prices, with the company assuming the risk of fluctuating costs," he added. Although GC felt that no refund was justified, the spokesperson explained that the company had "offered to work with the government because its 'reputation as a major defense contractor [was] being questioned.'"

The Packard Commission

In July 1985, President Reagan responded to the defense management scandals by establishing a Blue Ribbon Commission known as the "Packard

Commission" to conduct a study of the industry and to recommend a course of corrective action. The commission examined a wide array of issues and strategies related to government dealings with defense contractors and found that inefficiency within the system was a far larger problem than fraud. The "well publicized spare parts cases are only one relatively small aspect of a far costlier structural problem," the Packard Commission's final report noted. The report recommended that defense contractors "must promulgate and vigilantly enforce codes of ethics that address the unique problems and procedures incident to defense procurement. They must also develop and implement internal controls to monitor these codes of ethics and sensitive aspects of contract compliance." The commission called upon contractors to significantly improve efforts of self-governance.

Defense Industry Initiative

In 1986, a group of 32 defense contractors, including GC, established the Defense Industry Initiative (DII), as a direct result of the requests of the commission and, more broadly, to the crisis in public perception. A study of public attitudes toward defense management presented to the Packard Commission indicated that industry contractors were "seen as especially culpable for waste and fraud in defense spending." According to Gil Pazzo, the DII originated when a group of defense representatives, including John "Jack" Welch, General Electric's chairman of the board, decided that the industry needed a strong proactive response to the overall crisis in public trust. Welch invited the CEOs of several of GE's peer companies to discuss these issues as a group. The DII prescribed a detailed program of ethics education and voluntary compliance measures aimed at self-regulation. The program included six guidelines, referred to as the "Principles," to which all members of the initiative subscribed (see Exhibit 1 for a list of the six principles). The Principles, also detailed in the Packard Commission's report, outlined ways in which the members of the DII could cooperate on developing and maintaining ethical standards and practices, sharing their company's best practices within the group, and making commitments that each member company would self-regulate these issues.

Ethics and Compliance Regulation in the United States

Despite industry efforts to self-regulate, a 1988 Defense Department audit showed that overcharges to the government continued: almost $789 million or 47 percent of approximately $54 billion in military contracts. Also

Exhibit 1 Global Corporation: running a global ethics and compliance program.

The DII Principles

The DII Principles were adopted at the time of the establishment of the DII in June 1986, and have been periodically reconfirmed. The Principles are:

1. Each Signatory shall have and adhere to a written code of business conduct. The code establishes the high ethical values expected for all within the Signatory's organization.
2. Each Signatory shall train all within the organization as to their personal responsibilities under the code.
3. Signatories shall encourage internal reporting of violations of the Code, with the promise of no retaliation for such reporting.
4. Signatories have the obligation to self-govern by implementing controls to monitor compliance with federal procurement laws and by adopting procedures for voluntary disclosure of violations of federal procurement laws to appropriate authorities.
5. Each Signatory shall have responsibility to each other to share their best practices in implementing the DII principles; each Signatory shall participate in an annual Best Practices Forum.
6. Each Signatory shall be accountable to the public.

In addition to adopting and adhering to this set of principles of business ethics and conduct, Signatories have assumed a leading role in making the principles a standard for the entire defense industry, and a model for other industries.

Source: http://www.dii.org/; excerpt from THE STATEMENT OF DII PURPOSE AND ORGANIZATION; DEFENSE INDUSTRY INITIATIVE ON BUSINESS ETHICS AND CONDUCT.

Exhibit 2 Global Corporation: running a global ethics and compliance program.

Code of Ethics

Corporate principles: Global is committed to the highest standards of ethics and business conduct. This encompasses our relationship with our customers, our suppliers, our shareowners, our competitors, the communities in which we operate, and with each other as employees at every organizational level. These commitments and the responsibilities they entail are summarized here.

Our customers: We are committed to providing high quality and value, fair prices and honest transactions to those who use our products and services. We will deal both lawfully and ethically with all our customers.

Our employees: We are committed to treating one another fairly and to maintaining employment practices based on equal opportunity for all employees. We will respect each other's privacy and treat each other with dignity and respect irrespective of age, race, color, sex, religion, or nationality. We are committed to providing safe and healthy working conditions and an atmosphere of open communication for all our employees.

Our suppliers: We are committed to dealing fairly with our suppliers. We will emphasize fair competition, without discrimination or deception, in a manner consistent with long-lasting business relationships.

Our shareowners: We are committed to providing a superior return to our shareowners and to protecting and improving the value of their investment through the prudent utilization of corporate resources and by observing the highest standards of legal and ethical conduct in all our business dealings.

Our competitors: We are committed to competing vigorously and fairly for business and to basing our efforts solely on the merits of our competitive offerings.

Our communities: We are committed to being a responsible corporate citizen of the worldwide communities in which we reside. We will abide by all national and local laws, and we will strive to improve the well-being of our communities through the encouragement of employee participation in civic affairs and through corporate philanthropy.

Standards of Conduct: Our Code of Ethics, comprised of our Corporate Principles and these Standards of Conduct, governs our business decisions and actions. The Code is an expression of fundamental values and represents a framework for decision making. The Code is further explained and implemented in policy circulars and policies included in the Corporate Policy Manual. The integrity, reputation, and profitability of Global ultimately depend upon the individual actions of our directors, officers, employees, representatives, agents and consultants all over the world. Each is personally responsible and accountable for compliance with our Code. In addition, any representatives, agents or consultants used by the Corporation shall be prohibited from acting on its behalf in any manner that is inconsistent with the standards of conduct applicable to employees under the Code of Ethics.

The following Standards of Conduct serve to assist in defining our ethical principles and are not all-encompassing. The Standards must be interpreted within the framework of the laws and mores of the jurisdictions in which we operate, as well as in light of GC policies and good common sense. Reasons such as "everyone does it" or "it's not illegal" are unacceptable as excuses for violating our Standards. We must each be mindful of avoiding at all times, on and off the job, circumstances and actions that give even the appearance of an impropriety or wrongdoing which could discredit the Corporation.

These Standards of Conduct will be enforced equitably at all organizational levels in 1988, 34 of the 39 DII signatories were subject to over 200 investigations. Over 1,000 defense contractors were suspended from conducting business at some point in 1988 for a variety of ethical violations, "ranging from bribery and bid rigging to the manufacture of shoddy products and overcharging."

The U.S. government tried to increase the incentives for creating and implementing effective compliance programs. After years of data analysis and public hearings, the United States Sentencing Commission developed the Federal Sentencing Guidelines for Organizations (FSGO) in 1991. The FSGO outlined broad standards of ethical behavior for corporations that applied to all organizations whether publicly or privately held. Deputy General Counsel for the Sentencing Commission Winthrop Swenson headed up the task force responsible for developing these guidelines. "The task force collected formal and informal comments from the public," Swenson explained, "and the defense industry representatives were the most vocal participants in this process." As Swenson described, the defense contractors advocated the idea that self-regulating compliance and ethics programs should be key determinants in establishing punishments for violations. "The voice from the DII," he said, "helped to confirm and ratify the model that was being considered by the task force."

More than a decade after the original FSGO guidelines were established, the United States Congress passed the Sarbanes-Oxley Act of 2002 to provide additional government regulation of public companies' compliance to statutory and regulatory standards. Among other things, the act included a number of significant changes relating to the responsibilities of directors and officers, from reporting requirements to corporate governance obligations.

GC's Ethics and Compliance Program

In its quest to increase self-regulation of compliance issues in an increasingly government-regulated environment, GC first published its Code of Ethics in 1990. GC adopted this broad-ranging code in order to articulate standards of conduct over and above compliance with legal requirements. Since then, the company has woven the Code of Ethics into the corporate culture through various business practices programs and detailed policies in the *GC Corporate Policy Manual* (see Exhibit 2 for a Code of Ethics excerpt). In his introduction letter, CEO George David explained to GC employees that "ethics and compliance are our joint responsibility." He continued, "We must have a spotless, perfect record, period. We're counting on each other." GC also incorporated five major company commitments, originally published in GC's 2001 Annual Report, into the Code of Ethics. The five company commitments were performance, pioneering innovation, personal development, social responsibility, and shareowner value (see Exhibit 3 for details on these commitments). An *Industry Week* article naming George David as CEO of the Year for 2002 credited these five commitments for guiding GC's strong performance in 2001 during a U.S. recession. The words were important, according to David, because "they focus on the present and future of GC while incorporating achievements and values of the past."

Under the guidance of the Code of Ethics and GC's commitments, GC had two main ethics and compliance programs, serving specific, complementary functions. As vice president of Business Practices, Gil Pazzo oversaw both components: the Business Practices program and the Ombuds/DIALOG program. The Business Practices program is responsible for oversight of standards, beginning with corporate policies, training, assessments, and investigations. The Ombuds/DIALOG program is responsible for providing a confidential, anonymous avenue for employee communications.

GC had distinguished itself from many other companies, Pazzo explained, by fully institutionalizing its ethics and compliance programs, with a firm commitment to their success from top-level management. Ultimately, line management had responsibility. Rather than the typical pattern of declining infrastructure and authority he had observed in other companies' ethics programs, Pazzo applauded GC's commitment to providing the continued resources for the program and for maintaining the high-level of the vice president of Business Practices within the reporting structure of the organization.

The *GC Corporate Policy Manual* clearly outlined that the Code of Ethics should serve as "a framework for decision-making" and that in addition to "compli-

Exhibit 3 Global Corporation: running a global ethics and compliance program.

GC Commitments

Performance: Our customers have a choice, and how we perform determines whether they choose us. We aim high, set ambitious goals and deliver results, and we use customer feedback to recalibrate when necessary. We move quickly and make timely, well-reasoned decisions because our future depends on them. We invest authority where it needs to be, in the hands of the people closest to the customer and the work.

Pioneering innovation: We are a company of ideas that are nurtured by a commitment to research and development. The achievements of our founders – Willis Carrier, Charles and Jeremiah Exen, Tom Hamilton, Elisha Otis, Fred Rentschler (who founded Pratt & Whitney), Igor Sikorsky, and David Sundstrand – inspire us to reach always for the next innovative and powerful and marketable idea. We seek and share ideas openly, and encourage diversity of experience and opinion.

Personal development: Our employees' ideas and inspiration create opportunities constantly, and without limits. We improve continuously everything we do, as a company and as individuals. We support and pursue lifelong learning to expand our knowledge and capabilities and to engage with the world outside GC. Confidence spurs us to take risks, to experiment, to cooperate with each other and, always, to learn from the consequences of our actions.

Social responsibility: Successful businesses improve the human condition. We maintain the highest ethical, environmental and safety standards everywhere, and we encourage and celebrate our employees' active roles in their communities.

Shareowner value: We are a preferred investment because we meet aggressive targets whatever the economic environment. We communicate honestly and forthrightly to investors, and deliver consistently what we promise. We are a company of realists and optimists, and we project these values in everything we do.

ance with the law," it also required "avoidance of conflicts of interest, integrity and fair dealing." The manual stated that "each director, officer, employee and representative is personally responsible and accountable for meeting the requirements and standards of the Code." GC's chief executive officer and each business unit chief executive were "responsible for creating and fostering a culture of ethical business practices, encouraging open communications, and for instilling an awareness of and commitment to the Code of Ethics." In Pazzo's view, management also viewed the ethics and compliance programs as a tool to protect the company's bottom line, guarding the corporation from individuals who may have acted either dishonestly or in their own self-interest. "Every manager at GC knows that employees have an alternate channel to report a potential wrongdoing," Pazzo explained.

GC structured its programs so that the 206 Business Practices officers (BPOs) were integrated throughout the corporation, in local business units, located in the various countries in which GC operated. BPOs all worked in other positions within the corporation, and the duties of the BPOs were in addition to their regular jobs. Employees approached BPOs for guidance and advice on business ethics issues, assistance with interpreting GC's corporate policies or general compliance issues. BPOs were also responsible for reinforcing the Code of Ethics through training and communications, and they assisted with ethics and compliance reporting requirements. Although there were many difficulties in enforcing a single Code of Ethics across many countries and cultures, as Pazzo noted, the basic rules of "don't lie; don't cheat; don't steal" seemed to translate into any culture's ethical beliefs.

The other main component, the Ombuds program, was established at GC in 1986 to allow employees an alternate, confidential means of raising ethical concerns, making suggestions, registering complaints, or asking for guidance in ethically unclear situations. Employees were still encouraged to resolve issues via the traditional routes of human resources or through their supervisors, but for employees who preferred a confidential channel, the Ombuds program provided an alternative. The four Ombuds, all long-term GC employees with an average tenure of over 20 years, were assigned by geographic regions and assisted employees with complex ethical issues. Ombuds worked with employees over the phone, in person, or via the Internet. The Ombuds also trained and supervised approximately 175 DIALOG Program Administrators (DPAs), dispersed throughout the corporation, who, in addition to their full-time jobs, handled written inquiries to the DIALOG Program and assisted with the daily operations of a system for processing employee inquiries. Employees reached the DPAs via mail or a DIALOG Website, where they chose a secure password that they could later use to return to the site for resolution on their inquiry. The DIALOG system was available to employees in 29 languages. Since the start of the Ombuds/DIALOG program, it had dealt with more than 10,000 Ombuds cases and over 60,000 DIALOG inquiries. Inquiries were varied and included issues ranging from questions about company policies to queries related to ethical business practices.

Exen

Like its new parent company, Exen also conducted business on multiple continents and in many countries around the globe. The regional Exen headquarters were located in Sydney (covering Australia and New Zealand), Hong Kong (covering all of Asia), Paris (covering all of continental Europe), London (covering England, Scotland, and South Africa), and Toronto (covering the United States, Canada, and Mexico). All but about 1,000 of the approximately 46,000 Exen employees worked outside of the United States.

When it acquired Exen, GC obtained not only security and fire protection *systems*, but also security guard employees who were widely dispersed in various buildings in the regions where Exen operated, and who often had little affiliation with the central organization. Exen had in prior years made hundreds of small acquisitions and was struggling with integration of a skilled but geographically and culturally diverse workforce. The decentralized workforce appeared to have weaker allegiances to Exen than the typical GC employee had to her or his GC company. Further, a large number of Exen managers had very short tenure with the company. Additionally, Exen security guards reported directly to their assigned buildings, had little interaction with a central Exen office, and had no access to the company's intranet or computer system.

In 1999, Gil Pazzo had managed another large-scale integration of employees when GC acquired Sundstrand, which later became part of Hamilton Sundstrand. According to Pazzo, although the scope of the integrations was similar, the two situations were very different. Unlike Sundstrand, Exen had a corporate culture prior to joining GC that included no established ethics and compliance programs, so GC's Business Practices team needed to instill the basics of why such a program was necessary and what it encompassed. Sundstrand, on the other hand, had a centrally connected and technically proficient workforce and already had ethics and compliance self-regulation programs in place, so the focus during that integration was on strengthening the infrastructure and adding energy and resources to the existing programs.

Where to Start

With a well-established and highly trained network of Ombuds and Business Practices officers in place, Gil Pazzo now faced the daunting task of simultaneously bringing 46,000 new Exen employees into the GC ethics and compliance system. Not only were these employees unfamiliar with a corporate ethics and compliance program, but Pazzo and his team realized that GC's standard methods of communication might be ineffective with the Exen workforce, consisting primarily of security guards. Turning to his trusted team members for input and advice, Gil Pazzo asked them, "Where should we start?"

Note

This case is a hypothetical case for exam purposes only. The names of the original companies and of several individuals have been changed.

Barrick's Tanzanian Project Tests Ethical Mining Policies

Geoffrey York

Africa Bureau Chief, *The Globe and Mail*

Across the cavernous pits and the mountains of waste rock, the alarm wails eerily, warning that an explosion is imminent. Dozens of villagers gather silently at the edge of a pit, past the holes that have been torn in the fence, waiting for their chance.

Then comes the blast. As a plume of smoke curls into the sky, the scavengers scramble into the pit, eager to prise a living from the freshly smashed rock.

Suddenly the police appear, careering over the rocky road from another corner of the vast mine. The pickup truck full of armed men in green uniforms bounces across the wasteland like a scene from Mad Max. The truck hurtles toward the scavengers, but is halted by a boulder that they have pulled across its path. By the time the police can leap down and move the boulder, the scavengers have scattered into the nearby trees, where they wait for their next opportunity.

This is the daily ritual of conflict at the North Mara gold mine in Tanzania: Intrude and retreat, pursue and withdraw – punctuated by flare-ups that sometimes leave people dead.

For an eyewitness, it's difficult to reconcile this cycle of violence with the avowed community-friendly policies of the mine's parent company, Barrick Gold Corp. and the professed goal of its founder, Peter Munk, of making good corporate citizenship the "calling card that precedes us wherever we go." How did a leading Canadian corporate citizen and the world's top gold producer get itself into this contradiction? And why does Barrick continue mining in a place where bloodshed and corruption seem inescapable?

Geoffrey York, "Barrick's Tanzanian Project Tests Ethical Mining Policies," *Report on Business Magazine*, September 29, 2011. Reprinted with permission.

The alternate image of Barrick, fostered by watchdog activists, is that of a rogue company. These critics are happy to point out that North Mara is not the only trouble spot in the Barrick empire. Many of the same problems seen here – violence, pollution, sexual assault – have occurred at Barrick's Porgera gold mine in Papua New Guinea. After repeated denials, Barrick this year finally admitted the validity of some of the sexual assault allegations at Porgera, and dismissed some of its employees. But the remedial measures were accompanied by one of Munk's most controversial comments: that "gang rape" is a "cultural habit" in Papua New Guinea.

While activists are targeting Barrick worldwide, it is Tanzania that still puts the biggest dent in Barrick's reputation, especially after police killed at least five intruders at North Mara this year.

Much of the conflict stems from the history of the region: its poverty, its political culture, and the warrior tradition of its people. But another key factor is Barrick's determination to press on at the mine in an era when the price of, and demand for, gold keeps rising but sources of the precious metal are ever harder to come by.

The seven villages around North Mara, among the poorest and most underdeveloped in Tanzania, are located in the northwestern corner of the country, 30 kilometres from the Kenyan border. Despite the region's isolation, its gold wealth has been known since the 19th century, when small-scale mining began. Today the region is a key contributor to Tanzania's gold sector, which has emerged as the country's most valuable export, accounting for 40% of export earnings.

As a one-party socialist state until 1992, Tanzania barred foreign investors and prevented the development of a modern mining industry. By the time the country was finally opened to foreign miners in the mid-1990s, about 40,000 villagers in northwestern Tanzania had become dependent on artisanal mining, using shovels and pickaxes to search for gold in small mine shafts and surface pits. Most were forced to give up their livelihood when North Mara and other commercial mines began operating a decade ago.

The villagers belong mostly to the Kuria people, who were traditionally cattle farmers. Colonial records described them as "unruly and backward." They became notorious for cattle rustling and inter-clan fighting, and joined the Tanzanian army in huge numbers. But as they resisted the collectivist policies of the 1970s, the area became an opposition stronghold, neglected by the government and lacking in basic services.

To help each other understand the daily clashes on their mine site, Barrick managers pass around copies of an American ethnographic treatise, *Kuria Cattle Raiders: Violence and Vigilantism on the Tanzania/Kenya Frontier*. But not everything can be explained by ethnicity. There are other crucial factors that people outside Barrick point to.

One is the cheek-by-jowl existence of the villagers and the mine. Anyone who flies into the mine's airstrip can see the surreal sight from the air: hundreds of houses huddled next to the pits and waste heaps. Some dwellings are so close that rocks from the waste heaps tumble against their walls. Children play with empty tear-gas canisters from the daily clashes.

About 10,000 families have been displaced by the mine's growth since 1997, according to a prospectus issued last year by Barrick's subsidiary, African Barrick Gold, which is 74% owned by the Toronto-based mining giant. The relocations began with North Mara's original owner, Afrika Mashariki Gold Mines Ltd., which sold the mine in 2003 to Vancouver-based Placer Dome Inc.

Relocation has not guaranteed safety. Magige Nyamhanga, a 31-year-old farmer who lives about 100 metres from the mine, was accidentally shot in the abdomen in 2009 while walking on a nearby road as police were chasing a group of invaders. His house has been relocated twice in the past dozen years as the mine expanded. He says the blasting at the mine wakes him up at night, and the dust leaves him coughing and exhausted.

The displaced families were given compensation, but those who were relocated in the 1990s were paid less because of a socialist-era law that deemed all land to be owned by the state. The families were compensated only for their buildings and crops; they never received the full market value of their homes. "The process suffers from a local perception of inadequate compensation for previous resettlement," African Barrick acknowledged in its prospectus.

Privately, some company officials go further. The early payments were "peanuts," one official acknowledged.

"The mine is a salutary lesson in how not to establish a mine within or near to an existing community," said a report last year by the South African Institute of International Affairs, an independent think tank affiliated with the University of the Witwatersrand and funded by the United Nations. The institute's researcher was given access to Barrick's four Tanzanian mines, and Barrick made management available for interviews. "There is constant and persistent anecdotal evidence that the way in which the mine was established was neither transparent, nor did it secure the support of the local community," the report said. "Moreover, there are repeated reports from people involved in mining and community development work in the area over many years that the community feels duped and deceived by the way in which the mine was established."

The report says Barrick inherited a "perfect storm" of problems when it acquired North Mara In 2006 as part of the Placer Dome purchase. But it notes that those problems were compounded by Barrick's own mistakes, including a much-publicized spill of acidic water from the mine's storage ponds in 2009. The report concluded that Barrick may have a legal licence to operate at North Mara but it lacks a "social licence." In other words, it has failed to win the support of the local community, a crucial requirement for any mining company these days.

What's more, the report said, "The company has acknowledged that not only does it not enjoy a social licence to operate the North Mara mine, but that the very viability of the mine is under threat."

If someone at Barrick hinted to the institute's researchers that the company might abandon North Mara, the company now insists it is fully committed to it. "We think shutting down a mine that provides employment and other meaningful benefits to thousands is not a good solution," Barrick president Aaron Regent wrote on The Globe and Mail website recently.

Those employment benefits, however, are relatively small in comparison to the population. North Mara employs about 700 Tanzanians, along with another 900 on contracts. The jobs are far from enough for the community of about 70,000 villagers around the mine, and the high unemployment rate has added to their alienation and anger. Half of the Tanzanian population earns less than $2 a day.

When Barrick acquired the mine, it knew that North Mara would be a difficult and sensitive challenge. Shooting deaths have been documented at the mine site for at least the past six years. By last year, the company was claiming progress in reducing the violence. And then the deaths began again: At least five villagers were shot dead by Tanzanian police on May 16 at North Mara.

The Tanzanian government and the company both launched investigations into the shootings, but it wasn't enough to stem the tide of bad publicity.

The clashes with the invaders are far from the only controversy at North Mara. There are land and compensation disputes, environmental problems, arguments over economic benefits and, lately, allegations of sexual assault by police and security guards at the mine. Adding fuel to all of these disputes is a ferocious political climate, with Tanzanian and Canadian activists united in an intense campaign against Barrick, using everything from street protests to YouTube videos. Barrick has responded with an array of tactics, from greater transparency at some moments to threats of legal action at others.

Some activists claim that the mine's pollution has caused the deaths of dozens of people and hundreds of farm animals. Activists have circulated photos and videos of two villagers with gruesome skin diseases, blaming their illnesses on the company. These allegations seem to be false. The spill from the storage ponds into a small river in 2009 involved only acidic water, which damaged the local wetlands. Barrick has provided convincing testimony from medical experts that the skin conditions of the two villagers were chronic or genetic disorders that could not possibly have been caused by environmental factors – especially since the two villagers live far upstream from the mine. "There is no doubt that neither of these conditions is the result of contaminated water," a South African dermatologist said in the testimony.

Environmental issues do remain. By August, more than two years after the spill, the company was still working to satisfy government environmental orders to safeguard and manage the site. Once that is accomplished, Barrick can apply for crucial permits for water discharges at the mine. Norwegian scientists, who sampled the soil and water around North Mara in 2009 on behalf of church groups, have reported elevated levels of arsenic near the site, but Barrick has disputed their research.

Barrick tried to distance itself from its North Mara headache with the move last year to spin off its Tanzanian mines into African Barrick Gold. Nevertheless, it sees expansion in the future. Greg Hawkins, the CEO of African Barrick, says the company has invested $100 million in capital in North Mara this year, along with another $20 million in exploration around the mine, and it has no intention of giving up, despite costs that climbed close to $800 per ounce this year, far higher than the world average (all currency in U.S. dollars).

"We believe quite strongly in the asset," he said in an interview. "We've stepped up the investment because we see a lot of prospectivity there. We could be on the ground there for a lot longer than just the 10 years that the reserve life tells us."

Indeed, despite the high costs, profits are soaring. African Barrick's net income from its four mines (all in Tanzania) leaped by 51% to reach $69.8 million in the second quarter of this year, up from $46.2 million a year earlier. That translates into about 6% of the parent company's earnings from its 26 operating mines around the world.

Hawkins admits there is "frustration" and "venting of historical issues" in the villages around North Mara, but he is confident that the company and the government are improving the security situation. "We're sticking to our long-term plan," he says. "We've got a clear idea of where we're heading. It's a long-term asset for us, and for Tanzania. The mine is a key economic driver in the region and the country, and nobody wants to lose that."

Yet as gold prices rise and the mine becomes more valuable, the conflict intensifies. The massive piles of waste rock have become the only real source of income for the villagers, who have largely abandoned farming and have little hope of wage employment. And the rising price of gold has drawn a rush of newcomers from across East Africa.

Hundreds of villagers and migrants enter the mine illegally every day to scrounge for rock. They have borrowed an English word to describe themselves: "intruders." The word has entered the Swahili language, with no negative connotation, as the name of a new occupation that can produce money and even wealth. For many of the hundreds of intruders who enter the mine illegally every day, this is a profitable business.

Nelson Charles, a 22-year-old intruder, was shot in the arm by the Tanzanian police when he fled the shooting on May 16. He has become a fugitive, hiding from the police for fear that they will arrest anyone who was injured that day. His injury has left him too weak to work. But until now, the life of an intruder has been rewarding.

At the age of 19, Charles was a high-school dropout in a nearby town. A farmer's son, he had been unable to afford his school fees. Today, after working as an intruder for three years, he owns a motorcycle, a television, a DVD player and a $500 Nokia smartphone. He has spent thousands of dollars to buy a plot of land in his hometown, and he plans to build a house there for his family. Several of his friends from school have followed him to North Mara.

"My lifestyle has changed," Charles says. "My friends all congratulate me. They say I made a wise decision."

When he was able to spend his days working, Charles headed to the mine carrying a hammer, an empty bag for waste rocks, and a bottle of water so that he could wash the rocks to check for signs of mineralization. He chopped the rocks into smaller pieces, taking the fragments to small backyard crushing machines to turn them into powder, hired someone to rinse the powder with mercury, and then wrapped any gold grains that emerged in paper and took them to the local gold dealers. Some days he would earn nothing. On other days, he made hundreds of dollars.

The dealers – who make the biggest profits among local people – weigh the gold on small scales, using razor blades or bottle caps as units of measurement. For gold that weighs half of a razor blade, they pay the equivalent of about $14 to the intruders.

The entire business is protected by corrupt deals with the police, the security guards and mine employees. The employees tip off the intruders when the best rocks are being loaded into the waste trucks. The police accept bribes for access to the pits and the waste heaps – usually a dollar or two from each intruder. And when conflicts escalate, they open fire on the same people who normally do business with them.

For the police, shifts at North Mara can be so profitable that they often bribe their superiors for an assignment at the mine. "The police are benefiting from the conflicts," says Maulidl Issa, a 30-year-old villager who has worked as an intruder for the past 11 years. "They are becoming wealthy from the bribes."

Barrick has expressed concerns about the police shootings, but it has also pointed out that the intruders are illegally trespassing. The company is aware of the widespread reports that the police allow the intrusions in exchange for bribes – which raises the question of whether Barrick is too dependent on a corrupt police force that inevitably comes into conflict with the villagers in disputes over bribes.

"We are investigating whether employees and police have participated in a fraudulent scheme of accepting money for access to the site by illegal miners," the company said in a statement to The Globe and Mail. "We have also provided these allegations to the police."

A researcher at the Legal and Human Rights Centre, a respected Tanzanian rights group that is partially funded by several European governments, says the shootings cannot by justified by calling the villagers "illegal trespassers" if the police have given them access to the mine. "If they've made a deal to collect rocks from the mine, how can you call them intruders?" asks Onesmo Olengurumwa, a researcher at the centre. "When there are agreements between the community and the police, and the police fail to honour it, that's when the conflicts start."

The Tanzanian media have documented a long series of killings by police and security forces at North Mara, dating back to 2005 or earlier. In December, 2008, just after the mine's employees had finished blasting high-grade ore at one of its open pits, hundreds of intruders rushed into the pit, stealing and setting fire to mining equipment. One person was shot dead by police, the mine suffered $7 million in damage, and the company had to suspend operations for several days.

Barrick has never given any estimate of the number of deaths that have occurred since it took over at North Mara. In the prospectus for the public listing of its African subsidiary last year, the company addressed the issue briefly and laconically: "There have been additional incidents since 2008 involving trespassers…leading to conflict with security personnel and/or police, which have in some cases resulted in injuries and/or fatalities."

A report this year by the Legal and Human Rights Centre concluded that 19 villagers were killed by police and security guards at North Mara from January, 2009, to June, 2010. Some of the villagers were killed by stray bullets, while others were victims of "police brutality," the report said. Barrick does not agree with the analysis, noting that some deaths may have occurred in conflicts among illegal miners.

Indeed, not all deaths are caused by the police or security. Apart from deaths that may have resulted from clashes among the intruders themselves, two Barrick employees were killed by intruders in 2008. The villagers acknowledge that some people have carried machetes into the mine site and fought with other intruders. They say they stopped carrying machetes when a no-weapons order was issued by village elders. The company disagrees, saying that machetes are still sometimes carried.

Certainly the violence continues to flow in both directions. The company counted 70 stoning attacks on its staff or vehicles in the first five months of this year alone. Its vehicles are riddled with dents and holes from the stone-throwing attacks. On average, the company says, about 800 people invade the mine on a typical day. "If you chase them away every day, you'd have a war on your hands," says a Barrick manager.

But the conflict is already close to a war. The company employs more than 300 security staff and contractors to protect the mine site, along with about two dozen police officers who patrol the area under a separate security agreement (with funding from the company for their fuel, meals and even a portion of their salaries). Across its Tanzanian mines, African Barrick spent more than $20 million on security last year.

The level of violence is obvious from the protective gear of its security guards, who resemble RoboCops with their bulky layers of body armour, helmets, boots, gloves, and padding for their arms, shins and ankles. Unlike the police, the security guards are supposed to be limited to non-lethal force, so they wield an odd array of weapons, including tear-gas launchers and shotguns that fire "bean bag" cartridges. The bean bags (actually fibre socks, filled with shot) are intended to inflict nothing more than a painful bruising, but their manufacturer says they can cause "fatal or serious injury" if they hit the head, neck, thorax, heart or spine.

The police, meanwhile, are equipped with automatic weapons that account for most of the deaths at North Mara. They also fire weapons that the company describes as "sound and flash devices." Villagers describe them as "bombs" that can cause serious injury.

Over the years, Barrick erected fences around the open pits and the waste heaps to keep out the villagers, but they were always torn down. Now it has upped the stakes: It is planning to surround the mine in a 14-kilometre concrete wall, three metres high, planted deep in the ground and topped by razor wire, at a cost of about $14 million.

The villagers insist that they will breach the barrier. "It won't make any difference," Issa says. "The intruders have many skills, and I'm sure they will break the wall. They're always coming up with new ideas on how to get into the mine."

Human rights activists believe the bloodshed will continue as long as the mine is guarded by police who remain unaccountable and immune from prosecution. There are occasional investigations into the shootings at North Mara, but police are never prosecuted. "The people doing the killings are the same people who do the investigations," Olengurumwa says.

Chris Albin-Lackey, a senior researcher at Human Rights Watch who wrote a highly influential report on abuses by Barrick's security guards in Papua New Guinea, believes that ultimately the North Mara situation will require government oversight. Given the weakness of governments in the developing world, only the Canadian government can provide any oversight over Barrick's activities at North Mara, he said.

The Harper government has consistently opposed this idea. In 2010, with the help of some Liberal and NDP absenteeism, the minority Conservative government defeated the proposed Bill C-300, which would have set up a system of oversight for the human-rights and environmental Impact of Canadian resource companies overseas.

Barrick was among the leaders of the lobbying battle against C-300, which was proposed by Liberal MP John McKay. In a submission to a parliamentary committee, Barrick said the bill was "punitive" and would undermine the reputation of Canadian companies, lead to an exodus of mining companies from Canada and damage Canada's position as a global leader in the mining industry.

Barrick has been energetic in defending its interests in the political sphere. Until recently, it often took a pugnacious approach, sometimes threatening its critics with legal action. In 2008, it sued the publisher of a book on the Canadian mining industry (proceedings are scheduled for this fall). Last year, it denied The Globe and Mail access to its North Mara operations. Also last year, it threatened – but thus far has not pursued – a lawsuit against another book publisher, and it warned a Tanzanian rights group that it would take legal action unless it apologized for accusations it made springing from the 2009 storage-pond spill.

This year, the company has been shifting to a more open policy. It made its about-face conceding problems at its Porgera mine in Papua New Guinea and announced investigations into sexual assault allegations at both Porgera and North Mara. It released data on its emissions at its Tanzanian mines. And after the May 16 shooting incident, it allowed The Globe and Mail to visit the North Mara site. Even a vocal opponent of Barrick, social activist Sakura Saunders, says the company has become "more transparent" than most other miners.

And Barrick has a story to tell about the community benefits of its Tanzanian mining operations: It has contributed health clinics, scholarships, water and electricity projects, malaria and AIDS initiatives, training and income-generating programs. At its Bulyanhulu site in Tanzania, the company estimates that it has spent more than $19 million on community projects since 1999. And in September, the company launched a country-wide community fund to which it will contribute $10 million annually – triple its current spending.

At North Mara, the company already has doubled its annual community relations budget to $2 million and increased its community relations team to 50 employees. It hired a respected organization, Search for Common Ground, to train the police in human rights and "conflict minimization." Although Barrick worked to defeat Bill C-300, it became the first Canadian mining company to sign the Voluntary Principles on Security and Human Rights, an international set of guidelines for extractive industries. The rules oblige signatories to investigate and report any credible information about human rights abuses at their workplaces. And Barrick negotiated an agreement with the Tanzanian police, requiring the police to use "minimum force" and comply with international standards.

Graham Denyer Willis, executive director of the Canadian Centre for the Study of Resource Conflict, an independent research centre, says Barrick's agreement with the police is a deft political strategy. "It allows them to distance themselves from the police and to squarely allocate blame on someone else," he says. "It is short-sighted to think that police in rural Tanzania understand and have internalized international human rights standards or that they do not have vested interests in preserving their own livelihoods and allegiances."

Willis notes that the police have become dependent on African Barrick for vehicles, fuel and other daily expenses. "On the one hand, the company can wash its hands clean of any involvement because of the formal language of the memorandum of understanding, but on the other hand it can guarantee the outright allegiance of the police by providing them with things that are otherwise out of reach. As a result, local police have little accountability to anyone except Barrick."

The community benefits, meanwhile, are sometimes less than they might seem. Barrick's predecessor, Placer Dome, invested heavily in a small hospital near the mine – but the hospital was never provided with electricity, and its water supply soon stopped working. Today, its operating theatre is abandoned, its laundry block is used as a storeroom and it relies on kerosene lamps at night. In lieu of washrooms, staff and patients alike use buckets and outdoor pit latrines. "People from the community complain that the hospital is dirty and stinking," says the chief clinician, George Marwa.

Barrick blames vandals for damaging the water pipes, and the local government for failing to provide a generator for the hospital. It says the hospital is a "key priority" in an upcoming agreement on village benefits. The villagers see it differently: They say the company pledged to provide a working hospital and broke its promise.

Two years ago, Barrick was ranked as one of Canada's 50 top corporate citizens in the annual report of Corporate Knights, which studies the social responsibility records of Canadian companies. Since then, however, Barrick has fallen off the list. A report by the research division of Corporate Knights noted that African Barrick recorded nearly $63 million in earnings before interest and taxes from North Mara in 2009, yet its spending on social and community benefits for the region that year were "far lower" than 1% of those earnings. "The extent of the company's involvement In the social welfare of the North Mara region is therefore questionable," the report said.

Barrick says the North Mara mine has also provided substantial economic benefits to Tanzania, including $30 million in purchases of goods and services from Tanzanian businesses last year, along with a $40-million investment to connect North Mara to the Tanzanian power grid. Critics argue, however, that Barrick shouldn't get political credit for what are normal business expenses.

Ultimately, the violent conflicts at North Mara will continue as long as the region is plagued by unemployment and poverty. Many intruders say they would happily give up their invasions and switch to small-scale mining if they could. Barrick has promised to support the artisanal sector, but the villagers are skeptical of the company's promise, which dates to 2007.

Barrick says the artisanal project has been delayed because its safety and security aspects require more study. In the meantime, hundreds of villagers continue to work in highly dangerous conditions in small-scale mining operations, descending into pits and washing gold-laced powder with mercury, which carries a variety of health risks.

Theresia Johannes, a 48-year-old mother of nine children, has spent the past 10 years in a small-scale mining operation near North Mara. She handles drops of mercury with her bare hands. After years of this practice, Johannes notices that her hands are often shaking. Tremors are a common symptom of mercury poisoning. "I'm worried about it," she says. Yet she has no other way of supporting her family.

As long as Tanzanians are forced to choose between dying for a living and the potential wealth that they can gain by invading Barrick's gold mine, the bloodshed at North Mara is likely to continue. Weapons and walls are a poor solution.

An Ethical Approach to Crisis Management

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One of the biggest concerns for CEOs, senior executives and board members is waking up one morning to discover they are facing a crisis that could potentially threaten the very existence of their firms.

What would you do, for example, if you were the CEO of a major chemical company, and you

Mark S. Schwartz, Wesley Cragg, and W. Michael Hoffman, "An Ethical Approach to Crisis Management: Reflections on BP's Gulf Oil Spill," *IESE Insight*, 15, 2012. Reprinted with permission.

discovered that a poisonous gas leak from your pesticide plant had led to the deaths of thousands of people living in the vicinity? Or if you were the CEO of a major global beverage chain, and it came to your attention that one of your employees had charged an ambulance crew for cases of bottled water that were needed for survivors of the 9/11 terrorist attacks?

Far from being hypotheticals, these are all-too-real cases faced by the CEO of Union Carbide in 1984 and the CEO of Starbucks in 2001.

In the Union Carbide case, the CEO insisted that company operations in Bhopal, India, met all existing safety standards that were legally mandated in India at that time, and he blamed sabotage instead. That commenced long and messy legal battles that continue to this day, with some $470 million paid in compensation and several executives convicted for causing death by negligence.

In the case of Starbucks, calls to management were initially ignored – until the story was published, stirring up an Internet-based consumer boycott of Starbucks. Only then did the ambulance workers get their money back and the CEO apologized.

It didn't have to end up this way. Consider another case of a major pharmaceutical company that discovered people were dying from one of its most popular medicines: How did it respond? And when the media accused a producer of canned tuna of killing dolphins that were getting caught in its fishing nets, did it simply ignore the complaints or did it take immediate action?

These well-known stories of Johnson & Johnson and StarKist are still held up as textbook cases of how one should respond to a crisis.

In 1982, when seven deaths were linked to the taking of Tylenol capsules, the CEO of Johnson & Johnson ordered a nationwide recall of all Tylenol products. While the poisoned capsules appeared to be an isolated criminal act limited to the Chicago area, the company took no chances. Although costly, the openness and honesty with which Johnson & Johnson handled the incident transformed the Tylenol brand into one of the most trusted on the market, and led to the development of tamper-resistant packaging and safety seals.

For its part, StarKist announced in 1990 that it would no longer purchase tuna captured in nets that trapped dolphins, and then added "Dolphin Safe" to its labels, gaining significant competitive advantage over other tuna companies in the process.

Fortunately, more firms are realizing the importance of preparing for potential crises like these. The academic and consulting worlds have also entered the arena, providing both theoretical and practical guidance for firms.

However, most of the information related to crisis management is treated within the field of strategic management or disaster/risk management. This has resulted in less attention being paid to the ethical dimensions of crisis management, in spite of the fact that ethical considerations lie at the core of most crises.

Based on our combined decades of experience and research in the areas of ethics, compliance and responsible business, it is our contention that executives who ignore the ethical dimensions of crisis management expose themselves to serious risks that can lead to the collapse of their firms. In this article, we analyze the 2010 BP oil spill in the Gulf of Mexico to highlight some key principles that can help executives to skillfully manage the crises they may face during their professional lives, with greater responsibility and integrity.

What is a Crisis?

The definition of an organizational crisis by the academics Christine M. Pearson and Judith A. Clair remains as relevant today as it was when proffered in their 1998 paper, "Reframing Crisis Management": "An organizational crisis is a low-probability, high-impact event that threatens the viability of the organization and is characterized by ambiguity of cause, effect and means of resolution, as well as by a belief that decisions must be made swiftly."

To this definition of a crisis the dictionary adds these nuances: "the turning point for better or worse" and a "decisive moment."

Building on these definitions, we focus our discussion on one type of crisis that an organization can face – an ethical crisis – which we would define as a decisive moment caused by a severe ethical lapse, requiring the firm and its leadership to decide whether it will react based on a set of ethical values and principles, or based primarily on financial objectives.

Examples of such crises include: product defects that risk causing serious harm; environmental disasters; illegal conduct, such as bribery; and breaches of human rights.

While ethical crises do threaten the viability of an organization, our view is that they also present important opportunities for organizations to strengthen and communicate their commitment to the responsible management of their business activities and their potential impacts.

Moreover, firms that demonstrate their ethical commitment through their response to a crisis not only are more likely to survive, but can emerge stronger and more productive as a result.

In this regard, we concur with Peter Snyder et al. who stated in "Ethical Rationality: A Strategic Approach to Organizational Crisis" that "crises challenge the explicitness of a firm's ethical beliefs and the level of its top management team's conviction to them."

In other words, it is not merely the competence of executives and managers that determines whether a firm's response to a crisis will be successful, but the extent to which the firm's executives and managers ground their responses in a set of core ethical values.

A Case to Remember

To illustrate this point, let's analyze a real-life case that put one company's commitment to ethical values to the ultimate test.

The facts are these: On April 20, 2010, an explosion occurred aboard the Deepwater Horizon, an oil drilling rig connected to the oil company BP in the Gulf of Mexico, which resulted in the death of 11 workers.

A lengthy struggle to plug the oil leak ensued, until the well was finally capped on July 15, 2010, by which time upwards of five million barrels of crude had been discharged into the ocean.

Outcomes of the disaster – the largest offshore oil spill in U.S. history – included significant environmental damage to the wildlife in the region, severe damage to the fishing and tourism industries along the Gulf coast, as well as a collapse in the value of BP shares on international markets.

What lessons can we learn from BP's management of this crisis?

Core Ethical Values

While there are many possible ethical values, we believe that the following core ethical values are both universal in nature and critical to a firm that desires to take an ethical approach to crisis management. In fact, as Jim Collins and Jerry I. Porras assert in their best-selling book, *Built to Last*, companies that are guided by core values similar to those we list here, and that have a sense of purpose beyond just making money, tend to enjoy superior returns over many decades.

1. Trustworthiness

This implies several other associated values: honesty, keeping promises, integrity, transparency and loyalty. If a firm does not act in a trustworthy manner throughout the entire response to a crisis, it has failed from an ethical standpoint.

In the wake of the BP Deepwater Horizon oil spill, U.S. President Barack Obama set up a National Commission to investigate what went wrong. The findings are available for viewing or downloading at www.oilspillcom-mission.gov.

The Chief Counsel's final report noted that the disaster "was not, as some have suggested, the result of a coincidental alignment of disparate technical failures," but rather each technical failure could be traced back to "an overarching failure of management."

According to the report, the litany of management failures included: ineffective leadership at critical times; ineffective communication and siloing of information; failure to provide timely procedures; poor training and supervision of employees; ineffective oversight of contractors; inadequate use of technology; and failure to appropriately analyze and appreciate risk.

All of these undermined trust and represented the failure of BP to live up to its own professed commitment to safety, people development and doing no harm.

Since the crisis, BP's new Group Chief Executive Bob Dudley has tried to redress these failures. As he states in the foreword to BP's Code of Conduct: "Laws vary from country to country and we must always comply with them, but as a global company, we need to go further. To be a trusted company, year after year, we need to work to a consistent and higher set of standards and follow them in everything we do and say, every day, everywhere we work."

As BP learned the hard way, having noble aspirations to behave in an ethical manner is one thing, putting them into practice is another. How we behave is what ultimately earns the trust of others.

As such, in addition to the existence of a Code of Conduct, it is necessary to support it with mechanisms that ensure it is being upheld. To this end, BP has set up OpenTalk, a confidential helpline to facilitate people being able to speak up, ask for help and do the right thing whenever they have a question or feel that the code is being violated.

2. Responsibility

This value is the foundation for any response to a crisis – yet it is often one of the most difficult to live up to. It requires taking all necessary and reasonable steps to respond to the immediate crisis as well as ensure that it does not happen again.

Acting responsibly also means not trying to shift the blame for your mistakes. It requires that you apologize, and you need to be prepared to compensate those who have been harmed as a result of your actions or inactions.

At first, BP did none of these things. The CEO at the time, Tony Hayward, blamed the rig owner, Transocean, and then the cement contractor, Halliburton. Later, reports emerged that BP was trying to coax coastal residents into signing settlement agreements and waivers that would limit the company's liability and cap compensation at $5,000.

When the government got wind of this, Hayward admitted it was "an early misstep" and the company stopped. However, the fact that BP had sent letters urging affected residents to give up their right to sue made Hayward's earlier comments that "we are responsible for the oil and for dealing with it and cleaning the situation up" sound rather hollow.

3. Caring

This means caring about the impact of your actions on others. Against this standard, available evidence suggests that BP's actions both before and following the crisis did not measure up.

According to *The Wall Street Journal*, BP apparently chose not to install a remote-control shut-off valve that is required in Norway and Brazil and used by other oil companies, including Royal Dutch Shell and France's Total SA. The cost of installing such a safeguard device would have been $500,000 – which is not an extortionate amount in relation to BP's reported operating revenues of $240 billion, and far less than the billions that BP now has to pay out for the resultant disaster.

Beyond not using available technology to reduce safety risks, other reports emerged that BP did not appear to be responsive to the safety complaints of its workers.

According to CNN interviews with oil rig survivors, "It was always understood that you could get fired if you raised safety concerns that might delay drilling."

The New York Times obtained a copy of a confidential survey commissioned by Transocean just a few weeks before the accident, in which workers voiced concerns of "drilling priorities taking precedence over planned maintenance."

Quoting from the same research, the Final Report to the President noted: "Some 46 percent of crew members surveyed felt that some of the workforce feared reprisals for reporting unsafe situations."

This lack of caring revealed itself again in Tony Hayward's ill-judged comment about how the disaster was affecting him personally, when he said, "I'd like my life back." He later had to apologize to the families of the 11 men who had actually lost their lives in the accident and would never be given their lives back.

Later, in defense of going sailing on his yacht as the recovery effort faltered, a BP spokesperson tried to justify the jaunt on the basis that "it was the first break that Mr. Hayward has had since the spill began," reported the BBC.

4. Citizenship

This includes abiding by the law in the jurisdictions in which you operate, taking reasonable steps to protect the environment and pitching in to help your community as needed, especially during an emergency.

One way that BP could demonstrate its commitment to responsible corporate citizenship could be to join with others in the oil and gas industry to promote a safety culture by creating a self-policing body, in much the same way that those in the nuclear power industry did in creating the Institute of Nuclear Power Operations (INPO) after the Three Mile Island incident in 1979.

However, as the Final Report to the President acknowledges, certain features of the oil and gas industry make it harder to believe that companies like BP could ever be completely trusted to police themselves without some external government oversight.

"To be credible, any industry-created safety institute would need to have complete freedom from any suggestion that its operations are compromised by multiple other interests and agendas."

For this reason, BP's track record of working through its trade body, American Petroleum Institute (API), raises doubts over its commitment "to drive a safety revolution in the industry."

The Final Report states: "API's long-standing role as an industry lobbyist and policy advocate – with an established record of opposing reform and modernization of safety regulations – renders it inappropriate to serve a self-policing function. In the aftermath of the Deepwater Horizon tragedy, the Commission strongly believes that the oil and gas industry cannot persuade the American public that it is changing business-as-usual practices if it attempts to fend off more effective public oversight by chartering a self-policing function under the control of an advocacy organization."

5. Respect

The philosopher Immanuel Kant interpreted respect to mean treating people as an end and never merely using people as a means. For Kant, what mattered was whether one's actions were motivated by respect for others, which he regarded as a basic moral duty.

Against such a standard, how did BP's actions stack up? Again the evidence available is not encouraging, and the BP case is symptomatic of a bigger problem that has long plagued the oil and gas industry: putting profit before people.

The Final Report to the President reiterates this point: "Project profitability depended on how soon production could be brought online. Drilling vessels were contracted on day-rates, increasing time pressures. Production processes were highly interdependent: delay in one place could cause delays elsewhere. So there were relentless demands to drill the wells, install the platforms, and get the oil and gas flowing. 'When I first started working, they didn't care whether they killed you or not!' remembered one offshore veteran … 'If you got hurt, they just pushed you to the side and put somebody else in.'"

6. Fairness

This final core value is also related to justice. It could be argued that BP, in establishing a $20 billion compensation fund in June 2010, has met this standard at least in terms of its obligation as a responsible party to provide compensation for the harm done. However, whether BP's total response now estimated to be around $40 billion meets this standard is yet to be determined.

Constructing an Ethical Corporate Culture

By seeing where the ethical lapses were in the BP case, we can begin to construct ways to reduce the risk of a crisis happening, respond adequately to a crisis when it occurs, and emerge from a crisis stronger and more respected.

1. Establish a set of core ethical values

The starting point for any firm, big or small, to develop an effective ethical corporate culture is to establish a set of core ethical values that are infused throughout the policies, processes and practices of the organization. We believe our suggested list of trustworthiness, responsibility, caring, citizenship, respect and fairness will provide a solid foundation.

Whatever your core values, they should be present and stated upfront in your firm's code of ethics. They should also be included in your annual report, public accountability statement and/or social responsibility report, and should be indicated as clearly as possible on the home page of your corporate website.

Through the CEO, your firm must emphasize that, when there is a conflict between your stated values and the bottom line, the ethical values must take priority.

For example, in Scotiabank's "Guidelines for Business Conduct," President and CEO Richard E. Waugh makes his ethical priorities clear: "Each of us must always do what is right. This is always in the bank's best interests, even when doing the right thing seems to conflict with meeting sales or profit targets. We do not compromise our ethics for the sake of other goals."

Core values that are embedded in a firm's corporate culture are much more easily operationalized during a crisis. These values will guide your media strategy and the issuing of any apologies or admissions of fault, and they will help in planning ways to ensure that the same problems don't happen again.

In the case of the tainted Tylenol capsules, because Johnson & Johnson prized the safety and trust of consumers so highly, the recall of its products became a no-brainer for managers, above thinking about the negative financial implications for the stockholders.

Consider the opposite extreme: Ford's infamous leaked memo that led to lawsuits over the safety of its Pinto car during the 1970s. In that memo, Ford had calculated and compared the cost of a recall and product design changes ($137 million) versus the estimated cost to society of the accident victims ($50 million) and decided that a human life was cheaper. More recently, when safety concerns arose over its Explorer vehicle, Ford shifted the blame to the tire maker, Firestone, instead of immediately assuming responsibility. A nearly 100-year-old business relationship between Ford and Firestone ended in acrimony.

Your core ethical values should also be applied during hiring and firing, as well as in compensation and promotion decisions.

There is perhaps no more fitting example of living up to your stated ethical values than when the software firm Veritas – which is the Latin word for truth – chose to fire its CFO after it was discovered that he had lied on his resume about having an MBA from Stanford Business School.

2. Implement a comprehensive ethics program

Once you have agreed upon a set of core ethical values and developed your code of ethics, then you need to engage in some ethics training for all employees and managers.

You will need to designate an ethics officer, or some person responsible for the code of ethics, who has direct access to the board of directors. In addition, there must be some reporting channels in place, via which concerns can be relayed without fear of any reprisals.

In most cases, crises can be avoided if employees feel comfortable about reporting their concerns, and then if firms take appropriate and immediate action as soon as those concerns are brought to their attention.

In a May 2012 National Public Radio interview, Peter Solmssen, a managing board member and general counsel of Siemens, explained what his company did after it was discovered that some of its employees were routinely paying bribes to win contracts.

First, Siemens hired outside investigators to reveal the extent of the problem. Then, they offered amnesty to employees who were willing to come forward and help weed out corruption. Those who didn't come forward and were later found to have been involved in shady dealing were fired and then prosecuted.

Changing the corporate culture is not as hard as it seems, Solmssen said, adding that employees will generally opt to make things right if given half the chance. "Our employees are thrilled not to be part of the problem and to be part of the solution."

3. Give ethical leadership

This is potentially the most critical element of an effective ethical corporate culture. The starting principle must be not to let short-term personal financial gain – otherwise known as greed – outweigh considerations of the potential negative impact on other people.

Unfortunately, in too many companies, the narrow pursuit of profits and fat bonuses has prevented many leaders from setting the right ethical tone at the top. WorldCom's Bernie Ebbers and Enron's Kenneth Lay and Jeffrey Skilling are obvious examples. But besides those holding *Time's* dubious honor of "Top 10

Crooked CEOs," there are many less well-known examples that may not make international headlines but are no less egregious – perhaps in your own company?

Check out Exhibit 1 and see if you recognize any of the telltale signs of ethical leadership failure. Addressing these shortcomings and failings is key for boosting your level of ethical leadership.

Guiding Principles

Every firm faces the risk of an ethical crisis, no matter how serious an attempt has been made to build an ethical corporate culture. As such, being prepared to address potential crises effectively and ethically is a crucial element of strong and responsible management. We suggest the following principles to guide crisis management planning.

- Be honest, transparent and disclose all relevant information.
- Remain visible and available at all times throughout the crisis.
- Don't hide behind company media statements or "no comment."
- Accept fault and assume responsibility if indeed you are or your firm is at fault.
- Don't act defensively or try to deflect the blame.
- Take all reasonable steps to fix the problem and help ensure that it won't happen again.
- Apologize when the situation calls for it.

Exhibit 1 Signs of ethical leadership failure. By recognizing these symptoms and seeking the proper antidotes, you can minimize the occurrence of an ethical crisis and improve your chances of success.

Symptom	*Antidote*
• **Lack of Vision**: Not seeing the ethical issue in front of you	• View the world through "moral glasses," so to speak Raise your awareness level Sensitize yourself to the underlying issues
• **Keeping Quiet**: Having ethical values, but saying nothing	• Proactively communicate your values to others Publicly state your values in corporate documents
• **Incoherence**: Behaving in an incoherent way, e.g., basing performance evaluations totally on hitting economic targets, or not following your values through to their rightful conclusions	• Seek better understanding of the issues Develop your expertise in ethical decision-making Prioritize respect for people over profit
• **Inaction**: Not putting your values into action, either because you don't know how or you fear the consequences	• Actualize your values and manage their implementation to boost your effectiveness
• **Hypocrisy**: Not being committed to the values you espouse Saying one thing but doing another: "Do as I say, not as I do"	• Walk the walk: fully commit yourself to a unified set of guiding principles and operate accordingly, with integrity
• **Double Standards**: Using a different set of values in one situation than those used in another, e.g., lobbying for something at work that you would not tolerate at home with your own family	• Be consistent in all realms of your life
• **Complacency**: Allowing yourself to become complacent, believing that you are already ethically complete and mature Having an organizational mind-set and culture that believes it has achieved a perfect state of ethical nirvana	• Be humble Appreciate your own vulnerability and susceptibility to failure Recognize that ethical management is a continual process or journey, not a one-time destination

- Demonstrate sensitivity to those who may have been harmed.
- Ensure that the natural environment and local community are protected.
- Focus on respecting the rights of other stakeholders, not merely the shareholders.
- Ensure timely and fair compensation for the injured parties where and when appropriate.

Most importantly, everything said to any stakeholder – whether shareholders, employees, customers, governments, citizens, the media or special interest groups – and everything undertaken by the company should always be directly based on and directly connected to its core ethical values, such as those mentioned earlier like trustworthiness, responsibility, caring, citizenship, respect and fairness.

Exclusive or excessive reference to, and emphasis on, other values – such as profit maximization or protection of share value – have led to many of the most heavily criticized crisis management decisions that have occurred in recent years. Besides those cases already mentioned, think of the mess Nike found itself in when relying on local norms and business conventions as the standard-bearer for supplier decisions on the use of child labor in Asia.

Instead, we believe that a crisis can serve as a defining opportunity for a company to demonstrate its commitment to a higher set of core ethical values. This will put you in a much better position to survive a crisis, and moreover generate long-term goodwill for your enterprise. Firms that establish and sustain ethical corporate cultures also reduce the potential of other crises happening again in the future.

To Know More

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Why I Am Leaving Goldman Sachs

Greg Smith

Former Executive Director, Goldman Sachs

Today is my last day at Goldman Sachs. After almost 12 years at the firm – first as a summer intern while at Stanford, then in New York for 10 years, and now in London – I believe I have worked here long enough to understand the trajectory of its culture, its people and its identity. And I can honestly say that the environment now is as toxic and destructive as I have ever seen it.

To put the problem in the simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money. Goldman Sachs is one of the world's largest and most important investment banks and it is too integral to global finance to continue to act this way. The firm has veered so far from the place I joined right out of college that I can no longer in good conscience say that I identify with what it stands for.

It might sound surprising to a skeptical public, but culture was always a vital part of Goldman Sachs's success. It revolved around teamwork, integrity, a spirit of humility, and always doing right by our clients. The culture was the secret sauce that made this place great and allowed us to earn our clients' trust for 143 years.

Greg Smith, "Why I Am Leaving Goldman Sachs," *The New York Times*, March 14, 2012. Reprinted with permission of Pars International.

It wasn't just about making money; this alone will not sustain a firm for so long. It had something to do with pride and belief in the organization. I am sad to say that I look around today and see virtually no trace of the culture that made me love working for this firm for many years. I no longer have the pride, or the belief.

But this was not always the case. For more than a decade I recruited and mentored candidates through our grueling interview process. I was selected as one of 10 people (out of a firm of more than 30,000) to appear on our recruiting video, which is played on every college campus we visit around the world. In 2006 I managed the summer intern program in sales and trading in New York for the 80 college students who made the cut, out of the thousands who applied.

I knew it was time to leave when I realized I could no longer look students in the eye and tell them what a great place this was to work.

When the history books are written about Goldman Sachs, they may reflect that the current chief executive officer, Lloyd C. Blankfein, and the president, Gary D. Cohn, lost hold of the firm's culture on their watch. I truly believe that this decline in the firm's moral fiber represents the single most serious threat to its long-run survival.

Over the course of my career I have had the privilege of advising two of the largest hedge funds on the planet, five of the largest asset managers in the United States, and three of the most prominent sovereign wealth funds in the Middle East and Asia. My clients have a total asset base of more than a trillion dollars. I have always taken a lot of pride in advising my clients to do what I believe is right for them, even if it means less money for the firm. This view is becoming increasingly unpopular at Goldman Sachs. Another sign that it was time to leave.

How did we get here? The firm changed the way it thought about leadership. Leadership used to be about ideas, setting an example and doing the right thing. Today, if you make enough money for the firm (and are not currently an ax murderer) you will be promoted into a position of influence.

What are three quick ways to become a leader? (a) Execute on the firm's "axes," which is Goldman-speak for persuading your clients to invest in the stocks or other products that we are trying to get rid of because they are not seen as having a lot of potential profit. (b) "Hunt elephants." In English: get your clients – some of whom are sophisticated, and some of whom aren't – to trade whatever will bring the biggest profit to Goldman. Call me old-fashioned, but I don't like selling my clients a product that is wrong for them. (c) Find yourself sitting in a seat where your job is to trade any illiquid, opaque product with a three-letter acronym.

Today, many of these leaders display a Goldman Sachs culture quotient of exactly zero percent. I attend derivatives sales meetings where not one single minute is spent asking questions about how we can help clients. It's purely about how we can make the most possible money off of them. If you were an alien from Mars and sat in on one of these meetings, you would believe that a client's success or progress was not part of the thought process at all.

It makes me ill how callously people talk about ripping their clients off. Over the last 12 months I have seen five different managing directors refer to their own clients as "muppets," sometimes over internal e-mail. Even after the S.E.C., Fabulous Fab, Abacus, God's work, Carl Levin, Vampire Squids? No humility? I mean, come on. Integrity? It is eroding. I don't know of any illegal behavior, but will people push the envelope and pitch lucrative and complicated products to clients even if they are not the simplest investments or the ones most directly aligned with the client's goals? Absolutely. Every day, in fact.

It astounds me how little senior management gets a basic truth: If clients don't trust you they will eventually stop doing business with you. It doesn't matter how smart you are.

These days, the most common question I get from junior analysts about derivatives is, "How much money did we make off the client?" It bothers me every time I hear it, because it is a clear reflection of what they are observing from their leaders about the way they should behave. Now project 10 years into the future: You don't have to be a rocket scientist to figure out that the junior analyst sitting quietly in the corner of the room hearing about "muppets," "ripping eyeballs out" and "getting paid" doesn't exactly turn into a model citizen.

When I was a first-year analyst I didn't know where the bathroom was, or how to tie my shoelaces. I was taught to be concerned with learning the ropes, finding out what a derivative was, understanding finance, getting to know our clients and what motivated them, learning how they defined success and what we could do to help them get there.

My proudest moments in life – getting a full scholarship to go from South Africa to Stanford University, being selected as a Rhodes Scholar national finalist, winning a bronze medal for table tennis at the Maccabiah Games in Israel, known as the Jewish Olympics – have all come through hard work, with no shortcuts. Goldman Sachs today has become too much about shortcuts and not enough about achievement. It just doesn't feel right to me anymore.

I hope this can be a wake-up call to the board of directors. Make the client the focal point of your business again. Without clients you will not make money. In fact, you will not exist. Weed out the morally bankrupt people, no matter how much money they make for the firm. And get the culture right again, so people want to work here for the right reasons. People who care only about making money will not sustain this firm – or the trust of its clients – for very much longer.

Greg Smith is resigning today as a Goldman Sachs executive director and head of the firm's United States equity derivatives business in Europe, the Middle East and Africa.